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IN THE MATTER OF AN ARBITRATION UNDER CHAPTER 11 OF THE NORTH AMERICAN FREE TRADE AGREEMENT
(ICSID Case No. ARB(AF)/99/1)

MARVIN ROY FELDMAN KARPA

Claimant

v.

THE UNITED MEXICAN STATES

Respondent

CLAIMANT'S MEMORIAL

March 30, 2001

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INTRODUCTION AND SUMMARY

Marvin Feldman, a U.S. national, claims damages from the Government of Mexico under NAFTA Article 1117 for measures taken by Respondent, in breach of NAFTA Articles 1110 and 1102, withholding and denying rebates of taxes on cigarette exports by CEMSA, a Mexican company owned by Claimant. Export of cigarettes was, by far, the most important line of business for CEMSA, and the purpose and effect of Respondent's measures was to terminate cigarette exports by CEMSA in order to maintain the producers' monopoly on exports.

The denial of tax rebates to CEMSA is contrary to commitments made to Claimant by senior Mexican officials and contrary to Mexican law as declared by the Supreme Court of Justice and the legislature. Claimant relied on Respondent's representations in making substantial investments in the cigarette export business in 1996-97, and Respondent is estopped from objecting to CEMSA's entitlement to IEPS rebates in those years.

Summary of Facts

Mexico imposes an 85% tax on production and sale of cigarettes in the domestic market under the Impuesto Especial Sobre Produccion y Servicios ("IEPS") law, but cigarette exports are taxed at 0% and the law authorizes rebate of taxes when cigarettes are exported. The purpose of such rebates is to promote exports. CEMSA could not export Mexican cigarettes at prices including the IEPS tax. Whenever CEMSA purchased cigarettes in Mexico, the price it paid included a high IEPS tax. CEMSA resold the cigarettes abroad at prices well below their purchase price and would have lost a large amount on every sale without the IEPS rebate. Therefore, CEMSA could not export cigarettes at all without IEPS rebates.

Mexico allowed CEMSA to export cigarettes with IEPS rebates in 1992 and for sixteen months in 1996-1997. Under pressure from the Mexican producers and Philip Morris, however, Respondent cut off rebates to CEMSA in 1991, again in 1993, and it finally terminated rebates to CEMSA on or before December 1, 1997. The Mexican producers could not stop CEMSA's cigarette exports by legitimate means, because the exports were legal under Mexican law and could not be challenged by trademark holders. Therefore, cigarette producer Carlos Slim, a powerful figure in Mexico, persuaded Mexican officials to manipulate the IEPS law to deny rebates to resellers of cigarettes in violation of the Mexican Constitution and applicable legislation. Denial of rebates was also inconsistent with a decision CEMSA won in the Mexican Supreme Court of Justice and with assurances provided CEMSA by Mexican tax officials in 1995-1996. A senior Mexican official, Ismael Gomez Gordillo, told Marvin Feldman that he thought the Supreme Court decision was wrong, and that Carlos Slim had asked him to stop CEMSA.

CEMSA's problems with Respondent date back to 1990 when it first began exporting cigarettes. Carlos Slim protested, and the government took administrative steps and passed legislation to cut off rebates to CEMSA in 1991. CEMSA challenged these measures in the Mexican courts, and the Supreme Court of Justice ruled unanimously (15-0) in August, 1993 that measures allowing IEPS rebates only to producers and their distributors violated constitutional principles of tax equality and non-discrimination. Anticipating this result, the Mexican Congress had amended the IEPS law, effective January 1, 1992, to allow rebates to all cigarette exporters, and CEMSA was able to export cigarettes with rebates for most of that year.

Notwithstanding the 1992 legislation, which remained unchanged in all material respects through 1997, and the 1993 Supreme Court decision, Respondent continued to take measures to support the producers' monopoly on cigarette exports by manipulating the tax laws in a discriminatory manner. In January 1993, Respondent shut down CEMSA's cigarette export business for a second time. During the period 1993-1995, Respondent recognized that CEMSA was a taxpayer entitled to IEPS rebates on cigarette exports, but imposed formal, documentary conditions on rebates that were beyond CEMSA's control and impossible for it to meet. The IEPS law requires producers to pay the tax. The tax is passed on to purchasers in their purchase price. Purchasers do not pay an additional IEPS tax to the state, but the IEPS law requires producers to state the tax included in their sales price separately and expressly on their invoices. The reason for this requirement was to allow exporters to obtain rebates. Persons eligible for rebates are required to have invoices stating the tax separately and expressly. CEMSA could not obtain such invoices, however, because the producers refused to obey the law. Despite repeated petitions by CEMSA, government officials refused to require compliance with this law by the producers.

Because of this discrimination, CEMSA was unable to export cigarettes from Mexico until it succeeded, with the assistance of the U.S. Embassy and in light of NAFTA, in persuading the new administration of President Zedillo to allow rebates to CEMSA without obtaining invoices separating the tax. CEMSA was authorized to calculate the tax itself. These negotiations took place in 1995 and were confirmed and finally implemented in 1996. CEMSA resumed exporting cigarettes in large quantities in June 1996 and was paid rebates through September 1997.

Throughout this period, responsible Hacienda officials knew that CEMSA was receiving IEPS rebates on cigarette exports without having obtained invoices separating the tax.

By late 1997, CEMSA accounted for almost 15% of Mexico's cigarette exports. Undoubtedly, the producers were disturbed. Suddenly, without prior warning, the government reversed course, broke its agreement with CEMSA, and refused payment of US $2.35 million in rebates owed CEMSA on exports made in October-November 1997. Around December 1, 1997, Respondent shut down CEMSA's cigarette exports for the third and final time. CEMSA was told that outstanding rebates would not be paid and that future rebates would be denied. CEMSA was out-of-pocket US $2.35 million and out of the cigarette export business.

Since then, the IEPS law has been amended three times to bar rebates to CEMSA, and CEMSA was refused registration as an authorized exporter of cigarettes and alcoholic beverages under the 1998 amendment. In addition, Respondent has further discriminated against CEMSA in breach of NAFTA Article 1102 by making substantial rebates on cigarette exports to Mexican-owned resellers of cigarettes supposedly barred from receiving such rebates by the IEPS law after January 1, 1998.

Hacienda's Tax Assessment Against CEMSA

After Claimant delivered his Notice of Intent to arbitrate this dispute, Hacienda audited CEMSA and assessed CEMSA US $ 25 million for IEPS rebates it received in 1996-1997, with interest and penalties, relying on the same grounds asserted to deny the rebates owed CEMSA for October-November 1997. To avoid forfeiture and criminal sanction for non-payment, CEMSA challenged the assessment in the Mexican courts. Once this Tribunal was constituted, CEMSA

sought to terminate the proceeding in Mexico, but the court ignored that motion. At this point, the Fiscal Tribunal of the Federation has vacated the assessment, but the matter is on appeal.

Claimant does not know whether Respondent will pursue the matter as a counter-claim in this case or in the Mexican courts after the Tribunal issues its award. The same issues of fact and of law will be decided by the Tribunal when it considers the pending claims, but, we are advised, a Mexican court would not recognize the award as a defense *res judicata* or collateral estoppel. This opens the possibility that Respondent could seek to nullify this proceeding by setting off a tax assessment against the award in this case. To avoid this result and to protect the integrity of the arbitration process, Claimant requests the Tribunal to issue a declaration that Respondent is estopped from challenging CEMSA's entitlement to the rebates it received and to award damages for any assessment that Respondent may impose for IEPS rebates paid to CEMSA in 1996-1997.

Summary of Key Points of Law

Expropriation

International law establishes state responsibility for indirect expropriations, including "regulatory takings," and the words "tantamount to expropriation" were included in Article 1110 to cover such events. The Restatement (Third) of Foreign Relations Law ("Restatement") says: "A state is responsible as for an expropriation of property . . . when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory."[1]

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[1]Restatement (Third), Foreign Relations Law of the United States (1987) (hereinafter "Restatement") § 712, *comment* g.

CEMSA's ability to export is a property interest protected by NAFTA, and confiscatory and discriminatory taxation making exports impossible constitutes a regulatory taking of Claimant's export business. This case does not present, however, broad policy issues of what constitutes a regulatory taking under international law and NAFTA. Claimant is not asking the Tribunal to decide whether, in other circumstances, Mexico could, consistent with international law and NAFTA, establish an export monopoly for cigarette producers. Rather, Claimant will show that CEMSA's right to export cigarettes from Mexico with IEPS rebates was recognized by Mexican law, by the Supreme Court of Justice, by assurances given directly to CEMSA by Mexican officials in writing and verbally, and by the government's own actions. Moreover, the technical points of Mexican tax law are obscure and contradictory and have been applied in a discriminatory manner. The measures taken against CEMSA in this case violate international law because they are arbitrary, confiscatory and discriminatory.

Respondent's measures against CEMSA since January 1, 1994 are "tantamount to expropriation" under Article 1110 because of their concrete, substantial and intentional effect on Claimant's investment. There is no basis in NAFTA or international law for Respondent's position that Article 1110 applies only to measures that expropriate an Enterprise in its entirety. Any such construction would deprive NAFTA investors of traditional international law protections confirmed by the agreement. This is a case of "creeping expropriation" which has matured into the constructive taking of CEMSA's most important business.

Denial of IEPS rebates from January 1, 1994 - May, 1996 and after December 1, 1997, shut down CEMSA's most important line of business and interfered significantly with Claimant's use and enjoyment of his investment as a whole. (In 1997, cigarette exports accounted for more

than 90 % of CEMSA's profits.) And Respondent's retroactive change of policy constitutes the constructive taking of millions of dollars invested by Claimant in reliance on Respondent's promises that IEPS rebates would be made to CEMSA.

The evidence further shows that denial of rebates was in breach of Article 1110 because

a.) It was not for a public purpose. There was no intention to raise revenue and none was raised. Respondent openly sought to maintain the producers' monopoly on cigarette exports contrary to Mexican law. These decisions were made by senior officials to benefit Carlos Slim.

b.) It was discriminatory. The Mexican Supreme Court has held that the government may not rebate IEPS taxes on cigarette exports by producers and deny such rebates to resellers such as CEMSA.

c.) The denial was contrary to due process of law and constituted a denial of justice in violation of international law and NAFTA Article 1110 (c). CEMSA's entitlement to IEPS rebates was established by legislation in force from January 1, 1992 through December 31, 1997; by a 1993 decision of the Supreme Court of Justice founded on well established principles of Mexican jurisprudence; by administrative guidance to CEMSA in written communications during the period 1992-1997; and by an agreement with senior Hacienda officials in 1995 that was ratified and implemented by Hacienda in 1996 and most of 1997.

d.) No compensation was paid in respect of this expropriation.

In addition, Respondent's (1) refusal to rebate IEPS taxes paid by CEMSA in the purchase price of cigarettes exported in October-November 1997 and (2) retroactive tax assessment of US $ 25 million constitute a taking of capital investments made by CEMSA in direct reliance on assurances by Mexican government officials. CEMSA would never have

purchased cigarettes for export without assurance that the IEPS tax included in the purchase price would be rebated to it. Hacienda's retroactive refusal to make these rebates and its effort to recover past rebates in breach of its agreement with CEMSA are constructive takings contrary to equitable principles embodied in international law. Such conduct clearly is inconsistent with the reliability and transparency required by NAFTA.

Estoppel

Under equitable principles of international law, Respondent is estopped by its own conduct and acquiescence from denying CEMSA's entitlement to IEPS rebates on cigarette exports in 1996 and 1997. Respondent agreed to rebate IEPS taxes to CEMSA and made such rebates for sixteen months in full awareness of all the relevant facts. CEMSA relied on the representations and conduct of Respondent to its detriment. Respondent's retroactive refusal to pay the rebates owed to CEMSA and its punitive efforts to recover the rebates it paid CEMSA in 1996-97 are a gross injustice and incompatible with NAFTA.

Denial of Justice

This case also stands on a special footing because Respondent's measures constitute a denial of justice. Under long established principles of international law, denial of justice occurs when an alien is denied an effective administrative or judicial remedy by any branch of government. In this case, CEMSA has no effective remedy other than NAFTA, Chapter 11. In denying IEPS rebates to CEMSA, Respondent ignored decisions of the Supreme Court of Justice, applicable legislation, and specific administrative guidance provided CEMSA by Mexican officials interpreting and applying the IEPS law. Moreover, Respondent's interpretation of Mexico's

amparo law makes it impossible for any investor to vindicate the right to export in the Mexican courts.

Respondent's assertion that denial of justice by tax authorities is not arbitrable under NAFTA is frivolous. Article 1110 (c) expressly incorporates both due process of law and Article 1105 (1). The latter binds the States Party to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." Respondent failed to accord CEMSA the treatment required by this provision when it arbitrarily withheld rebates of IEPS taxes on CEMSA's cigarette exports.

Article 1102

This pattern of discrimination and illegality is further compounded by the fact that Hacienda continued, after December 1, 1997, to make rebates of IEPS taxes on cigarette exports by favored export companies owned by Mexican nationals who were similarly situated to CEMSA. Preferring export companies owned by Mexican nationals violates NAFTA Article 1102 (2) as well as Article 1110 (b).

Damages

CEMSA "has incurred loss or damage by reason of, or arising out of" Respondent's breach of NAFTA Chapter 11, Section A, and Claimant seeks damages in the amount of US $ 30,381,939 plus direct costs, including attorney fees, to compensate CEMSA for (1) lost profits in the period January 1, 1994 - May 30, 1996; (2) denial of IEPS rebates for October - November 1997, and (3) expropriation of its cigarette export business as of December 1, 1997.

Claimant also seeks a declaration that CEMSA was entitled to the rebates it received in 1996-1997 and that Respondent is estopped by its past promises and actions from asserting otherwise. Finally, absent assurances by Respondent that it will not continue to pursue these claims against CEMSA, Claimant asks the Tribunal to award damages to compensate CEMSA for the tax assessment levied against it by Respondent in 1999 or hereafter.

STATEMENT OF RELEVANT FACTS[2]

A. CEMSA's Organization, Registration and General Business.

1. Corporación de Exportaciones de México S.A.de C.V. ("CEMSA") is a Mexican foreign trade (import/export) company established on May 23, 1988. Claimant owns nearly all of CEMSA's stock and is the sole person empowered to act on the company's behalf as Administrador Único under CEMSA's articles of incorporation. Declaration of Claimant Marvin Feldman in Support of Claimant's Memorial ("Feldman Decl."), attached at Exhibits, Tab 1, ¶ 1.[3]

2. At the time of incorporation, Claimant owned 490 out of 1,000 shares. CEMSA's capital was expanded on November 7, 1989 and on November 13, 1991, and Claimant now holds an additional 299,000 shares, or 299,490 of the total 300,000 shares. No formal stock certificates have been issued. Feldman Decl. ¶ 2.

3. On April 23, 1990, CEMSA was registered as a highly dedicated export company under the Empresas de Comercio Exterior ("ECEX") Law, a major new program to promote Mexican

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[2] Facts that predate the effective date of NAFTA are included in order to give the factual background for Respondent's post January 1, 1994 measures that are violations of NAFTA, and to show the measures that commenced before January 1, 1994 and continued thereafter, becoming violations on January 1, 1994.

[3] All references to particular paragraphs in Feldman Decl. incorporate any documents referenced in such paragraph.

exports. This registration was revalidated on July 26, 1990. ECEX companies are eligible for tax rebates on exports of various products including rebates of the special tax on processed tobacco and alcoholic beverages imposed by the Impuesto Especial Sobre Producción y Servicios ("IEPS") Law. CEMSA was also registered under the Empresas Altamente Exportadoras ("ALTEX") law on July 18, 1990. App. 1218-20. CEMSA was registered as a IEPS taxpayer authorized to export alcohol and tobacco products by the Ministry of Finance and Public Credit ("Hacienda") in 1990. Feldman Decl. ¶ 3; and *see* App. 1352.

4. CEMSA's business activities have included imports of milk from the United States and exports of various products, such as film, lenses and cigarettes from Mexico to customers in the United States and other countries. Cigarette exports were, by far, the most important and lucrative line of business for CEMSA. *See* Feldman Decl. ¶ 4. At the time Hacienda shut down CEMSA's cigarette export business on December 1, 1997, cigarette exports accounted for more than 90% of CEMSA's total gross profits. *See* Declaration of Jaime Zaga Hadid ("Zaga Decl.") at Exhibits, Tab 3; Feldman Decl. ¶ 4.

B. CEMSA's Cigarette Export Business, IEPS Rebates and Carlos Slim.

5. CEMSA began exporting cigarettes in 1990. It bought cigarettes from Mexican vendors and exported them to various countries. CEMSA conducted this business in 1990, 1992, and 1996-1997, and would have conducted this business continuously from 1990 to date but for Respondent's refusal to allow IEPS rebates on CEMSA's cigarette exports in 1991, 1993-1995 and after November 1997. CEMSA could not export cigarettes without rebate of the IEPS tax because it could not find buyers for Mexican cigarettes at prices including the tax. Feldman Decl. ¶ 6.

6. The IEPS law imposes a high tax on production and sale of cigarettes in Mexico. In 1990, the IEPS tax on high-end cigarettes was 139.3%. The rate was reduced to 85% in 1995. The IEPS tax rate on cigarette exports, however, was and remains 0%, and the IEPS law provides a mechanism for rebate to exporters of the tax passed along to them under Article 4 of the IEPS law by their vendors in Mexico. *See* Opinion of Carlos Loperena Ruiz Concerning Mexican Law ("Loperena"), Exhibits, Tab 6, § III B at 6; Declaration of Oscar Roberto Enriquez Enriquez in Support of Claimant's Memorial ("Enriquez Decl."), Exhibits, Tab 2, ¶ 8. This form of exemption from the tax was granted "in order to favor competitiveness of Mexican products in international markets," according to the legislature's recital of the law's purpose.[4]

7. CEMSA purchased cigarettes from vendors such as SAM'S Club ("SAM'S") at prices including the high IEPS tax, and resold them abroad at much lower prices. CEMSA's payment of the IEPS tax included in its purchase price (*see* Loperena at 6) and its subsequent recovery of this payment through the IEPS rebate was essentially a "wash." Without the IEPS rebate, however, CEMSA could not have had a cigarette export business at all. The cost of the cigarettes to CEMSA would have been prohibitive. For example, in 1997 CEMSA paid an average of US $7.40 for each carton of cigarettes including the 85% IEPS tax. CEMSA sold the same carton to a foreign customer for an average of US $4.05. Feldman Decl. ¶ 6.

8. The main brand CEMSA exported was Marlboro, a Philip Morris brand manufactured in Mexico by CIGATAM, a Mexican corporation once 70% owned by Carlos Slim Helu, reportedly one of the richest and most powerful men in Mexico. Philip Morris now holds the majority of

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[4] Statement of Purpose of IEPS Law for 1981, *Diario Oficial de la Federacion* ("D.O."), December 30, 1980.

CIGATAM's stock. Carlos Slim retains 30% of the stock and sits on the Philip Morris Board. Feldman Decl. ¶ 13; and *see* Enriquez ¶ 12.

9. Carlos Slim, CIGATAM and Philip Morris have always opposed export of Marlboro and other cigarettes by CEMSA because they want to maintain a monopoly on distribution for themselves. CEMSA's sales were legal, however, and CIGATAM had no basis for legal action against CEMSA. Therefore, Carlos Slim pressured the Mexican government to "stop" CEMSA by denying IEPS rebates to CEMSA. Feldman Decl. ¶ 15; Enriquez ¶ 13; App. 1236 (translated transcript of statement of Gomez Gordillo acknowledging same). Particular facts and events demonstrating intervention by Slim, CIGATAM and Philip Morris over the years are described below.

C. CEMSA's Cigarette Exports 1990 - 1993

10. In 1990 and 1991, CEMSA applied to Hacienda for IEPS rebates for its cigarette exports. Hacienda denied CEMSA's November 1990 and 1991 applications for IEPS rebates, effectively cutting off CEMSA's cigarette export business. Feldman Decl. ¶ 16.

11. Effective January 1, 1991, the IEPS law was amended at Article 2, Section III, to state:

> In the definitive exportation under the terms of the customs law of the goods referred to in Section I hereof [including processed tobacco] carried out by the producers or packers thereof, foreign trade companies referred to in the following paragraph, as well as those executing agreements with the producing or packaging companies that comply with the requirements published for that purpose in general rules by the Ministry of Finance and Public Credit, even when such goods are exported to be disposed of abroad. – 0%.
>
> For the purposes of this Law, the disposal of goods referred to in Section I hereof carried out by the producers or packers to foreign trade companies is assimilated to the exportation thereof, provided that such disposals comply with the rules set forth by the Ministry of Finance and Public Credit for that purpose, by means of general provisions. Foreign trade companies are only those whose finished goods

> that they dispose of in Mexico are totally imported and those that they acquire in the country are totally intended for their exportation.[5]

The main purpose of this amendment was to bar the exportation of alcohol and tobacco by foreign trade companies like CEMSA. Enriquez ¶ 2.

12. Hacienda's General Technical Director of Income Ruben Aguirre Pangburn issued a January 23, 1991 notice by telex to Hacienda's Tax Administration Coordinators stating:

> Until the general rules which set forth the requirements to apply the 0% rate on final exports pursuant to section III of Article 2 of the Special Tax on Production and Services Law are published, *any tax refunds resulting from any transactions carried out during 1991, shall only be authorized for manufacturers or packers.*

App. 0221-22, emphasis added.

13. Hacienda's Undersecretary for Income Francisco Gil Diaz issued General Rule 121-B published in the Official Gazette on January 24, 1991 that stated:

> for the effects of section III of article 2 of the Special Tax on Production and Services, *the foreign trade companies indicated in the first paragraph of such section are those that acquire the goods they export from the producers or bottlers/container companies* referred to in paragraph two of such section.

Emphasis added.

14. The denial of IEPS rebates to CEMSA in 1990 and 1991 put CEMSA out of the cigarette export business by limiting the availability of IEPS rebates for cigarette exports to producers and their distributors only. Feldman Decl. ¶ 17.

15. CEMSA and one other non-producer exporter, LYNX EXPORTADA, S.A. de C.V. ("LYNX"), challenged the constitutionality of the 1991 amendment to Article 2, Section III of the

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[5] D.O. December 31, 1990.

IEPS law, and of the administrative telex and the general rule, by filing separate *amparos* with the appropriate federal district courts. Feldman Decl. ¶ 18. Enriquez ¶¶ 2-3.

16. The district court considering the CEMSA *amparo* ruled, on April 15, 1991, *inter alia*, that the actions taken by Hacienda officials in issuing the telex and General Rule 121-B were illegal in that the officials had exceeded their authority. Feldman Decl. ¶ 18. Both the CEMSA and LYNX cases were ultimately reviewed and resolved in favor of the reselling exporters in unanimous decisions by the Mexican Supreme Court of Justice. App. 0526-637, and 0785-919; Enriquez Decl. ¶ 4; Feldman Decl. ¶ 24.

