

## **ARBITRAL AWARD**

In the matter of a NAFTA arbitration under the  
UNCITRAL Arbitration Rules  
between:

**International Thunderbird Gaming Corporation**  
Claimant

and

**The United Mexican States**  
Respondent

Before the Arbitral Tribunal constituted under Chapter Eleven of  
the North American Free Trade Agreement, and comprised of:

Lic. Agustín Portal Ariosa  
Professor Thomas W. Wälde  
Professor Dr. Albert Jan van den Berg (President)

Washington D.C., January 26, 2006

**TABLE OF CONTENTS**

I. THE PARTIES..... 3

II. PROCEDURAL HISTORY ..... 4

III. SUMMARY OF FACTS..... 10

IV. ISSUES TO BE DETERMINED BY THE ARBITRAL TRIBUNAL ..... 21

V. ANALYSIS OF ISSUES FOR DECISION ..... 30

    A. General ..... 30

    B. Jurisdiction and/or Admissibility ..... 33

    C. Merits – General..... 41

    D. Merits – Articles 1102, 1105 and 1110 of the NAFTA..... 56

    E. Merits – Damages..... 68

VI. COSTS ..... 68

VII. DECISIONS ..... 73

**I. THE PARTIES**

1. Claimant:

INTERNATIONAL THUNDERBIRD GAMING CORPORATION  
Thunderbird Greeley Inc.  
11545 West Bernardo Court Suite 307  
San Diego, CA 92127  
United States of America

hereinafter: “Thunderbird” or “Claimant.”

2. Thunderbird is a publicly held Canadian Corporation, with its principal offices in San Diego, California, U.S.A.

3. In these proceedings, Thunderbird is represented by its duly authorised attorney James D. Crosby, California, U.S.A, and by Professor Todd Weiler, Ontario, Canada.

4. Respondent:

THE UNITED MEXICAN STATES  
General Directorate of Legal Consulting of Negotiations  
Ministry of Economy  
Mexico, DF, Mexico

hereinafter: “Mexico” or “Respondent.”

5. In these proceedings, the government of Mexico is represented by Mr. Hugo Perezcano Díaz, *Director General de Consultoría Jurídica de Negociaciones, Secretaría de Economía.*

**II. PROCEDURAL HISTORY**

6. On 21 March 2002, Thunderbird submitted a “Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement,” alleging that Mexico had breached its obligations under the North American Free Trade Agreement (“NAFTA”), more specifically under Article 1102 (National Treatment), Article 1103 (Most-Favoured Nation Treatment), Article 1105 (Minimum Standard of Treatment) and Article 1110 (Expropriation and Compensation) of the NAFTA.
7. On 1 August 2002 (and received by Mexico on 22 August 2002), Thunderbird submitted a Notice of Arbitration and Statement of Claim against Mexico pursuant to the provisions of Chapter Eleven of the NAFTA and under the UNCITRAL Rules of Arbitration (the “Notice of Arbitration”).
8. In the Notice of Arbitration at ¶34, Thunderbird sought the following relief: “i. Damages of not less than USD\$100,000,000; ii. Costs associated with these proceedings, including all professional fees and disbursements; iii. Pre-award and post-award interest at a rate to be fixed by the Tribunal; iv. Tax consequences of the award to maintain the integrity of the award; v. Such other and further relief that counsel may advise and that this Tribunal may deem appropriate.”
9. By letter dated 4 September 2002, Mexico raised objections regarding the language of the proceedings and alleged further that the Notice of Intent did not fully satisfy the NAFTA requirements. Correspondence was subsequently exchanged between the Parties regarding Mexico’s objections.
10. On 14 March 2003, the Arbitral Tribunal was constituted. The Tribunal is composed of Professor Dr. Albert Jan van den Berg (appointed as President of the Tribunal by the Secretary-General of ICSID), of Dutch nationality, residing in Tervuren, Belgium; Professor Thomas W. Wälde (appointed by Thunderbird), of German nationality, residing in Dundee, Scotland, United Kingdom and Mr.

Agustin Portal Ariosa (appointed by Mexico), of Mexican nationality, residing in Mexico DF, Mexico. Mr. Gonzalo Flores of ICSID was designated to serve as Secretary of the Tribunal.

11. The first session of the Tribunal was held, with the Parties' agreement, in Washington D.C. on 29 April 2003. During that session, after having heard the Parties' arguments, the Tribunal informed the Parties that the arbitration would be conducted in the English and Spanish language; that the place of arbitration in the legal sense would be Washington, D.C.; and that Mexico was invited to inform Thunderbird and the Tribunal whether it pursued objections based on lack of jurisdiction and/or inadmissibility (the "Preliminary Question"), following which the Tribunal would issue a ruling on the question of bifurcation of the proceedings with respect to the Preliminary Question. It was agreed further that the Secretariat of ICSID would render administrative services in relation to the arbitral proceedings similar to those rendered in arbitrations under the ICSID Additional Facility Rules.
12. Order No. 1 (by Consent) was issued by the Arbitral Tribunal on 27 June 2003, in which the sequence of the proceedings and a number of procedural matters were set out.
13. On 29 May 2003, Thunderbird submitted a Request for Production of Documents; Mexico filed objections to said request on 27 June 2003. By Order No. 2 dated 31 July 2003, the Tribunal ruled on the Request for Production of Documents and offered Thunderbird the possibility to submit timely a renewed request that comported with Order No. 2.
14. On 27 June 2003, Thunderbird filed a Motion to Obtain an Interim Measure under Article 1134 of the NAFTA. Mexico filed observations on Thunderbird's motion on 17 July 2003. A telephone conference was held between the Tribunal and the Parties on 15 August 2003 to discuss Thunderbird's motion. During the telephone conference, a number of practical aspects relating to Thunderbird's motion were agreed, and in particular that the Parties would carry out a joint

visit of the sites. The joint visit took place on 5-7 November 2003. By letter of 26 November 2003, the Tribunal accordingly informed the Parties that it considered Thunderbird's motion to have become moot.

15. On 15 August 2003, Thunderbird filed a Particularized Statement of Claim.
16. On 27 August 2003, Thunderbird filed a Supplemental Request for Production of Documents, pursuant to Order No. 2; Mexico filed observations in response on 15 October 2003. By letter of 26 November 2003, the Tribunal informed the Parties that, in the absence of any reaction from Thunderbird, it inferred that the matter required no further action from the Tribunal.
17. On 29 August 2003, Mexico filed a Supplementary Request for Production of Documents; Thunderbird responded thereto on 22 September 2003. Subsequent correspondence was exchanged between the Parties. On 11 December 2003, the Tribunal ruled on Mexico's Supplementary Request (*see* Order No. 3).
18. On 18 December 2003, Mexico filed an "*Escrito de Contestación*" (Statement of Defence), including "*Excepciones de Incompetencia y Admisibilidad* [Exceptions of Jurisdiction and Admissibility]."
19. On 22 December 2003, Thunderbird filed a Submission on Whether to Bifurcate the Proceedings.
20. Pursuant to Order No. 4 dated 24 December 2003, the Tribunal ruled that the Preliminary Question was joined to the merits and it invited the Parties to address the Preliminary Question in their forthcoming submissions.
21. On 9 February 2004, Thunderbird filed a Statement of Reply.
22. On 24 February 2004, Mexico submitted a further Request for Production of Documents. Thunderbird filed objections thereto on 3 March 2004. The Tribunal ruled on Mexico's Request in Order No. 5 dated 12 March 2004.

23. On 7 April 2004, Mexico filed a Statement of Rejoinder.
24. On 9 April 2004, Thunderbird filed a Motion to Strike the Witness Statement of Professor Nelson Rose (submitted by Mexico); Mexico objected thereto on 14 April 2004. Thunderbird's Motion to Strike was denied pursuant to Order No. 6 dated 19 April 2004.
25. On 20 April 2004, a pre-hearing telephone conference was held between the Parties and the President of the Tribunal to discuss procedural matters relating to the Hearing; those matters were recorded in Order No. 7 dated 22 April 2004 (which was further supplemented by Order No. 8 dated 25 June 2004).
26. On 26 through 29 April 2004, a hearing for oral argument and witness testimony took place at the offices of ICSID, Washington D.C. (the "Hearing"). For Thunderbird appeared: Mr. James D. Crosby, Professor Todd Weiler, and Mr. Carlos Gomez. For Mexico appeared: Mr. Hugo Perezcano Díaz, Ms. Alejandra Treviño and Mr. Luis Marin of Secretaria de Economía; Mr. Stephan E. Becker, Mr. Sanjay Mullik, Ms. Suzanne Wilkinson and Ms. Zuraya Tapia Alfaro of Pillsbury Winthrop Shaw Pittman LLP; and Mr. Christopher J. Thomas and Mr. J. Cameron Mowatt of Thomas & Partners.
27. At the Hearing, testimony was heard from Mr. Jorge Montaña; Mr. Albert Atallah; Mr. Jack Mitchell; Mr. Peter Watson; Mr. Kevin McDonald; Mr. Luis Ruiz de Velasco; Mr. Steven M. Rittvo; and Mr. Carlos Gomez for Thunderbird. Testimony was heard from Professor I. Nelson Rose; Mr. Alberto Alcántara Martínez; and Mr. Luis Martínez for Mexico.
28. The Government of Canada was represented at the Hearing by Mr. Roland Legault. The Government of the United States of America was represented at the Hearing by Mr. Mark S. McNeill.

29. During the Hearing, the Tribunal circulated a draft tentative list of issues, which was subsequently revised pursuant to the Parties' comments on the draft. The Parties addressed the list of issues in their Post-Hearing Memorials.
30. On 28 April 2004, the Parties filed a *Dramatis Personae*.
31. On 21 May 2004, the Governments of the United States of America and Canada each filed a Submission pursuant to Article 1128 of the NAFTA.
32. On 2 August 2004, the Parties filed Post-Hearing Briefs.
33. On 3 August 2004, the Parties filed a jointly prepared chronology of events.
34. By letter of 3 August 2004, Thunderbird applied to the Tribunal to consider and admit new evidence regarding a complaint filed on 30 November 2001 with the Office of Internal Control of the Secretary of State of Mexico, and the latter's response thereto on 20 July 2004. By letter of 6 August 2004, Mexico objected to Thunderbird's request. By letter of 10 August 2004, Thunderbird applied to the Tribunal to consider and admit new evidence regarding the Bella Vista Entertainment Centre in Monterrey and the Reflejos facilities in Rio Bravo and Reynosa. By letter of 13 August 2004, further to its letter of 3 August 2004, Thunderbird requested the Tribunal to admit into evidence a copy of the Office of Internal Control file pertaining to the complaint. By letter of 17 August 2004, Mexico objected to the requests made by Thunderbird in its letters of 3, 10, and 13 August 2004.
35. Mexico filed a cost submission on 12 August 2004. Thunderbird filed a cost submission on 26 August 2004.
36. Pursuant to Order No. 9 dated 13 September 2004, the evidence submitted by Thunderbird in its letters of 3, 10, and 13 August 2004 was admitted into the record, without prejudice to the relevance, materiality and weight of the evidence in question.



37. On 22 October 2004, Mexico filed further observations regarding the new evidence submitted by Thunderbird. On 5 November 2004, Thunderbird filed reply observations.
38. On 19 November 2004, Mexico submitted a “Dúplica al escrito de réplica de la demandante”; On 22 November 2004, Thunderbird filed a Motion to strike Mexico’s submission. Pursuant to Order No. 10 dated 30 November 2004, Thunderbird’s motion to strike was denied and Thunderbird was afforded the possibility to submit a response to the “Dúplica”; said response was filed by Thunderbird on 8 December 2004.
39. The Tribunal deliberated on various occasions before issuing the Award.
40. In this Award, the Tribunal shall use the following method of citation:
  - “Notice of Intent” refers to Thunderbird’s 21 March 2002 Notice of Intent to Submit a Claim to Arbitration;
  - “Notice of Arbitration” refers to Thunderbird’s 1 August 2002 Notice of Arbitration and Statement of Claim;
  - “PSoC” refers to Thunderbird’s 15 August 2003 Particularized Statement of Claim;
  - “SoD” refers to Mexico’s 18 December 2003 Statement of Defence;
  - “SoR” refers to Thunderbird’s 9 February 2004 Statement of Reply;
  - “SoRej” refers to Mexico’s 7 April 2004 Statement of Rejoinder;
  - “Tr.” refers to the Transcript made of the 26-29 April 2004 Hearing;

- “C-PHB” and “R-PHB” refer to the Post-Hearing Briefs filed by Thunderbird and Mexico on 2 August 2004.

### III. SUMMARY OF FACTS

41. Thunderbird is engaged in the business of operating gaming facilities.
42. In the period late 1999 to early 2000, according to Thunderbird, Mr. Jack Mitchell, president and CEO of Thunderbird, with the assistance of Mr. Peter Watson, an American attorney, initiated investigations concerning potential “skill machine” opportunities in Mexico. Meetings were held with Messrs. Doug Oien and Ivy Ong (of A-1 Financial Ltd), both involved in gaming activities, and with Messrs. Julio Aspe and Oscar Arroyo, two Mexican attorneys who had allegedly represented a Mexican national, Mr. Jose Guardia, with respect to his gaming operations in Mexico.
43. In the period April through June 2000, according to Thunderbird, Mr. Luis Ruiz de Velasco of Baker & McKenzie, Mexican counsel of Thunderbird, met with Messrs. Aspe and Arroyo to discuss procedures utilized by Mr. Guardia to defend his gaming operations against actions by the Mexican government, such as “*amparo*” proceedings (temporary injunctive relief), but concluded that such procedures would not provide Thunderbird with the certainty necessary to proceed with its proposed operations in Mexico.
44. On 5 April 2000, Entertainments de México S.A. de C.V. (“EDM”) was formed by Messrs. Juan Jose Menendez Tlcatelipa and Alejandro Rodriguez Velazquez.
45. On 1 May 2000, EDM entered into a lease for a location in Matamoros (which was revised and extended for 5 years on 20 July 2000).
46. On 26 May 2000, Thunderbird and Messrs. Oien and Ong entered into a “Letter of Intent” regarding the operation of gaming facilities in Mexico.