17. Effective January 1, 1992, Article 2, Section III, of the IEPS law was amended again as follows:

> In the definitive exportation under the terms of the customs law of the goods referred to in Section I of this Article, provided it is made to countries with an income tax rate applicable to legal entities higher than 30%, as well as the disposal of assets that the mentioned customs law provides as temporary export made by persons residing in Mexico to foreign trade companies . . . 0%.[6]

18. Hacienda confirmed CEMSA's eligibility to obtain IEPS rebates under this 1992 amendment in a letter to CEMSA from Hacienda's Regional Tax Administrator for the Eastern District, Jose Antonio Riquer Ramos, dated March 12, 1992. Mr. Riquer quoted the above section of the law and stated:

> From the above transcribed Article, it may be seen that the individuals or legal *entities making definitive exports* in accordance with the customs law, *of goods taxed by the IEPS*, to countries with an income tax rate applicable to legal entities of more than 30% *are entitled to the application of a 0% rate* as regards such operations, for which reason *the tax paid on the acquisition of said goods is a creditable tax*, under the terms of Article 4 of the respective law, *which due to the tax reduction resulting from the 0% rate results in a favorable balance, to which*

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[6] D.O., December 20, 1991.

return you are entitled, based on the provisions of Article 5 of the law itself in connection with Article 22 of the Fiscal Code of the Federation.

Due to the above, you request the confirmation of your opinion in the sense that you are entitled to request the return of the balance in your favor resulting from the crediting of the special tax on production and services paid on the acquisition of the assets subject to such tax that you may export, due to the fact that such exports are taxed as a 0% rate.

This Administration . . . . hereby informs you as follows:

Based on the provisions of Articles 2, Section III and 5 of the Law on the Special Tax on Production and Services in force as from January 1, 1992 and Article 22 of the Fiscal Code of the Federation, *you are hereby confirmed in your opinion* in the sense that *you are entitled to request the return of the balance in your favor resulting from the crediting of the special tax on production and services paid on the acquisition* of alcoholic beverages and processed tobacco exported as from January 1, 1992, provided such exports are made to countries with an Income tax rate applicable to legal entities exceeding 30%.

App. 0062-69, emphasis added.[7]

19. After receiving the March 12, 1992 confirmation from Regional Administrator Riquer, CEMSA resumed exporting cigarettes and applying for IEPS rebates. Feldman Decl. ¶ 20. Hacienda rebated the IEPS tax to CEMSA on these cigarette exports through 1992. Hacienda did not require CEMSA to obtain or submit purchase invoices with the tax separately and expressly stated. Feldman Decl. ¶ 20.

20. In 1992, CEMSA exported 2,950 master cases of cigarettes. CEMSA' s profit on these sales was 210,003,293 pesos. Feldman Decl. ¶ 21; Zaga Decl. ; Declaration of Ernesto Cervera ("Cervera") Exhibits, Tab 4, at 15.

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[7] CEMSA's entitlement to obtain IEPS rebates on cigarette exports was also confirmed to CEMSA by Hacienda in writing on at least two later occasions. *See* letters from Attorney General Gomez Gordello (May 10, 1994) discussed at Paragraph 44 below, and Miguell Gomez Bravo (March 16, 1997) Central Administration, discussed at Paragraph 97 below.

21. As Hacienda's General Administrator Miguel Gomez Bravo recognized in a resolution to CEMSA dated March 16, 1997 (quoted below at Paragraph 95), there was no material change in the IEPS law relating to rebates on cigarettes from 1992 through 1997. App. 0100-104. *See also* Enriquez Decl. ¶ 21 (no material change in law prior to 1998); Loperena at 15; App. 1229 (acknowledgment of no change by Attorney General Gomez Gordillo).

22. Nevertheless, in January 1993, Hacienda made known to CEMSA that it was no longer going to authorize payments of IEPS rebates to CEMSA for cigarette exports. Hacienda advised CEMSA that it must obtain invoices that stated the IEPS tax separately and expressly in order to apply for IEPS rebates for cigarette exports. Claimant objected because it was impossible for CEMSA to obtain such invoices. Feldman Decl. ¶ 22. CIGATAM would not issue such invoices to CEMSA's vendors, so the vendors could not issue them to CEMSA. *See* App. 0185-86 (February 7, 1994 letter from Claimant to Hacienda's General Director of Collection citing Carlos Slim's refusal to break down IEPS tax on invoices). Claimant asked Hacienda to require CIGATAM to issue this kind of invoice as it was required to do under the IEPS law but Hacienda refused. Feldman Decl. ¶ 23.

23. At a later date, Claimant asked SAM'S, its main vendor, to separate the IEPS tax on its invoices to CEMSA. The Director of SAM'S, told Claimant that he could not do that because CIGATAM did not separate the tax on its invoices to SAM'S and CIGATAM would stop selling to SAM'S if it pressed CIGATAM to do so. Feldman Decl. ¶ 70.

24. Because Hacienda terminated IEPS rebates to CEMSA, the company was forced to stop exporting cigarettes in 1993. Claimant looked to the pending determination of Supreme Court of Justice for relief, expecting that judgment to vindicate his position, but CEMSA was not

permitted to resume cigarette exports and obtain IEPS rebates until 1996. Feldman Decl. ¶¶ 22-23, 58.

D. The 1993 Supreme Court Decision.

25. On August 18, 1993, the Mexican Supreme Court of Justice ruled unanimously (15-0) that the 1991 amendment to Article 2, Section III of the IEPS law violated principles of tax equality and non-discrimination enshrined in Article 31 (4) of the Mexican Constitution and that CEMSA was entitled to receive IEPS rebates on cigarette exports on the same basis as producers *Corporacion de Mexicanas, S.A. de C.V.*, Amparo Proceeding Under Review 1241/91, Aug. 18, 1993, (the "1993 Supreme Court Decision" or "1993 Decision"). App. 0526-637.

26. In particular, the Court stated:

> Indeed, the claimed amendment [to Article 2, Section III, of the IEPS law] violates the principles of tax generality and equality because, before such amendment, the exception was granted by taking into consideration the definitive exportation of the taxed goods in an objective manner isolated from any personal relationship, regardless of who carried it out, while now the application of the 0% rate is limited because the exemption is applicable to the subjects referred to in Section III of Article 2 of the claimed law.
>
> Additionally, the zero rate thus becomes a privilege of a few subjects, since it does not give the same treatment to all the persons carrying out the same export activities.
>
> Furthermore, the mentioned provision established the following until the year 1990: "Article 2. The following rates shall be Applied to the value of the acts or activities herein below mentioned: . . . III. In the definitive exportation, under the terms of the customs laws, of the goods referred to in Section I of this Article, even when they are exported to be sold abroad . . . 0%." When this provision was amended according to the decree published in the Official Gazette of the Federation on the twenty-sixth day of December, 1990, the text of the mentioned Section III was drafted as follows: "III. - In the definitive exportation, under the terms of the customs laws, of the goods referred to in Section I of this Article carried out by the producers or packers thereof, the foreign trade companies referred to in the following paragraph as well as those executing agreements with

> the companies and complying with the requirements made known for such purpose by means of general rules made by the Ministry of Finance and Public Credit even when such goods are exported to be disposed of abroad . . . 0%. . . ." This amendment to the laws violates the constitutional principles regarding tax matters because the fixing of the 0% rate granted originally considering the definitive exportation of the taxed goods as an objective element, fails to take into account such element when introducing subjective or personal differences among the subjects whose activities create the assumptions of the taxable fact. Therefore, if the fixing of a zero rate was carried out without taking into account personal elements or in order to settle differences among the passive subjects and the original taxable fact remains as such without any modification, there is no justification for distinguishing among the subjects carrying it out. That is, if the objective element – the definitive exportation of taxed goods – which was taken into consideration when fixing the amount of the rate – remains as such and without any amendment whatsoever, there is no justification whatsoever for distinguishing among the subjects carrying it out because when doing so, the equity principle is infringed.

App. at 0574-76.

27. The Court had made a similar unanimous ruling on the LYNX *amparo* on September 23, 1992 holding that foreign trade companies were entitled to IEPS rebates based on the 0% rate regardless of whether they acquired the goods from producers or intermediaries in the case of LYNX Exportada, S.A. de C.V., Amparo Proceedings Under Review 1177/91, Oct. 14, 1992. App. 0785-919; *and see* Enriquez Decl. ¶ 4; Loperena at 6. In the 1993 Decision, the Supreme Court cited its 1992 LYNX ruling as precedent for its holding that the 1991 amendment to Article 2, Section III was unconstitutional. App. 0576-77. Further, the Court applied the ruling in the LYNX *amparo* (and its ruling in another precedent) to find that the challenged administrative measures – the general rule and telex resolution – were also unconstitutional. App. at 0578-80.

E. Respondent's Noncompliance with the 1993 Supreme Court Decision and Continued Noncompliance with the IEPS Law, August 1993 - 1995.

28. Following the 1993 Supreme Court Decision, Claimant sought assurances from Hacienda that CEMSA would be permitted to obtain IEPS rebates for future cigarette exports. CEMSA also requested payment from Hacienda for the IEPS rebates for cigarette exports that Hacienda had refused for November 1990 and early 1991. *See* Feldman Decl. ¶ 25.

29. The Regional Administrator for CEMSA's district, Rosa Maria Reza Sosa, wrote to Hacienda's Central Administration for Legal Operations to ask for instructions regarding CEMSA's requests for payment under the 1993 Decision. She particularly asked if the judgment of the Court "remained firm." App. 0231-232.

30. For months, Hacienda refused to comply with the 1993 Supreme Court Decision and insisted that it had no obligation to take any action under the decision. *See* Feldman Decl. ¶ 25. In a memorandum dated October 27, 1993, from Hacienda's Attorney General Roberto Hoyo to Undersecretary Gil Diaz, (App. 0070-78) the Attorney General did not recommend compliance with the Supreme Court Decision. Inexplicably, Mr. Hoyo wrote that CEMSA's demands for IEPS rebates were "without any foundation whatsoever . . . [because Hacienda] had already made returns on four occasions to LYNX," a totally unrelated business. App. 0071, ¶ I. d (trans. at 0076). Neither Claimant nor CEMSA was related to LYNX. Feldman Decl. ¶ 93; Enriquez Decl. ¶ 3.

31. Mr. Hoyo also cited "Documentation provided by Carlos Slim Helu" from which he concluded that CEMSA was not entitled to IEPS rebates. App. 0071, ¶ II (trans. at 0077). The

Hoyo memorandum shows that Carlos Slim continued to press Hacienda to deny IEPS rebates to CEMSA even after the 1993 Supreme Court Decision.

32. At CEMSA's request, the Federal Administrative Court for the Fifth District issued an order on November 8, 1993 giving Hacienda 24 hours to show its compliance with the Supreme Court decision. Feldman Decl. ¶ 25. In response, Attorney General Hoyo filed a statement advising the court that, because Article 2, Section III of the 1990 IEPS law had been amended and Rule 121-B had been revoked, there was no act for Hacienda to perform to comply with the judgment. App. 0239-41.

33. On November 26, 1993, Claimant wrote to Hacienda's Regional Tax Administration Office for the Eastern District (the "Regional Office") requesting the rebates for November 1990 and January and April 1991 due under the 1993 Supreme Court Decision and attaching a calculation of the requested refunds, a certified copy of the decision, and a copy of the District Court's 24 hour compliance order. App. 0242-250.

34. On or about January 13, 1994, Attorney General Hoyo wrote a memorandum to Ms. Reza Sosa advising her that she could impose conditions on compliance with the 1993 Decision by requiring CEMSA to submit invoices with the IEPS tax stated separately and expressly under Article 4 of the IEPS law. App. 0079-82.

35. Claimant saw this memorandum and wrote to Attorney General Hoyo on January 19, 1994 strongly objecting to this advice on the ground that no official "has the right to condition, modify, or interpret [the decision] of the Supreme Court of the Nation." Feldman Decl. ¶ 27; App. 0262-65.

36. Nevertheless, Regional Administrator Reza Sosa wrote to CEMSA on January 24, 1994 directing CEMSA to file

> supporting documents where evidence appears to the fact that the special tax on production and services was expressly and separately transferred, which make up the amounts the tax reimbursement of which you are requesting. . . . [for Hacienda] to be in a position to comply with the verdict issued on August 18, 1993.

App. 0266-268.

37. Claimant responded immediately in writing to this letter (App. 0269-270) and continued to object vigorously to the imposition of impossible conditions on CEMSA by Hacienda before Hacienda would perform its obligations under the order of the Supreme Court. The formality demanded by Hacienda was impossible for CEMSA to fulfill because CIGATAM refused to comply with its statutory obligation under Article 19, Section II of the IEPS law[8] to state the IEPS tax separately and expressly on its invoices. *See* Feldman Decl. ¶ 29. Ms. Rosa Sosa sent this letter to Technical Tax Administrator Angel Suarez Gonzalez asking for his opinion on CEMSA's request for refund without undue requirements. App. 0281-83.

38. CEMSA returned to court and obtained another order requiring evidence of compliance within 24 hours from Hacienda dated February 3, 1994. App. 0284.

39. Finally, on February 10, 1994, Regional Administrator Reza Sosa wrote to CEMSA acknowledging Hacienda's obligation to pay the past rebates due under the 1993 Supreme Court Decision and ordering payment to CEMSA of 428,645 pesos, including interest and inflation adjustments, for exports made in November 1990 and January and April 1991. No documentary conditions were imposed. App. 0287-291.

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[8] *See* D.O. December 30, 1983.

40. CEMSA received payment of 428,645 pesos on February 21, 1994. *See* Feldman ¶ 28. CEMSA objected to the short-fall to Hacienda and the court. Hacienda responded with an additional payment of 20,440 pesos and again asserted that it had complied fully. No invoices separating the tax were required. Feldman Decl. ¶ 28.

41. Hacienda continued to refuse to permit CEMSA to resume cigarette exports with IEPS rebates, however.

42. At one point, Hacienda advised CEMSA that it was required to present invoices separating the IEPS tax in order to obtain the rebates while simultaneously denying that the cigarette manufacturers were obliged to state the IEPS taxes separately on their invoices. *See* App. 0083-86 (April 8, 1994, resolution of General Tax Administrator Ruben Aguirre Pangburn to CEMSA stating that cigarette producers "have no obligation of expressly and separately transferring such [IEPS] tax.").

43. Claimant met with Undersecretary Ismael Gomez Gordillo on April 21, 1994 regarding this Aguirre resolution, and wrote to him the next day asking for revocation of the Aguirre resolution. App. 0292-96; Feldman Decl. ¶ 30.

44. On May 10, 1994, Undersecretary Gomez Gordillo responded to this request and reversed the April 8 resolution relating to the transfer of the IEPS tax. Feldman Decl. ¶ 31. The Undersecretary confirmed that CEMSA was entitled to have the IEPS tax transferred expressly and separately, stating:

> In connection with your written communication submitted last April 22 by means of which you request the reconsideration of the resolution contained in official communication no. 325-A-2042 dated April 8, 1994, issued by the General Tax Administrator by means of which the consultation made by such company is answered in a partially unfavorable manner and request the confirmation that when

> it acquires alcoholic beverages and processed tobacco it is entitled to be transferred the special tax on production and services expressly and separately.
>
> In connection with the above, you are hereby informed that *when such company acquired both alcoholic beverages and processed tobacco it is entitled to be transferred the special tax on production and services expressly and separately.*
>
> The resolution contained in official communication no. 325-A-2042 dated April 8, 1994, issued by the General Tax Administrator by means of which it answered in a partially unfavorable manner the consultation made by such company is left ineffective.

App. 0087-89, emphasis added.

45. While CEMSA's dialogue with Hacienda was going on, CIGATAM's parent company, Philip Morris, visited Hacienda to lobby against allowing CEMSA to receive IEPS rebates for cigarette exports pursuant to the 1993 Supreme Court Decision. Claimant wrote to Maximilian Becker, Director General of CIGATAM, April 29, 1994, objecting to this interference in CEMSA's rights. *See* App. 0187-88. Michael B. Adams, Counsel of Philip Morris responded, acknowledging the visit and defending Philip Morris' right to oppose IEPS rebates to CEMSA. App. 0297-99. In addition (and as confirmed by Mr. Gomez Gordillo in 1998), CIGATAM and Carlos Slim asked the Undersecretary to "stop" CEMSA from exporting cigarettes in 1994 and 1995. App. 1231-37; Feldman Decl. ¶ 80; Enriquez Decl. ¶ 12 .

46. Despite the Undersecretary's May 10, 1994 confirmation of CEMSA's right to have the IEPS transferred to it expressly and separately, Hacienda officials, including the Undersecretary himself, refused to require compliance with this law by the cigarette producers. Claimant met with the Undersecretary again on August 29, 1994 on this issue, and CEMSA's counsel Oscar Enriquez also was present. Mr. Gomez Gordillo told Claimant emphatically that Hacienda would not compel the cigarette producers to comply with their legal obligation to separate the IEPS tax

and that he did not wish to enforce this law. *See* Feldman Decl. ¶ 35; Enriquez Decl. ¶ 11 ; and *see also* App. 0168-71 (Claimant's August 29, 1994 letter to the secretary to the President describing this meeting).

47. Claimant also advised Respondent's Anti-Monopoly Commission of his correspondence with Philip Morris, CIGATAM and Undersecretary Gomez Gordillo. App. 0300-01.

48. In addition to his meetings with Undersecretary Gomez Gordillo described above, Claimant made repeated requests throughout 1994, in writing and orally, for Hacienda officials to require the producers to comply with the law. Alternatively, Claimant requested permission for CEMSA to make the separation of the IEPS tax itself, and pointed out the impossibility for CEMSA to produce invoices separating the tax when the law was not enforced against the producers. Feldman Decl. ¶¶ 30-37; *see also* Enriquez Decl. ¶¶ 10-11. Additional contemporaneous documentary evidence of Claimant's continued efforts to obtain compliance with the 1993 Supreme Court Decision and the IEPS law or permission for CEMSA to make the separation of the IEPS tax itself in light of the impossibility it faced regarding the invoices includes:

- App. 0153-56. Letter from Claimant to Undersecretary Gomez Gordillo, June 10, 1994, requesting authority to make the IEPS tax breakdown on Form 32, and showing fruitless requests to CIGATAM.

- App. 0157-59. Letter from Claimant to Juan Manuel Galarza, Administrator, General Tax Collection Office, June 17, 1994, requesting authorization to make the separation of IEPS tax directly and compliance with the May 10, 1994 resolution.

- App. 0160-61. Facsimile from Claimant to General Tax Administrator Ruben Aguirre Pangburn, June 30, 1994 citing CIGATAM's refusal to disclose the IEPS and asking permission to make the breakdown.

- App. 0162-0163. Facsimile from Claimant to Lic. Juan Manuel Galarza, July 12, 1994, attaching copies of his correspondence to CIGATAM.

- App. 0164-65. Facsimile from Claimant to Undersecretary Ismael Gomez Gordillo, August 1, 1994, requesting enforcement of the law requiring CIGATAM to make the tax separation.

- App. 0166-67. Letter from Claimant to President Salinas's personal secretary, Santiago Oñate, August 6, 1994, asking for the President's intervention to combat the influence of Carlos Slim.

- App. 0168-71. Letter to Claimant to Sr. Santiago Oñate, August 29, 1994, seeking an appointment, summarizing his meeting that day with Undersecretary Gomez Gordillo and citing the Undersecretary's refusal to enforce the law against the producers and proposing:

> "Since the Secretaria de *Hacienda is unable or unwilling to compel producers to list the IEPS as a separate item*, and given that it is unfair that the tax refund should be conditioned on a requirement that we cannot fulfill, because *Carlos Slim 's CIGATAM has no intention of complying with the Law, we could break down the tax directly.* The legal guidelines for doing this would be the *retail price and the tax rate* stipulated by Law." [emphasis added].

- App. 0172-73. Letter from Claimant to Administrator General Angel Ramirez Castillo, December 13, 1994, asking the Finance Ministry to authorize CEMSA to separate taxes or to enforce Philip Morris Inc.'s obligation to do so.

49. Claimant also attempted repeatedly to resolve the matter of separation of the IEPS tax directly with CIGATAM. Feldman Decl. ¶ 34. Contemporaneous documentary evidence of Claimant's efforts with CIGATAM includes:

- App. 0185-86. Claimant's letter to General Director of Collection Juan Manuel Galarza, February 7, 1994, citing Carlos Slim's statement that he will not break down the taxes on his invoices.

- App. 0189-90. Facsimile from Claimant to Maximillian Becker, Director General, CIGATAM, May 16, 1994, requesting compliance with the Supreme Court decision and with the attached letter from Undersecretary Gomez Gordillo dated May 10, 1994, confirming that CEMSA was entitled to have CIGATAM transfer the IEPS tax separately and expressly on its invoices.

- App. 0191. Facsimile from Claimant to Michael B. Adams, May 25, 1994 and requesting meeting regarding 1993 Decision.

- App. 0192-93. Facsimile from Claimant to Michael B. Adams, Philip Morris Inc., May 26, 1994, requesting meeting during Mr. Feldman's June 1 trip to Columbus, Ohio, including Claimant's telephone bill for June 1, 1994 recording conversation between Mr. Feldman, in Columbus, Ohio and Mr. Adams in Westchester County, New York.

- See App. 0194-97. Letter from Claimant to Undersecretary Gomez Gordillo, June 10, 1994, referencing eight letters from CEMSA to CIGATAM and Philip Morris Inc., in which CEMSA asked those companies to break down the IEPS tax on their invoices, and citing the companies' failure to do so.

50. CEMSA filed once more with the Court seeking to compel full performance of the 1993 Decision so as to permit CEMSA to export cigarettes and recover IEPS rebates. App. 0302-05. On July 5, 1994, the court declined to issue an order at that time because the authority had indicated to the court that it was undertaking continuing compliance and that the "execution of the resolution" had already begun. App. 0306-07. The court file remained open, however.

51. After it received the July 5, 1994 decision of the district court, CEMSA made a small shipment of cigarettes in August 1994 in order to test Hacienda's statement that it had "already started to fulfill the judgment." CEMSA filed an application for a rebate of IEPS taxes for this export, and other non-cigarette exports, on September 8, 1994. An IEPS rebate of 1322 pesos was paid to CEMSA by check dated September 23, 1994 for the claimed IEPS tax on the cigarette export. App. 0308-11; Feldman Decl. ¶ 33.

52. Claimant then asked Regional Administrator Reza Sosa whether this payment meant CEMSA would be paid IEPS rebates for future cigarette exports. She told Claimant that the payment was a mistake; that CEMSA was not eligible for IEPS rebates, because it did not have invoices stating the IEPS tax separately and expressly; and that CEMSA should not apply again

for such rebates. Claimant asked that this position be put in writing, but the Administrator refused. Feldman Decl. ¶ 34; *see also* Enriquez Decl. ¶ 7. Being the officer who paid rebates to CEMSA to implement the 1993 Supreme Court Decision, Ms. Reza Sosa was intimately familiar with CEMSA's dispute with the government. Feldman Decl. ¶ 28 . So was her successor Juan Carlos Espinoza. *Id.* ¶¶ 44-45, 48-49, 63.

F. The 1995 Negotiations and Agreement Confirming CEMSA's Entitlement to IEPS Rebates On Cigarette Exports.

53. After NAFTA entered into force on January 1, 1994, Claimant frequently told Mexican officials that the government's treatment of CEMSA violated NAFTA and urged them to comply. A number of these discussions took place at monthly meetings of the Comisión Mixta para la Promoción de las Exportaciones ("COMPEX"), an industry/government committee organized by the Ministry of Commerce & Industry ("SECOFI") to promote Mexican exports. Hacienda officials often attended these meetings. Feldman Decl. ¶ 38; Enriquez Decl. ¶ 14.

54. In December 1994, there was a change in administration in Mexico. President Carlos Salinas departed and the newly-elected President Ernesto Zedillo took office. At that time, several new officials joined Hacienda, including officials from SECOFI who favored export promotion. *See* Enriquez Decl. ¶ 14. Claimant brought CEMSA's concerns to the attention of a number of officials at Hacienda including the new Undersecretary for Income, Dr. Pedro Noyola; Attorney General Emilio Romano; General Administrator for Tax Collection Angel Ramirez Castillo; Judicial Administrator for Tax Collection Fernando Heftye; Technical Administrator of Tax Collection Angel Suarez Gonzalez and Tax Administrator Jose Antonio Riquer Ramos. Feldman Decl. ¶¶ 39-40.

55. Claimant briefed these officials on the history of the dispute including Carlos Slim's opposition to CEMSA's cigarette exports, the 1993 Supreme Court Decision, Hacienda's demand for invoices stating the IEPS tax separately and expressly, the impossibility of CEMSA's producing such invoices because of CIGATAM's refusal to separate the tax for its customers, Gomez Gordillo's resolution of May 10, 1994 that CEMSA was entitled to have the tax separated on its invoices, and Hacienda's refusal to require CIGATAM to comply with its obligation under the IEPS law to separate the IEPS tax on its invoices. He gave them documentation of his case, his efforts to date. He also expressed his intention to bring the dispute to arbitration under NAFTA. Feldman Decl. ¶¶ 39-40.

56. Documentary evidence of Claimant's contacts with the Mexican government at the beginning of the Zedillo administration includes:

- App. 0174. Claimant's letter to Hacienda's Secretary Jaime Serra Puche, December 4, 1994, introducing the "Red Book"–a compilation of Claimant's early efforts.

- App. 0175. Letter from Claimant to Undersecretary Pedro Noyola, December 6, 1994, seeking an appointment, referencing Gomez Gordillo's statement that he would seek a change in the law, and proposing solutions to Hacienda's unwillingness to follow court decision.

- App. 0176. Letter from Claimant to Mexican Attorney General Antonio Lozano Gracia, December 7, 1994, asking for a meeting.

- App. 0177-78. Letter from Claimant to Administrator Angel Ramirez Castillo, December 13, 1994, asking the Finance Ministry to authorize CEMSA to separate taxes or to enforce Philip Morris Inc.'s obligation to do so.

- App. 0179-80. Letter from Claimant to Undersecretary Pedro Noyola, Attorney General Emilio Romano and Administrators Angel Ramirez and Fernando Heftye, December 28, 1994, enclosing documents and asking for Appointment.

57. Claimant received positive responses to his petitions and wrote Judicial Administrator Heftye on January 16 that General Administrator Ramirez and Attorney General Romano were working on a plan for CEMSA to obtain IEPS rebates on cigarette exports. App. 0181-84 ; Feldman Decl. ¶ 41.

58. On or about March 15, 1995, Claimant met with Undersecretary Noyola and explained the same issues to him in person. Dr. Noyola agreed to a policy permitting CEMSA to resume cigarette exports with IEPS rebates and suggested that Claimant work out the details with Hacienda tax officials. Dr. Noyola also asked Claimant to provide him some "cover" with which he could answer those in the administration who opposed this policy. Claimant suggested a letter from the U.S. Embassy, and Noyola agreed. Feldman Decl. ¶ 42.

59. After this meeting, Claimant sought the assistance of the U.S. Embassy. Feldman Decl. ¶ 43.

60. United States Economic Minister Dan Dolan wrote to Dr. Noyola on March 29, calling upon the Government of Mexico to comply with its NAFTA obligations towards CEMSA. App. 0314-18.

61. On March 20, 1995, Claimant wrote to Administrator Reza Sosa's successor, Juan Carlos Espinoza Guerrero, citing Ms. Reza Sosa's refusal to agree to future rebates and asking that he provide a written statement of the basis of this refusal. Espinoza responded on April 4 that his inquiry had been "addressed in Official Letter No. 46766, dated September 15, 1994, and under account-to-be-paid #236-14." App. 0312-13. Claimant understood this must be a reference to the documents which ordered the September payment for CEMSA's August cigarette export, and

this response encouraged Claimant to believe that he was making progress towards resolving the issue of CEMSA's inability to produce invoices separating the IEPS tax. Feldman Decl. ¶ 45 .

62. Following his March meeting with Undersecretary Noyola, Claimant met a number of times with senior Hacienda tax officials to work out the details of the policy approved by Dr. Noyola. These officials included General Administrator Angel Ramirez Castillo, Judicial Administrator Fernando Heftye, and Technical Administrator Angel Suarez Gonzalez. Claimant met with these three officials together at least twice when CEMSA's counsel, Oscar Roberto Enriquez, was also present. Feldman Decl. ¶¶ 46-47; Enriquez Decl. ¶ 13. He also met frequently with Administrators Ramirez and Suarez. Feldman Decl. ¶ 46.

63. In addition, Claimant sought the assistance of President Zedillo and Hacienda's Secretary Guillermo Ortiz; he requested a meeting with President Zedillo or, in the alternative, an order from the President to Hacienda to comply with the 1993 Supreme Court Decision (App. 0322-23; and he also sought a meeting with Secretary Ortiz expressing the hope that the Secretary would not be influenced by Carlos Slim but would order compliance with the CEMSA Supreme Court Decision (App. 0324-25; Feldman Decl. ¶ 46).

64. At a meeting in June 1995, attended by Claimant, CEMSA attorney Oscar Enriquez, and Administrators Angel Ramirez, Fernando Heftye and Angel Suarez to work out the details of the policy approved by Dr. Noyola, Mr. Ramirez agreed that CEMSA could receive IEPS rebates on cigarette exports without obtaining vendor invoices separating the IEPS tax. Claimant proposed, once again, that CEMSA compute the tax itself, and Ramirez agreed. Ramirez noted that, because CEMSA was an ECEX company, it did not have to supply supporting documentation for the IEPS rebates under the law. CEMSA could compute the tax itself, and Hacienda would

rebate the IEPS taxes as stated by CEMSA without requiring vendor invoices separating the tax. Administrators Heftye and Suarez concurred in this solution, and Claimant agreed to proceed on this basis. Feldman Decl. ¶ 47; Enriquez Decl. ¶¶ 13-16.

65. Claimant was pleased with the agreement but could not risk buying cigarettes without knowing for certain that the agreement would be implemented by the Regional Office. As a test, CEMSA exported a small amount of cigarettes in June 1995 and applied on July 7, 1995 for an IEPS rebate of 23,894 pesos for this export. Feldman Decl. ¶ 48. The application was denied on July 19, 1995 by Regional Administrator Espinoza for the stated reason that CEMSA did not have invoices with the tax stated separately. App. 0334-35. The application procedure did not require submission of these invoices with the application, but Regional Administrator Espinoza knew that CEMSA did not have and could not obtain them. Feldman Decl. ¶ 49.

66. Claimant brought this denial to the attention of the three administrators Ramirez, Heftye and Suarez. They assured him that their agreement with CEMSA, under the policy approved by Undersecretary Noyola, stood although the word had not yet reached the Regional Office. They assured Claimant again that Hacienda would rebate IEPS taxes on future exports by CEMSA. Feldman Decl. ¶ 50.

67. In late June 1995, Hacienda suddenly commenced an audit of CEMSA. On July 5, 1995, the audit was abruptly revoked. App. 0332-33. CEMSA was never told the reason for the audit or why it was canceled. Feldman Decl. ¶ 51. But Hacienda records provided to Claimant in this case show that

a. the audit was ordered by Andres Alvarez Kuri, Central Administrator of the General Administration of Federal Fiscal Auditing, on June 9, 1995 to verify the validity of VAT and IEPS

refunds to CEMSA in 1992-1994 "[s]ince the requested refund amount is higher than the estimate." App. 0326-28 (Application for Issuance of Review Order).

b. Mr. Kuri revoked the audit a month later, the reason stated being, "BECAUSE IT IS AN EXAMINED TAXPAYER." App. 0329-31 (Memorandum of Revocation).

68. Termination of an audit in this manner was most unusual and could only be at instruction from the highest level of Hacienda (Enriquez Decl. ¶¶ 17-18), and Claimant took this revocation as confirmation that the agreement he had reached with Messrs. Ramirez, Heftye and Suarez had been approved by their superiors. Feldman Decl. ¶ 51.

69. On the basis of his agreement with Hacienda, Claimant began steps to restart CEMSA's cigarette export business. It took months to develop suppliers, customers and financing to reestablish the business that Hacienda had closed down three years before. Feldman Decl. ¶ 52.

70. CEMSA needed additional financing because the cost for CEMSA to purchase cigarettes for export exceeded its sale price. Although CEMSA received full payment of its sale price in advance from its foreign customers, CEMSA needed more cash to cover each purchase, because its purchase price included the IEPS tax which could not be passed on to its customers. There was no foreign market for Mexican cigarettes at prices including the IEPS tax. Feldman Decl. ¶ 8. CEMSA continued to export other goods until it had raised enough cash to recommence the purchase and export of cigarettes on a large scale in May 1996. Feldman Decl. ¶ 52.

71. Even more important, Claimant had to be sure that Hacienda would honor its agreement to make rebates to CEMSA. He would not put up large sums of money, and no creditor would

advance CEMSA funds, unless they were certain the IEPS rebates would be paid. Feldman Decl. ¶ 52.

72. Pedro Noyola did not stay long at Hacienda. He was succeeded as Undersecretary by Tomás Ruiz in December 1995, and Claimant wanted assurance that Mr. Ruiz would honor Hacienda's agreement. He received that assurance from Dr. Noyola and from Messrs. Ramirez and Suarez. Feldman Decl. ¶ 53.

73. While conducting his start-up activities, Claimant met frequently with Administrators Suarez, Ramirez, and Riquer throughout the rest of 1995 and into the Spring of 1996 to confirm that the agreement was still effective. He was able to visit these officials without a formal appointment and did so frequently. These officials consistently assured Claimant that CEMSA would be permitted to obtain rebates of IEPS taxes on cigarette exports without the documentation that CIGATAM refused to provide, and that CEMSA could separate the IEPS tax itself. Feldman Decl. ¶¶ 53, 55.

74. In December 1995, Undersecretary Noyola left his position in the government. Just before his departure, Dr. Noyola assured Claimant that Hacienda's agreement with Claimant regarding IEPS rebates for CEMSA's cigarette exports would be honored by his successor, Undersecretary Tomas Ruiz, and that Hacienda would permit CEMSA to export cigarettes and obtain the IEPS rebates without the documentation that the producers refused to provide. Dr. Noyola advised Claimant that he was leaving an internal memorandum for his successor that set forth the parties' understanding. Feldman Decl. ¶ 53. Although specifically requested to do so, Respondent has failed to provide this document to Claimant.

75. Also, around this time, Hacienda consulted Claimant on changes being considered in procedure for tax rebates of various kinds, including IEPS rebates. Jose Riquer Ramos, who was then the Director of Major Taxpayers, sent Marvin Feldman a handwritten note dated December 8, 1995 asking to meet with him to discuss the proposed changes. The letter stated that General Administrator Ramirez had suggested the meeting. App. 0336-37. Claimant did meet with Mr. Riquer as requested. Feldman Decl. ¶ 54.

G. CEMSA's Cigarette Export Business 1996 - 1997.

76. CEMSA made some small test shipments of cigarettes in the first part of 1996, and was paid the requested IEPS rebates on these shipments. No one from Hacienda raised any question to Claimant about these applications or payments. At the time of these shipments and payments, the Regional Administrator responsible for issuing the IEPS payments to CEMSA was still Mr. Espinoza, who knew that CEMSA did not have invoices stating the IEPS tax separately and expressly. Feldman Decl. ¶ 56. CEMSA's applications and Hacienda's payments were consistent with the parties' agreement.

77. Thus, by May 1996, Claimant was satisfied that Hacienda would keep its word, and CEMSA began purchasing and exporting cigarettes on a large scale. CEMSA would not have invested large sums in the purchase of cigarettes at prices including the high IEPS tax if Claimant did not have absolute assurance from Hacienda that the IEPS tax would be refunded to CEMSA. In reliance on this agreement, Claimant did not pursue legal remedies in the Mexican courts or under NAFTA, but he did not waive his right to do so if the government breached its agreement. Feldman Decl. ¶ 58.

78. Also in February, 1996, the Federal Fiscal Tribunal decided a case that had been brought by LYNX to challenge Hacienda's denial of rebates to LYNX for cigarette exports made under the 1992 IEPS law. Despite Hacienda's arguments to the contrary, that court determined that LYNX was a taxpayer subject to the IEPS tax on cigarettes; as an exporter, it was subject to the 0% rate and entitled to refund of the IEPS tax included in the purchase price of the cigarettes it exported (the "Lynx Tax Court Decision"). App. 1010-70. This decision was consistent with the Supreme Court's rulings in the earlier LYNX and CEMSA amparos. *See* Enriquez Decl. ¶ 19. Hacienda did not appeal this decision and eventually made a very large settlement with LYNX without requiring invoices separating the IEPS tax separately and expressly. Enriquez Decl. ¶ 19. The Lynx Tax Court Decision was consistent with Claimant's view of the law, which he had consistently propounded to Hacienda and on which he had finally come to an agreement with Hacienda. The reasoning of this Decision strengthened his confidence in the firmness of his agreement with Hacienda. Feldman Decl. ¶ 57.

79. Claimant's on-going dialogue with Hacienda continued after he recommenced exporting cigarettes. The applications for IEPS rebates were filed in the Regional Office where Claimant and CEMSA were well-known. This is the same office from which CEMSA had been paid IEPS rebates for cigarette exports in 1992, and which had denied certain rebates in 1994 and 1995 because the officials knew that CEMSA did not and could not have invoices with the tax separately and expressly stated. Throughout 1996 and 1997, while CEMSA was exporting, Claimant was in regular communication with this Regional Office to expedite the payment of the IEPS rebates. Rebates were supposed to be made within 5-10 days of CEMSA's application.

Feldman Decl. ¶ 12. If payment was delayed, as was always the case, Claimant would call on this office to request that payment be expedited. Feldman Decl. ¶ 62.

80. On October 15, 1996, Regional Administrator Espinoza told Claimant that he did not remember the agreement Claimant had reached with Hacienda that IEPS taxes would be refunded to CEMSA on cigarette exports without CEMSA's obtaining invoices separating the tax. Claimant reminded him of the terms of the agreement, and asked him to confirm this with Administrator Suarez. Mr. Espinoza called Mr. Suarez's office in Claimant's presence, and Mr. Sergio Sanchez of that office confirmed the agreement to him by telephone in Mr. Suarez's absence. Later that day, Claimant wrote to Mr. Ramirez's personal secretary, Edgar Lopez to tell him of this meeting and asked him to call Mr. Espinoza to confirm the agreement. *See* App. 0090-91. The next day, Claimant sent Mr. Espinoza a copy of the 1993 Decision and Mr. Dolan's March 29, 1995 letter to Undersecretary Noyola as further support for CEMSA's agreement with Hacienda. App. 0092-94. These contemporaneous letters referred specifically to Claimant's "agreement" with Hacienda. Hacienda did not deny the agreement on receipt of these letters, but confirmed it and continued to pay the IEPS rebates as agreed. Thus, these communications resolved the issue and Hacienda continued to rebate IEPS taxes to CEMSA on its cigarette exports until November 1997. Feldman Decl. ¶¶ 63-64.

81. In June and August of 1996, the Supreme Court sent notices to Hacienda asking the authority to reply to show its exact compliance with the 1993 Supreme Court Decision. Attorney General Gomez Gordillo responded in September 1996 that the Secretary had complied. The Court forwarded this response to Claimant in October asking for Claimant's view. Because Hacienda had recognized CEMSA's on-going right to obtain IEPS rebates for its cigarette

exports through its agreement with Claimant and its performance of that agreement with the payment of IEPS rebates, Feldman Decl. ¶ 65, Claimant's attorney filed a notice to the Court stating CEMSA's agreement. App. 0344; Enriquez Decl. ¶ 20. As a result, the Court closed the file in November, 1996.

82. Sometime in 1997, the Director of SAM'S told Claimant that a business partner of Carlos Slim had asked SAM'S not to sell cigarettes to CEMSA. Feldman Decl. ¶ 70.

83. Also in 1997, CIGATAM continued to take steps to drive CEMSA out of the cigarette export business. It engaged in deliberate harassment of CEMSA by sending three of more agents to the airport, docks and warehouses from which CEMSA was exporting or purchasing to ask questions about CEMSA and threaten its suppliers, brokers, and customers. *See* App. 0198-0201 (June 25, 1997 letter from Claimant to Maximillian Becker, General Director of CIGATAM asking him to cease this practice.)

84. CEMSA's cigarette business grew significantly from June 1996 to December 1997. In 1996, CEMSA's revenues on cigarette exports were US $ 1,507,782, and it earned profits on these sales of at least US $ 199,599. See Zaga Decl.; Cervera at 18, 32. (These sales and profit figures are the most that can be fully documented and are significantly understated. Zaga Decl.)

85. In 1997, CEMSA revenues on cigarette exports were US $ 5,522,981, and would have earned profits of almost US $ 4 million on these sales if Respondent had paid the IEPS rebates owed for CEMSA's cigarette exports in October, November and December. Respondent's failure to make these rebates reduced CEMSA's cigarette profits in 1997 to just over US $ 1.6 million. (These sales and profits figures are the most that can be fully documented and are understated. Zaga Decl.)

86. The routine by which CEMSA exported cigarettes in 1996 and 1997 was consistent. When CEMSA received an order, it purchased the required quantity of cigarettes from a Mexican vendor, such as SAM'S. CEMSA then gave the details about the purchase and sale to CEMSA's export broker by telephone or facsimile so that the broker could generate the proper export documents ("*pedimentos de exportacion*" or "*pedimentos*"). CEMSA's export broker in the 1996-1997 time period was Multi Modal. After purchase, CEMSA took the cigarettes to the airport directly from the vendor in a rental truck supplied by CEMSA's broker and paid for by CEMSA. CEMSA hired one or two police guards to escort the truck to the airport. CEMSA's broker met the truck at the airport, and the truck drove directly into the secure Customs area. The broker brought the necessary *pedimento* with him and presented this to Customs officials for a check by the Customs computer system. If the *pedimento* was in order, the truck was directed to go on to the secure holding area for the particular airline shipping the cigarettes. Occasionally, Customs officials did an inspection of the truck and the boxes before directing the truck to the holding area, which was also within the secure Customs area at the airport. The cigarettes were unloaded there, where they stayed until the airline loaded them for shipment. Feldman Decl. ¶ 9.

87. To produce the required *pedimentos* before meeting the cigarettes at the airport, the broker entered the information CEMSA had provided about the nature and quantity of goods being shipped, the value of the shipment in U.S. dollars (which was the same as CEMSA's sale price to its customers), the customer and destination, and CEMSA's RFC or Tax ID number which showed registration as an authorized exporter, into a computer that was connected to the central computer system and databank maintained by Hacienda. *See* Feldman Decl. ¶ 10. Because of CEMSA's registrations as a foreign trade company and as an ECEX exporter, the

Hacienda central system recognized CEMSA as a longtime, qualified exporter of cigarettes and alcoholic beverages, and the broker was able to generate the *pedimento*. If CEMSA had not been a registered exporter recognized by Hacienda's databank, the broker's computer could not have generated the *pedimento*, and permission to export would have been denied. This information was reconfirmed by the government's Customs officials at the point of the Customs computer check described above. *See* Feldman Decl. ¶ 10.

88. CEMSA submitted applications for the IEPS rebates to Hacienda monthly covering exports over the prior four weeks or so. Feldman Decl. ¶ 11. In 1996 and 1997, Claimant did not know what the actual IEPS tax as calculated by the manufacturers was. CIGATAM would not disclose the tax in its invoices to its vendors so CEMSA's vendors could not disclose it to CEMSA. Hacienda would not compel the manufacturers to separate the tax. Feldman ¶ 70.

89. The records show that, in 1996 and for part of 1997, Claimant calculated the IEPS tax on the basis of a formula applied to CEMSA's purchase price using the statutory IEPS rate of 85%. *See* Feldman Decl. ¶ 70. In the first part of 1997, Claimant consulted with Jose Riquer Ramos, Director of Major Taxpayers, concerning the 1997 amendment to the IEPS law and the proper method of calculating the IEPS tax on cigarettes purchased by CEMSA. In his meeting with Mr. Riquer, Claimant explained that, under the IEPS law as written, he considered that the tax should be calculated as 85% of the cost of the cigarettes. The cost for CEMSA was its purchase price, which was below ordinary retail prices because CEMSA purchased from a discounter and was given a further discount because of its high volume purchases. After examining the law and going through an exercise of model calculations together at Mr. Riquer's standing easel, Mr. Riquer agreed with Claimant that this was the correct calculation method for CEMSA under the law as it

read. After this meeting, Claimant adjusted the formula for calculating CEMSA's IEPS rebates and calculated the tax on CEMSA's subsequent applications by the method confirmed with Mr. Riquer, *i.e.*, CEMSA's purchase price multiplied by 85%. Feldman Decl. ¶ 70.

90. Hacienda was notified by CEMSA of each cigarette export in 1996 and 1997 in the following manner:

a. Each application for IEPS rebates submitted by CEMSA to the Regional Office was comprised of a Form 32, Hacienda's form application for various tax rebates, with a "Carta Responsiva" or Letter of Responsibility in which CEMSA set out the legal basis for its application for IEPS rebates. Feldman Decl. ¶ 60; and see App. 0001-11 for examples of Form 32 application and Carta Responsiva.

b. In addition, in 1997, CEMSA submitted each month to the same Regional Office a "Constancia de Exportacion" showing the amount of cigarettes purchased from each vendor for export. The Constancia referenced the *pedimento* for each purchase which identified the foreign purchaser of the exported cigarettes. This filing was required in order for CEMSA to purchase the cigarettes for export without being charged the value added tax (IVA) during 1997. Feldman Decl. ¶ 61; and see App. 0354-55 (examples of a Constancia de Exportación and of a Pedimento).

c. At the time of actual export, Hacienda was given all details of each shipment, including name of exporter, quantity and type of goods, value, destination and identity of customer, through the process followed by CEMSA's export broker to obtain export documents and by the Customs officials to confirm the *pedimentos*. Feldman Decl. ¶ 10.