47. On 22 June 2000, Juegos de México Inc. (“JDMI”) and A-1 Financial Ltd. entered into a “Revenue Share and Consulting Agreement” regarding the operation of gaming facilities in Mexico.
48. In July 2000, according to Thunderbird, following contacts between Messrs. Aspe and Arroyo and the Mexican government, Thunderbird decided to request an official opinion concerning the legality of its proposed gaming operations and if the response were favourable, Thunderbird would proceed with the opening and operation of its “skill machine” facilities in Mexico.
49. On 31 July 2000, EDM imported 50 Bestco Model MTL19U-8L video gaming machines.
50. On 3 August 2000, EDM presented a written request to the Director General de Gobierno de la *Secretaría de Gobernación* (“SEGOB”) concerning its proposed gaming operations in Mexico (the “*Solicitud*”). The full text of the *Solicitud* (English Translation submitted by Thunderbird) provides as follows (numbering between square brackets added):

JÚAN JOSÉ MENÉNDEZ TLACATELPA, legal representative of ENTERTAINMENS DE MÉXICO, S.A DE C.V. which accredits his personality by a certified copy of a notarized document attached hereby, and who has as conventional address, for receiving and hearing any type of communication and documents, Plaza Inverlat piso 12, Blvd. M. Avila Camacho n/ 1, C.P. 1 1009, Mexico D.F., authorizes, for this purpose, Mr. Luis Ruiz de Velasco y P. and with all respects I appear before you to say:

By the means of these writings, I come to request from you that this *Dirección General* give an opinion about the activities that the party I represent is carrying out and which consist in the commercial exploitation of video game machines for games of skills and ability in accordance with the following:

1. - Entertainments de México, S.A. de C.V., is a legal entity incorporated in accordance with the Laws of the Republic of Mexico with the public deed 38,765, which was issued and granted by the Public Notary Number 53, Mr. Rodrigo Orozco Perez, in Mexico D.F. as in proven by the attached notarial affidavit; and which is also registered in the Federal Registry of Taxpayers under the symbol EME-000405 -LQ7.

2. - The entity which I represent opened a business, at Av. de las Rosas N° 70-A, Colonia Jardin in the city of Matamoros, Tamaulipas, under the commercial name “La Mina de Oro”, which operates video game machines for games of skills and ability, and complies with all Municipal requirements.

3. - The video game machines for games of skills and ability, which the entity I represent commercially exploits, are devices for recreation which have been designed for the enjoyment and entertainment of its users. In these games, chance and wagering or betting is not involved, but the skills and abilities of the user who has to align different symbols on the machine screen by touching the screen or pushing buttons in order to stop the wanted symbol from several other symbols which spin in a sequential manner in each of the lanes or squares of each video game. The user has to align symbols in an optimum combination to receive a ticket with points which can be traded for goods or services; as this is already done at different locations in the country.

4.- The video game machines for games of skills and ability which we operate, at this present time at the place indicated above on this writings, are trademark Bestco, model MTL19U-8L and S.C.I. model 17”UR; and the entity I represent is trying to place about 2,000 (two thousand) more machines at other locations in the Republic of Mexico and these machines are of the same identical mechanical nature and functioning as those described in point 3, above.

[5] For all I have declared above, I come to this *Dirección General* requesting your opinion about the commercial activities which hereby I have detailed, and, therefore, you can express your opinion about the video game machines for games of skills and ability, which we have referred hereby, in order to

determine if these games are regulated by the *Ley Federal de Juegos y Sorteos*.

[6] We are requesting an opinion from this *Dirección General* so the entity I represent has the certainty that the commercial exploitation of video game machines for games of skills and ability is legal; after an analysis of the nature of our machines, and the legal dispositions, we have concluded that our machines are not bound by *Ley Federal de Juegos y Sorteos* and, therefore, are not regulated by *Secretaría de Gobernación* or any other federal authority since the activity which this company is engaged in is not found within the faculties foreseen in Article 73, of Constitution General de la República and which in its Fraction X clearly indicates that the Congress of the Union has exclusive authority to legislate, in the whole of the Republic, about games with bets, wagers and drawings, and that the Executive Federal has the authority to regulate these activities; but in entertainment where skills and ability is involved, it is logical that these are not under federal authority since *La Constitución General de la República* doesn't indicate that the Congress of the Union can exclusively legislate in such matters. Consequently, the authority to regulate this type of entertainment is not granted exclusively to the Federation, and, therefore, this is excluded from *la Ley Federal de Juegos y Sorteos*.

[7] The nature of video game machines for games of skills and ability is not games of chance or games with bets, wagers or drawings, since, in the operation of these machines, the player seeks entertainment and is playing with our machines assuming an active position where his intelligence, his willpower, his experience and his skills to optimally answer to specific stimulus with the object of finding a combination, effect or boast on the machine, intervene; which can only be possible with ability, experience and control over the machine, and all of this is for the purpose of entertainment and enjoyment, and at the time, the player can receive points that he can trade for a prize as a reward for the skills achieved and in no way as the result of chance.

[8] For this, it is clear to us, that is the skills and ability of the person who produces the effect over the videogame machine, and it is not the chance, the possibility, the fortune, or bet since the determinant to get results is the skills and ability of players; something very different from games of bets and wagers where there is a previous pact or covenant between the company and the user and, therefore, there is an agreement to handle an amount of money or any other thing, and all of this depends on a chance, on the unforeseen, or is not subject to the willpower or control of the user.

[9] For that declared above, we have concluded that our operation is not of the type prohibited by *la Ley Federal de Juegos y Sorteos* since our video game machines do not use chance, bets or wagers, and these video games are only for the purpose of entertainment in which the users can obtain prizes for their skills and abilities, and I'm requesting from this *Dirección General* your opinion about this.

51. On 4 August 2000, EDM bought 30 SCI model 17" U R “*máquinas de video para juegos de habilidad y destreza,*” which were imported on 14 August 2000.
52. On 10/11 August 2000, JDMI acquired all EDM shares from Messrs. Tlacaltelpa and Velasquez. Mr. Mitchell was designated president of EDM’s board of directors.
53. On 10 August 2000, EDM filed an “Aviso de Apertura,” whereby it gave notice to local authorities of its intended operations in its Matamoros facility, called “La Mina de Oro.”
54. According to a draft letter dated 10 August 2000, Mr. Watson wrote to Messrs. Aspe and Arroyo to confirm payment of a “success fee” of US\$300,000 upon delivery of a letter from SEGOB “which indicates that, according to the applicable laws of Mexico, there is no opposition or limitation to operate our skill machine venture in the Republic of Mexico.” Thunderbird confirmed payment of US\$300,000 in a signed letter dated 15 August 2000 to Messrs. Aspe and Arroyo.

55. By letter dated 15 August 2000, SEGOB issued a formal response to Thunderbird's *Solicitud* (the "*Oficio*"). The *Oficio* was signed by Rafael de Antuñano Sandoval, *Director de Juegos y Sorteos*, in the name and on behalf of, Mr. Sergio Orozco Aceves, Director General of Government of SEGOB. The *Oficio* was copied to Messrs. Roberto Pedro Martinez Ortiz, Director General of Legal Affairs of SEGOB, and Sergio Orozco Aceves, Director General of Government of SEGOB. The full text of the *Oficio* (English translation provided by Thunderbird) provides as follows (numbering between square brackets added):

[1] Regarding your letter dated August 3, 2000, received on August 8, 2000 by the Directorate of Games and Sweepstakes, entity that depends from this Directorate, whereby you request this entity to issue a response regarding your representative's exploitation of machines that operate under the concept of ability and skilfulness of its users, please be advised as follows:

[2] As you may be aware, the Federal Law of Games and Sweepstakes, establishes with precision diverse dispositions that prohibit gambling and luck related games within the Mexican territory. Article I of such law establishes that "... - All gambling and luck related games are prohibited within the Mexican territory, under the disposition of this law."

[3] Likewise, Article 3 of such law establishes that, "The federal executive branch, by means of the Ministry of State, shall supervise the regulation, authorization, control and vigilance of all games when such games contact gambling of any kind; as well as the sweepstakes, with the exception of the National Lottery, which shall be governed by its own law."

[4] In the same light, Article 4 of such law establishes that "in order to establish or operate any open or closed place, in which gambling games or sweepstakes take place, the Ministry of State shall authorize such establishments or operations, specifying the corresponding requirements and conditions to be fulfilled in every case."

[5] According to the above mentioned, the provisions established under the Federal Law of Games and Sweepstakes are enforceable legal dispositions that specifically prohibit gambling and luck related games within the Mexican territory; notwithstanding the above mentioned, according to your statement, the machines that your representative operates are recreational video game devices for purposes of enjoyment and entertainment of its users, with the possibility of obtaining a prize, without the intervention of luck or gambling, but rather the user's ability and skilfulness.

[6] In this light, it is important to clarify that, if the machines that your representative exploits operate in the form and conditions stated by you, this governmental entity is not able to prohibit its use, in the understanding that the use of machines known as "coins-swallowers", "token-swallowers" or "slot machines", in which the principal factor of the operation is luck or gambling and not the user's ability of skilfulness as you stated, could constitute any of the hypothesis described under the Federal Law of Games and Sweepstakes, with the corresponding legal consequences that may be derived therefrom, under article 8 of such law.

[7] In that view, and based on articles 27, section XXI of the Organic Law of the Federal Government; 1, 2, 3, 4, 5, 7, 8 and other articles related and applicable to the Federal Law of Games and Sweepstakes; as well as articles 8 and 14, Section XVII of the Interior Regulations of the Ministry of State, thus Directorate, in accordance with the faculties previously conferred for such effect; warns you that in the machines that your representative operates there shall be no intervention of luck or gambling; warning that will not be in effect if the machines to be operated are video game devices that operate under the concept of ability and skilfulness.

[8] Please be advised that, even though the machines of your representative operate under the concept of the user's ability and skilfulness, it is necessary that the obligations and requirements set by the laws and regulations of each state and/or municipality be met.



56. On 16 August 2000, Thunderbird Greely, Inc., wired US\$300,000 to an entity called “Consultoria Internacional Casa de Cambio, S.A. de C.V.,” a Mexican Currency Exchange entity, for further credit to Rafael Ramos Velasco.
57. On 17 August 2000, Thunderbird announced that it had entered into an agreement with JDAMI to operate a business of “*máquinas de destreza*” of games and video in Matamoros.
58. On 18 August 2000, according to Thunderbird, EDM-Matamoros opened “*La Mina de Oro*.”
59. On 25 August 2000, Mr. Ruiz de Velasco of Baker & McKenzie addressed a legal opinion to Mr. Mitchell of Thunderbird with respect to the 15 August 2000 *Oficio*, which provides as follows:

As requested, we hereby give you our opinion with respect to the official letter dated August 15, 2000, (the “Official Letter”) issued by the Mexican Ministry of Interior (“*Secretaría de Gobernación*”) in favour of Entertainments de México, S.A. de C.V. (“EDM”), and which refers to the operation in Mexico of video game skill machines. Copy of the Official Letter and the English translation thereof is attached hereto.

Based on the principal terms of the Official Letter, the Ministry of Interior states that it does not have any jurisdiction over the operation of said machines, since in accordance with the representations made by EDM in its application, the video games skill machines to be operated by EDM do not fall into the classification of “slot machines”, which are forbidden in Mexico pursuant to the applicable laws, in view of the fact that they are considered to be gaming and/or betting machines.

Furthermore, under the Official Letter the Ministry of Interior emphasizes that EDM can operate the video games skill machines as long as they do not become, in any manner whatsoever, as gaming or betting machines; provided; however,

that EDM complies with the states and/or municipal laws or regulations in Mexico.

Based upon the foregoing, we are of the opinion that EDM is allowed to operate in Mexico the video game skill machines as long as EDM complies with the administrative requirements set forth by the state or municipal laws and regulations in Mexico.

Evenmore, in the event the Ministry of Interior intends to close down EDM's operations, EDM will be able to appeal; in the understanding, that EDM must comply at all times with each and everyone of the requirements set forth by the competent authorities where the machines are operating.

Should you have any questions, please do not hesitate to contact us.

60. In October 2000, Thunderbird formed Entertainmens de Mexico-Monterrey S. De R.L. de C.V. ("EDM-Monterrey"). Thunderbird's intended Monterrey gaming facility never opened.
61. In November 2000, JDMI and Thunderbird Brazil formed Entertainmens de Mexico Laredo S. de R. L. de C.V. ("EDM-Laredo").
62. In December 2000, Mr. Vicente Fox's administration came into office in Mexico. Mr. Jose Guadalupe Vargas Barrera was appointed the new "*Director de Juegos y Sorteos.*"
63. On 21 December 2000, Mr. Albert Atallah wrote to Messrs. Oien and Ong "to confirm that A-1 Financial and its principals are no longer authorized to represent International Thunderbird Gaming Corporation, its affiliates and subsidiaries (including Entertainmens de Mexico) with respect to the Mexico Skill Game Operation" and stating, "Thunderbird does not believe that A-1 Financial met its obligations contemplated by the original agreement."