91. There were numerous written and oral communications between CEMSA and Hacienda during this period addressing IEPS rebates to CEMSA on cigarette exports, including

correspondence from Hacienda to CEMSA as a taxpayer entitled to IEPS rebates for cigarette exports and concerning the schedule for payment of IEPS rebates to CEMSA. For example, on February 25, 1997 and again on September 10, 1997, Hacienda's Regional Tax Administration Office sent CEMSA its taxpayer registration certificate for the year, which shows that CEMSA had been a registered taxpayer entitled to rebates of the IEPS tax for cigarette exports since at least March 12, 1992. App. 0352. On August 22, 1997 there was an official communication from SECOFI's General Director Rocío Ruiz Chávez to Claimant stating that IEPS rebates would be made in ten days according to the attached Official Document from Hacienda's Administrator of General Revenue, Angel Suárez González. App. 0357-62. Administrator Suarez Gonzalez wrote to Claimant on October 10, 1997 advising in response to CEMSA's inquiry that the ten-day time frame for issuing IEPS tax rebates was effective September 1, 1997. App. 0363-68.

92. Thus, Hacienda was fully informed, throughout 1996-1997, of CEMSA's cigarette export business and the basis on which it applied for IEPS rebates on cigarette exports. Hacienda performed its commitment to CEMSA and paid the IEPS tax rebates for which CEMSA applied on cigarette exports made by CEMSA between May 1996 and September 1997. No Hacienda official, at any time when CEMSA was exporting cigarettes in 1996-1997 or earlier, questioned the fact that CEMSA was a taxpayer entitled to rebate of the IEPS tax. Nor did any official ever question the methods Claimant used in calculating CEMSA's rebates. To the contrary, Hacienda officials confirmed that the methods used were proper. Feldman ¶¶ 56, 60-70.

93. CEMSA's status as a taxpayer entitled to IEPS rebates for cigarette exports was expressly recognized by Hacienda in a letter addressed to Honduran tax authorities, dated March 15, 1998, in connection with its investigation of CEMSA's alleged relationship with a customer named

DILOSA. In that letter from Hacienda's Assistant General Director of International Audits, Hacienda stated:

> *In agreement with our IEPS law, the exportation done by CEMSA is found to be taxed at a 0% rate which implies that the taxpayer is able to credit the tax transferred and, in his time, to solicit its return*, having to attach a signed letter by the legal representative of the importer, in which it shows that he is not a related part of the Mexican exporter already mentioned [CEMSA].

App. 0119-22, emphasis added.

94. The IEPS law, like other Mexican tax legislation, is amended annually. *See* Loperena Decl. at § III F at 23. Certain changes were made as of January 1, 1997, which Claimant did not understand. To be sure that CEMSA was not affected, he wrote Mario de la Vega, Personal Secretary to Hacienda's Secretary Guillermo Ortiz reminding him of Hacienda's agreement with CEMSA and requesting assurance that there would be no change in policy affecting CEMSA. Claimant also advised de la Vega that CEMSA continued to export cigarettes. Feldman Decl. ¶ 66. App. 0395-97. Claimant's letter of January 23, 1997 states:

> As you can see from our file, we have a Supreme Court judgment in our favor, and the SHCP respected this judgment in 1996 and was giving us IEPS rebates for exports of cigarettes we made. There is an agreement about this within the SHCP, and I am very certain that the Secretary knows about it, as well as Tomas Ruiz and the other people that authorize such refunds at the Eastern Tax Office.
>
> *With the changes in the [IEPS] law, the SHCP has a basis on which to continue respecting the Supreme Court's judgment,* or to reject the tax policy already established in our case, and if so, we will fight again.
>
> I urgently request a guideline of what the SHCP intends to do, *since we continue to export cigarettes.*

App. 0095-96. emphasis added.

95. On January 28, 1997, Claimant wrote to Undersecretary Tomás Ruiz, reminding him of the agreement with Hacienda by which CEMSA had been exporting cigarettes in 1996 (Feldman Decl. ¶ 67) and asking:

> We want to know if [Hacienda's] policy will be the same in 1997 as 1996.
>
> This is why we are requesting an appointment. The matter is very clear. If [Hacienda's] policy is going to be the same as in 1996, we do not need an appointment. If not, we request an appointment with the [Under] Secretary. We are exporting cigarettes as in 1996, and there are IEPS refunds outstanding.

App. 0097-99.

96. On February 11, 1997, Hacienda's General Director for Revenue Policies Mario Gabriel Budebo sent Claimant a copy of the reform to the IEPS law published in the *Diario Oficial de la Federacion* on December 30, 1996. App. 0350-51.

97. Claimant's contacts at Hacienda assured him that they had received no instructions changing the policy towards CEMSA. Feldman Decl. ¶ 69. Then, on March 16, 1997 Hacienda's General Administrator Miguel Gomez Bravo responded to Claimant's January 28 letter to Tomás Ruiz. Mr. Gomez Bravo reviewed the history of the IEPS law and stated: "Starting in 1992, the mentioned section was again amended, therefore opening the possibility for *any exporter* to apply ly for the 0% rate." App. 0100-04, emphasis added. Thus, Claimant understood that Mr. Ruiz, through Mr. Gomez Bravo, agreed with his view there was no material change in the law and that CEMSA would continue to receive IEPS rebates for its cigarette exports without obtaining invoices separating the tax. Feldman Decl. ¶ 69. He also understood from his meeting with Mr. Riquer, discussed above, that CEMSA would receive the rebates under the 1997 law. Feldman Decl. ¶ 70.

98. In reliance on the foregoing, CEMSA continued to export cigarettes and apply for IEPS rebates in 1997 on the understanding that the rebates would be paid. Hacienda knew that CEMSA continued to export cigarettes in reliance on the Gomez Bravo letter. Feldman Decl. ¶ 71.

99. Some of CEMSA's cigarette exports were shipped to the Honduras airport at the instruction of CEMSA's customer DILOSA, S.A. de C.V. ("DILOSA"). Feldman Decl. ¶ 75. Apparently, these shipments were not entered into the customs territory of Honduras and may have been reshipped to third countries. (*See* App. 0136-38, November 3, 1998, Tax Audit Administrator Mejia Guizar to Tax Audit Administrator Gabriel Oliver, produced by Respondent.) It is common practice in international trade for a buyer to protect his commission by not disclosing the ultimate consumer of the goods. Feldman Decl. ¶ 74. CEMSA and DILOSA are not related parties. Feldman Decl. ¶ 75. Neither Claimant nor CEMSA have any financial interest in DILOSA, direct or indirect. Feldman Decl. ¶ 75. On October 29, 1997, Claimant filed a declaration with Hacienda pursuant to Rule 6.1.1, Temporary Annual IEPS Regulations, stating that CEMSA and DILOSA were not related parties. App. 0360-72. A statement to the same effect by Raul Gutierrez Maradiaga, General Director of DILOSA, was submitted to Hacienda in support of CEMSA's declaration. App. 0373-75. Because the companies are not related, CEMSA was permitted to export to Honduras, a low tax jurisdiction, under the IEPS law. Nevertheless, documents produced by Respondent in this proceeding indicate that Hacienda rejected the IEPS rebates for exports to this company because of its view that CEMSA and DILOSA are related. *See* App. 0123-41.

100. As CEMSA's cigarette export business expanded in 1996 and 1997, CEMSA invested large sums in purchasing cigarettes for export. Some of these amounts were borrowed, other funds were advanced by Claimant to the company in cash or by way of the use of his credit card to purchase the cigarettes. Neither Claimant nor his creditors would have risked these funds without assurance that CEMSA would recover the IEPS tax included in the price it paid for cigarettes. Feldman Decl. ¶ 71.

101. In 1996-1997, when CEMSA borrowed funds from individuals to finance its purchase of cigarettes (primarily that portion of the price comprised of the IEPS tax), these loans were repaid, plus 14% of the loan amount (on average), when the IEPS taxes were rebated by Hacienda. Feldman Decl. ¶ 72. According to checks retrieved from CEMSA's records, the company made the following payments to creditors for such loans in 1996-1997:

Dr. Ariel Zagorin - 29,889,301 pesos
Mr. César Poblano and Mr. Gustavo Gamez - 3,828,277 pesos.

Claimant computes the interest included in these payments to total 4,984,626 pesos.

102. CEMSA's principal outstanding debts for such loans are the following:

Dr. Ariel Zagorin – 4,418,819 pesos
Mr. César Poblano – 1,763,180 pesos.
Mr. Gustavo Gamez – 1,763,180 pesos.

These loans are related to CEMSA's cigarette purchases and exports in October - December 1997 for which the IEPS rebates were denied, discussed below. Feldman Decl. ¶ 73.

H. Termination of CEMSA's Cigarette Export Business

103. CEMSA's cigarette export business continued as normal through November 1997. In October, CEMSA exported 2,805 master cases of cigarettes and applied on November 3, 1997

for an IEPS rebate of 10,134,669 pesos. App. 0001-04. In November, CEMSA exported 2,093 master cases and applied on December 1, 1997 for an IEPS rebate of 8,841,061 pesos. App. 0005-11.

104. Administrator Angel Suarez told Claimant in late November or very early in December 1997, that the IEPS rebates for October and November would not be paid and that CEMSA would not be allowed to export cigarettes with IEPS rebates in the future. Feldman Decl. ¶ 77.

105. As a result of this sudden reversal of policy by Hacienda without notice to Claimant, CEMSA was out-of-pocket 18,975,730 pesos, or approximately US $ 2.35 million, that it had paid for the IEPS component of the purchase price of the cigarettes it exported in October and November 1997. Feldman Decl. ¶ 76. This out-of-pocket loss, which CEMSA incurred in reliance on Hacienda's on-going promise to pay IEPS rebates on the company's cigarette exports, will amount to US $ 6.54 million by June 1, 2001, based on the statutory formula used to adjust tax debts to and refunds by Hacienda under Mexican law. Declaration of Ernesto Cervera ("Cervera"), Exhibits, Tab 4, ¶ IV.1 at 17 and Att. 7.

106. On hearing the news from Suarez, CEMSA immediately prepared and filed a formal *consulta* with Hacienda, setting forth the bases on which it claimed entitlement to IEPS rebates relating to its October and November 1997 cigarette exports. App. 0380-94.

107. CEMSA immediately ceased purchasing cigarettes for export except for small test shipments it made in December 1997 (to confirm the oral advice received from Mr. Suarez) and January 1998 and January 2000 (to test the amendments to the IEPS law for those years). CEMSA's applications for IEPS rebates for these shipments were rejected. Feldman Decl. ¶ 77, 83. App. 0020-27.

108. CEMSA did not receive formal notification of Hacienda's rejection of CEMSA's Fall 1997 rebate applications until March 3, 1998 (Feldman Decl. ¶ 83), even though the rejection notices were dated November 7, 1997 (for the October shipments) (App. 0012-15, and December 5, 1997 (for the November shipments) (App. 0016-0019). The reason stated was the absence of invoices stating the IEPS tax separately and expressly.

109. The November 7, 1997 date on the first rejection notice shows that Hacienda had decided by early November 1997 to shut down cigarette exports by CEMSA permanently. Tomás Ruiz confirmed this decision in a conversation with Alfonso Perez Lizeaur and Ariel Zagorin in about January, 1998 in which he said Hacienda would pay the rebates owed for October and November only if Claimant agreed to stop exporting cigarettes and to waive all legal rights of action. Feldman Decl. ¶ 84.

110. Claimant vigorously objected to the termination of CEMSA's cigarette export business, verbally, in writing, and in the media. Feldman Decl. ¶ 78; and see, *e.g.*, App. 0380-94 (Consulta filed with Hacienda regarding the denial dated 12/12/97; App. 0395-97 (letters of 12/1/97 to Hacienda's Secretary Ortiz and Alejandro Garay, and Luist Tellez); (Complaint filed with Contralor Interno, Jose Luis Martinez, 11/28/97, re: 1998 Amendment to Article 11, premature application of to 1997 exports, and abuse of power); App. 0376-79 (response to same from Gabriel Armeria Gutierres saying Claimant applied to the wrong office for help, 12/24/97); App. 0432-33 (Claimant's further objection filed with Martinez, 12/30/97) App. 0434-35 (Position Paper presented to Attorney General Gomez Gordillo with legal basis for CEMSA's entitlement to IEPS rebates for cigarette exports, 12/20/97). App. 0403-31. He also sought the assistance of the United States Embassy, and, on December 17, 1997, United States Economic Counselor

William Brew wrote to Undersecretary Tomas Ruiz Gonzalez requesting his intervention. App. 0395-0402.

111. Claimant also met personally with Hacienda's Attorney General Ismael Gomez Gordillo in a series of three meetings between December 1997 and January 1998 to press CEMSA's claims for IEPS rebates. The meetings between Claimant and Gomez Gordillo were also attended by counsel for CEMSA and other representatives of Hacienda and were tape recorded by both parties by mutual consent. Feldman Decl. ¶ 79. The parties' transcripts of portions of recordings of the meetings are at App. 1071-1127 (Claimant's partial transcription), App. 1128-1257 (Eng. trans. of same), App. 1258-1428 (Respondent's transcription)[9], and App. 1429-1602 (Claimant's Eng. trans. of same).

112. During these meetings, Mr. Gomez Gordillo acknowledged that CEMSA had a right to IEPS rebates from 1992 to 1997, stating:

> Yes, yes I totally agree .. . the amparos protected you until 1997 when the law was amended. . . Your amparos protected you during a long time; it ceases to protect you in accordance with the amendment of 1997. . . .

See App. 1229.

113. Mr. Gomez Gordillo also conceded that CEMSA won the right to the zero rate in the Supreme Court: "And I tell you, and you won it, well, as painful as it may be, right? What can we do?" and explained that it was "painful" because Hacienda "lost" the income of the IEPS it had to reimburse to CEMSA which it had originally considered not reimbursable. App. 1214.

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[9] The portions of the recording that the parties transcribed are not the same in every instance, nor are the transcriptions of portions that are of the same discussion identical. References are to Claimant's English translation of his transcription.

And the Attorney General admitted that he had discussed the matter of rebates to CEMSA with Carlos Slim when Slim came to him in 1994 and said "hey, stop them". App. 1236.

114. Moreover, the Attorney General acknowledged, in the following colloquy, that he had initiated the process that led to CEMSA's obtaining IEPS rebates in 1996-1997 by issuing the resolution [of May 10, 1994]:

> MRF: Because when you were deputy Secretary we came to an agreement, OK? You were not happy with the resolution of the Court and you told me so, that 'I do not agree with the Court', the Court in my opinion, your words are also taped, then I am presented with another opinion and you thought, from your opinion that what I do is take advantage of loopholes for tax evasion.
>
> IGG: The only term I do not accept is evasion, the rest . . . . I was commenting that, with all due respect for the Court, that I did not coincide with its criteria, but that I was obliged by the criteria of the Court and that in accordance with such an obligation (...)
>
> MRF: (...)(the Ministry of) Finance started to respect the resolution of the court, it began to allow me to recover said taxes.
>
> IGG: During whose term as Deputy Minister of Revenues?
>
> MRF: Pedro Noyola
>
> IGG: Since my term, do you remember that there were a series of resolutions and that we began to (...)?
>
> MRF: Yes, we began, yes (...)
>
> IGG: and I told you, I do not agree as a Lawyer, as a citizen, but as an authority, I am bound.
>
> MRF: Yes, and you did it, you did it, yes sir, since that time.

App. 1245-46

115. The IEPS law was amended effective January 1, 1998. This amendment changed

Article 11 to provide that the IEPS tax "shall not be paid in respect to subsequent sales, provided that no credit or return of the tax shall apply in respect to said sales," and added a requirement in Article 19 that exporters of processed tobacco must be registered with the exporter registry kept by Hacienda.[10]

116. CEMSA purchased and exported a small shipment of cigarettes in January 1998 and applied for IEPS rebates for this export on February 3, 1998 in order to test the 1998 legislation. Feldman Decl. ¶ 84. Hacienda denied this rebate application on February 10, 1998 on the ground that CEMSA did not have invoices with the IEPS tax stated separately and expressly. App. 0024-27.

117. On February 24, 1998 Hacienda responded to CEMSA's December 12 *consulta*. See App. 0105-118 (Resolution of Alberto Real Benitez, Local Juridical Tax Administrator for the Eastern Federal District to CEMSA, denying rebates on the grounds that CEMSA's acquisition and disposal of the cigarettes were "subsequent disposals" ineligible for a credit or return of the tax notwithstanding that CEMSA exported the cigarettes, and taking the position that the March 16, 1997 resolution cited by CEMSA had no effect in this specific case).

118. CEMSA filed a proceeding in the Mexican courts challenging the resolution of February 24, 1998. One purpose of this action was to preserve CEMSA's legal position concerning the 1996-1997 IEPS rebates and to avoid admissions of illegality under Mexican law that could lead to criminal penalties. Another was to challenge the constitutionality of the amendment to Article 11 of the IEPS law effective January 1, 1998. Feldman Decl. ¶ 84.

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[10] D.O. December 31, 1997.

119. After the 1998 IEPS amendments, Hacienda established a new procedure requiring exporters of cigarettes or alcoholic beverages to be approved and registered by Hacienda. CEMSA attempted to obtain such approval and registration, and provided requested documents, but Hacienda did not respond. Feldman Decl. ¶¶ 88-89.

120. Documents produced by Respondent show that (1) CEMSA applied on June 30, 1998 for registration as an exporter of cigarettes, alcoholic beverages and tobacco products (App. 0444-47), (2) this application was circulated to representatives of these industries, including CIGATAM (0448-460) and CEMSA was blackballed by the National Beer Makers Association because "there is no purchase or sale agreement executed with any manufacturer [by CEMSA]" (App. 0459-460). The cigarette industry's response to Hacienda was not produced.

I. Hacienda's 1998 Tax Audit of CEMSA

121. On February 16, 1998 Claimant delivered to Respondent and to the United States Government his Notice of Intent to Submit a Claim to Arbitration pursuant to NAFTA Article 1119. He also advised Respondent that he intended to publish his complaint in the Wall Street Journal. President Zedilo's office passed the word that Claimant "would have the Mexican Government all over me" if he published. Claimant did publish on March 9, 1998, and Hacienda began a campaign of harassment against CEMSA that continues to this day. Feldman Decl. ¶ 85.

122. In July 1998, the Servicio de Administracion Tributaria ("SAT"), Hacienda's audit branch, launched a three day audit of CEMSA's exports 1996-1997 exports. Audit officials with armed guards descended on CEMSA's office with several copy machines. They seized and copied records in CEMSA's possession. Feldman Decl. ¶ 86.

123. SAT issued a tax assessment against CEMSA on March 1, 1999, in an amount equal to US $ 25 million, asserting a claim for recovery of some US $ 9.1 million in IEPS rebates paid in 1996 and 1997, plus interest, penalties, and actualization. The main basis for this assessment was SAT's assertion that CEMSA did not have invoices from its vendors stating the tax separately and expressly. SAT did not claim that CEMSA was not a taxpayer under the IEPS Law. Feldman Decl. ¶ 86.

124. To avoid forfeiture and criminal penalties, CEMSA filed another action in the Mexican courts challenging the audit and the tax assessment that followed. The assessment has been vacated by the Fiscal Tribunal of the Federation on procedural and substantive grounds, but the case is on appeal. Feldman Decl. ¶ 87.

125. After this Tribunal was constituted, Claimant sought to withdraw both of his defensive actions from the Mexican courts. In both cases, the Mexican courts disregarded these applications. Feldman Decl. ¶ 84, 87.

126. When Claimant learned that the Fiscal Tribunal had assigned the tax assessment case to Judge Ruben Aguirre Pangburn, Claimant filed a motion asking that Judge Aguirre be recused from the matter due to his previous involvement with material issues directly affecting CEMSA and its right to IEPS rebates for cigarette exports and Claimant's criminal complaint against him. The court rejected this motion. Feldman Decl. ¶ 87.

127. On January 19, 2000, CEMSA again attempted to export a test shipment of cigarettes in order to be able to apply for the IEPS rebates for this export and be in a position, when the rebates were denied, to challenge the January 1, 2000 amendment to the IEPS law in court. The export was rejected when CEMSA's customs broker could not obtain an export declaration or

"*pedimento*" through its computer link with Hacienda. The broker showed Claimant a report advising that "RFC [Federal Taxpayer's registry number] not authorized to import or export the product corresponding to the stated customs section. The RFC is not registered in the list of importers/exporters of the stated product." *See* Feldman Decl. ¶ 89 and copy of report at App. 0142-0145, 0139.

J. Hacienda's rebates to Mexican-owned exporters.

128. Around July, 1999, Claimant learned that Hacienda was permitting cigarette exports and making rebates of IEPS taxes on such exports to at least one company owned by Mexican citizens that, like CEMSA, is not a cigarette producer. That company was Mercados Regionales S.A. de C.V. ("Mercados I"). This information came from Cesar Poblano, a principal in the LYNX business, who had also been a lender to CEMSA in 1997 when CEMSA borrowed to finance cigarette purchases as discussed above. Feldman Decl. ¶ 91.

129. Later, Claimant obtained documents showing Hacienda's payment of IEPS rebates to Mercados I for cigarette exports made in 1999. He received these documents from CEMSA's former counsel, Javier Moreno Padilla. Feldman Decl. ¶ 91; and see documents at App. 0473-0505.

130. CEMSA's complaints to the Tribunal about this discrimination apparently disrupted Mercados I's arrangements with Hacienda, and its owners made efforts to substitute a new corporation as the exporter of record, Mercados Extranjeros S.A. de C.V. ("Mercados II"). These efforts failed, at least temporarily, because Hacienda mistakenly believed that Marvin Feldman was involved in Mercados II's business. Feldman Decl. ¶ 92; App. 0470-72.

131. Poblano visited Claimant to complain about this situation and gave him a copy of a Hacienda document, captioned "Mercados Extranjeros, S.A.de C.V." which refers to a memorandum by Rafael Obregon, Deputy Director of Tax Policy and Coordination, instructing the Administrative Unit not to register Mercados II on its internal registry or "sectional list" as an approved exporter of cigarettes. Feldman Decl. ¶ 92. The document notes that Mr. Obregon informed the Office that:

> . . . Lic. Luis Medardo Guemes Cabrera and Mr. Marvin R. Feldman have a long relationship.
>
> In the same way, it is known that Mr. Marvin R. Feldman Karpa has a negative past history with this Administrative Unit, in virtue of the fact that as legal representative of the business named CEMSA, he has requested the return of large sums of money, as rebates of the payments of the IEPS, without the right to said return, in virtue of the fact that the business he represents is a marketer and not a producer of manufactured tobacco and alcoholic beverages.
>
> Additionally, the record shows that Mr. Feldman by letter of the 16th of February, 1998 [initiated] arbitration under the North American Free Trade Agreement to obtain from SHCP the said return plus reparation of damages, or in its case, compensation for not being permitted to develop his activities, for an amount equal to the whole value of the company.

App. 0470-72 (excerpt from courtesy translation). Although requested specifically, Respondent has failed to produce this document.

132. Neither Claimant nor CEMSA has or ever had any financial interest in or business relationship with either Mercados I or Mercados II. Claimant's sole business relationship with Mr. Poblano since December 1997 is the debt described at Paragraph 102 above. Feldman Decl. ¶ 93.

133. Claimant learned in October, 2000, that another Mexican-owned exporter, MEXCOBASA S.A. de C.V., obtained registration from Hacienda in 1999 as an exporter of cigarettes and

alcoholic beverages and obtained IEPS rebates for exports of alcoholic beverages and, possibly, cigarettes in 1999. Feldman Decl. ¶ 94.

134. Respondent admits that it has paid close to 91,000,000 pesos (approximately US $ 9.1 million) IEPS rebates to three trading companies, other than CEMSA, since September 1996, including after December 1, 1997. It states that two additional trading companies "applied for the refund of IEPS levied on cigarette exports" but were "refused." It does not state the basis of the refusals. *See* Declaration of Eduardo Enrique Díaz Guzmán ("Guzmán Decl.") (App. 0506-525) at 0516 (trans.). Respondent also states that the nationality of the owners or shareholders of any taxpayer is "irrelevant" and that documents filed for the tax refund do not reveal the nationality of the applicant. *Id.* at 0515. It does not deny knowing the nationality of the owners of five trading companies mentioned. Respondent also admits that CEMSA is a taxpayer classified as a "high exporter". *Id.* at 0512-13.

135. Claimant is in a position to know if there were any non-Mexican owned trading companies who exported or are exporting cigarettes from Mexico. He states that CEMSA is the only such company. Feldman Decl. ¶ 95.

136. Claimant has not used a website to promote the sale of cigarettes by CEMSA since January 1998 and no longer maintains a subscription to CEMSA's former website. Feldman Decl. ¶ 96.

137. After Claimant filed a Notice of Arbitration in this case, Claimant asked the U.S. Embassy for assistance in negotiating with Respondent. As a result, Ambassador Davidow wrote to SECOFI Secretary Hermino Blanco Mendoza on September 14, 1998 (App. 0438-0440) and

Charles Brayshaw wrote to Hacienda Secretary Jose Angel Gurria on April 6, 1999. (App. 0461-463).

STATEMENT OF LAW AND ARGUMENT

I. Applicable Law under NAFTA Chapter 11

138. Article 1131 (1) of Chapter 11, Section B, Dispute Resolution, provides that the Tribunal shall decide the issues in dispute in accordance with NAFTA and applicable rules of international law. In addition, the Parties to NAFTA are to "interpret and apply the provisions of this Agreement in the light of its objectives . . . and in accordance with applicable rules of international law."[11] One "object and purpose" of NAFTA is to "ENSURE a predictable commercial framework for business planning and investment . . . ."[12] Express NAFTA objectives also include transparency and the substantial increase of investment opportunities in the territory of the Parties.[13]

139. The tribunal in a previous NAFTA investment dispute, *Ethyl Corporation v. Government of Canada*, held[14] that the applicable rules of international law include the Vienna Convention on the Law of Treaties[15] (the "Vienna Convention"). Article 31 of the Vienna Convention requires that NAFTA be "interpreted in good faith in accordance with the ordinary meaning to be given to

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[11] NAFTA Art. 102 (2).

[12] NAFTA Preamble ¶ 6, (emphasis in original.)

[13] NAFTA Art. 102 (1) (c).

[14] *See Ethyl Corporation v. Government of Canada*, NAFTA/UNCITRAL Case, (Award on Jurisdiction), ¶ 51 (June 24, 1998), *reprinted* in 38 I.L.M. 708, 722 (1999) (hereinafter "*Ethyl*").

[15] Done at Vienna, May 23, 1969, entered into force, January 27, 1980, 1155 U.N.T.S. 331, reprinted in 8 I.L.M. 679 (1969).

the terms of the treaty in their context and in the light of its object and purpose." In addition, Article 27 of the Vienna Convention provides that a State party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform a treaty.[16] NAFTA, as an international agreement signed in accordance with the Mexican Constitution, is now part of the supreme law of Mexico.[17] Thus, the principles of due process and customary international law incorporated in Article 1110 are binding on government officials in Mexico.

140. The statute establishing the International Court of Justice identifies the various sources of international law in a hierarchy that includes international conventions, international custom, general principles of law recognized by civilized nations, judicial decisions and teachings of highly qualified publicists.[18] In the practice of international tribunals, both judicial and arbitral precedents have been commonly treated as authoritative sources of international law.[19]

II. Claimant Is an "Investor" and CEMSA Is an "Investment" Under NAFTA Chapter 11

141. Chapter 11 applies to disputes relating to the investment of an investor of a Party,[20] *i.e.*, 'an investment owned or controlled directly or indirectly by an investor of such Party."[21] The definition of "investment" is very broad and includes all forms of investment, including an

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[16] *See also Westland Helicopters Ltd v. Arab Organization for Industrialization, et al.*, ICC Arb. (Case No. 3879/45) reprinted in 80. I.L.R/ 596, 616 (1989).

[17] *See* Mex. Const. Art. 133.

[18] Statute of the International Court of Justice, Article 38.

[19] *See* Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*. 85 A.I.L. 474, 497-501 (1991) for discussion of this point.

[20] NAFTA Art. 1101 (b).

[21] NAFTA, Art. 1139.

enterprise; ownership interests in an enterprise that entitles the owner to share in its income or profits or in its assets on dissolution; other property, tangible or intangible, acquired in the expectation, or used for the purpose, of economic benefit or other business purposes; and interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under contracts involving the presence of an investor's property in the territory of the Party or contracts where remuneration depends substantially on the production, revenues, or profits of an enterprise.[22] An "enterprise" includes "any entity constituted or organized under applicable law" including a corporation.[23]

142. CEMSA, a Mexican corporation, is clearly an "enterprise" under NAFTA, and, thus, is also an "investment" under Article 1139. Moreover, Claimant's interest in CEMSA's cigarette export business is an investment under these definitions. The *Pope & Talbot* tribunal found as much with regard a similar type of investment, *i.e.*, a U.S. company's interest in its Canadian subsidiary's ability to sell softwood lumber from Canada to the U.S. market. Addressing this point, the tribunal quoted the Article 1139 (g) definition of investment ("other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purpose"), and ruled:

> While Canada suggests the ability to sell softwood lumber from British Columbia to the U.S. is an abstraction, it is, in fact, a very important part of the "business" of the Investment. Interference with that business would necessarily have an adverse effect on the property that the Investor had acquired in Canada, which, of course, constitutes the Investment. . . . The Tribunal concludes that the Investor properly

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[22] *Id.*

[23] NAFTA, Art. 201(1).

asserts that Canada has taken measures affecting its "investment," as that term is defined in Article 1139 and used in Article 1110.[24]

143. An "investor of a Party" includes a "national . . . of such Party, that seeks to make, is making or has made an investment."[25] Investors are those who "make an investment," that is, commit capital and resources to an enterprise, through debt, equity, or other means listed in the Article 1139 definition of investment.[26]

144. Claimant and CEMSA fit within the plain meanings of the NAFTA definitions. Claimant is a U.S. citizen and thus a U.S. national. Claimant owns and operates CEMSA, is entitled to share in CEMSA's income or profits, and is entitled to CEMSA's assets upon dissolution. Feldman Decl. ¶ 1. His nationality and his ownership and control of CEMSA make him an investor. CEMSA, as a corporation organized under Mexican law, constitutes an enterprise of a Party, and as such is an "investment" within the meaning of NAFTA. In addition, CEMSA and CEMSA's cigarette export business are property acquired in the expectation or used for the purpose of economic benefit and other business purposes. Claimant also has committed capital and other resources to contracts and other economic activity within Mexico where remuneration depends substantially on CEMSA's revenues. CEMSA and CEMSA's business activities, therefore,

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[24] *Pope & Talbot, Inc. v. Canada*, UNCITRAL Arb., (hereinafter "Pope & Talbot") Interim Award, (June 6, 2000), ¶ 98.

[25] NAFTA Art. 1139. *See also, Pope & Talbot,* Award on Motion to Dismiss (Jan. 26, 2000), ¶¶ 1 (applying these NAFTA definitions in a straightforward manner and denying motion to dismiss).

[26] *Id.* and *see* Rex J. Zedalis, "Claims by Individuals in International Economic Law," 7 Amer. Rev. Int'l. Arb. 115, 124 (stating that a commitment of capital or resources to a company in a NAFTA country, with repayment based on revenues or profits, comes within the definition of "investment"); Justine Daly, "Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens?," 25 St. Mary's L.J. 1147, 1179 (1994) (hereinafter "Daly") ("An investment under the NAFTA includes all forms of ownership and interests in a business enterprise, property (tangible and intangible), or contractual investments.")

including its business of exporting cigarettes, constitute "investments" by Claimant under NAFTA. See Affidavit of Professor Alan C. Swan (hereinafter "Swan"), Exhibits, Tab 5, ¶ 32. This arbitration concerns measures relating to Claimant's investments, and this dispute is covered by NAFTA Chapter 11.

III. Measures under NAFTA Article 1101.

A. The meaning of "measures".

145. NAFTA Chapter 11 applies to "measures adopted or maintained by a Party" relating to investors of another Party and investments of investors of another party.[27] NAFTA Article 201 states "measure includes any law, regulation, procedure, requirement or practice." A contextual look at this general definition article demonstrates that the definition of measure is not exclusive. All of the definitions found in NAFTA Article 201(1) use the formula "x *means* y," with the exception of the definition for measure, which uses the word "*includes*" instead of the word "means."[28] This different terminology shows the Parties did not intend to limit the definition to the specific types of measures listed. Canada confirmed this in implementing NAFTA.[29] The NAFTA tribunal in *Ethyl* also held that the definition of "measure" was not exhaustive.[30]

146. In this case, the actions and inactions taken by Respondent are measures within the ordinary meaning of NAFTA in that they are regulations, procedures, requirements, and practices

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[27] NAFTA Art. 1101.

[28] Use of the words "means" and "includes" in this manner continues in Article 201 (2) and Annex 201.1.

[29] *Statement on Implementation of the North American Free Trade Agreement*, Can. Gaz. Part IC (1), Jan. 1994, at 80 ("The term "measure" is a non-exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions.")

[30] *Ethyl*, 38 I.L.M. at 725-26 (1999) ¶ 66, ("Clearly something other than a "law," even something in the nature of a "practice," which may not even amount to a legal stricture, may qualify.")

adopted or maintained by Respondent. Moreover, these measures "relate to" Claimant, a United States investor, and to CEMSA, Claimant's investment, in that they all were directed at and directly affected Claimant's conduct and operation of CEMSA's cigarette export business.[31]

147. The measures at issue were primarily taken by Respondent's Ministry of Finance and Public Credit ("Hacienda"). It is a well-settled principle of international law that "[t]he conduct of an organ of a State. . . or an entity empowered to exercise elements of the governmental authority, such organ having acted in that capacity, shall be considered as an act of the State under international law even if, in the particular case, the organ exceeded its competence according to internal law or contravened instructions concerning its activity."[32]

B. The Measures at Issue

148. The dispute at hand arises out of specific measures taken by Respondent to suppress CEMSA's cigarette export business by withholding or denying IEPS rebates to CEMSA. Certain resolutions or statements issued by Respondent to CEMSA relating to IEPS rebates clearly stand alone as statements of policy or practice and are specific measures subject to Chapter 11. Moreover, Respondent's actions, omissions, resolutions and written and oral statements, when taken together, comprise law, regulations, procedures, requirements or practices that fit squarely within the meaning of "measure" under Article 1101. Steps taken by a Party to implement a

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[31] *See Pope & Talbot*, Award in relation to Canada's Preliminary Motion to Dismiss, (January 26, 2000), ¶¶ 33-34.

[32] Article 10, Draft Articles on State Responsibility, International Law Commission of the United Nations, 1975, Y.I.L.C. 1975, vol. ii, p. 61, quoted in *Metalclad Corp. v. United Mexican States*, NAFTA/ICSID Case, ARB(AF), Award, August 30, 2000 (hereinafter "*Metalclad*").

particular law are measures within the meaning of NAFTA,[33] and a series of measures together may be a constructive expropriation.[34]

149. The measures to which Claimant objects are listed below. Each measure commenced or continued after January 1, 1994. Respondent applied each of these measures to Claimant's detriment in violation of NAFTA Articles 1110 and 1102.

a. Respondent's failure to allow CEMSA to obtain IEPS rebates on cigarette exports in 1994-1995 notwithstanding the terms of the IEPS law in force and the Supreme Court Decision of August 18, 1993.

i. by imposing an arbitrary requirement impossible for CEMSA to fulfill that it obtain vendor invoices stating the IEPS tax separately and expressly (see Facts[35] ¶¶ 37, 43, 48-52, 55, 64, 106, 114, 121); and

ii. by failing to require the cigarette producers to comply with their obligation under the IEPS law to state the IEPS tax separately and expressly on their invoices; (see Facts ¶¶ 43-44, 46, 48, 55).

b. Respondent's discriminatory administration of the IEPS law in 1993-1995 contrary to the 1993 Supreme Court Decision and other Mexican laws and jurisprudence in order to protect the producers' monopoly on cigarette exports. See Facts ¶¶ 21-65.

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[33] *Cf. Metalclad.*, ¶ 37 (steps taken by Canada to implement an international agreement "are capable of constituting measures within the meaning of Articles 201 and 1101 of NAFTA.")

[34] *See, e.g., Biloune v. Ghana Investments Centre*, UNCITRAL 95 I.L.R. 183, 209 (Award: Jurisdiction and Liability, October 27, 1989).

[35] All citations to specific "Facts" paragraph following refer to the previous "Statement of Facts" paragraphs and all documents referenced in such paragraph.

c. Respondent's denial of CEMSA's applications for rebates on cigarette exports that CEMSA made in October-December 1997 in reliance on Respondent's representations and promises which denials were contrary to Respondent's agreement with Claimant and contrary to the 1993 Supreme Court Decision and the IEPS law in force. See Facts ¶¶ 103-106.

d. Respondent's decision in November or December 1997, for the benefit of cigarette producers, to terminate future cigarette exports by CEMSA by denying IEPS rebates to CEMSA on such exports. See Facts ¶¶ 102-103, 106-107.

e. Respondent's measures to recover IEPS rebates received by CEMSA in 1996-1997 plus interest and penalties, including Respondent's 1998 audit of, and 1999 tax assessment against, CEMSA. See Facts ¶¶ 120-121.

f. Respondent's refusal to list CEMSA in Hacienda's registry of cigarette exporters in 1998 and its failure to give CEMSA notice of such denial. See Facts ¶¶ 117-118, 125.

g. Respondent's further discrimination against Claimant on the basis of nationality after December 1, 1997 by permitting Mexican-owned exporters and trading companies in like circumstances to export cigarettes and by providing IEPS rebates to such Mexican-owned companies on their cigarette exports. See Facts ¶¶ 126-133.

IV. Respondent's Withholding and Denial of IEPS Rebates Are Measures Tantamount to Expropriation Under NAFTA Article 1110

Article 1110 provides:

> 1. 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.

Thus, NAFTA extends the protections of general principles of international law to investment in very broad terms.[36] These conditions are cumulative. If any one condition is not met, the expropriation violates NAFTA.[37]

A. Article 1110 includes Indirect, Constructive, and Creeping Expropriations that Interfere Significantly with an Investor's Use of or Benefit from his Investment.

150. On its face, Article 1110 applies not only to direct expropriation but also to indirect expropriation and measures "tantamount to expropriation." The phrase "tantamount to expropriation" was adopted from various bilateral investment treaties ("BITs") which served as prototypes for NAFTA.[38] The United States, in transmitting such a BIT to Congress, has explained the meaning of the phrase "tantamount to expropriation" as follows:

> These rights and obligations also apply to direct or indirect measures "tantamount to expropriation or nationalization" and thus apply to "creeping expropriations" –

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[36] *See* Daniel M. Price and P. Bryan Christy, III, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement, in* Judith H. Bello, Alan F. Holmer & Jos. J. Norton, Eds., The North American Free Trade Agreement: A New Frontier in International Trade and Investment in the Americas 165, 173 (Amer. Bar Assn., 1994) (hereinafter "Price & Christy"). Mr. Price was one of the U.S. negotiators of the NAFTA investment article.

[37] *See, e.g., Metalclad*, ¶ 104 (holding that, because Mexico permitted or tolerated conduct (effectively halting the claimant's business) that the NAFTA tribunal had already held to be unfair and inequitable in breach of Article 1105, Mexico had to be held also to have taken a measure tantamount to expropriation under Article 1110 (1) (c).)

[38] Price & Christy at 167; *and see* Daly, *supra*, at 11844) (stating that BIT expropriation language influenced NAFTA negotiations and is, in addition, indicative of customary international law). *See* Swan ¶¶ 23-24 for discussion of various BITs and constructive expropriation.

a series of measures which effectively amount to an expropriation of a covered investment without taking title.[39]

A U.S. negotiator of NAFTA Chapter 11 also confirms that Article 1110 "covers direct, indirect, and so-called 'creeping' expropriation."[40]

151. NAFTA's recognition of state responsibility for measures which are not formal expropriations but have equivalent effects is well founded in general principles of international law. Section 711 of the Restatement[41] provides:

> A state is responsible under international law for injury to a national of another state caused by an official act or omission that violates . . . (c) a right to property or another economic interest that, under international law, a state is obligated to respect for persons, natural or juridical, of foreign nationality, as provided in § 712.

Section 712 states, in language strikingly similar to Article 1110 (1):

> A state is responsible under international law for injury resulting from:
>
> 1. a taking by the state of the property of a national of another state that:
>
> a. is not for a public purpose, or
> b. is discriminatory, or
> c. is not accompanied by provision for just compensation
>
> * * *
>
> 2. other arbitrary or discriminatory acts or omissions by the state *that impair property or other economic interests* of a national of another state. [Emphasis added.]

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[39] *See* Message of the President of the United States transmitting the Treaty concerning the Encouragement and Reciprocal Protection of Investment, with Annex and Protocol, Treaty Doc. 104-14, 104th Cong., 1st Sess. (1995), July 11, 1995 (emphasis added).

[40] Price & Christy, at 175.

[41] At least two NAFTA tribunals have looked to the Restatement as an appropriate source of international law in determining whether there has been an expropriation under NAFTA Chapter 11. *See Pope and Talbot* (Interim Award) ¶¶ 102, 104 and notes 8, 87; *S.D. Myers, Inc. v. Canada,*, NAFTA UNCITRAL case (partial award) November 13, 2000 (hereinafter "*S.D. Myers*") at ¶ 286 concurring with *Pope and Talbot,* Interim Award, ¶ 104.

Comment g to Section 712 explains:

> Subsection (1) applies not only to avowed expropriations in which the government formally takes title to property but also to other actions of the government that have the effect of "taking" the property, in whole or in large part, outright or in stages ("creeping expropriation"). A state is responsible as for an expropriation of property . . . *when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an aliens's property* or its removal from the state's territory. Depriving an alien of control of his property, as by an order freezing his assets, might become a taking if it is long extended. [Emphasis added.]

Comment i to Section 712 explains further:

> Under Subsection (1), a state is responsible for expropriation of alien property without just compensation even if the property of nationals is treated similarly, but economic injuries that fall within Subsection (3) are generally unlawful because they involve discrimination or are otherwise arbitrary. An alien enterprise that has been lawfully established is protected by international law against changes in the rules governing its operations that are discriminatory, Comment f, or are so completely without basis as to be arbitrary in the international sense, *i.e.*, unfair.

The Restatement also suggests that one test for creeping expropriation is whether taxation or other regulatory measures are "designed to make continued operation of a project uneconomical so that it abandoned,"[42] or make it "impossible for the firm to operate at a profit."[43]

NAFTA Decisions on Expropriation

152. NAFTA tribunals considering expropriation claims have specifically determined that the phrase "tantamount to expropriation" refers to indirect, creeping, constructive, or *de facto* expropriations.[44] As the tribunal in *Metalclad* explained:

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[42] Restatement § 712, note 7.

[43] *Id.*, note 6.

[44] *Pope & Talbot, Interim Award*, (June 26, 2000, ¶ 104 ("'Tantamount' means nothing more than equivalent."); *S.D. Myers* ¶ 286, agreeing with *Pope and Talbot*, that "the drafters of the NAFTA intended the word

> [E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host state, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or significant part, of the use of reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.[45]

153. There are numerous precedents including cases holding that expropriation occurs when a government's measures or conditions force an investor to abandon property or to sell it at less than fair market value.[46]

B. Tax Regulations and Administration May Be Measures Tantamount to Expropriation.

154. Respondent may argue that all of the measures at issue were simply legitimate exercises of the government's police powers which cannot be subject to claims of expropriation under Article 1110. This argument cannot stand. In *Pope & Talbot,* the tribunal rejected Canada's similar argument that, because the measures in dispute in that case were cast in the form of regulations, they were a valid exercise of "police powers" which, if non-discriminatory, were beyond the reach of Article 1110. The tribunal noted:

> While the exercise of police powers must be analyzed with special care, the Tribunal believes that Canada's formulation goes too far. Regulations can indeed be exercised in a way that would constitute creeping expropriation . . . .
>
> Indeed much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriations [fn omitted]. For these reasons,

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'tantamount' to embrace the concept of so-called 'creeping expropriation' rather than to expand the internationally accepted scope of the term expropriation."

[45] *Metalclad*, ¶ 103.