64. On 21 January 2001, EDM-Laredo opened a gaming facility in Nuevo Laredo.
65. On 25 February 2001, SEGOB proceeded to an official closure of the Nuevo Laredo facility.
66. On 16 March 2001, because of administrative irregularities affecting SEGOB’s order for official closure of Nuevo Laredo, SEGOB lifted the seals of the Nuevo Laredo facility. Thunderbird reopened the facility on 20 March 2001.
67. On 12 April 2001, Thunderbird, Messrs. Oien, Ong and A-1 Financial entered into a Termination Settlement and Release Agreement.
68. On 5 June 2001, JDMI & Thunderbird Brazil formed Entertainmens de Mexico-Reynosa S. de R. L. de C.V. (“EDM-Reynosa”).
69. On 20 June 2001, Thunderbird formed Entertainmens de Mexico-Puebla S. de R.L. de C.V. (“EDM-Puebla”). Thunderbird’s intended Puebla gaming facility never opened.
70. On 10 July 2001, an administrative hearing was held at the offices of the *Director de Juegos y Sorteos* in Mexico City (the “Administrative Hearing”). Thunderbird was represented at the Administrative Hearing by Messrs. Watson, Jorge Montaña, Mauricio Girault, Carlos Gomez and Mr. Ruiz de Velasco. Thunderbird submitted documentary evidence and witness testimony, and Mr. Kevin McDonald of SCI appeared and provided a briefcase-sized machine for demonstration. On SEGOB’s side, Mr. Guadalupe Vargas and Mr. Alcántara were present.
71. On 13 July 2001, Thunderbird formed Entertainmens de Mexico-Juarez S. de R.L. de C.V. (“EDM-Juarez”). Thunderbird’s intended Juarez gaming facility never opened.
72. In August 2001, EDM-Reynosa opened a gaming facility in Nuevo Laredo.

73. On 10 October 2001, SEGOB issued a “*Resolución Administrativa*,” declaring that the EDM machines were prohibited gambling equipment under the *Ley Federal de Juegos y Sorteos* and ordering the official closure of the EDM-Matamoros and EDM-Laredo facilities (the “Administrative Order”). The Administrative Order was signed by Mr. Humberto Aguilar Coronado, Director General of Government of SEGOB.
74. On 11 October 2001, SEGOB proceeded to an official closure of the EDM-Matamoros and EDM-Laredo facilities.
75. On 15 October 2001, EDM filed a “*juicio de amparo*” before the “Juez de Distrito en Turno” seeking injunctive relief with respect to the official closure of the EDM-Laredo facility, which was denied by the court on 18 October 2001.
76. On 23 October 2001, EDM filed a “*juicio de amparo*” before the Mexican District Court seeking injunctive relief with respect to the official closure of the EDM-Matamoros facility, which was denied on 21 January 2002.
77. On 5 December 2001, EDM filed a “*juicio de nulidad*” for the annulment of the Administrative Order before the “*Tribunal Federal de Justicia Fiscal y Administrativa*.”
78. On 21 January 2002, SEGOB proceeded to the official closure of the Reynosa facility. EDM-Reynosa filed a “*juicio de amparo*” for temporary injunctive relief.
79. On 21 March 2002, Thunderbird initiated the present arbitration proceedings.
80. On 10 May 2002, EDM’s “*juicio de nulidad*” was denied by the *Tribunal Federal de Justicia Fiscal y Administrativa*.

81. On 30 May 2002, a “*Tribunal Colegiado*” denied EDM’s “*amparo*” with respect to the official closure of the EDM-Laredo facility. EDM-Laredo was subsequently closed down.
82. On 10 June 2002, the judge ratified the decision denying EDM’s “*amparo*” for Matamoros.
83. On 17 July 2002, EDM discontinued the “*juicio de amparo*” with respect to the official closure of the EDM-Reynosa facility.
84. On 21 August 2002, EDM discontinued the “*juicio de amparo*” with respect to the official closure of the EDM-Matamoros facility.

**IV. ISSUES TO BE DETERMINED BY THE ARBITRAL TRIBUNAL**

85. In resolving this dispute, the Tribunal shall determine the main issues by reference to the draft Tentative List of Issues referred to in ¶ 29 above:

**A. General**

1. What is the applicable law for resolving each of the Issues mentioned below?
2. Which of the Parties has the burden of proof for each of the Issues mentioned below?

**B. Jurisdiction and/or admissibility**

3. Does Thunderbird “own or control directly or indirectly” at the relevant times any of the companies listed below (the “EDM Companies”) that would entitle it to submit to arbitration a claim on behalf of them under Article 1117 NAFTA? If not, what are the consequences thereof?

- (a) Entertainmens de Mexico S. de R. L. de C.V. (“EDM-Matamoros”)
- (b) Entertainmens de Mexico Laredo S. de R. L. de C.V. (“EDM-Laredo”)
- (c) Entertainmens de Mexico Reynosa S. de R. L. de C.V. (“EDM-Reynosa”)
- (d) Entertainmens de Mexico Puebla S. de R. L. de C.V. (“EDM-Puebla”)
- (e) Entertainmens de Mexico Monterrey S. de R. L. de C.V. (“EDM-Monterrey”)
- (f) Entertainmens de Mexico Juarez S. de R. L. de C.V. (“EDM-Juarez”).

4. Does the filing by Thunderbird of waivers on behalf of EDM-Puebla, EDM-Monterrey and EDM-Juarez on 15 August 2003 comply with the requirements of Article 1121 NAFTA? If not, what are the consequences thereof?

Subject to the answers to Issues 3 and 4, the Issues regarding the merits are:

**C. Merits – General**

5. What is the role, if any, of Chapter Eleven of the NAFTA in the present case? Specifically:

5.1 Does Chapter Eleven of the NAFTA recognize and protect the right of a Contracting Party to regulate a certain conduct that it considers illegal?

5.2 If so, does the *Ley Federal de Juegos y Sorteos* of 31 December 1947 form part of Mexico’s law to regulate a certain

conduct that it considers illegal, and what are the consequences thereof?

5.3 What is the role and jurisdiction of the Tribunal in relation to the Mexican judicial system regarding the subject matter of Thunderbird's claims in the present case?

5.4 If and to what extent do administrative proceedings of SEGOB form part of Issue 5.3?

6. Is the functionality of the machines, technically or otherwise, operated by the EDM Companies relevant in the present case?

6.1 If so, is that question to be determined under the *Ley Federal de Juegos y Sorteos* of 31 December 1947 and/or on some other basis?

6.2 If so, by whom should that question be determined? In particular, is the Tribunal to defer to the determination by SEGOB? And if so, was that opinion relevant for the dispute?

(a) before 15 August 2000;

(b) between 15 August 2000 and 10 October 2001;  
and/or

(c) after 10 October 2001?

6.3 Assuming that the question is to be determined by the Tribunal, what are the relevant criteria for such a determination? Specifically:

(a) Were the machines in question skill machines or slot machines?

(b) Is there a “uniqueness for Mexico,” as is contended by Thunderbird, and if so, is it relevant for such determination?

6.4 Assuming that the question is to be determined by the Tribunal and in light of the answer to Issue 6.3, did the machines in question meet the applicable criteria?

7. Was a legitimate expectation created by SEGOB’s letter of 15 August 2000 to the effect that it brings Thunderbird’s claims in the present case under Article 1102, 1105 and/or 1110 NAFTA? Specifically:

7.1 If and to what extent is a legitimate expectation legally relevant under Article 1102, 1105 and/or 1110 NAFTA?

7.2 What are the standards for a legitimate expectation in that respect?

7.3 What is the meaning and legal status of the SEGOB letter of 15 August 2000, and what is the relevance thereof?

7.4 Did EDM fail to disclose relevant facts, in particular in its *solicitud* of 3 August 2000, as it is alleged by Respondent, and if so, what is the relevance thereof?

7.5 What are the consequences of the answers to the foregoing Issues 7.1 -7.4?

**D. Merits – Articles 1102, 1105 and 1110 NAFTA**

8. Did Respondent breach the “National Treatment” standard under Article 1102 NAFTA?

8.1 Which of the following tests as postulated by the disputing parties is the test to be applied under Article 1102 NAFTA? Specifically:



(a) As it is contended by Thunderbird, is the Tribunal to apply a three-part test, being:

(i) identification of the relevant subjects of the national treatment comparison (the basis being the likeliness of comparators);

(ii) consideration of the relative treatment received by each comparator (the basis being the best level of treatment available to any other domestic investor operating in like circumstances); and

(iii) consideration whether factors exist which could justify any difference in treatment so found (to be construed narrowly and the burden of proof shifting to Respondent)?

(b) Or, as it is contended by Respondent, is the Tribunal to apply Article 1102 in the sense that it is directed only to nationality-based discrimination and proscribes only demonstrable and significant indications of bias and prejudice on the basis on nationality, which are to be proven by Thunderbird, “the like circumstances” of Article 1102 requiring an adequate comparison on the basis of the facts, thereby taking into account, in particular, compliance with local law relating to illegal conduct?

8.2 On the basis of the test to be applied, did Respondent actually breach Article 1102? Specifically, and to the extent relevant under the test to be applied:

(a) Does the fact that *Guardia* and *de la Torre* are allegedly operating machines essentially identical to the machines operated by the closed EDM Companies mean that Respondent has not accorded to the EDM Companies treatment no less favourable than that it accords, in the like circumstances, to its own investors under Article 1102?

(b) Are other “skill game” operators that have resorted to local remedies and that have obtained injunctive relief pending a final disposition of the legality of *Gobernación*’s closure order against them ‘in like circumstances’ to the EDM companies, as contended by Thunderbird?

(c) Did SEGOB take action against facilities of the kind of the EDM Companies, including those owned by *Guardia* and *de la Torre*, as it is alleged by Respondent, and if so, what is the relevance thereof?

(d) What is the relevance, if any, of the fact that EDM abandoned judicial redress in Mexico against the closure of its facilities?

9. Did Respondent breach the “Minimum Standard of Treatment” under Article 1105 NAFTA?

9.1 What does the “Minimum Standard of Treatment” under Article 1105 NAFTA mean and how is it to be applied by a NAFTA arbitral tribunal?

9.2 Subject to the answer to Issue 7 and 9.1 above, was there a detrimental reliance by Thunderbird on SEGOB’s letter of 15 August 2000, also in light of Thunderbird’s *solicitud* of 3 August 2000, and if so, did it constitute a breach of Article 1105 NAFTA?

9.3 Subject to the answer to Issue 9.1 above, was there a failure to provide due process, constituting an administrative denial of justice, in the proceedings relating to the ruling of 10 October 2001, and if so, did it constitute a breach of Article 1105 NAFTA?

9.4 Subject to the answer to Issue 9.1 above, was there manifest arbitrariness in administration, constituting proof of an abuse of right, in the proceedings before SEGOB, and if so, did it constitute a breach of Article 1105 NAFTA?

10. Did Respondent engage in an expropriation in violation of Article 1110 NAFTA?

10.1 Does the fact that Thunderbird did not submit to arbitration a claim on its own behalf under Article 1116 NAFTA, but rather on behalf of the EDM Companies under Article 1117 NAFTA, preclude it from obtaining compensation under Article 1110?

(a) In this connection, should, as it is requested by Thunderbird at pages 69-70 of its SoR, leave be granted to Thunderbird to amend its PSoC to include, in the further alternative, a claim for 100% of the damages caused to the businesses of each EDM Company as a result of Respondent's alleged breach of Article 1110, using Article 1116 NAFTA?

(b) Does a breach of Article 1110 NAFTA also constitute a breach of Article 1105 NAFTA, as it is contended by Thunderbird?

(i) In this connection, what is the relevance, if any, of Section B.3 of the Notes of Interpretation of Certain Chapter 11 Provisions by the NAFTA Free Trade Commission of 31 July 2001 ("A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)")?

(c) Does Article 1110 NAFTA impose an obligation of Respondent vis-à-vis the EDM Companies?

10.2 Subject to the answer to Issue 10.1 above, and having also regard to Issue 10.3 below, is it relevant to determine which is or are the expropriation standard or standards to be applied under Article 1110 NAFTA? If so, which is that standard or are those standards?

10.3 Subject to the answers to Issues 7, 10.1 and 10.2 above, did any rights legitimately acquired by the EDM Companies exist in the businesses conducted by them? Specifically:

(a) Did the EDM Companies operate on the basis of a business undertaking that is unlawful under Mexican law?

(b) Did the EDM Companies operate on the basis of a legitimate expectation, being similar to the detrimental reliance as alleged by Thunderbird under Article 1105?

(c) Assuming that the answers to Issues (a) and (b) of the present Issue 10 are in the affirmative, do the actions of SEGOB amount to expropriation within the meaning of Article 1110 NAFTA?

**E. Merits – Damage**

11. If the answer to Issues 8 and/or 9 and/or 10 above is in the affirmative, is Thunderbird entitled to damages, and if so for what amount?

11.1 What are the compensation principles to be applied to damages in the present case?

(a) Are these principles different with respect to breaches of Articles 1102, 1105 and 1110 NAFTA, and if so, what are the differences?

(b) Does a distinction arise from whether the act complained of is lawful or unlawful?

(c) At which date are the damages to be determined?

11.2 Is there a sufficient causal link between the breach and the damages claimed by Thunderbird?

11.3 Are the damages claimed by Thunderbird a reasonably foreseeable consequence of the act that constituted the breach by Respondent?

11.4 Subject to the answers to Issues 11.1 – 11.3 above, should the damages be valued on the basis of a fair market value of the EDM Companies calculated for anticipated future profits by a discounted cash flow (“DCF”) method, as contended by Thunderbird?

11.5 To the extent that it is not addressed under Issues 11.1 - 11.4 above, has Thunderbird proven the damages as claimed by it?

11.6 Subject to the answers to the foregoing Issues 11.1-11.5, what is the amount of damages?

11.7 As regards interest with respect to the damages:

- (a) What is the rate of interest to be applied, and which is the currency to be taken into account in that respect?
- (b) Is interest to be compounded?
- (c) For which period of time is interest to be applied?

**F. Costs**

12. What are the costs of the arbitration and which party shall bear those costs or in which proportion shall those costs be allocated between the parties?

**V. ANALYSIS OF ISSUES FOR DECISION**

86. The Tribunal shall now proceed to evaluate the issues *seriatim*. In this regard, the Tribunal has considered all arguments, documents, and testimony that form part of the record in this case, and shall address the contentions made by the Parties to the extent relevant to the Tribunal's decisions. The Tribunal's decisions are based on the entire record in this case.