[46] *Osthoff v. Hoelfe*, 1 U.S. Ct. Rest. App. 111 (1950); *Poehlmann v. Kulmbacher Spinnerai A. G.*, 3 U.S. Ct. Rest. App. 701 (1952); *Stadt Wuertzburg v. Institute der Englischen Fraulein, B.M.V.*, 3 U.S. Ct. Rest. App. 753 (1952)

> the Tribunal rejects the argument of Canada that the Export Control Regime, as a regulatory measure, is beyond the coverage of Article 1110.[47]

In the footnote to this paragraph, the *Pope & Talbot* Tribunal explained further:

> This is not to say that every regulatory restraint can be likened to expropriation. The *Restatement* recognizes that the distinction between taking and regulation is not always clear but may rest on the degree of interference with the property interest. *See Restatement* §712, comment (g) and note 6. Canada's suggestion that regulations can run afoul of international legal requirements only if discriminatory is inconsistent with the *Restatement*: "[A] state is responsible for expropriation of alien property without just compensation even if the property of nationals is treated similarly." *Ibid*, comment (i).[48]

155. Many international legal writers have also acknowledged that arbitrary, confiscatory, or discriminatory taxes, fees, or other overly burdensome economic measures can constitute expropriation under international law.[49] Weston commented on

> . . . the many ways in which aliens, not the targets of "confiscation," "expropriation," "nationalization," or "requisition" *stricto sensu*, can be and have been effectively deprived, in whole or in part, of the "use and enjoyment" of their foreign based wealth by the exercise of so-called police powers.[50]

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[47] *Pope & Talbot*, Interim Award, ¶ 99.

[48] *Id*; n. 73.

[49] *See* Jason L. Gudofsky, Written Remarks for American Bar Association Panel Discussion on NAFTA Chapter 11 Investor-State Disputes Washington, D.C., U.S.A. (Feb. 1, 2000), 34-38 ("[T]here is no legitimate reason why an excessively onerous taxation measure should not be deemed a compensable injury."); Patricia M. Robin, Comment: The BIT Won't Bite: The American Bilateral Investment Treaty Program, 33 Am. U. L. Rev. 931, 952-53 (1984) (discussing the prototype U.S. BIT upon which NAFTA, Chapter 11 is based); Daly *supra*, at 1150 ("State taxes and regulatory measures that impair the economic viability of a business enterprise sometimes result in what is effectively a taking or expropriation."); Christie, *What Constitutes a Taking Under International Law*, 38 BRIT. Y.B. INT'L LAW 307 (1962) ("Christie") at 331-32 (stating that tax laws and currency revaluations can be unjustifiable expropriations when they discriminate with respect to aliens or to certain other classes of persons); Ian Brownlie, Principles of Public International Law, 5th ed. 1998, 535 ("Taxation which has the precise object and effect of confiscation is probably unlawful [footnote omitted].")

[50] Weston, *Constructive Takings" Under International Law: A Modest Foray into the Problem of "Creeping Expropriation."* 16 VA. J. OF INT'L LAW 103, 106 (1975) (hereinafter "Weston).

Recognizing this basic reality, the Iran – United States Claims Tribunal has more than once affirmed that:

> A deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to the property is not affected.[51]

Moreover, a state cannot avail itself of domestic laws to escape its international obligations.[52]

Article 2103

156. The Restatement recognizes that tax measures may constitute expropriatory actions for which states are accountable under international law,[53] and this view is expressly adopted in NAFTA. As Professor Swan testifies:

> If there is any doubt that 'constructive expropriations' in the form of tax measures, such as Respondent's denial of IEPS rebates to CEMSA, can come within the cognizance of Article 1110(1) of NAFTA, that doubt is put to rest by Article 2103 of NAFTA.

Declaration of Professor Alan C. Swan ("Swan") ¶ 26. Paragraph 1 of Article 2103 states: "Except as set out in this Article, nothing in this Agreement shall apply to taxation measures." Paragraph 6 then creates an exception in the following terms:

> Article 1110 (Investment -- Expropriation) shall apply to taxation measures except that no investor may invoke that Article as the basis for a claim under Article 1116 or 1117 where it has been determined [by designated Mexican and American officials] that the measure is not an expropriation.

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[51] *Tippets, Abbot, McCarthy, Stratton v. Tams-Affa*, Awd. No. 142-7-2, 22 June 1984, reprinted in 6 IRAN-U.S. CL. TRIB. REP. 219, 225 (1984), citing 8 WHITEMAN, DIGEST OF INTERNATIONAL LAW 1006-20; Christie, *What Constitutes a Taking Under International Law*, 38 BRIT. Y.B. INT'L LAW 307 (1962); the *Lena Goldfields Case* reprinted in Nussbaum, *The Arbitration Between the Lena Goldfield's Ltd. and the Soviet Government*, 36 CORNELL L. Q. 31 (1950). See also *Starrett Housing Corporation et. al v. Iran*, Awd. No. ITL 32-24-1, 19 December 1983, reprinted in 4 IRAN – U.S. CL. TRIB. REP. 122, at 147 (1983).

[52] Vienna Convention, Article 27.

[53] Restatement § 712, cmt. g.

After quoting the above articles, Professor Swan continues:

> Plainly, Article 2103 (6) recognizes that "taxation measures," as such, can qualify as an 'expropriation' or as a measure 'tantamount to an expropriation' within the meaning of Article 1110 (1). Indeed, Respondent expressly recognized this point when it sought from the tax officials designated under Article 2103 (6) a "no expropriation" determination for both the "taxation measures" (*i.e.*, pre-1998 rebate denials) challenged by Claimant and the "taxation measures" (rebate denials contained in the 1998 legislation) and obtained a declaration only with respect to the latter. Respondent's own actions, in other words, effectively *estop* it from denying that taxation measures, as a class, can fall within the cognizance of Article 1110 (1) as a form of 'constructive expropriation.' The question then remains whether the precise measures challenged by Claimant (the denial of IEPS rebates) comes within the scope of that Article and, if so, whether they violate its terms.

Swan ¶ 26, emphasis in original.

157. As discussed below, Respondent's measures against CEMSA were not ordinary or legitimate regulation. Their sole purpose and effect was to make it impossible for CEMSA to export cigarettes in competition with the producers and their distributors. Hacienda's decision to deny CEMSA registration as an approved exporter of cigarettes and alcoholic beverages after consultation with the Mexican manufacturers of these products is proof positive of Respondent's intent to shut down CEMSA's cigarette export business and keep it closed. The documents show that Hacienda consulted representatives of these industries, including CIGATAM, and that one or more blackballed CEMSA. App. 0448-60.

C. Partial Expropriations Are Compensable Under Article 1110.

158. Respondent appears to argue that its measures directed against CEMSA are not tantamount to expropriation of Claimant's Investment under NAFTA Article 1110 because CEMSA continues to exist as a corporation and to conduct some business. According to this view, a State Party to NAFTA would be free to seize significant corporate assets or to terminate

a company's major line of business, formally or informally, so long as it did not take the stock of the corporation or all of its assets. This interpretation of Article 1110 is contrary to established principles of international law and to common sense. It would seriously limit the protections that NAFTA was intended to extend to Investors and their Investments.

159. The Restatement, writers on international law, and decisions by international tribunals under NAFTA and other agreements are all in accord that government action is "tantamount to expropriation" when it interferes significantly with an investor's use or enjoyment of his investment. According to the Restatement, state responsibility attaches when the state "prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an aliens's property or its removal from the state's territory."[54] As noted above in Part III. A, the Restatement also suggests that one test for creeping expropriation is whether taxation or other regulatory measures are "designed to make continued operation of a project uneconomical so that it abandoned,"[55] or make it "impossible for the firm to operate at a profit."[56] Likewise, Weston finds an expropriation when investors "have been effectively deprived, in whole or in part, of the 'use and enjoyment' of their foreign based wealth by the exercise of so-called police powers."[57]

160. NAFTA tribunals have reached the same conclusion. The test is the degree of interference, which must be "substantial." Again as noted above, the *Metalclad* tribunal defines expropriation under Article 1110 to include "covert or incidental interference with the use of

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[54] Restatement § 712, cmt. g.

[55] Restatement § 712, note 7.

[56] *Id.*, note 6.

[57] Weston, at 106.

property which has the effect of depriving the owner, in whole or significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.'[58] The *Pope & Talbot* tribunal held that the interference must be a "substantial deprivation" that is "sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner."[59] In that case, the tribunal found no taking because the respondent's interference with the Investment's exports of softwood lumber export to the United States was marginal. The Investor's company continued to export softwood lumber to the United States and to earn substantial profits on its U.S. sales.[60] *S.D. Myers* involved a temporary Canadian restriction on exports of hazardous waste for processing in the United States, and the tribunal found a serious violation of Article 1102 National Treatment. Although it approved the *Pope & Talbot* analysis of "tantamount to expropriation," the *S.D. Myers* tribunal did not find an Article 1110 violation because it considered that the temporary suspension of hazardous waste exports merely delayed establishment of a new U.S. investment in Canada. In any event, the Tribunal indicated that the Claimant was entitled to compensation for all the profits it lost as a result of Canada's regulatory measures due to the Article 1102 violation.

161. Numerous cases heard by the Iran-U.S. claims Tribunal involved expropriation of particular assets or business activities. For example, in several cases, the tribunal found there

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[58] *Metalclad*, ¶ 103.

[59] *Pope & Talbot*, Interim Award, ¶ 102.

[60] *Id.*, ¶¶ 96-105.

was an expropriation where the Iranian Government failed to issue permits necessary for the claimant to re-export certain equipment from Iran.[61]

162. None of the above opinions suggests, as Respondent does, that the confiscation of significant assets or termination of a major line of business would not engage state responsibility because the remaining assets and/or business have some commercial value. Moreover, as Professor Swan points out, there are numerous cases of partial expropriation in which tribunals have awarded compensation

> irrespective of whether other assets of an enterprise have been taken, irrespective of whether the claimant continues as a going concern, and irrespective of whether other claims – expropriatory or contractual – are upheld or not. If there is an expropriation, partiality is simply no bar to full recovery. Indeed, the singular feature of the cases is that the possibility of partiality defeating compensation, as Respondent would have it, is never discussed. Apparently, the idea is sufficiently eccentric, the right to compensation so well understood, that the point never needs discussion.

Swan ¶ 41.

163. Professor Swan makes another telling point. Under Respondent's theory, there could be no expropriation unless CEMSA was driven out of every last product line it exports. Swan ¶ 45. This would eliminate the concept of "creeping expropriation" from Article 1110 and seriously diminish the intended scope of the phrase "tantamount to expropriation." A creeping expropriation is one which occurs in pieces over time. Surely, an investor is entitled to compensation for such a taking when it reaches the level of substantial deprivation or interference. If no compensation is due until an expropriation is complete, international law

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[61] *See, e.g., Seismograph Service Corp. v. National Iranian Oil Co.*; *Petrolane, Inc. v. Iran* (1991) *reprinted in* 27 Iran-U.S. C.T.R. 64, 96 (1992); *Sedco v. National Iranian Oil Co.*, Award No. ITL 32-24-1, 19 December 1983, reprinted in 4 Iran – U.S. Cl. Trib. Rep. 122 (1983).

would not recognize the concept of creeping expropriation. The fact that the law recognizes state responsibility for creeping expropriation means that compensation is due for a partial expropriation.

164. As noted above, not all governmental regulations engage state responsibility even when an investor suffers some significant economic injury. Professor Swan thoughtfully explains that there are both quantitative and normative elements to a finding of expropriation in breach of Article 1110. Swan ¶ 46. In this case, Mexico's treatment of CEMSA meets both requirements. Claimant is entitled to compensation under Article 1110 because

(1) Respondent's withholding and denial of IEPS rebates to CEMSA caused serious economic injury to CEMSA and interfered substantially with Claimant's use of and benefit from his Investment (thus satisfying the quantitative elements), and

(2) Respondent's measures were arbitrary, discriminatory, in violation of due process and in violation of minimum standards of international law under Article 1110 (a), (b), (c) and (d) (thus meeting the normative elements).

D. CEMSA's Cigarette Export Business Is A Compensable Interest Under Article 1110.

165. Respondent may argue that CEMSA has no legal right to export cigarettes under Mexican law and/or that it had no reasonable expectation of being able to continue to do so in light of Respondent's policy supporting an export monopoly by cigarette producers. This argument lacks merit because (1) the right to export is protected as a matter of international law under NAFTA Article 1110, and (2) CEMSA's right to export cigarettes has been confirmed by the Mexican Supreme Court of Justice and by Respondent's commitments to Claimant.

1. NAFTA Protects The Right to Export

166. *Pope & Talbot*, discussed above at Paragraph 154, held that "the Investment's access to the U.S. market is a property interest subject to protection under Article 1110 and that the scope of that article covers nondiscriminatory regulation that might be said to fall within an exercise of a state's so-called police powers."[62] The Tribunal recognized that quantitative limitations on exports could constitute an expropriation if they were sufficiently severe. *A fortiori*, measures prohibiting all exports of a product would constitute expropriation. In this case, Respondent has imposed measures that were intended to and had the effect of terminating all cigarette exports by CEMSA. Facts ¶¶ 101-125. The purpose of the 0% tax rate was to support export of Mexican cigarettes. Facts ¶ 6 and authorities therein. Denial of rebates to CEMSA did not raise revenues; it merely terminated cigarette exports in competiton with the producers. See Loperena § III.E at 21-22.

167. To prove expropriation, it is sufficient for the Investor to show substantial harm to the Investment where, as here, the harm is accompanied by the normative elements of an expropriation, as discussed in Part V below. CEMSA's cigarette export business accounted for more than 90% of CEMSA's profits at the time Respondent shut it down. The loss of this business struck at the heart of CEMSA. It deprived Claimant of CEMSA's most lucrative business activity, and had a substantial impact on the enterprise as a whole. Facts ¶ 4. Unlike the Investment in *Pope & Talbot*, CEMSA was not able to continue the same export business in substantial quantities; it was not able to export any quantities of cigarettes at all. Unlike the

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[62] *Pope & Talbot*, (Interim Award) ¶ 96.

Investment in *Pope & Talbot*, CEMSA was not able to make substantial profits on exports of softwood lumber; it made no more profits on cigarette exports.

168. The impact of the measures on CEMSA is also unlike impact of the measures on the investment in *S.D. Myers* where the suspension of exports for some months had the limited effect of delaying establishment of a new business for a short time. CEMSA has been permanently shut out of an established business by Respondent's actions.

2. CEMSA Is Entitled to IEPS Rebates Under Mexican and International Law and Respondent Is Estopped From Denying That Right.

Entitlement

169. Respondent may argue that CEMSA is not entitled to IEPS rebates on cigarette exports under Mexican law notwithstanding the 1993 Supreme Court Decision. As noted above, the Tribunal is to decide this case under NAFTA and general principles of international law. Mexican law as interpreted by the Mexican Supreme Court of Justice and as applied by Mexican government authorities may be relevant to aspects of this case, but a State Party may not invoke the terms of domestic law to defeat its obligations under NAFTA[63], particularly where the provisions of domestic law at issue do not meet NAFTA's requirements for transparency and certainty.[64]

170. CEMSA's entitlement to IEPS rebates on cigarette exports as a matter of international law rests on the following facts and propositions:

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[63] Vienna Convention, Article 27.

[64] *See Metalclad*, ¶ 76. ("All relevant legal requirements for the purpose of . . . successfully operating investments . . . should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters.")

a. The Mexican Supreme Court of Justice has issued two unanimous opinions – one in a case brought by CEMSA – holding that all exporters of cigarettes are entitled to IEPS rebates to make good the 0% tax rate on cigarette exports established by that law, and that the Mexican Constitution precludes legislation and administrative action limiting that benefit to cigarette producers and their distributors. App. 0526 (the 1993 Supreme Court Decision) and App. 0785 (the 1992 LYNX Supreme Court decision); Enriquez ¶ 4-5 ; Loperena § III B at 7-8. These decisions were based on well established principles of Mexican jurisprudence. Loperena § III A and B 10. In the absence of any contrary decision by the Supreme Court of Justice – and there is none – the Tribunal must rely on these opinions as authoritative statements of Mexican constitutional principles. Loperena § III B at 8; Swan ¶ 57.

b. The IEPS Law in force from January 1, 1992 through December 31, 1997 recognized that all cigarette exporters were taxpayers entitled to rebates of the IEPS tax included in the purchase price of the cigarettes that they exported. Enriquez ¶ 21; Loperena § III C at 13. Respondent is estopped from asserting a contrary view against Claimant now, because Mexican officials consistently confirmed that interpretation to him over the years both in writing (see App. 0062-69, 0087-89, 0100-104 (letters from Regional Administrator Riquer, Gomez Gordillo and General Administrator Gomez Bravo), and verbally (Facts ¶¶ 58-80, 88-96). Claimant relied on those representations in conducting CEMSA's cigarette business. Facts ¶¶ 77, 98, 105. Even those officials who opposed rebates for CEMSA, including Attorney General Hoyo, Undersecretary Gomez Gordillo, and Administrators Aguirre, Reza Sosa, and Espinoza did not deny CEMSA's eligibility but sought instead to impose other impossible conditions as a barrier to such rebates. Facts ¶¶ 34-36, 42, 46, 52, 65.

c. The formal requirement of the IEPS law that a taxpayer seeking an IEPS rebate obtain a vendor's invoice stating the IEPS tax separately and expressly is not opposable to CEMSA as a matter of Mexican or international law because that requirement was impossible for CEMSA to fulfill for reasons beyond its control. Loperena § III D at 19. Cigarette producers were required by Article 19 of the IEPS law to state the tax separately and expressly on invoices to their customers. Enriquez ¶ 8; Loperena § III C at 13. The purpose of this requirement is to promote Mexican exports by rebating the high domestic tax to the exporters (Facts ¶ 6), and Hacienda's Undersecretary Gomez Gordillo confirmed to Claimant in writing that CEMSA was entitled to have the IEPS tax stated separately and expressly when it purchased cigarettes for export (Facts ¶ 45). Nonetheless, CIGATAM refused to separate the IEPS tax, and Respondent refused to require the producers to comply with that obligation. Facts ¶¶ 37, 46, 49; Enriquez ¶ 10.

The principle *Ad impossibiliam nemo tenetur* is a general rule of law adopted in Mexican law (Loperena § III D at 19) and the law of nations. No one is obligated to do the impossible. The European Court of Justice has ruled that any domestic requirement of proof which has the effect of making it virtually impossible or excessively difficult to secure the repayment of charges levied contrary to Community law is not compatible with Community law.[65] Mexican jurisprudence is clear on this point. Loperena § III C at 7. Moreover, Respondent is estopped from asserting this formality against Claimant because senior Hacienda officials waived the

[65] *Les Fils de Jules Blanco S.A. v. Directeur General des Douanes et Droits Indirects* [1998] ECR 1099.

requirement for CEMSA in 1995.[66] Hacienda ratified that waiver by making rebates to CEMSA in 1996-97, knowing that CEMSA did not and could not comply for reasons beyond its control. Claimant relied on these representations, promises and measures in conducting CEMSA's cigarette export business.

d. In 1995, Undersecretary Pedro Noyola resolved Claimant's long-standing dispute with Hacienda by approving IEPS rebates for CEMSA without invoices separating the IEPS tax separately and expressly. This policy decision was implemented by other senior Hacienda officials who negotiated an agreement with Claimant and his attorney Oscar Enriquez. Facts ¶¶ 58-64. After some difficulties, including efforts to intimidate CEMSA by a tax audit (Facts ¶¶ 67-69), and resistance by the Regional Office responsible for making rebates to CEMSA, (Facts ¶¶ 65-66), this agreement was confirmed and implemented. Facts ¶¶ 76-77. Respondent paid rebates to CEMSA for sixteen months. Facts ¶ 92.

e. A senior Hacienda official Jose Riquer Ramos confirmed the method Claimant used to calculate the IEPS tax on CEMSA's rebate applications. Facts ¶¶ 88.

f. Hacienda again confirmed CEMSA's right to receive IEPS rebates on cigarette exports in March 1997 after some confusing technical amendments were made to the IEPS law. Facts ¶¶ 92-95 and App. 0100-104.

171. In reliance on Respondent's commitments, guidance and actions, Claimant and CEMSA invested large sums of money to purchase cigarettes for export in 1996-97 and obtained IEPS rebates to cover that part of their costs. Respondent now refuses to pay the rebates it owes

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[66] *See* Biloune v. Ghana Investments *Centre, 95 I.L.R. 183, 208 (1993).*

CEMSA for shipments made in October-December 1997 (about US $ 6.5 million per Respondent's own statutory formula) and seeks to recover the rebates it paid CEMSA in 1996-97 together with interest and penalties (more than US $ 25 million). As shown below, Respondent is estopped, as a matter of international law from (a) disputing its liability for the IEPS rebates claimed by CEMSA and (b) asserting claims against CEMSA for the rebates CEMSA received in 1996-97.

172. Under NAFTA and general principles of international law, a host government cannot rely on self-serving interpretations of uncertain and technical provisions of local law to avoid state responsibility for injury to an investor who has reasonably relied on the government's representations concerning the requirements of local law. In *Metalclad*, for example, the tribunal found that the federal and state governments had led the investor to believe that federal and state permits allowed it to construct the hazardous waste landfill at issue. Relying on these representations, the investor commenced construction, openly and continuously for a period of months, with the full knowledge of federal, state and municipal governments, until the municipal government issued a stop work order based on the investor's failure to obtain a municipal construction permit. Federal officials then told the investor that, if it applied for such a permit, the municipality would have no basis for denial and it would be issued as a matter of course. The investor applied, and "continued its obvious and open investment activity" by continuing construction. Thirteen months later, after construction was "virtually complete" and ready to commence operation, the municipality denied the permit at a closed meeting of which the investor received no notice and was given no opportunity to appear.[67] The tribunal found that:

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[67] *Metalclad*, ¶¶ 85-91.

> [t]hese measures [by the municipality], taken together with the representations of the Mexican federal government, on which Metalclad relied, and the absence of a timely, orderly or substantive basis for the denial by the Municipality of the local construction permit, amount to an indirect expropriation.[68]

173. The *Metalclad* tribunal attached importance to NAFTA's objectives and purpose, including the promotion of investment opportunities and the assurance of successful implementation of investment initiatives.[69] In finding that Mexico had not met its obligations under Article 1105 and 1110, the tribunal reasoned:

> Prominent in the statement of principles and rules that introduces the Agreement is the reference to "transparency" (NAFTA Article 102(1)). The Tribunal understands this to include the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government of any Party . . . become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.[70]

174. In this case, as in *Metalclad*, government officials made representations to Claimant on which he relied in recommencing CEMSA's cigarette export business in 1996 and in making substantial investments in that business. CEMSA conducted the business openly and continuously until it was shut down by the decision of Hacienda to deny IEPS rebates for October and November 1997. Hacienda was fully aware of CEMSA's cigarette export activities at all times: it was advised before CEMSA undertook these exports by oral and written

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[68] *Id.*, ¶ 107.

[69] *Id.*, ¶ 75.

[70] *Id.*, ¶ 76 and 107.

communications from Claimant to Fernando Heftye, Angel Suarez, Angel Ramirez, Jose Ramos Riquer, and Juan Carlso Espinoza (Facts ¶¶ 64-68, 73-74, 76-77); it was advised of the particulars of every cigarette export when CEMSA's export broker connected with Hacienda's computer to obtain approval to issue the required *pedimento* or export document (Facts ¶¶ 86-87, 90); it was advised with every application for IEPS rebates for cigarette exports which CEMSA submitted monthly (Facts ¶¶ 88, 90); it was advised by Claimant's regular visits to Hacienda's Regional Office to expedite the rebates (Facts ¶ 79); it was advised by Claimant's regular visits to, discussion with, and written communications with federal and regional tax officials, including Angel Suarez, Angel Ramirez, Jose Ramos Riquer and Juan Carlos Espinoza. (Facts ¶¶ 79-80, 89-91). And it was advised again in January, 1997 when Claimant wrote to Mario de la Vega, personal secretary to Hacienda's, Secretary Guillermo Ortiz and to Undersecretary Tomas Ruiz to confirm CEMSA's continuing ability to obtain rebates on cigarette exports under the IEPS law in force in 1997, which resulted in verbal assurances and the written confirmation from General Administrator Miguel Gomez Bravo to Claimant of CEMSA's right to continue receiving IEPS rebates on cigarette exports under the 1997 law (Facts ¶¶ 94-97).

175. Hacienda's awareness of CEMSA's export activities, and the fact of its agreement to make rebates without requiring invoices stating the IEPS tax separately is further demonstrated by Claimant's discussions with, and letters to, Hacienda officials in October 1996 to overcome objections by the Regional Tax Office. Facts ¶ 80; and see App. 0090-94. Hacienda officials knew CEMSA well, knew of the agreement concerning IEPS rebates, acknowledged and confirmed the agreement in instructing the Regional Administrator in October 1996 about the

payment of rebates to CEMSA, and knowingly paid such rebates until the policy was changed in November 1997. Any assertion by Respondent that Hacienda unwittingly paid rebates to CEMSA assuming that it was in compliance with all formalities of the IEPS law is simply untrue. In this case, as in *Metalclad*, there was a complete absence of a "timely, orderly or substantive basis for the denial."

176. Another arbitral decision in point is *Biloune, et al. v. Ghana Investments Centre, et al.*,[71] cited by the *Metalclad* tribunal as "persuasive authority."[72] The *Biloune* case involves the claimant's reliance on government representations, the impossibility for the investor through no fault of its own to perform certain technical requirements demanded by the government (obtaining a construction permit), and the government's waiver of any possible defense of misrepresentation by the investor by the government's approval and acceptance of the arrangement. Like *Metalclad*, the case relates to a construction project which the host government stopped after substantial completion because of the lack of a building permit. The investor was a Syrian national and long time resident of Ghana. His company began rehabilitation of a hotel resort complex under a framework established by the Ghana Investments Centre, a government entity charged with the encouragement of foreign investments in Ghana. The investor formed a joint venture with another government entity to undertake this project. His company began work without a permit in reliance on the representation of its joint venturer that a permit was not necessary to start work, that it was a mere formality that would eventually be discharged. Although the investor applied, a permit was never issued, and a stop work order

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[71] 95 I.L.R. 183 (1993).

[72] *Metalclad*, ¶ 108.

was issued, giving a deadline to explain the lack of a permit or face demolition. One day before the deadline, the government ordered and carried out the complete demolition of the new construction.

177. The tribunal held the investor was entitled to rely on "indications" that a permit was not necessary by the joint venturer, which was the long-term leaseholder of the premises and "an experienced government-affiliated entity." The fact that the original structure had been built without a permit indicated "a permit was not indispensable."

> The Tribunal has regard especially to that fact that it appeared from the testimony . . . that inability of the [local authority] to act upon the application [for the permit] resulted from the absence of any prior permit authorizing the building of the original structure. While the letter of the law, as pleaded by Respondents supports the contention that extension works of the character contemplated could not go forward without a permit – or, if they did, would be subject to fine or demolition – nevertheless, the practice with regard to this site indicates an exception to this rule.[73]

178. In the instant case, Respondent may also assert that the "letter of the law" requires CEMSA to obtain invoices from its vendors with the IEPS tax stated separately and expressly. Nevertheless, Respondent's practice in CEMSA's case, in 1992, 1996 and 1997, indicates an exception to this rule. As in *Biloune*, the "letter of the law" was an impossibility with which CEMSA could not comply through no fault of its own. For long periods, Respondent did not require compliance from CEMSA. Respondent's reversal of this practice in November 1997, based on its discriminatory enforcement of that law, had the same affect on CEMSA that the government-authorized demolition of the construction had on the *Biloune* investment – an indirect expropriation.

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[73] *Biloune*, at 208.

Estoppel

179. Under established principles of international law, Respondent is estopped from asserting that Claimant was not entitled to IEPS rebates for the period 1996-1997. General principles of international law have long included the concept of equity or equitable principles.[74] The International Court of Justice ("I.C.J.") has frequently noted that equity constitutes an integral part of international law. In an early case, Judge Hudson declared: "What are widely known as principles of equity have long been considered to constitute a part of international law, and as such they have often been applied by international tribunals."[75] Similarly, the Iran-U.S. Claims tribunal has relied upon equity under law to decide various issues. "Our search is for justice and equity, even in cases where arguably relevant national laws might be designed to further other and doubtless quite legitimate goals."[76]

180. Moreover, the equitable doctrine of estoppel is itself accepted as a general principle of international law. Judge Pirzada at the I.C.J recently noted: "A considerable weight of authority supports the view that estoppel is a general principle of international law, resting on principles of

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[74] N.W. Janis, *Equity in International Law, in* 7 Encyclopedia of Public International Law 74-75 (1984) (noting the acceptance of equity as part of international law by Grotius in 1625 and continuing through the 19th and 20th centuries); Prosper Weil, *L'équité dans la Jurisprudence de la Cour International de Justice, in* Fifty Years of the International Court of Justice 121, 122-126 (Vaughan Lowe & Malgosia Fitzmaurice eds. 1996); D.P. O'Connell, International Law 14 (1970).

[75] *Diversion of Water from the Meuse (Netherlands-Belgium)*, 1937 P.C.I.J. (ser. A/B) No. 70, at 76 (June 28) (concurring opinion of Hudson) (where the Netherlands complained that a lock built by Belgium contravened a treaty, previous Dutch conduct estopped claim). *See also Gulf of Maine (Canada-United States)*, 1984 I.C.J. 246, 288-90 (Oct. 12) ("[E]quitable criteria . . . may be used to ensure *in concreto* that a particular situation is dealt with in accordance with the principles and rules" of international law); *North Sea Continental Shelf (Germany-Denmark; Germany-Netherlands)*, 1969 I.C.J. Reports 3, 48 (Feb. 20) (Equity lies not outside the rule of law, but within it, guiding the reasoning of judges to be just and fair, and therefore equitable); and Weil, *supra*, at 122 (citing numerous other I.C.J. cases that relied upon a concept of equity).

[76] *CMI International, Inc. v. Iran*, Case No. 40, Dec. 27, 1983, 4 Iran-U.S. Cl.Trib.Rep. 263, 268.

good faith and consistency."[77] Brownlie explains further that, in international law, "the essence of estoppel is the element of conduct which causes the other party, in reliance on such conduct, detrimentally to change its position or to suffer some prejudice."[78] The doctrine of preclusion appears under various equitable theories or nomenclatures in international tribunals. The Iran-U.S. Claims Tribunal concluded in this regard that there is "no doubt that the doctrine of preclusion, whether based upon concepts of acquiescence, estoppel, or waiver, is available as a general principle of law which the Tribunal is authorized to consider."[79]

181. The concept has long been recognized in international tribunals and under differing legal systems. In a thorough examination of the principle in the international sphere, Bowett introduced his discussion, almost a half-century ago, as follows:

> The rule of estoppel, whether treated as a rule of evidence or as a rule of substantive law, operates so as to preclude a party from denying before a tribunal the truth of a statement of fact made previously by that party to another whereby that other has acted to his detriment or the party making the statement has secured some benefit. The basis of the rule is the general principle of good faith and as such finds a place in many systems of law. . . .[80]

He continues:

> The rationale of estoppel is expressed in the maxim *allegans contraria non audiendus est*; its essential aim is to preclude a party from benefitting by his own

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[77] *Pakistan v. India* (Judgment) (dissenting op.) I.C.J., June 21, 2000, citing Judges Alfaro and Fitzmaurice in the *Case concerning the Temple of Preah Vihear*, I.C.J. Reports 1962; 39-51, 61-65 and Prof. Ian Brownlie, Principles of Public International Law, 646

[78] Ian Brownlie, Principles of Public International Law 646 (5th ed. 1998).

[79] *Phillips Petroleum Co. Iran v. Iran*, Case No. 39, June 29, 1989, 21 Iran-U.S. Cl.Trib.Rep. 79, 154-55.

[80] D. W. Bowett, Estoppel Before International Tribunals and its Relation to Acquiescence, 33 Brit. Y.B. Int'l. L. 176 (1957) (hereinafter "Bowett").

> inconsistency to the detriment of another party who has relied in good faith upon a representation of fact made by the former party.[81]

182. Moreover, representations may be made expressly or by conduct where a reasonable construction of a party's conduct presupposes a certain state of fact to exist and where the representation reasonably supports the meaning given it by the other party.[82] Tribunals will look to the words used, the circumstances in which they were used, and the subsequent developments.[83] In the *Shufeldt Claim*, the arbitrator found the following contention of the United States to be "sound . . . and in keeping with the principles of international law":

> The principle that an international tribunal will not regard as a nullity a contract concluded by a government when that government, by its acts performed in pursuance of that contract, has clearly recognized the contract as valid, is similar to the doctrine of estoppel in municipal law . . . . the U. S. contends that where, as in this case, a government enters a contract, repeatedly assures the other party . . . of the validity of that contract and accepts from the other party . . . benefits growing out of the contract, an international tribunal is constrained to hold that such a contract is a valid and binding one.[84]

183. A NAFTA tribunal has also recognized the concept. The *Pope & Talbot* tribunal explained:

> In international law it has been stated that the elements of estoppel are (1) a statement of fact which is clear and unambiguous; (2) this statement must be voluntary, unconditional, and authorised; and (3) there must be reliance in good faith upon the statement either to the detriment of the party so relying on the statement or to the advantage of the party making the statement. That statement is cited without disapproval by Professor Brownlie in Public International law 5th Ed. 646. At the same place, Brownlie suggests that the essence of estoppel is the

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[81] *Id.* at 177.

[82] *Id.*, 183-84.

[83] *See, e.g., Eastern Greenland Case*, P.C.I.J. (1933), Series A/B, No. 53, 22, 69 (finding no estoppel on facts of case, although finding a commitment to future conduct) *quoted in* Bowett at 185.

[84] *Shufeldt Claim* (U.S. v. Guatemala), R.I.A.A. 1083 (July 24, 1930).

element of conduct which causes the other party in reliance on such conduct detrimentally to change its position or to suffer some prejudice.[85]

184. In *Pope & Talbot*, the tribunal found no representations and, therefore, no reliance.[86] In the present case, however, senior Hacienda officials made express commitments to Claimant that Hacienda would rebate IEPS taxes to CEMSA on cigarette exports and that CEMSA was authorized to calculate the tax itself without having invoices from its vendors with the IEPS tax stated separately and expressly. Some of the most important representations and commitments supporting an estoppel in this case are:

(1) Regional Administrator Jose Riquer Ramos' letter of March 12, 1992, confirming CEMSA's eligibility to receive IEPS rebates on cigarette exports under the IEPS law in force from January 1, 1992 and Undersecretary Ismael Gomez Gordillo's letter of May 10, 1994 confirming that CEMSA was entitled to have the IEPS tax stated for that purpose. Facts ¶¶ 18, 45.

(2) Undersecretary Pedro Noyola's agreement with and assurances to Claimant. Facts ¶¶ 57, 72.

(3) Claimant's agreement with the General Administrator for Tax Collection Angel Ramirez Castillo, the Judicial Administrator for Tax Collection Fernando Heftye, and the Technical Administrator of Tax Collection Angel Suarez Gonzalez in June 1995. Facts ¶¶ 62-68.

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[85] *Pope & Talbot*, (Interim Award) June 26, 2000 ¶ 111 (footnote omitted).

[86] *Id.* ¶ 112.

(4) Hacienda's payment of IEPS rebates to CEMSA on test shipments of cigarettes in early 1996 (Facts ¶¶ 74-75) and its payment of IEPS rebates to CEMSA for sixteen months from June 1996 through October 1997. Facts ¶ 80.

(5) Hacienda's reaffirmation of its agreement with Claimant in October 1996 and its continued payment of IEPS rebates. Facts ¶ 78.

(6) Claimant's agreement with the Director of Major Taxpayers, Jose Riquer Ramos on the method CEMSA should use to calculate the IEPS rebate. Facts ¶ 87.

(7) Claimant's correspondence with senior Hacienda officials in early 1997 culminating in the March 16 letter from Miguel Gomez Bravo. Facts ¶¶ 92-95

185. Claimant and CEMSA relied on these representations and commitments to their detriment when CEMSA purchased cigarettes including an 85% IEPS tax. Hacienda paid CEMSA the IEPS rebates on the basis of CEMSA's calculations for a period of sixteen months. At all times during this period, authorized officials of Respondent (including Tomas Ruiz, Angel Ramirez, Jose Riquer Ramos, Angel Suarez, and Juan Carlos Espinoza) were aware of CEMSA's practice and made no objection. Facts ¶¶ 79, 90-92. Also, because of Hacienda's performance of its agreement with CEMSA, Claimant advised the Supreme Court that he was in agreement that Hacienda had performed what it was required to do under the 1993 Decision. Facts ¶ 81. Therefore, Respondent is estopped under equitable principles of international law from (1) denying CEMSA's application for rebates of IEPS taxes on cigarette exports it made in October-November 1997, and (2) claiming repayment of rebates Hacienda made to CEMSA on its cigarette exports in 1996-1997.

186. The *Metalclad* tribunal did not decide on the basis of estoppel but, in its discussion of the NAFTA objective of transparency, it applied similar principles by which it effectively barred the government from denying its representations (express and by silence) on which the claimant had relied in going forward with the construction of its waste treatment plant.[87]

187. In addition to the substantive preclusion discussed above, Respondent's agreement with Claimant in regard to these rebates tolled the running of the NAFTA limitations period under Article 1117 (2). As noted in Claimant's Memorial on Preliminary Issues and Claimant's Additional Observations on Preliminary Issues (both incorporated herein), a finding of equitable estoppel or "tolling" is appropriate in a case such as this one where a lawsuit was discouraged by the actions of a defendant.[88] Although the clearest example is where a defendant has expressly agreed not to raise a defense based upon a statute of limitations, other representations, promises, or actions will suffice to estop a party from invoking a statute of limitations.[89]

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[87] *Metalclad*, ¶¶ 85, 87-89.

[88] Claimant's Memorial ¶¶ 56-59; Claimant's Additional Observations ¶ 45.

[89] *See Holmberg v. Armbrecht*, 327 U.S. 392 (1946); *Kruger v. The Queen*, 31 A.C.W.S. 2d 188 (1985) (Can.) (stating that government cannot promise one thing, thereby inducing alteration of legal position to citizen's detriment, then simply ignore the promise to citizen); *Glus v. Brooklyn Eastern Dist. Terminal*, 359 U.S. 231, 232-33 (1959) (holding that conduct by a defendant which tends to lull a plaintiff into a false sense of security can, under general equitable principles, estop the defendant from raising a limitations defense); *United States v. Reliance Insurance Co.*, 436 F.2d 1366, 1370 (10th Cir. 1971). ("Estoppel . . . arises where one party by his words, acts, and conduct led the other to believe that it would acknowledge and pay the claim, . . . but when, after the time for suit had passed, breaks off negotiations and denies liability and refuses to pay.")

V. Respondent's Withholding and Denial of IEPS Rebates to CEMSA Is In Breach of Article 1110 (1) (a)-(d).

A. The Measures Have No Public Purpose Under Article 1110 (1) (a).

188. Claimant has documented that Respondent's repeated efforts to curtail cigarette exports by CEMSA, dating back to 1990, were instituted at the request, and for the benefit, of Carlos Slim, CIGATAM and Philip Morris. Facts ¶¶ 9, 23, 31, 37, 42, 45-49, 78, 82-83, 113. In fact, Respondent has frequently acknowledged that it withheld and denied IEPS rebates to CEMSA to protect the cigarette producers' power to control the distribution of cigarettes made in Mexico in foreign markets. The Mexican Government took this position in its domestic litigation with CEMSA and LYNX Enriquez ¶ 19; Loperana § III B at 7 and D at 15-16, and before this Tribunal.[90] Undersecretary Gomez Gordillo told Marvin Feldman, notwithstanding the 1993 Supreme Court Decision, that the IEPS law was not intended to benefit resellers such as CEMSA. Gomez Gordillo said more than once that the Supreme Court Decision was wrong. Facts ¶¶ 113-114; App. 1181, 1234-35.

189. The purpose of the 0% IEPS tax rate on cigarette exports was to facilitate exports of Mexican cigarettes to foreign markets.[91] Withholding such rebates from non-producers was intended to have the opposite effect – to constrain their exports. This intended effect, by which Hacienda gave preference to private persons and interests, was completely contrary to the public purpose stated in the IEPS law. Denial of rebates to CEMSA did not raise revenue for the state. It merely terminated exports by CEMSA. The sole beneficiaries of this discrimination were

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[90] *See* Respondent's Additional Observations On The Preliminary Questions, September 25, 2000, ¶¶ 55, 69.

[91] Statement of Purpose of IEPS Law for 1981, D.O., December 30, 1980.

private persons – Mexican cigarette manufacturers and trading companies – and not the Mexican State or public. Expropriations for the sole benefit of a private person fail to satisfy the public purpose requirement of international law and Article 1110 (1) (a).[92] *See* Swan ¶¶ 55-63.

190. In *Letco v. Liberia*,[93] a French-owned company brought an ICSID arbitration against the Government of Liberia for breach of a concession agreement. After entering into an agreement granting Letco the right to lumber 470,000 acres of Liberian forests for twenty years, Liberia, alleging various breaches of the agreement by Letco, reduced the size of the concession by nearly 300,000 acres and then terminated the concession altogether. After ruling that Liberia had breached the agreement by completely ignoring its carefully crafted termination procedures and that Letco's alleged defaults were entirely fabricated, the Tribunal went a step further and asked whether Liberia's actions could be justified as a nationalization under international law. It concluded:

> [E]ven if the Government had sought to justify its action as an act of nationalization, it would have had . . . to show that its action was taken for a *bona fide* public purpose; that it was non-discriminatory; and that it was accompanied by payment (or at least the offer of payment) of appropriate compensation. . . .
>
> None of these conditions is satisfied in the present case. . . . There was no evidence of any stated policy on the part of the Liberian Government to take concessions of this kind into public ownership for the public good. On the contrary, evidence was given to the Tribunal that areas of the concession taken away from LETCO were granted to other foreign-owned companies, according to

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[92] *See, e.g.*, exchange of diplomatic letters concerning King of Greece's expropriation of an Englishman's garden's for inclusion in the palace grounds, XXXIX British and Foreign State Papers, 1849-1850 [2] at 431-32; L. Tribe, American Constitutional Law, 588 (2d ed. 1988), quoting Calder v. Bull, 3 U.S. (3 Dall) 386, 388 (1798) (J. Chase op.) (U.S. constitutional law condemns "any law attempting to 'take property from A. and give it to B.'").

[93] *Liberian Eastern Timber Corporation [Letco] v. Government of the Republic of Liberia*, Award of 31 March 1986, 2 ICSID REPORTS 343 (1986).

> Mr. Alain de Marti, who was LETCO'S general manager in Liberia for the entire period of the concession, these foreign companies were run by people who were 'good friends' of the Liberian authorities. . . . Finally, no offer of compensation has been made to LETCO for the loss of its concession.
>
> Accordingly, it is the opinion of the Tribunal that even if the argument as to nationalization had been raised, it would have failed. [94]

Swan ¶ 57.

191. Professor Swan, quoting Schwartz's concurring opinion in *S.D. Myers*, notes that the phrase "tantamount to an expropriation" requires a tribunal "to take a hard look at the "real purpose and real impact of a measure" not merely the "official explanations offered by government for the technical wrapping in which the measure is cloaked."[95]

> Expropriations tend to deprive the owner and to enrich . . . the public authority . . . or the third party to whom the property is given. There is both unfair deprivation and unjust enrichment when an expropriation is carried out with[out] compensation. By contrast, regulatory action tends to prevent an owner from using property in a way that unjustly enriches the owner.[96]
>
> If "[t]he measure was arbitrary and discriminatory . . that weights in favor of finding that it amounts to an expropriation."[97]

Swan concludes,

> it would not be surprising if, under Schwartz's "hard look," the Tribunal arrived at the conclusion that a principal purpose behind Respondent's successful attempt to drive CEMSA out of the cigarette exporting business was the desire to reserve that business to politically favored interests. . . . As such, the case is a forthright example of Schwartz's "unfair deprivation" and "unjust enrichment" as hallmarks of an "expropriation." It also brings to mind his insistence that a discriminatory effect "weights" in favor of classifying a measure as expropriatory.

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[94] *Id.*, at 366.

[95] [Add Citation] concurring opinion ¶ 217.

[96] Id., concurring opinion ¶ 212.

[97] *Id.*, concurring opinion, ¶ 219.

Swan ¶ 56.

192. Respondent may argue that the protection of CIGATAM's or Philip Morris's investment in Mexico serves a public purpose and that Mexico does not violate international law by favoring cigarette producers over other exporters in the administration of what amounts to an export subsidy. Claimant takes no position, and the Tribunal need not decide, whether such discrimination is permissible under NAFTA or general principles of international law in the abstract or on the facts of some other case. In this case, the Mexican Supreme Court of Justice has determined that this policy violates fundamental principles of equity and non-discrimination embodied in Article 31 (4) of the Mexican Constitution. This ruling is an authoritative statement of Mexican public policy binding on this Tribunal. Loperena § II B. Professor Swan makes the same point:

> It is your Affiant's view that this judgment by the highest judicial authority in Mexico must be treated as an unequivocal statement that Respondent's actions in denying CEMSA rebates and driving it out of the cigarette exporting business served no legitimate "public purpose" within the meaning of Article 1110(1)(a). A measure that violates fundamental principles of public order important enough to be enshrined in a constitution can hardly be said to serve a "public purpose."

Swan ¶¶ 56-58.

B. The Measures Are Discriminatory under Article 1110 (1) (b).

193. Respondent's actions against CEMSA are discriminatory under Article 1102 (National Treatment), because it made IEPS rebates on cigarette exports to Mexican-owned trading companies in like circumstances as CEMSA. (Part VI below incorporated herein by reference.) Whatever Respondent's motives for such discrimination, these payments show that Respondent's denial of rebates to CEMSA was -- and is -- arbitrary and discriminatory under Article 1110 (1)

(b). For the reasons discussed above, Respondent cannot justify its discrimination in favor of cigarette producers or their distributors. The Supreme Court has ruled that such discrimination is barred by the Mexican Constitution.