**A. General****Issue 1. What is the applicable law for resolving each of the Issues mentioned below?****(i) Thunderbird's position**

87. Thunderbird contends that the applicable law for resolving all issues presented in this arbitration consists of the claimed provisions of Section A of Chapter Eleven of the NAFTA and the applicable rules of international law. Further, according to Thunderbird, the Chapter Eleven of the NAFTA provisions should be interpreted in accordance with the customary international law rules of treaty interpretation and in light of the objectives of the NAFTA and its governing principles specified in Article 102.

**(ii) Mexico's position**

88. Mexico refers to Article 1131(1) of the NAFTA and contends that the Tribunal must decide the issues in dispute by reference to the relevant provisions of Chapter Eleven of the NAFTA and the applicable rules of international law. MEXICO adds that the jurisdiction of a NAFTA Tribunal is more limited in contrast with other tribunals such as those constituted under ICSID rules since NAFTA tribunals may not decide a dispute by reference to the internal law of a NAFTA Party.

(iii) The Tribunal's findings

89. Pursuant to Article 1131(1) of the NAFTA (captioned “Governing Law”), the Tribunal shall decide the issues in this arbitration “in accordance with this Agreement and applicable rules of international law.”

90. In particular, the Tribunal has regard to the sources of law listed in Article 38(1) of the Statute of the International Court of Justice, which provides as follows:

The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

(a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;

(b) international custom, as evidence of a general practice accepted as law;

(c) the general principles of law recognized by civilized nations;

(d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

91. The Tribunal shall construe the terms of Chapter Eleven of the NAFTA “in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose” (*see* Article 31 of the Vienna Convention on the Law of Treaties; *see also* ¶¶ 125-126 below).

**Issue 2. Which of the Parties has the burden of proof for each of the Issues mentioned below?**

(i) Thunderbird’s position

92. Thunderbird contends that it has the legal “burden of proof” upon its claims under the applicable rules of international law and that, conversely, Mexico has the legal burden of proof upon any affirmative defences raised. According to Thunderbird, the “burden of producing evidence” shifts upon a sufficient evidentiary showing. Thunderbird alleges further that it has made its *prima facie* showing of the NAFTA violations and that Mexico has failed to meet its burden of producing evidence to rebut such showing.

(ii) Mexico’s position

93. Mexico refers to Article 24 of the UNCITRAL Rules and international case law, arguing that a party asserting a fact or a claim is responsible for providing proof of all the elements thereof, and that the burden of proof may shift to the other Party on the basis of *prima facie* evidence.

(iii) The Tribunal’s findings

94. The present arbitration is governed by the UNCITRAL Rules. Article 24(1) of the UNCITRAL Rules provides:

Each party shall have the burden of proving the facts relied on to support his claim or defence.

95. The Tribunal notes that the Parties do not seem to diverge on the principles governing the burden of proof. The Tribunal shall apply the well-established principle that the party alleging a violation of international law giving rise to



international responsibility has the burden of proving its assertion<sup>1</sup>. If said Party adduces evidence that *prima facie* supports its allegation, the burden of proof may be shifted to the other Party, if the circumstances so justify.<sup>2</sup>

**B. Jurisdiction and/or Admissibility**

**Issue 3. Does Thunderbird “own or control directly or indirectly” at the relevant times the EDM Companies that would entitle it to submit to arbitration a claim on behalf of them under Article 1117 of the NAFTA? If not, what are the consequences thereof?**

96. Article 1117 of the NAFTA provides:

1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under:

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<sup>1</sup> See Bin Cheng, GENERAL PRINCIPLES OF LAW APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS, at p. 302 *et seq.* (1987)

<sup>2</sup> See in this regard *Feldman v. Mexico*, Interim Decision on Preliminary Jurisdictional Issues, 6 December 2000, ICSID Case No. ARB(AF)/99/1, [http://www.worldbank.org/icsid/cases/feldman\\_mexico\\_interim-en.PDF](http://www.worldbank.org/icsid/cases/feldman_mexico_interim-en.PDF), which quotes *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, 23 May 1997, WT/DS33/AB/R p. 14, in which the Appellate Body of the WTO stated:

[...] various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or respondent, is responsible for providing proof thereof. Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.

(a) Section A or Article 1503(2) (State Enterprises), or

(b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach.

2. An investor may not make a claim on behalf of an enterprise described in paragraph 1 if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage.

3. Where an investor makes a claim under this Article and the investor or a non-controlling investor in the enterprise makes a claim under Article 1116 arising out of the same events that gave rise to the claim under this Article, and two or more of the claims are submitted to arbitration under Article 1120, the claims should be heard together by a Tribunal established under Article 1126, unless the Tribunal finds that the interests of a disputing party would be prejudiced thereby.

4. An investment may not make a claim under this Section.

(i) Mexico's position

97. Mexico objects to the jurisdiction of the Tribunal to hear Thunderbird's claim under Chapter Eleven of the NAFTA. According to Mexico, Thunderbird did not own or control any of the EDM companies that would entitle it to present a claim on behalf of them under Article 1117 of the NAFTA, namely, Thunderbird did not demonstrate that it owned Juegos de Mexico and Thunderbird Brazil; that these companies acquired the EDM companies; or that Juegos de Mexico and Thunderbird Brazil were the owners of the EDM companies.

98. As to control, Mexico maintains that the NAFTA requires that legal control be demonstrated, and that Thunderbird did not have legal control of EDM-

Matamoros, EDM-Laredo or EDM-Reynosa. Mexico argues further that Thunderbird has also not demonstrated that it had factual control of the companies in question.

(ii) Thunderbird’s position

99. Thunderbird contends that it may properly proceed under Article 1117 of the NAFTA because it “owns or controls” the EDM entities. According to Thunderbird, it directly owned, and still owns, at all relevant times all outstanding shares of EDM-Puebla, EDM-Monterrey, and EDM-Juarez.
100. As to EDM-Matamoros, EDM-Laredo, and EDM-Reynosa, Thunderbird argues that, while it at all relevant times owned, and still owns, significant interests in those EDMs, it has never claimed full ownership thereof. Rather, Thunderbird maintains that it has at all times possessed, and still possesses, control of EDM-Matamoros, EDM-Laredo and EDM-Reynosa, directly or indirectly, at all relevant times, thus enabling Thunderbird to proceed under Article 1117 of the NAFTA. Thunderbird refers to case law of the Iran-US Claims Tribunal and to NAFTA case law (such as *S.D. Myers Inc.*) in support of its proposition that factual control may suffice to bring a NAFTA claim, and argues that it has brought a claim supported by substantial evidence that Thunderbird, as a matter of fact, controlled all of the EDM investments involved in its claim.

(iii) The Tribunal’s findings

101. Mexico has objected to the jurisdiction of the Tribunal to hear Thunderbird’s claim under Chapter Eleven of the NAFTA, because of an alleged lack of ownership or control by Thunderbird over the EDM Entities for the purposes of Article 1117.
102. Article 1117 of the NAFTA requires that the investor bringing a claim on behalf of an enterprise “own or control” the enterprise. Thunderbird must therefore establish that it owned or controlled the EDM entities. The Tribunal is satisfied

that Thunderbird has met the requirements of Article 1117 of the NAFTA, for the following reasons.

103. It is not disputed that Thunderbird owned the majority of the shares of EDM-Puebla, EDM-Monterrey, and EDM-Juarez. None of these entities effectively engaged in operations or business activities in Mexico.
104. On the other hand, Thunderbird had acknowledged that it had only a partial ownership of EDM-Matamoros (36.67%), EDM-Laredo (33.3%), and EDM-Reynosa (40.1%) (jointly the “Minority EDM Entities”).
105. Therefore, the present discussion turns on whether Thunderbird exercised control over the Minority EDM Entities. The question arises whether “control” must be established in the legal sense, or whether *de facto* control can suffice for the purposes of Chapter Eleven of the NAFTA. According to Mexico, to determine what constitutes “control” of a corporation, the Tribunal must turn to the corporate law of the Party under whose laws the enterprise was incorporated, and Article 1117 of the NAFTA therefore requires that legal control be demonstrated under Mexican corporate law.
106. The Tribunal does not follow Mexico’s proposition that Article 1117 of the NAFTA requires a showing of legal control. The term “control” is not defined in the NAFTA. Interpreted in accordance with its ordinary meaning, control can be exercised in various manners. Therefore, a showing of effective or “*de facto*” control is, in the Tribunal’s view, sufficient for the purposes of Article 1117 of the NAFTA<sup>3</sup>. In the absence of legal control however, the Tribunal is of the opinion that *de facto* control must be established beyond any reasonable doubt.

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<sup>3</sup> See in this regard the definition of control provided in an “Understanding” with respect to Article 1(6) of the Energy Charter Treaty (which is virtually identical in language to Article 1117 NAFTA): “For greater clarity as to whether an Investment made in the Area of one Contracting Party is controlled, directly or indirectly, by an Investor of any other Contracting Party, control of an

107. Despite Thunderbird having less than 50% ownership of the Minority EDM Entities, the Tribunal has found sufficient evidence on the record establishing an unquestionable pattern of *de facto* control exercised by Thunderbird over the EDM entities. Thunderbird had the ability to exercise a significant influence on the decision-making of EDM and was, through its actions, officers, resources, and expertise, the consistent driving force behind EDM’s business endeavour in Mexico.
108. It is quite common in the international corporate world to control a business activity without owning the majority voting rights in shareholders meetings. Control can also be achieved by the power to effectively decide and implement the key decisions of the business activity of an enterprise and, under certain circumstances, control can be achieved by the existence of one or more factors such as technology, access to supplies, access to markets, access to capital, know how, and authoritative reputation. Ownership and legal control may assure that the owner or legally controlling party has the ultimate right to determine key decisions. However, if in practice a person exercises that position with an expectation to receive an economic return for its efforts and eventually be held responsible for improper decisions, one can conceive the existence of a genuine link yielding the control of the enterprise to that person.
109. In the present case, having regard to the record as a whole, the Tribunal finds that without Thunderbird’s key involvement and decision-making during the relevant time frame, i.e., during the planning of the business activities in Mexico, the initial expenditures and capital, the hiring of the machine suppliers, the consultations with SEGOB, and the official closure of the EDM facilities,

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Investment means control in fact, determined after such an examination of the actual circumstances in each situation. In any such examination, all relevant factors should be considered, including the Investor’s (a) financial interest, including equity interest, in the Investment; (b) ability to exercise substantial influence over the management and operation of the Investment; and (c) ability to exercise substantial influence over the selection of members of the board of directors or any other managing body. [...]” (emphasis added).

EDM’s business affairs in Mexico could not have been pursued. Namely, the key officers of Thunderbird and the Minority EDM Entities were one and the same (*see* Dramatis Personae of 26 April 2004: Mr. Jack Mitchell was President and CEO of Thunderbird and the EDM entities; Mr. Peter Watson, counsel to Thunderbird, was shareholder in Thunderbird and the EDM entities). The initial expenditures, the know-how of the machines, the selection of the suppliers, and the expected return on the investment were provided or determined by Thunderbird. Likewise, legal advice regarding the operation of the EDM machines in Mexico was addressed to Thunderbird (*see* Mr. de Ruiz de Velasco’s legal opinion of 25 August 2000 at Exh. R-112).

110. In the Tribunal’s view, it is clear from the record that without the consistent and significant initiative, driving force and decision-making of Thunderbird, the investment in Mexico could not have materialized. Accordingly, the Tribunal finds that Thunderbird exercised control over the Minority EDM Entities for the purpose of Article 1117 of the NAFTA, in a manner sufficient to entitle it to bring a claim on behalf of those entities under said provision.

**Issue 4. Does the filing by Thunderbird of waivers on behalf of EDM-Puebla, EDM-Monterrey and EDM-Juarez on 15 August 2003 comply with the requirements of Article 1121 of the NAFTA? If not, what are the consequences thereof?**

111. Article 1121 of the NAFTA, captioned “Conditions Precedent to Submission of a Claim to Arbitration”, provides:

[...]

2. A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise:

(a) consent to arbitration in accordance with the procedures set out in this Agreement; and

(b) waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

3. A consent and waiver required by this Article shall be in writing, shall be delivered to the disputing Party and shall be included in the submission of a claim to arbitration.

[...]

(i) Mexico's position

112. Mexico submits that Thunderbird did not file waivers on behalf of EDM-Puebla, EDM-Monterrey, and EDM-Juarez in accordance with the requirements under the NAFTA. Specifically, Mexico contends that, pursuant to Article 1121 of the NAFTA, Thunderbird should have presented written waivers of the right to initiate or continue any actions in local courts or other fora at the time of submitting the claim to arbitration, i.e., at the time of presenting the Notice of Arbitration. As a result, Mexico argues, the claims of those three EDM entities are not admissible under the NAFTA.

(ii) Thunderbird's position

113. Thunderbird alleges that it satisfied all the requirements of Articles 1121(2) and (3) of the NAFTA with its delivery on 15 August 2003 (concurrent with the PSoC) of waivers for EDM-Puebla, EDM-Monterrey and EDM-Juarez, which had been inadvertently missing from earlier filings. Thunderbird argues in any event that even if it were assumed that the waiver letters were submitted after delivery of the “claim to arbitration,” previous NAFTA tribunals have found that such minor procedural defects cannot be used to defeat an otherwise meritorious

claim. Thunderbird adds that none of the EDM entities have commenced actions in breach of the Article 1121 waiver.

(iii) The Tribunal's findings

114. Mexico has argued that with respect to EDM-Puebla, EDM-Monterrey, and EDM-Juarez, Thunderbird failed to submit a claim to arbitration in compliance with the requirements of Article 1121 of the NAFTA.
115. Article 1121 of the NAFTA is concerned with conditions precedent to the submission of a claim to arbitration. One cannot therefore treat lightly the failure by a party to comply with those conditions. The Tribunal finds however that the waivers filed for EDM-Puebla, EDM-Monterrey, and EDM-Juarez were valid within the meaning of Article 1121 of the NAFTA, for the following reasons.
116. Thunderbird submitted a claim to arbitration by means of a Notice of Arbitration dated 1 August 2002 (and received by Mexico on 22 August 2002). Pursuant to Article 1121 of the NAFTA, Thunderbird would have been required to file the appropriate waivers under Article 1121 of the NAFTA at the time of the submission of its claim to arbitration, which was, pursuant to Article 1137(1) of the NAFTA, at the time of receipt by Mexico of the Notice of Arbitration under the UNCITRAL Rules. However, Thunderbird only filed written waivers for EDM-Puebla, EDM-Monterrey, and EDM-Juarez with its Particularised Statement of Claim of 15 August 2003. The issue at hand is therefore not an actual failure to file waivers for EDM-Puebla, EDM-Monterrey, and EDM-Juarez, but rather the (un-)timeliness of the filings in question.
117. Although Thunderbird failed to submit the relevant waivers with the Notice of Arbitration, Thunderbird did proceed to remedy that failure by filing those waivers with the PSoC. The Tribunal does not wish to disregard the subsequent filing of those waivers, as to reason otherwise would amount, in the Tribunal's view, to an over-formalistic reading of Article 1121 of the NAFTA. The Tribunal considers indeed that the requirement to include the waivers in the submission of



the claim is purely formal,<sup>4</sup> and that a failure to meet such requirement cannot suffice to invalidate the submission of a claim if the so-called failure is remedied at a later stage of the proceedings. The Tribunal joins the view of other NAFTA Tribunals that have found that Chapter Eleven provisions should not be construed in an excessively technical manner<sup>5</sup>.

118. In construing Article 1121 of the NAFTA, one must also take into account the rationale and purpose of that article. The consent and waiver requirements set forth in Article 1121 serve a specific purpose, namely to prevent a party from pursuing concurrent domestic and international remedies, which could either give rise to conflicting outcomes (and thus legal uncertainty) or lead to double redress for the same conduct or measure. In the present proceedings, the Tribunal notes that the EDM entities did not initiate or continue any remedies in Mexico while taking part in the present arbitral proceedings. Therefore, the Tribunal considers that Thunderbird has effectively complied with the requirements of Article 1121 of the NAFTA.

### C. Merits – General

#### **Issue 5. What is the role, if any, of Chapter Eleven of the NAFTA in the present case?**

##### (i) Thunderbird’s position

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<sup>4</sup> See in this regard the distinction made by the majority of the tribunal in *Waste Management, Inc. v. Mexico*, Arbitral Award, 2 June 2000, ICSID Case No. ARB(AF)98/2, [http://www.worldbank.org/icsid/cases/waste\\_award.pdf](http://www.worldbank.org/icsid/cases/waste_award.pdf), between “formal” and “material” requirements under 1121 of the NAFTA.

<sup>5</sup> See *Mondev International Ltd. v. USA*, Award, 11 October 2002, ICSID Case No. ARB(AF)99/2, <http://www.state.gov/documents/organization/14442.pdf>. “Chapter 11 should not be construed in an excessively technical way, so as to require the commencement of multiple proceedings in order to reach a dispute which is in substance within its scope.” (¶44)

119. Thunderbird accepts that Article 1114 NAFTA allows governments to label and regulate conduct they choose as being “illegal” for domestic purposes. A NAFTA tribunal may determine, Thunderbird contends, whether the NAFTA party has carried out its regulatory activities in a manner that does not violate its Chapter Eleven obligations. Thunderbird considers that the *Ley Federal de Juegos y Sorteos* of 31 December 1947 constitutes a “measure” under Chapter Eleven of the NAFTA, as do the various forms of enforcement activity arising from it.
120. Thunderbird accepts further that the Tribunal has no role in relation to the Mexican judicial system regarding the subject matter of this case – it does not stand as a domestic court of appeal or review – the Tribunal must simply determine whether Mexico has developed and executed the measures in question in a manner consistent with Mexico’s obligations under Chapter Eleven of the NAFTA. In this regard, Thunderbird characterises the SEGOB administrative proceedings as administrative fact-finding or quasi-judicial proceedings, to be adjudged against the standards of due process and procedural fairness applicable to administrative officials, rather than judicial officials.

(ii) Mexico’s position

121. Mexico contends that Chapter Eleven of the NAFTA recognises and protects the right of a Contracting Party to regulate certain conduct that it considers illegal, and that the *Ley Federal de Juegos y Sorteos* forms part of Mexico’s law to regulate such conduct that it considers illegal.
122. With respect to the role and jurisdiction of the Tribunal in relation to the Mexican judicial system regarding the subject matter of Thunderbird’s claims, Mexico argues that the Tribunal may not act as a court of appeal with authority to review the decisions of the domestic Mexican courts. According to Mexico, the Tribunal may only assess whether the conduct of the Mexican administration in enforcing domestic law was compatible with the three NAFTA provisions relied upon by Thunderbird. As to the administrative proceedings of SEGOB, Mexico points out that they were subject, at all stages, to Mexican judicial

review, and that the Tribunal may not review those proceedings in the manner of an appellate court.

(iii)The Tribunal's findings

123. The Parties do not dispute that Chapter Eleven of the NAFTA recognizes in principle the right of a Contracting Party to regulate conduct that it considers illegal.
124. The Tribunal notes that under Mexican law, specifically the *Ley Federal de Juegos y Sorteos* of 31 December 1947, gambling is an illegal activity.
125. The Tribunal's role in this arbitration is not to determine whether the EDM machines were prohibited gambling equipment under the *Ley Federal de Juegos y Sorteos*, as acknowledged by both Parties. It is not the Tribunal's function to act as a court of appeal or review in relation to the Mexican judicial system regarding the subject matter of the present claims, or in relation to the SEGOB administrative proceedings for that matter.
126. Rather, the Tribunal shall examine whether the conduct of Mexico and the measures employed by SEGOB in relation to the EDM entities were consistent with Mexico's obligations under Chapter Eleven of the NAFTA.
127. The role of Chapter Eleven in this case is therefore to measure the conduct of Mexico towards Thunderbird against the international law standards set up by Chapter Eleven of the NAFTA. Mexico has in this context a wide regulatory "space" for regulation; in the regulation of the gambling industry, governments have a particularly wide scope of regulation reflecting national views on public morals. Mexico can permit or prohibit any forms of gambling as far as the NAFTA is concerned. It can change its regulatory policy and it has a wide discretion with respect to how it carries out such policies by regulation and administrative conduct. The international law disciplines of Articles 1102, 1105 and 1110 in particular only assess whether Mexican regulatory and

administrative conduct breach these specific disciplines. The perspective is of an international law obligation examining national conduct as a “fact.”

**Issue 6. Is the functionality of the machines, technically or otherwise, operated by the EDM Companies relevant in the present case?**

(i) Thunderbird’s position

128. Thunderbird contends that the functionality of the machines is relevant in assessing Mexico’s justification (or lack thereof) for seizing Thunderbird’s investment enterprises; to the issue of detrimental reliance under Article 1105 in that use of similar equipment was already familiar to Mexican officials – prior to 15 August 2000 – due to their use in facilities already being regulated by Mexico (e.g. the Guardia facilities); and for Article 1102 to the extent that similar equipment has been, and remains, in use in other facilities while the EDMs remain closed.
129. Thunderbird contends further that the manner in which the functionality of the machines is relevant in the present case does not involve a determination by the Tribunal as to the legality of the EDM machines under Mexican law.
130. Thunderbird also argues that the determination of SEGOB concerning the functionality of the machines, at any given time, is only relevant to the issue of whether any actions taken on the basis of these determinations violates the relevant NAFTA provisions.
131. According to Thunderbird, the only criteria relevant for the Tribunal to determine the functionality of the machines is the standard set forth in the *Oficio* i.e., whether “the principal factor of the operation is luck or gambling and not the user’s ability of skilfulness.” Thunderbird contends that the machines in question met the applicable criteria and were as a matter of fact established by the evidence before the Tribunal, to be “skill machines” operated in accordance with the *Oficio*. Thunderbird

refers in this regard to the briefcase version demonstration carried out by Mr. McDonald at the Hearing.

(ii) Mexico's position

132. According to Mexico, the functionality of the machines is relevant to the issues of whether SEGOB could be deemed to have acted arbitrarily at international law in finding that such machines were prohibited equipment under Mexican law; and whether Thunderbird could have had a reasonable expectation that SEGOB would agree that the machines operated by EDM were not illegal gaming machines.
133. Mexico recalls that the Tribunal does not have jurisdiction to determine whether the gaming operations of EDM were legal, or whether the machines in question were prohibited under Mexican law. Mexico disputes however Thunderbird's characterisation of the machines as "skill" machines, arguing instead that the evidence produced by Mexico establishes that the EDM machines are no more than "video poker" or "slot" machines, similar or identical to machines that were held to be gambling equipment in U.S. legal proceedings, and previously described as gambling equipment by Thunderbird itself. Mexico refers in this regard to the expert testimony of Prof. Rose and Mr. McDonald's demonstration at the Hearing.

(iii) The Tribunal's findings

134. Both Parties have argued that the functionality of the EDM machines is relevant to certain issues pending before the Tribunal. Thus, Thunderbird has submitted evidence in support of its contention that the EDM machines are "skill" machines, whereas Mexico has provided evidence establishing, according to Mexico, that the machines in question are "*tragamonedas*" [slot machines] prohibited under Mexican law.

135. The Tribunal agrees that the nature and functionality of the machines may be relevant in considering certain issues in this arbitration. However, the Tribunal does not need to enter into a detailed technical discussion as to the precise nature and functionality of the machines, since both Parties acknowledge that it is not up to the Tribunal to determine the legality of the machines under the *Ley Federal de Juegos y Sorteos*.
136. The Tribunal notes that the machines operated by EDM are equipped with computerised random number generators and that it is possible to set the level of payouts, and thus the odds for winning. For example, the Bestco “Fantasy 5 Game Manual” that was found at the EDM-Laredo Facility provides that the default base pay rate “is set to 75%. This can be changed to a value within the range of 50%-95%.” (Ex. R-15, p. 13) The Tribunal notes further that the machine’s percentage of payout is not visible or otherwise known to the player (*see* McDonald at Tr. 498-502). The Tribunal infers that the operation of these video game machines with a built-in and modifiable random number generator involves a considerable degree of chance, and that by adjusting the payout rate, the machine operator can manipulate the odds for winning regardless of the skill of the player.

**Issue 7. Was a legitimate expectation created by SEGOB’s letter of 15 August 2000 to the effect that it brings Thunderbird’s claims in the present case under Article 1102, 1105 and/or 1110 of the NAFTA?**

(i) Thunderbird’s position

137. Thunderbird contends that this issue is relevant to the application of Articles 1105, 1110, and 1102 of the NAFTA.
138. As to the standard of protection for legitimate expectations, Thunderbird argues that if an investor or investment reasonably relies on the representations of government officials and suffers damages because of such reliance, the responsibility of the State is engaged under international law. Thunderbird cites

a number of cases in this regard<sup>6</sup>, arguing that detrimental reliance arises from the general international law principle of good faith and the customary international standard of fair and equitable treatment. Through its ratification of the NAFTA, Thunderbird contends, Mexico authored a set of legitimate expectations upon which an investor or investment could reasonably rely.

139. Thunderbird contends that, seeking certainty as to the legality and propriety of its intended operations in Mexico, Thunderbird and EDM solicited the Mexican government for an official opinion. According to Thunderbird, SEGOB’s response to the *Solicitud* provided the EDMs with written assurance or “negative clearance” to operate the specific machines identified in the *Solicitud*; and defined a standard in accordance with which Thunderbird could operate skill machines without regulation by SEGOB, the standard being that the machines had to be ones in which the “principal factor” of operation was the user’s skill and ability. Thunderbird does not assert that it had thus obtained a government permit or licence to operate. Rather, SEGOB generated, according to Thunderbird, a legitimate expectation upon which the EDMs should have been able to rely reasonably.
140. Thunderbird denies having failed to disclose relevant facts in the *Solicitud*. According to Thunderbird, the SEGOB officials who issued the letter must have been familiar with the skill machines whose operation was proposed by the EDMs, since, amongst others, Mexico had been involved in litigation with Guardia over similar machines and SEGOB did not request any additional information in relation to the EDM machines.

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<sup>6</sup> In particular, *Metalclad Corp. v. Mexico*, Award, 30 August 2000, ICSID Case ARB(AF)/97/1, <http://www.worldbank.org/icsid/cases/mm-award-e.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADF-award.pdf>; *Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467, [http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward\\_001.pdf](http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf).

(ii) Mexico's position

141. Mexico denies that the *Oficio* created a legitimate expectation for Thunderbird with respect to its investments in Mexico. According to Mexico, the *Oficio* was an advisory opinion, not an approval or permit, based on the information provided by EDM in the *Solicitud*, stating that if the machines operated by EDM were as described in the *Solicitud*, then they fell outside SEGOB's jurisdiction. Mexico asserts that it clearly and expressly made known to EDM the nature of the machines that were prohibited by law and that the *Oficio* was a clear warning that the operations EDM was conducting could be illegal.
142. However, Mexico argues, EDM did not operate the machines in the form or manner described in the *Solicitud*, neither with respect to the element of "ability and skill" nor with respect to "betting," and EDM did not present any evidence on the operation of the machines. Mexico adds that the *Solicitud* did not allude to the fact that the EDM machines were similar or identical to those operated by Guardia.
143. Further, Mexico contends, EDM did not treat the *Oficio* as a permit or authorisation at the time it was issued by SEGOB, as evidenced by Mr. Ruiz de Velasco's legal opinion, which concurred with the *Oficio* (quoted at ¶ 59 above).
144. Mexico denies in any event that Thunderbird relied on the *Oficio* as the basis for its investments in Mexico, arguing that Thunderbird undertook actions before the *Oficio*'s issuance; that Thunderbird expressly advised investors in EDM that the *Oficio* was no specific entitlement for EDM's operations; that Thunderbird reported to its shareholders that it relied on private sector advisors in making the investment; and that it asserted in U.S. court proceedings that it was fraudulently induced to enter this business by Messrs. Oien en Ong.



(iii) The Tribunal's findings

145. EDM's *Solicitud* dated 3 August 2000 is quoted at ¶50 above. SEGOB's *Oficio* dated 15 August 2000 is quoted at ¶55 above.
146. Thunderbird has argued that it reasonably relied, to its detriment, upon the assurances provided by SEGOB in the *Oficio*. Mexico, on the other hand, denies that the *Oficio* gave rise to any legitimate expectations for Thunderbird to operate the EDM machines in Mexico.
147. Having considered recent investment case law and the good faith principle of international customary law<sup>7</sup>, the concept of "legitimate expectations" relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.
148. The threshold for legitimate expectations may vary depending on the nature of the violation alleged under the NAFTA and the circumstances of the case. Whatever standard is applied in the present case however – be it the broadest or the narrowest – the Tribunal does not find that the *Oficio* generated a legitimate expectation upon which EDM could reasonably rely in operating its machines in Mexico.

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<sup>7</sup> Bin Cheng, *General Principles of Law applied by International Courts and Tribunals*, at p. 123 *et seq.* (1987); Joerg Mueller, *Vertrauensschutz im Voelkerrecht* (1971); E. Zoller, *La bonne foi en droit international public* (1977); F. Orrego Vicuña, *Regulatory Authority and Legitimate Expectations*, 5 *Intl Law Forum*, 188m 193 (2003); *Nuclear Test Case*, ICJ Reports 1974, 253 at p. 268.

149. The Tribunal considers that the point of departure in assessing whether Thunderbird could reasonably rely to its detriment on SEGOB’s response to the *Solicitud* is to ascertain what was requested by Thunderbird in the *Solicitud*.
150. Given the lack of contemporaneous evidence on the record regarding the background of the *Solicitud* (such as witness evidence from Messrs. Aspe and Arroyo or from SEGOB officials in office when the *Solicitud* was submitted), the Tribunal cannot rely on presumptions or inferences, let alone speculation concerning that background. For instance, the Tribunal has noted the existence of a “success fee” arrangement between Thunderbird and Messrs. Aspe and Arroyo (who, according to Thunderbird, had numerous contacts with SEGOB officials in relation to Thunderbird’s proposed operations). Thunderbird offered the two Mexican lawyers US\$ 300,000 to secure a letter from SEGOB authorising Thunderbird’s gaming operations in Mexico (*see* correspondence at Exs. R-106, R-107, and R-121). According to Mr. Watson’s draft letter of 10 August 2000, Thunderbird was prepared to pay Messrs. Aspe and Arroyo an additional US\$ 700,000 if the letter was “granted exclusively for Thunderbird [...] and that no other such permission would be granted to other potential competing parties; otherwise, no additional fees would be owed.” (Ex. R-121) In the absence of any evidence on the record in relation to the “success fee” arrangement and the nature of the dealings between Messrs. Aspe and Arroyo and SEGOB, these facts do not have a bearing on the Tribunal’s analysis below. Under those circumstances, the Tribunal can only interpret the 3 August 2000 *Solicitud* on its face value.
151. In the Tribunal’s view, the information presented by EDM in the *Solicitud* is incomplete and, in particular, inaccurate in two regards.
152. First, it is asserted in the *Solicitud* that the machines operated by EDM do not involve luck or betting (*see* ¶3: “*In these games, chance and wagering or betting is not involved [...]*”). The Tribunal notes in ¶7 the use of the explicit terms “in no way”: “*The nature of video game machines for games of skills and ability is not games of chance or games with bets, wagers or drawings [...] the player can*

*receive points that he can trade for a prize as a reward for the skills achieved and in no way as the result of chance* (“*de ninguna manera*” in the original Spanish version). To represent that luck does not affect the outcome of the game in any manner whatsoever contradicts the evidence on the record (*see* the Tribunal’s findings at ¶136 above).

153. Second, it is asserted in the *Solicitud* that the machines in question are “*devices for recreation which have been designed for the enjoyment and entertainment of its users*” (¶3), “*only for the purpose of entertainment in which the users can obtain prizes for their skills and abilities*” (*Solicitud* at ¶9; *see also* ¶8 “[...] *the determinant to get results is the skills and ability of players; something very different from games of bets and wagers where there is a previous pact or covenant between the company and the user and, therefore, there is an agreement to handle an amount of money or any other thing.*”). It is thus suggested that the machines operated by EDM do not involve any “agreement to handle an amount of money,” attributing instead prizes to the players. Such a representation is not accurate since the player must insert dollar bills to begin the game and any winning ticket is redeemable for cash.
154. In this regard, Mr. Ruiz de Velasco testified that had he known when he rendered his legal opinion on 20 August 2000 that the winning tickets were redeemable for cash, he would have most likely revised his opinion “because it probably could have bid in [*sic*] as gambling or betting.” (Ruiz de Velasco at Tr. 649-650)
155. The Tribunal is therefore of the opinion that the *Solicitud* is not a proper disclosure and that it puts the reader on the wrong track. The *Solicitud* creates the appearance that the machines described are video arcade games, designed solely for entertainment purposes.
156. Thunderbird has argued that SEGOB was well aware of the nature of the EDM machines since it had attempted to proceed with the closure of similar gaming facilities of Mr. Guardia. The Tribunal notes, however, that there is no

disclosure in the *Solicitud* that the machines operated by EDM were similar or identical to those of Mr. Guardia.

157. Likewise, Thunderbird's identification in the *Solicitud* of the trademark and model number of the machines ("Bestco, model MTL19U-8L and S.C.I. model 17"UR") cannot be deemed sufficient to establish the functionality of the machines. According to the evidence, the model references used in the *Solicitud* were not proper model numbers but rather a description of the size of the computer monitor used to display the video game (*see* Tr. 125-126 and Exs. C-36 and C-87; *see also* Tr. 1163-1165). The model numbers did not therefore elucidate the nature of the machines and furthermore appeared to be inaccurate or incomplete. For instance, in the Bestco invoice, the machines sold were identified under the model reference "7100 Fantasy 5" (Ex. C-87; *see also* operating manual captioned "Fantasy 5 Game Manual" at Ex. R-15), whereas in the *Solicitud* a random combination of abbreviations and numbers was used to identify the same machines ("MTL19U-8L"), without any reference to the name "Fantasy 5." In this respect, Mr. McDonald testified that he was not familiar with the Bestco model numbers (Tr. 445-446). Mr. Ruiz de Velasco also testified that he was not familiar with the meaning of the Bestco and SCI model numbers (Tr. 583-585). No operating manuals, catalogues, or photos of the machines were presented with the *Solicitud*.
158. The Tribunal finds no evidence on the record establishing that SEGOB was indeed familiar with the nature and operation of the EDM machines.
159. Thunderbird has also argued that in the event of doubt, SEGOB should have made a request for additional information regarding the operation of the machines, or for an inspection of the machines. Yet Thunderbird was the moving party presenting a "*Solicitud*" to the Mexican administration; one would therefore expect that the moving party supply adequate information and make a proper disclosure. In the Tribunal's view, the *Solicitud* did not give the full picture, even for an informed reader.

160. The Tribunal turns to the contents of the *Oficio*. Again, in the absence of any contemporaneous evidence surrounding the issuance of the *Oficio* (namely, the lack of witness testimony from SEGOB officials involved in the issuance of the *Oficio*, as well as that of Messrs Aspe and Arroyo; *see also* ¶150 above), the Tribunal cannot rely on presumptions or inferences, let alone speculation, regarding its issuance and can only analyse the letter on its face value. In addition, it is not up to the Tribunal to determine how SEGOB should have interpreted or responded to the *Solicitud*, as by doing so, the Tribunal would interfere with issues of purely domestic law and the manner in which governments should resolve administrative matters (which may vary from country to country). Rather, the Tribunal can only assess whether the contents of the *Solicitud* gave rise to legitimate expectations for Thunderbird within the context of Mexico’s obligations under Chapter Eleven of the NAFTA.
161. SEGOB, in ¶¶ 2-4 of the *Oficio*, recalls the legal provisions applicable in relation to “gambling and luck related games.” In ¶5, SEGOB states: “[...] notwithstanding the above mentioned, according to your statement, the machines that your representative operates are recreational video game devices for purposes of enjoyment and entertainment of its users, with the possibility of obtaining a prize, without the intervention of luck or gambling, but rather the user’s ability and skilfulness”. In ¶6, SEGOB adds: “if the machines that your representative exploits operate in the form and conditions stated by you, this governmental entity is not able to prohibit its use, in the understanding that the use of machines known as “coins-swallowers”, “token-swallowers” or “slot machines,” in which the principal factor of the operation is luck or gambling and not the user’s ability of skilfulness as you stated, could constitute any of the hypothesis described under the Federal Law of Games and Sweepstake [...]”. The Tribunal understands the message conveyed by SEGOB in the *Oficio* to be that if the machines operate in accordance with EDM’s representations in the *Solicitud*, SEGOB does not have jurisdiction over said machines.
162. Thunderbird has argued that the *Oficio* defined a standard according to which machines that involved as “principal factor” the user’s skill and ability do not

fall within SEGOB’s jurisdiction. The Tribunal does not follow Thunderbird’s interpretation. In ¶ 6, SEGOB refers to slot machines (or “coin-swallowers” or “token-swallowers”). According to SEGOB, such machines are devices in which the “principal factor” (“factor *preponderante*” in the original Spanish text) of the operation is luck or gambling. SEGOB’s description of slot machines cannot be interpreted *a contrario* as describing a standard for skill machines, according to which machines in which skill is the “factor preponderante” cannot be treated as gambling equipment. SEGOB’s use of the term “preponderante” in reference to luck or gambling is not unusual. Prof. Rose testified, “gambling means that it is predominantly chance. Probably the easiest way to understand that is that if chance determines the outcome at any point, then it’s gambling. So skill has to determine the outcome at every point in the game.” (Tr. 729) Furthermore, Thunderbird was clearly cautioned in ¶ 7 of the *Oficio*, “in the machines that your representative operates there shall be no intervention of luck or gambling.”

163. As to Mr. Ruiz de Velasco’s legal opinion of 20 August 2004 (quoted at ¶ 59 above), the contents thereof reinforce the Tribunal’s view that Thunderbird could not have reasonably relied to its detriment upon the *Oficio* to operate its gaming facilities in Mexico. In his letter to Thunderbird, Mr. Ruiz de Velasco made clear that (i) the *Oficio* was based upon the EDM’s representations in the *Solicitud* (“[...] *the Ministry of Interior states that it does not have any jurisdiction over the operation of said machines, since in accordance with the representations made by EDM in its application, the video games skill machines to be operated by EDM do not fall into the classification of ‘slot machines’ [...]*” at R-112); and (ii) that EDM was prohibited from operating gaming or betting machines (“[...] *EDM can operate the video games skill machines as long as they do not become, in any manner whatsoever, as gaming or betting machines*” at R-112 (emphasis added)).
164. It cannot be disputed that Thunderbird knew when it chose to invest in gaming activities in Mexico that gambling was an illegal activity under Mexican law. By Thunderbird’s own admission, it also knew that operators of similar machines (Guardia) had encountered legal resistance from SEGOB. Hence, Thunderbird

must be deemed to have been aware of the potential risk of closure of its own gaming facilities and it should have exercised particular caution in pursuing its business venture in Mexico. At the time EDM requested an official opinion from SEGOB on the legality of its machines, EDM must also be deemed to have been aware that its machines involved some degree of luck, and that dollar bill acceptors coupled with winning tickets redeemable for cash could be reasonably viewed as elements of betting. Yet EDM chose not to disclose those critical aspects in the *Solicitud*.

165. Further, the fact that SEGOB took action against Thunderbird's gaming facilities in February 2001, i.e., approximately six months after the issuance of the *Oficio*, is insufficient to establish that prior to that date, SEGOB had authorised (or was intentionally tolerating) Thunderbird's operations. Six months under the circumstances is by any standard a reasonable period for a government to seek enforcement of local gambling legislation.
166. Considering the foregoing, the Tribunal finds that there was no legitimate expectation created by the *Oficio* to the effect of bringing Thunderbird's claims in the present case under Article 1102, 1105 and/or 1110 of the NAFTA.
167. Finally, the Tribunal questions to what extent Thunderbird invested in Mexico in reliance on the *Oficio*, considering the non-negligible steps that Thunderbird had completed for the operation of its gaming machines prior to the issuance of the *Oficio* on 15 August 2000. The record shows that before 15 August 2000: EDM had been incorporated; JDMI had entered into a detailed Revenue Sharing Agreement with Messrs. Ong and Oien regarding the operation of the gaming facilities in Mexico (Exh. R-98); EDM had opened bank accounts (C-6); EDM had obtained land use permits (Ex. C-7); EDM had entered into a lease for a gaming facility location in Matamoros (Exs. C-3 to C-5); EDM had imported 50 Bestco machines and 30 SCI machines (Exs. C-9, C-87 and C-15); EDM had filed an "Aviso de Apertura" for the establishment of "La Mina de Oro" (Ex. C-10); and by Thunderbird's own admission in ¶2 of the *Solicitud*, EDM had already "opened a business [...] in the city of Matamoros, Tamaulipas, under the

commercial name ‘La Mina de Oro’, which operates video game machines for games of skills and ability, and complies with all Municipal requirements.” (*see also the Solicitud* at ¶4)

**D. Merits – Articles 1102, 1105 and 1110 of the NAFTA**

**Issue 8. Did Respondent breach the “National Treatment” standard under Article 1102 of the NAFTA?**

168. Articles 1102 (1) and (2) of the NAFTA provide as follows:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

(i) Thunderbird’s position

169. Thunderbird contends that Mexico has breached Article 1102 of the NAFTA by according different treatment to EDM and its investments than that what has been provided to domestic investors and investments operating in like circumstances.

170. According to Thunderbird, the Tribunal is to apply a three-part test under Article 1102 of the NAFTA, being identification of the relevant subjects of the national treatment comparison (the basis being the likeliness of comparators); consideration of the relative treatment received by each comparator (the basis being the best level of treatment available to any other domestic investor



operating in like circumstances); and consideration whether factors exist which could justify any difference in treatment so found (to be construed narrowly and the burden of proof shifting to Mexico). Thunderbird cites NAFTA and BIT case law in support of this three-part test<sup>8</sup>.

171. Thunderbird’s EDM enterprises were seized and closed by Mexico because the skill machines operated at those facilities were deemed illegal, Thunderbird argues, whereas domestic investors, operating skill machines under essentially identical circumstances, remain open and operating. Thunderbird cites Guardia’s “Club 21,” de la Torres’s Reflejos facility, and the Bella Vista Entertainment centre in Monterrey as appropriate comparators. Thunderbird disputes Mexico’s argument that the EDM entities were not in “like circumstances,” arguing instead that Mexico has not provided a sufficient evidentiary basis upon which to make the argument.
172. Finally, Thunderbird maintains that its decision to abandon recourse to judicial proceedings for relief in Mexico is irrelevant to the issue of whether Mexico breached its NAFTA obligations under Chapter Eleven of the NAFTA.

(ii) Mexico’s position

173. Mexico denies having accorded less favourable treatment to EDM than that accorded to Mexican companies in like circumstances. SEGOB has acted consistently, Mexico argues, in enforcing the law against all operators (including

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<sup>8</sup> *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2, 10 April 2001, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/PopeandTalbot-Merit.pdf>; *S.D. Myers Inc. v. Canada*, First Partial Award, 13 November 2000, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/SDMeyers-1stPartialAward.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case No. ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADF-award.pdf>; *Feldman v. Mexico*, Award, 16 December 2002, ICSID Case No. ARB(AF)/99/1, [http://www.worldbank.org/icsid/cases/feldman\\_mexico-award-en.PDF](http://www.worldbank.org/icsid/cases/feldman_mexico-award-en.PDF); *Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467, [http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward\\_001.pdf](http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf).

Mexican nationals) who have attempted to operate facilities with so-called “skill” machines, and it has proceeded with the closure of every similar facility of which it became aware of and defended its actions in every court of appeal initiated by the operators of machines similar or identical to those of EDM.

174. Mexico contends that Thunderbird has not succeeded in proving any discrimination against EDM, whether based on nationality or otherwise. In this regard, Mexico disputes Thunderbird’s three-part test Article 1102. According to Mexico, Article 1102 is directed only to nationality-based discrimination and proscribes only demonstrable and significant indications of bias and prejudice on the basis on nationality, which are to be proven by Thunderbird, “the like circumstances” of Article 1102 requiring an adequate comparison on the basis of the facts, thereby taking into account, in particular, compliance with local law relating to illegal conduct. Mexico adds that EDM is not “in like circumstances” with the operators of facilities that have been able to continue operating under temporary injunctive relief while their legal challenges were pending, as even if EDM filed “*juicio de amparo*” proceedings, it was not granted injunctive relief and moreover withdrew its appeals.

(iii)The Tribunal’s findings

175. In construing Article 1102 of the NAFTA, the Tribunal gives effect to the plain wording of the text. The obligation of the host NAFTA Party under Article 1102 of the NAFTA is to accord non-discriminatory treatment towards the investment or investor of other NAFTA Parties. It must therefore be established that discriminatory treatment was accorded to the foreign investment or investor.
176. The burden of proof lies with Thunderbird, pursuant to Article 24(1) of the UNCITRAL Rules. In this respect, Thunderbird must show that its investment received treatment less favourable than Mexico has accorded, in like circumstances, to investments of Mexican nationals.

177. It is not expected from Thunderbird that it show separately that the less favourable treatment was motivated because of nationality. The text of Article 1102 of the NAFTA does not require such showing. Rather, the text contemplates the case where a foreign investor is treated less favourably than a national investor. That case is to be proven by a foreign investor, and, additionally, the reason why there was a less favourable treatment.<sup>9</sup>
178. In the Tribunal's view, Thunderbird has not sufficiently established – not even on a *prima facie* basis – that the EDM investments were treated, in like circumstances, worse than those of Mexican nationals (or any other nationals for that matter).
179. The record shows that SEGOB has sought to enforce Mexican legislation on gambling by pursuing the closure of numerous gambling facilities (most of which have been closed definitely), and that the official closure of Mexican gambling facilities was in fact pursued at the very same time SEGOB proceeded to the official closure of the EDM facilities in Nuevo Laredo and Matamoros (*see* Exh. R-9). The Tribunal notes that SEGOB met resistance from the gaming facilities in question, including those of EDM, before the Mexican courts. As a result, it appears that some of the facilities closed by SEGOB were able to continue to operate under temporary injunctive relief, but the record also shows that SEGOB legally challenged the court decisions granting injunctive relief in connection with SEGOB's official closure orders and that appeals are pending.

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<sup>9</sup> See *S.D. Myers Inc. v. Canada*, First Partial Award, 13 November 2000, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/SDMeyers-1stPartialAward.pdf>; *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2, 10 April 2001, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/PopeandTalbot-Merit.pdf>; *Feldman v. Mexico*, Award, 16 December 2002, ICSID Case No. ARB(AF)/99/1, [http://www.worldbank.org/icsid/cases/feldman\\_mexico-award-en.PDF](http://www.worldbank.org/icsid/cases/feldman_mexico-award-en.PDF); *Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467, [http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward\\_001.pdf](http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf).

180. As to the gambling facilities that apparently continue to operate without having obtained temporary injunctive relief, the Tribunal finds insufficient evidence on the record establishing that Mexico had knowledge of the existence of those facilities and deliberately allowed them to remain open. In this regard, it should be noted that some of the gambling facilities appeared to operate in a clandestine manner (*see* the videos submitted by Thunderbird).
181. With respect to the Guardia facilities, the Tribunal notes that this is a particular case where SEGOB has experienced long-standing legal altercations with Mr. Guardia. The Tribunal infers that even if any of the facilities operated by Mr. Guardia remain open today, one cannot talk of discrimination towards EDM since the record shows that SEGOB has repeatedly taken action to close Mr. Guardia’s facilities, but has met fierce legal and other resistance in the process (*see* Exs. R-97; R-114; R-31, R-32).
182. It thus appears from the facts of the case that SEGOB’s policy and actions in enforcing the *Ley Federal de Juegos y Sorteos* were directed at both Mexican and non-Mexican gambling operations and that they were overall consistent. Accordingly, the Tribunal finds that Thunderbird has not established a breach the “National Treatment” standard under Article 1102 of the NAFTA.
183. In any event, even if Thunderbird had established without doubt that Mexico’s line of conduct with respect to gambling operations was not uniform and consistent, one cannot overlook the fact that gambling is illegal in Mexico. In the Tribunal’s view, it would be inappropriate for a NAFTA tribunal to allow a party to rely on Article 1102 of the NAFTA to vindicate equality of non-enforcement within the sphere of an activity that a Contracting Party deems illicit.

**Issue 9. Did Respondent breach the “Minimum Standard of Treatment” under Article 1105 of the NAFTA?**

184. Article 1105(1) of the NAFTA provides as follows:

Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

(i) Thunderbird's position

185. With respect to the meaning of the “Minimum Standard of Treatment” under Article 1105 of the NAFTA and its application by a NAFTA tribunal, Thunderbird cites various NAFTA awards, alleging that the conduct of SEGOB officials in this case reflects exactly the kind and level of arbitrariness that the *Waste Management II* tribunal would conclude violates the minimum standard under Article 1105.
186. According to Thunderbird, three international law doctrines – detrimental reliance, denial of justice, and abuse of rights – can be used to inform the Tribunal’s interpretation of how “fair and equitable treatment” was not provided to Thunderbird or its investments. Hence, Thunderbird contends that the detrimental reliance by Thunderbird and the EDMs on the *Oficio* in pursuing their investments in Mexico and Mexico’s subsequent actions against Thunderbird and its EDM entities, in contravention to the content of the *Oficio*, establish a breach of Article 1105 of the NAFTA, adding that the EDMs were not only entitled to rely upon the SEGOB letter because of its contents, but also because of the expectations generated by Mexico’s ratification of the NAFTA. Thunderbird alleges further a failure by Mexico to provide due process, constituting an administrative denial of justice, in the proceedings relating to the ruling of 10 October 2001, which constituted a breach of Article 1105 of the NAFTA; and manifest arbitrariness in administration, constituting proof of an abuse of right, in the proceedings before SEGOB, in breach of Article 1105 of the NAFTA.

(ii) Mexico's position

187. Mexico denies having violated the “Minimum Standard of Treatment” of Article 1105 of the NAFTA.

188. According to Mexico, Thunderbird's complaints about the SEGOB administrative proceedings are factually incorrect and in any event pertain to issues of pure domestic law; and Thunderbird has not presented any evidence of failures of the Mexican judicial system that it argues prejudiced it and constituted the principal reason why it withdrew its judicial appeals.
189. Mexico contends that it has adopted a uniform and consistent line of conduct with respect to illegal gaming operations. In particular, Mexico argues that it has, to its knowledge, closed down all facilities where so-called slot machines were operating and has legally challenged all court decisions granting injunctive relief regarding SEGOB official closure orders.
190. With respect to any alleged detrimental reliance on the *Oficio*, Mexico contends that SEGOB's determination that it would consider the machines to be prohibited games cannot be considered arbitrary, given that Thunderbird itself knew the nature of the machines and knew of the existing risk that they would be inspected by SEGOB and it would reach that conclusion.
191. As to the SEGOB administrative proceedings, Mexico denies that they were illegal, arbitrary or unfair, arguing that the decision itself indicates that EDM's evidence was taken into account even when not in strict accordance with the applicable domestic legal requirements and the decision set out a reasoned basis for its conclusions; that the procedure was transparent and in compliance with Mexican laws, validated by EDM's lawyers who were experts in Mexican law; and that if there had been a violation during the proceedings, there were appropriate judicial remedies available to challenge it.

(iii) The Tribunal's findings

192. The Tribunal shall interpret Article 1105(1) of the NAFTA in accordance with the NAFTA Free Trade Commission's Notes of Interpretation of certain Chapter

Eleven Provisions (“Minimum Standard of Treatment in Accordance with International Law”) dated 31 July 2001<sup>10</sup>, which provides as follows:

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

193. The Tribunal shall accordingly measure the Article 1105(1) of the NAFTA minimum standard of treatment against the customary international law minimum standard, according to which foreign investors are entitled to a certain level of treatment, failing which the host State’s international responsibility may be engaged.
194. The content of the minimum standard should not be rigidly interpreted and it should reflect evolving international customary law.<sup>11</sup> Notwithstanding the

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<sup>10</sup> <http://www.dfait-maeci.gc.ca/tna-nac/Nafta-interpr-en.asp>.

<sup>11</sup> See in particular *Mondev International Ltd. v. USA*, Award, 11 October 2002, ICSID Case No. ARB(AF)/99/2, <http://www.state.gov/documents/organization/14442.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case No. ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADF-award.pdf>; *Waste Management Inc. v. Mexico*, Arbitral Award, 2 June 2002, ICSID Case No. ARB(AF)/98/2, [http://www.worldbank.org/icsid/cases/waste\\_award.pdf](http://www.worldbank.org/icsid/cases/waste_award.pdf); Final Award, 30 April 2004, ICSID Case No. ARB(AF)/00/3, [http://ita.law.uvic.ca/documents/laudo\\_ingles.pdf](http://ita.law.uvic.ca/documents/laudo_ingles.pdf).

evolution of customary law since decisions such as *Neer Claim* in 1926<sup>12</sup>, the threshold for finding a violation of the minimum standard of treatment still remains high, as illustrated by recent international jurisprudence<sup>13</sup>. For the purposes of the present case, the Tribunal views acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law as those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards<sup>14</sup>.

195. In the present case, the Tribunal is not convinced that Thunderbird has demonstrated that Mexico's conduct violated the minimum standard of treatment, for the following reasons.
196. The Tribunal has already found that Thunderbird could not reasonably rely on the *Oficio* to its detriment (*see* the Tribunal's findings under Issue 7 above).
197. As to the alleged failure to provide due process (constituting an administrative denial of justice) and the alleged manifest arbitrariness in administration (constituting proof of an abuse of right) in the SEGOB proceedings, the Tribunal

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<sup>12</sup> *USA (L.F. Neer) v. Mexico* (1926), 4 R.I.A.A. 60 (Gen. Cl. Comm'n 1926).

<sup>13</sup> *See* in this regard *Alex Genin et al. v. Estonia*, Award, 25 June 2001, ICSID Case No. ARB/99/2, <http://www.worldbank.org/icsid/cases/genin.pdf>; *Waste Management Inc. v. Mexico*, Final Award, 30 April 2004, ICSID Case No. ARB(AF)/00/3, [http://ita.law.uvic.ca/documents/laudo\\_ingles.pdf](http://ita.law.uvic.ca/documents/laudo_ingles.pdf).

<sup>14</sup> *See* in this regard *Alex Genin et al. v. Estonia*, Award, 25 June 2001, ICSID Case No. ARB/99/2, <http://www.worldbank.org/icsid/cases/genin.pdf>; *S.D. Myers Inc. v. Canada*, First Partial Award, 13 November 2000, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/SDMeyers-1stPartialAward.pdf>; *Mondev International Ltd. v. USA*, Award, 11 October 2002, ICSID Case No. ARB(AF)/99/2, <http://www.state.gov/documents/organization/14442.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case No. ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADF-award.pdf>; *Azinian v. Mexico*, Arbitral Award, 1 November 1999; ICSID Case No. ARB(AF)/97/2, [http://www.worldbank.org/icsid/cases/robert\\_award.pdf](http://www.worldbank.org/icsid/cases/robert_award.pdf); *Loewen v. USA*, Award, 26 June 2003, ICSID Case No. ARB(AF)/98/3, <http://ita.law.uvic.ca/documents/Loewen-Award-2.pdf>; *Case concerning Elettronica Sicula SpA (ELSI) (United States v. Italy)*, 20 July 1989, 1989 I.C.J. 15.



cannot find sufficient evidence on the record establishing that the SEGOB proceedings were arbitrary or unfair, let alone so manifestly arbitrary or unfair as to violate the minimum standard of treatment.

198. In particular, the Tribunal notes that Thunderbird was given a full opportunity to be heard and to present evidence at the Administrative Hearing, and that it made use of this opportunity. The Tribunal does not find anything reproachable about the Administrative Order. The 31-page document appears, in the Tribunal's view, to be adequately detailed and reasoned; it reviews the evidence presented by Thunderbird at the hearing; and discusses at length the legal grounds on which SEGOB based its determination that the EDM machines were prohibited gambling equipment (*see* Exh. R-93).
199. As to the official closures of the EDM facilities, the Tribunal does not find that the manner in which SEGOB proceeded for the official closure was arbitrary. In fact, the record shows that on one occasion, SEGOB itself recognized that the official closure order for Nuevo Laredo was irregular and accordingly rectified its error by lifting the seals of the Nuevo Laredo facility.
200. The Tribunal does not exclude that the SEGOB proceedings may have been affected by certain irregularities. Rather, the Tribunal cannot find on the record any administrative irregularities that were grave enough to shock a sense of judicial propriety and thus give rise to a breach of the minimum standard of treatment. As acknowledged by Thunderbird, the SEGOB proceedings should be tested against the standards of due process and procedural fairness applicable to administrative officials. The administrative due process requirement is lower than that of a judicial process. Hence, for instance, even if one views the absence of Lic. Aguilar Coronado (who signed the Administrative Order) at the 10 July hearing as an administrative irregularity, it does not attain the minimum level of gravity required under Article 1105 of the NAFTA under the circumstances.
201. Finally, the SEGOB proceedings (including the Administrative Resolution) were subject to judicial review before the Mexican courts. The Tribunal notes in this

regard that EDM filed a nullification (*juicio de nulidad*) of the 10 October Ruling before the federal tax and administrative court (in which it did not raise any complaint about Lic. Aguilar Coronado's absence at the Administrative Hearing). EDM went on to appeal the court's decision on the nullification (*juicio de amparo*), but subsequently withdrew from the proceedings, which decision cannot be attributed to Mexico.

**Issue 10. Did Respondent engage in an expropriation in violation of Article 1110 of the NAFTA?**

202. Article 1110 (1) of the NAFTA provides as follows:

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

(a) for a public purpose;

(b) on a non-discriminatory basis;

(c) in accordance with due process of law and Article 1105(1);  
and

(d) on payment of compensation in accordance with paragraphs 2 through 6.

(i) Thunderbird's position

203. With respect to Mexico's jurisdictional objections, Thunderbird contends that the purposes of the NAFTA would be completely frustrated if investors were not entitled to bring claims under Article 1110, on behalf of their investment enterprises established in the territory of another NAFTA Party. Thunderbird requests that leave be granted to Thunderbird to amend its PSoC to include, in the further alternative, a

claim for 100% of the damages caused to the businesses of each EDM Company as a result of Respondent’s alleged breach of Article 1110, using Article 1116 of the NAFTA.

204. Thunderbird contends that Article 1110 of the NAFTA, which requires the payment of full, prompt, and effective compensation for the taking of an “investment,” imposes an obligation upon Mexico vis-à-vis the EDMs. The standard for determining whether a taking has occurred is whether government action has resulted in substantial interference with the investment.
205. According to Thunderbird, the EDM Companies had legitimately acquired rights in the businesses they conducted. The actions of SEGOB amounted to expropriation within the meaning of Article 1110 of the NAFTA, Thunderbird argues, because the EDMs established their investments in Mexico on the general promise of fair and equitable treatment and with the added security of the “negative clearance” contained within the *Oficio*, and the official closure of these facilities destroyed the EDMs’ businesses, requiring the payment of fair market value for these investments so taken.

(ii) Mexico’s position

206. Mexico raises a jurisdictional objection to the effect that Thunderbird cannot succeed in its claim of expropriation because it failed to bring a claim on its own behalf as an investor of a Party under Article 1116 of the NAFTA. Thunderbird’s request in the SoR to amend its claim should be denied according to Mexico.
207. Mexico contends that SEGOB determined that EDM was operating prohibited gambling equipment and that, therefore, bona fide law enforcement actions by SEGOB, such as the closure of illegal gambling operations, do not amount to an expropriation. Further, Mexico argues, EDM filed appeals in the national courts that it subsequently withdrew.

(iii) The Tribunal’s findings

208. The Tribunal does not need to decide on Mexico’s jurisdictional objection regarding Thunderbird’s failure to present its claim under Article 1116 of the NAFTA, since the Tribunal has already found that the EDM Companies could not have operated based on a legitimate expectation in Mexico. Accordingly, as acknowledged by Thunderbird, compensation is not owed for regulatory takings where it can be established that the investor or investment never enjoyed a vested right in the business activity that was subsequently prohibited.

**E. Merits – Damages**

209. The Tribunal has found that Mexico did not violate any of the NAFTA provisions relied upon by Thunderbird (*see* the Tribunal’s findings on Issues 8, 9 and 10 above). Accordingly, Thunderbird is not entitled to damages and the Tribunal does not need to address Issue 11.

**VI. COSTS**

210. In Thunderbird’s Cost Submission of 26 August 2004, Thunderbird claimed US\$ 995,934.50 for its legal fees and expenses. In Thunderbird’s Supplementary Statement of Costs of 31 March 2005, Thunderbird claims US\$ 1,163,375.20 (including previous sums claimed).
211. In Mexico’s Cost Submission of 12 August 2004, Mexico claimed US\$ 1,310,943.78 for its legal fees and expenses. In Mexico’s Supplementary Statement of Costs of 31 March 2005, Mexico claimed an additional US\$ 191,122.06.
212. Pursuant to Article 1135 of the NAFTA, a tribunal may “award costs in accordance with the applicable Arbitral Rules,” i.e., the UNCITRAL Rules. Pursuant to Article 38 of the UNCITRAL Rules, the “arbitral tribunal shall fix the costs of arbitration in its award.” Article 38 (e) includes within the scope of the definition of the “costs of arbitration” the “costs for legal representation and assistance of the successful party if such costs were claimed during the arbitral proceedings, and only to the

extent that the arbitral tribunal determines that the amount of such costs is reasonable”. Articles 40 (1) and (2) of the UNCITRAL Rules provide as follows:

1. Except as provided in paragraph 2, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.

2. With respect to the costs of legal representation and assistance referred to in article 38, paragraph (e), the arbitral tribunal, taking into account the circumstances of the case, shall be free to determine which party shall bear such costs or may apportion such costs between the parties if it determines that apportionment is reasonable.

213. The majority view in *S.D. Myers v. Canada* believed that there is a “subtle distinction” between these two paragraphs, the first emphasizing “success,” and the second “the circumstances of the case.”<sup>15</sup> The present Arbitral Tribunal does not see the distinction between the two paragraphs in that way. The first paragraph too refers to “the circumstances of the case” whilst the second, as conceded by the majority view in *S.D. Myers*, also implies success. Rather, the difference between the two paragraphs is that the first paragraph sets forth a rule with an exception to that rule, whereas the second paragraph gives an arbitral tribunal unfettered discretion. According to the first paragraph, the costs of the arbitration “shall in principle be borne by the unsuccessful party,” whilst according to the second paragraph, an arbitral tribunal “shall be free” to determine which party bears the costs of legal representation (or may apportion such costs). In the present case, the Arbitral Tribunal does not see a reason to rely on that distinction, as the more objective benchmark for both types of costs is the rate of success of a party.

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<sup>15</sup> *S.D. Myers v. Canada*, Final Award, 30 December 2002, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/SDMyersFinalAward.pdf>

214. It is also debated whether “the loser pays” (or “costs follow the event”) rule should be applied in international investment arbitration. It is indeed true that in many cases, notwithstanding the fact that the investor is not the prevailing party, the investor is not condemned to pay the costs of the government. The Tribunal fails to grasp the rationale of this view, except in the case of an investor with limited financial resources where considerations of access to justice may play a role. Barring that, it appears to the Tribunal that the same rules should apply to international investment arbitration as apply in other international arbitration proceedings.
215. It may be added that Article 1135 of the NAFTA explicitly contemplates the possibility for a tribunal to award costs: “[a] tribunal may also award costs in accordance with the applicable arbitration rules.” The treaty does not contain any limitation in regard of the award of costs.
216. The parties to the present case have themselves each claimed an award of costs (*see* Notice of Arbitration at ¶34 and SoD at ¶372). Although Thunderbird has contended that it is rarely appropriate for costs to be awarded to an unsuccessful NAFTA claimant, it has at the same time recognized: “[n]o Nafta provisions exist which would modify the application of [Articles 38 and 40 of the UNCITRAL] arbitration rules. Accordingly, it lies within the discretion of this Tribunal to award costs in the manner it determines to be the most appropriate and reasonable in the circumstances.” (*see* PSoC at p.121)
217. The Tribunal is mindful of other NAFTA awards such as the decision in *Azinian v. Mexico*,<sup>16</sup> in which the tribunal considered four factors for deciding that the losing investor need not pay the costs of the respondent (state party):

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<sup>16</sup> *Azinian v. Mexico*, Arbitral Award, 1 November 1999; ICSID Case No. ARB(AF)/97/2, [http://www.worldbank.org/icsid/cases/robert\\_award.pdf](http://www.worldbank.org/icsid/cases/robert_award.pdf)

The claim has failed in its entirety. The Respondent has been put to considerable inconvenience. In ordinary circumstances it is common in international arbitral proceedings that a losing claimant is ordered to bear the costs of the arbitration, as well as to contribute to the prevailing respondent's reasonable costs of representation. This practice serves the dual function of reparation and dissuasion.

In this case, however, four factors militate against an award of costs. First, this is a new and novel mechanism for the resolution of international investment disputes. Although the Claimants have failed to make their case under the NAFTA, the Arbitral Tribunal accepts, by way of limitation, that the legal constraints on such causes of action were unfamiliar. Secondly, the Claimants presented their case in an efficient and professional manner. Thirdly, the Arbitral Tribunal considers that by raising issues of defective performance (as opposed to voidness *ab initio*) without regard to the notice provisions of the Concession Contract, the Naucalpan Ayuntamiento may be said to some extent to have invited litigation. Fourthly, it appears that the persons most accountable for the Claimants' wrongful behaviour would be the least likely to be affected by an award of costs; Mr. Goldenstein is beyond this Arbitral Tribunal's jurisdiction, while Ms. Baca – who might as a practical matter be the most solvent of the Claimants – had no active role at any stage.

218. With respect to the first factor, investment arbitration in general and NAFTA arbitration in particular have become so well known and established as to diminish their novelty as dispute resolution mechanisms. Thus, this factor is no longer applicable when considering apportionment of costs in international investment disputes. As for the second factor, although it may be said that the Parties here presented their case in an efficient and professional manner, the Tribunal does not find it a decisive factor for awarding costs in deviation of the general principle. Finally, the third and fourth *Azinian* factors are not applicable in the present case.
219. In the present case, the Tribunal has found that Mexico is the successful party, except on issues of jurisdiction and/or admissibility.

220. Accordingly, the Tribunal finds that Mexico may in principle recover an appropriate portion of the costs of its legal representation and assistance. In this regard, the amount of US\$ 1,502,065.84 claimed by Mexico appears to be reasonable in light of the scope and length of the present arbitral proceedings. Mexico did not however prevail on all issues. In consideration of this fact, the Tribunal shall exercise its discretion and allocate the costs on a  $\frac{3}{4}$ - $\frac{1}{4}$  basis. Accordingly, the Tribunal hereby determines that Thunderbird shall reimburse Mexico in the amount of US\$ 1,126,549.38 in respect of the costs of legal representation for this arbitration.
221. As regards the fees of the arbitrators, the Arbitral Tribunal has determined the fees of the Arbitrators to be US\$405,620. The disbursements of the arbitration, including rent of hearing rooms, travel, hotel accommodation and court reporters amount to US\$99,632.08. Consequently, the costs of the arbitration amount to US\$505,252.08 and will be paid out of the deposits made by the Parties. For the same reasons as expressed in the preceding paragraph, the costs referred to in this paragraph shall be allocated between Thunderbird and Mexico on a  $\frac{3}{4}$ - $\frac{1}{4}$  basis. Accordingly, the Arbitral Tribunal hereby determines that Thunderbird shall reimburse Mexico in the amount of US\$126,313.02 in respect of the aforementioned deposits made by Mexico.



**VII. DECISIONS**

222. FOR THE FOREGOING REASONS, the Arbitral Tribunal renders the following decisions:

- 1) FINDS that Mexico did not breach Articles 1102, 1105 or 1110 of the NAFTA or otherwise;
- 2) DISMISSES Thunderbird's claims in their entirety;
- 3) DETERMINES the costs of the arbitration referred to in ¶ 221 above at US\$505,252.08, and further DETERMINES that these costs are to be shared by the Thunderbird and Mexico on a 3/4-1/4 basis, and are to be paid out of the deposits made by the Parties;
- 4) DETERMINES that Thunderbird shall reimburse Mexico in the amount of US\$ 1,126,549.38 in respect of the costs of legal representation and US\$126,313.02 in respect of the deposits made by Mexico for the fees and disbursements of the Arbitral Tribunal.

Made in Washington D.C., U.S.A., being the place of arbitration, on January 26, 2006,

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Lic. Agustin Portal Ariosa,  
Arbitrator

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Professor Thomas W. Wälde,  
Arbitrator  
(see separate opinion)

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Professor Dr. Albert Jan van den Berg,  
President