194. As explained in the Restatement, discriminatory measures aimed at aliens in general, aliens of a particular nationality, *or even particular aliens*, would violate international law.[98] Here, aside from Respondent's preference for Mexican-owned exporters over alien-owned exporters such as CEMSA, Respondent's actions against CEMSA also indicate a clear discrimination against the particular alien investor, *i.e.*, Claimant. Respondent discriminated against Claimant particularly in order to favor the Mexican producers. Whether Respondent occasionally enforced the IEPS law against other resellers who were Mexican-owned in order to favor the producers does not make the discrimination against Claimant permissible. Under Article 1110 (1) (b), Respondent was required to treat Claimant in a non-discriminatory manner. If, in some cases, it did not accord its own nationals such treatment, this cannot excuse the mistreatment of Claimant who is a United States citizen.

195. The targeted discrimination against Claimant is apparent from the fact that Hacienda denied a Mexican-owned reseller registration as an authorized cigarette exporter, not because of any requirement of the IEPS law, but because of the company's supposed affiliation with Claimant. The internal Hacienda report given to the reseller, Mercados Extranjeros, by the Regional Tax Administration Office in Monterrey, states that Mercados' principal had a "long relationship" with Claimant, as reported by the Deputy Director General of Tax Policy. The report notes Claimant's "negative past history with this Administrative Unit, in virtue of the fact

[98] Restatement, § 712, cmt. f.

that as legal representative of the business named CEMSA, he has requested the return of large sums of money, as rebates of the payment of the IEPS, without the right to said return, in virtue of the fact that the business he represents is a marketer and not a producer of manufactured tobaccos and alcoholic beverages." It also notes Claimant's NAFTA action as further evidence of his negative history. App. 0151-52.

196. This memorandum is telling because it reveals the true basis for Hacienda's denial of rebates to CEMSA – that is, the fact that it is not a producer. The denial was not based on the ostensible reason Hacienda asserted to Claimant, *i.e.*, the absence of invoices with the taxes stated separately and expressly. The denial was, in fact, based on Hacienda's illegal preference for the producers by which it sought to protect the *de facto* monopoly enjoyed by these private concerns. This is clear discrimination. Such preference is unconstitutional under Mexican jurisprudence. *See* Loperena § III. E at 22-23 discussing theses of the Supreme Court to the effect that market interventions through taxation to benefit a set of producers are unconstitutional and that exemptions from fiscal laws may create monopolies. .

C. The Measures Violate Due Process and Constitute a Denial of Justice Under Article 1110 (1)(c).

197. Article 1110 (1) (c) prescribes that "No party may directly or indirectly ...take a measure tantamount to nationalization or expropriation of such an investment . . . except . . . in accordance with due process of law and Article 1105 (1)." Article 1105 (1) in turn requires that "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." Paragraph (c) thus incorporates into Article 1110 the principle of denial of justice from

international law. This principle is one aspect of "due process" which is expressly referenced in 1110 (c). Moreover, "Fair and equitable treatment" in Article 1105 (1) is a principle drawn from numerous treaties and agreements, and it is a broader concept than non-discrimination, due process and denial of justice.[99] An expropriation is prohibited by NAFTA Article 1110 (1) (c), if it violates international standards of "fair and equitable treatment."

198. Respondent's measures against CEMSA in 1994-1995 and from December 1, 1997, violate due process, are incompatible with international law standards of fair and equitable treatment, and constitute a denial of justice in breach of Article 1110 (1) (c), because they

(1) fail to comply with decisions of the Mexican Supreme Court of Justice and the terms of the IEPS law in force from January 1, 1992-December 31, 1997 which recognized the right of non-producers to obtain IEPS rebates on cigarette exports,

(2) discriminate against CEMSA in the administration of the IEPS law by imposing formalities impossible for it to meet without the cooperation of the producers and by refusing to make the producers comply with provisions of the IEPS law obligating them to provide the documentation necessary for CEMSA to meet the requirements imposed on it by the tax authorities, and

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[99] *See* Edward A. Laing, *Equal Access/Non-Discrimination and Legitimate Discrimination in International Economic Law*, 14 Wis. Int'l. L.J. 246, 265 and 284-85 (1996) (hereinafter "Laing"). *See id*, generally, for an analysis of the historical development of non-discrimination in international law from early treaties to the present, including NAFTA. *See also* Kenneth J. Vandevelde, United States Investment Treaties: Policy and Practice 76 (1992) (fair and equitable standard is an additional standard that provides a "baseline of protection" even where "other substantive provisions of international and national law provide no protection"); F. A. Mann, *British Treaties for the Promotion and Protection of Investments*, [1981] 52 Brit. Y.B.Int'l L. 241, 243-44 (1982) (explaining, in context of British BITs, that fair and equitable treatment "envisage[s] conduct which goes far beyond the minimum standard and afford[s] protection to a greater extent and according to a much more objective standard than any previously employed words.")

(3) contradict both administrative guidance provided to CEMSA by government officials and Hacienda's 1995 agreement with Claimant promising to rebate IEPS taxes on CEMSA's cigarette exports even though CEMSA could not obtain invoices stating the tax separately and expressly.

199. Respondent's retroactive repudiation of the 1995 agreement, its refusal to rebate to CEMSA large amounts of the IEPS tax CEMSA had advanced in October-November 1997 in reliance on that agreement, and its punitive effort to recover the IEPS rebates paid to CEMSA in 1996-97 pursuant to that agreement in an apparently retroactive application of the 1998 IEPS amendments, are particularly egregious violations of due process and fair and equitable treatment. Such a retroactive reversal of tax policy is arbitrary, harsh and oppressive and constitutes a clear denial of justice and violation of due process.[100]

Denial of Justice

200. The rule that a state is responsible for a denial of justice by any of its organs is long established.

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[100] *See Landgraf v. USI Film Prods.*, 511 U.S. 244, 265 (1994) ("the presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted. For that reason, the 'principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal.' [Footnotes and citation omitted]"). *See also Eastern Enterprises v. Apfel*, 524 U.S. 498, 538 (1998) (imposition of severe, disproportionate and extremely retroactive pension liability held to be a taking under Fifth Amendment; "retroactive legislation . . . presents problems of unfairness that are more serious than those posed by prospective legislation, because it can deprive citizens of legitimate expectations and upset settled transactions. [cite omitted]"); and *see id.*, at 566, (dissent by Stevens, J.) ("Due Process Clause can offer protection against legislation that is unfairly retroactive . . . a law that is fundamentally unfair because of its retroactivity is a law which is basically arbitrary [cites omitted]").

> [i]f no effective administrative or judicial remedy is available to the alien to review the legality under international law of an action causing economic injury, the state may be liable for a denial of justice, as well as for the violation of economic rights.[101]

Denial of justice is not limited to actions by the courts. Failure to comply, for the benefit of an alien, with the decision of a State's highest court is a classic denial of justice.[102] D.P. O'Connell explains,

> When one speaks of 'denial of justice' one ordinarily refers to a lapse on the part of the courts themselves, but the conception is somewhat wider than this and *includes equally the executive obstructions which prevent a case from being properly litigated, and a failure of the executive to execute a judgment.*[103]

Likewise, Alwyn Freeman, in his authoritative work, writes

> [The terminology, 'denial of justice'] is quite appropriate when applied to a refusal or omission on the part of public officials to give effect to civil judgments rendered in an alien's favor.
>
> The principle of responsibility of delinquencies of this character has become so well-established as no longer to brook any doubt. The fact that the omission now in question can properly be considered as chargeable to the administrative branch of government provides no ground for objecting that it falls outside the category of wrongs accurately classified as denials of justice to aliens. ..."[104]

201. Thus, the British - Mexican Claims Commission held that administrative authorities can be guilty of a denial of justice and, in the course of its opinion, described acts by non-judicial

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[101] Restatement § 712, Comment j. *See also, Eliza Case*, Moore, History and Digest of the International Arbitrations to which the United States Has Been a Party (GPO 1989) 1630.

[102] 5 Hackworth §522, at 526.

[103] D.P. O'Connell, International Law, ii (1965) 1025-26, emphasis added.

[104] Alwyn Freeman, The International Responsibility of States for Denial of Justice (Longmans, Green & Co. 1938) (hereinafter "Freeman").

authorities that can become a denial of justice and cited a fact pattern that is close to the instant case:

> If an alien, having won a lawsuit and being desirous of seeing the judgment executed, addresses himself to those non-judicial authorities upon whom, in most countries, execution of the judgments of civil courts is incumbent, and they either *refuse to assist him*, or postpone their action indefinitely, the alien in question is certainly entitled to complain of denial or undue delay of justice, although responsibility cannot be laid at the door of the tribunal that sustained his action.[105]

Hyde agrees:

> A denial of justice, in a broad sense, occurs whenever a State, through any department or agency, fails to observe, with respect to an alien, any duty imposed by international law or by treaty with his country. Such delinquency may, for example, be manifest in arbitrary or capricious action on the part of the courts, or *in legislative enactments destroying the exercise of a privilege conferred by treaty*, or *in the action of the executive department in ordering the seizure of property without due process of law*.[106]

202. The European Court of Human Rights has applied the same fundamental principles in cases arising under Article 6 of the European Convention on Human Rights.[107] In *Hornsby v.*

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[105] *Interoceanic Railway of Mexico (Limited) et al.* (Great Britain v. Mexico), British-Mexican Claims Commission, *Further Decisions and Opinions of the Commissioners* (1933) 118, 127, quoted in 5 Hackworth 529; *see also H. G. Venable* (United States v. Mexico), Opinions of the Commissioners, RIAA IV 219, 246-47 (1927) ("It appears to be a well established principle of international law that a denial of justice may be predicated on the *failure of the authorities of a government to give effect to the decisions of its courts*." [Cites omitted, emphasis added]). *See also Jane Joynt Davies and Thomas W. Davies* (United States v. Mexico), Opinion of the Commissioners (1931) 146, 149 (holding that the failure of Mexico to enforce a court decree ordering the insane murderer of an American citizen to be confined in an asylum was not a denial of justice, *unlike* those cases where "*the authorities of a country refuse to comply with their own legal provisions as interpreted by the courts*," emphasis added); and *Francisco Mallen* (Mexico v. United States) Opinions of the Commissioners (1927) 254, 261 (holding that United States was liable for denial of justice on the ground of nonexecution of a penalty imposed upon the American police officer for his attack on Mallen)

[106] Hyde, *International Law Chiefly as Interpreted and Applied by the United States*, 1922, vol. 1, 491 (emphasis added).

[107] See Council of Europe, Convention for the Protection of Human Rights and Fundamental Freedoms, dated 4 November, 1950 (the European Human Rights Convention) Article 6(1) of which provides as follows:

> "1. In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly but the press and

Greece,[108] two British citizens resident in Greece appealed to the Court of Justice of the European Communities after being told that only Greek citizens could operate an English language school. That Court ruled that the Greek law in question violated the Treaty of Rome. When the applicants again applied to the Greek educational authorities and were turned down, they brought an action in the Supreme Administrative Court of Greece. After the latter court ruled that the administration had acted unlawfully, the applicants again applied for an authorization. This time they received no direct response from the Greek authorities. Some time later a Presidential decree was issued with conditions which effectively foreclosed their obtaining the desired authorization. The Hornsbys then applied to the European Court of Human Rights which concluded that, in failing to take the measures necessary to comply with a "final, enforceable judicial decision," the Greek authorities had committed a breach of Article 6 of the Convention. In its opinion the Court noted:

> It would be inconceivable that Article 6 should describe in detail procedural guarantees afforded to litigants – proceedings that are fair, public and expeditious – without protecting the implementation of judicial decisions; to construe Article 6 as being concerned exclusively with access to a court and the conduct of proceedings. . . . would be incompatible with the principle of the rule of law. . . . Execution of a judgment given by any court must therefore be regarded as an integral part of the 'trial' for the purposes of Article 6 . . .

As Professor Swan observes, "one could scarcely find a clearer statement of the principle that a State's administrative officers – its executive– are as much a part of and responsible for the

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> public may be excluded from all or part of the trial in the interest of morals, public order or national security in a democratic society, where the interest of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.

[108] [1997] 24 Eur. H. R. Rep 250, 19 March 1997.

administration of justice as the judiciary and that acts of the executive can give rise to a 'denial of justice' as surely as any default of the judiciary." Swan ¶ 67.

203. The principle of denial of justice has also been explicated in numerous proceedings in which Mexico was a party before the United States Mexican General Claims Commission. In the *Neer* case, the Commission considered whether the Mexican government's alleged failure to investigate diligently the murder of a U.S. citizen constituted a denial of justice. The Commission recognized that there was not a precise formula for determining whether such a denial had taken place, but held:

> (first) that the propriety of governmental acts should be put to the test of international standards, and (second) that the treatment of an alien, in order to constitute an international delinquency, should amount to outrage, *to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action* so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether the insufficiency proceeds from *deficient execution of an intelligent law*, or from the fact that the *laws of the country do no empower the authorities to measure up* to international standards is immaterial.[109]

Commissioner Nielson stated in a separate opinion:

> Although there is this clear recognition in international law of the scope of sovereign rights relating to matters that are the subject of domestic regulation, it is also clear that the domestic law and the measures employed to execute it must conform the requirements of the supreme law of members of the family of nations which is international law, and that any failure to meet those requirements is a failure to perform a legal duty, and as such, an international delinquency.[110]

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[109] *L. F. H. Neer and Pauline E. Neer* (United States v. Mexico), Opinions of the Commissioners (1927), 71, 73, reprinted in [1927] A.J.I.L. 555, 556 (emphasis added).

[110] *Neer* at 559.

204. The *Robert E. Brown* case, brought before the Anglo-American Tribunal, is also instructive here.[111] In *Brown*, the tribunal considered the nature of the claimant's rights in certain South African mines. While the tribunal found that the claimant held no title to real property or any specific mining claims, and that, at most, he was entitled to a license under which he might have located and become an owner of particular mining claims, still he was a victim of "a definite denial of justice" due to the "*cumulative strength of the numerous steps taken by the Government of the South African Republic to defeat [his] claims.*"

> We cannot overlook the broad facts in the history of this controversy. *All three branches of the Government conspired to ruin his enterprise.* The Executive department issued proclamations for which no warrant could be found in the Constitution and laws of the country. The Volksraad enacted legislation which, on its face, does violence to fundamental principles of justice recognized in every enlightened community. The judiciary, at first recalcitrant, was at length reduced to submission and brought into line with a determined policy of the Executive to reach the desired result regardless of Constitutional guarantees and inhibitions ...
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> * * *
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> [W]e hold that through compliance with the law and regulations in force . . . [claimant] acquired rights of a substantial character, the improper deprivation of which did constitute a denial of justice.[112]

205. So in this case, CEMSA's right to obtain IEPS rebates on cigarette exports was recognized by the Mexican Supreme Court. The Mexican legislature amended the IEPS law in 1992 to eliminate the provisions that discriminated against non-producer exporters, but the executive branch acting through Hacienda perpetuated the unconstitutional preference for producers proscribed by the Supreme Court. In 1994-1995, this discrimination was

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[111] O'Connell at 1026, citing *Robert E. Brown Case*, U.N. Rep. Vol. VI, 120 (1923).

[112] *Robert E. Brown* (United States v. Great Britain), Nielson's Report (1926) 162, 198-199, quoted in 5 Hackworth at 530-531.

accomplished by imposing impossible formalities on CEMSA while refusing to require cigarette producers to comply with the counterpart requirements of the IEPS law. By letter dated May 10, 1994, Undersecretary Gomez Gordillo confirmed that CEMSA was entitled to have the IEPS tax separated on its invoices for cigarettes as well as alcoholic beverages (App. 0087-89), but CEMSA's vendors, such as SAM's Club, could not – and dared not– separate the tax for CEMSA, because the producers would not separate the tax on their invoices to SAM's. Facts ¶¶ 23, 82.

206. Claimant made vigorous efforts to persuade CIGATAM to separate the tax and repeatedly petitioned the government to require CIGATAM to do so. Facts ¶¶ 48, 49. But Hacienda refused. As then Attorney General and former Undersecretary Gomez Gordillo explained to Claimant on several occasions, the Mexican government continues to believe, notwithstanding the 1993 Supreme Court decision, that the IEPS law is supposed to benefit only the producers and their distributors, not independent resellers such as CEMSA. At one of his meetings with Claimant following the 1997 shut down of CEMSA's cigarette export business, the parties discussed the different treatment of CIGATAM under the IEPS law, Mr. Gomez Gordillo stated:

> That is what I told you that day, I believe the Court made a mistake; I, as a lawyer, do not agree, but I no longer have a way out, as a Lawyer. Whether I like it or not, whether I agree or not, I obey. That is what we agreed upon, right? And I told you, so long as we can take advantage of loopholes, let us all take advantage, and as we believe, and continue to believe, with all due respect, that *the tax is not designed for your benefit, or for the benefit of those in your position*; this is nothing personal.

App. 1235 (emphasis added.) This refusal to apply the Mexican Constitution as interpreted by the Supreme Court and the IEPS law as amended by Congress was a denial of justice in 1994-95 and is a denial of justice today.

207. In the *Azinian* case,[113] a NAFTA tribunal addressed the principle of denial of justice, even though the claimant did not plead a violation. In *Azinian*, the claimants objected to an administrative denial of the validity of the claimant's concession contract with a municipality and brought an Article 1110 NAFTA claim even though three levels of Mexican courts had upheld the administrative act. They did not make any argument about the judicial decisions or contend that the decisions themselves were violations of international law. The tribunal felt constrained to show there was no denial of justice in that case so that the decision could not be attributed to defective pleading.[114] The tribunal explained the principle: to hold a state liable internationally for its judicial decisions, a claimant must show either a "denial of justice or a pretence of form to achieve an internationally unlawful end."[115] A denial of justice includes "the clear and malicious misapplication of the law. This type of wrong doubtless overlaps with the notion of 'pretence of form' to mask a violation of international law."[116]

208. Here, Claimant does contend, as the *Azinian* claimants did not, that there has been a "clear and malicious misapplication of the law" by the administrative authorities, notwithstanding

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[113] *Robert Azinian, et al. v. United Mexican States*, (NAFTA/ICSID) ARB(AF)/97/2 (award) November 1, 1999, ¶ 103 (no denial of justice argument pleaded in this case where claimant challenged administrative decision declaring concession contract invalid and this decision had been upheld by three levels of Mexican courts, and did not question administration of justice by the judiciary.)

[114] *Id.* ¶ 101.

[115] *Id.*, ¶ 99.

[116] *Id.*, ¶ 103.

the correct enunciation of the law by the Mexican Supreme Court, and that this misapplication is a denial of justice. Moreover, Claimant contends that Hacienda's selective enforcement of the technicalities of the IEPS statute against CEMSA is a 'pretence of form' to mask its discrimination against CEMSA in violation of international law.

209. Further, Respondent committed another, serious denial of justice in 1997 by repudiating Hacienda's agreement with Claimant to make rebates to CEMSA even though CEMSA could not obtain vendor invoices stating the IEPS tax separately and expressly. This change in Hacienda's policy, which occurred in November 1997, was not due to a routine audit of CEMSA as has been alleged. Hacienda did not open an audit of CEMSA until July 1998, after Claimant had delivered his Notice of Intent to Submit a Claim to Arbitration under NAFTA Article 1119. While Respondent has not provided any of the documents Claimant requested, pursuant to the Tribunal's Orders 2 and 5, concerning the reasons for its sudden reversal of policy,[117] the history of this dispute and Claimant's evidence establish beyond doubt that Respondent acted to reestablish the producers' monopoly on cigarette exports. Gomez Gordillo acknowledged and defended this policy in his meetings with Claimant. See App. 1235, quoted above at Paragraph 206.

210. Hacienda's decisions to deny CEMSA's rebate applications for shipments made in October-November 1997, to withhold rebates on future cigarette exports by CEMSA, to impose a US $ 25 million tax assessment on CEMSA to recover rebates paid to it in 1996-1997, and to cancel CEMSA's registration as a qualified exporter of cigarettes and alcoholic beverages, all violate Mexican law and Hacienda's commitments to CEMSA. CEMSA relied on Hacienda's

[117] See Claimant's Request for Production of Documents.

representations and promises to its detriment. It would, therefore, be a gross injustice if Respondent were permitted to withhold the rebates owed CEMSA, let alone recover rebates it paid to CEMSA in 1996-97. The inequity of these actions is clear.

211. As in the *Neer* case, the acts of Respondent here constitute bad faith, a "wilful neglect of duty", and "an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency." Each of these acts is a denial of justice on it own. Taken together, these acts acquired the "cumulative strength of the numerous steps taken by the Government" in *Brown* to deprive Claimant of substantial rights.

The Amparo Law

212. Respondent may argue that the 1993 Supreme Court Decision is not binding on the Mexican Executive on a theory that an *amparo* applies only to the precise language of a particular statute and becomes inoperative if there is any change whatever in the statute concerned in subsequent years, even if such change is purely formal and not material to the point at issue. As demonstrated in the expert opinion of Carlos Loperena, this is not a correct view of Mexican law. While the Mexican court cases conflict on this point, the better view is that an *amparo* remains binding on the parties to the particular case unless there is a material change in the statutory provision which is the subject of the *amparo*. Loperena § III B at 8-10; *see* also Declaration of Chief Justice Carlos del Rio Rodriquez ("del Rio"), Exhibits, Tab 7, ¶ 33 citing Ignacio Burgoa. In this case, the changes in the IEPS law were favorable to Claimant, affirming the right of all cigarette exporters to obtain IEPS rebates.

213. Notwithstanding the fine points of amparo law, Mexican attorneys and courts commonly cite Supreme Court decisions as precedents, especially where, as here, the only Supreme Court

decisions agree. Loperena § III B at 12. Moreover, as Loperena testifies, the unanimous Supreme Court decisions in the *CEMSA* and *LYNX* cases were based on, and required by, long established Supreme Court jurisprudence. Loperena § III A. Such jurisprudence is binding on the Executive even if a particular *amparo* decision technically is not. Loperena § III B at 12. In any event, as Professor Swan states, from the standpoint of international law, the normative indictment of Respondent's discrimination in the 1993 Supreme Court Decision "persists irrespective of any technical point of Mexican law concerning the continuing effect of a particular amparo judgment."

> From a normative point of view the unconstitutional discrimination condemned by the Mexican Court occurred each and every time Respondent, through-out the period of this dispute, denied rebates to CEMSA. It occurred with each refusal to rebate taxes paid on exports actually made. It occurred with each refusal to give Claimant an assurance that rebates would be forthcoming on future exports. It is a discrimination that still persists. And the normative indictment of that discrimination contained in the Supreme Court judgment also persists irrespective of any technical point of Mexican law concerning the continuing effect of a particular amparo judgment. For the Tribunal, the question is the effect to be given the Mexican Court's judgment at the international level under NAFTA Article 1110 (1) (a), not its technical effect under Mexican law. At the international level the decision must be honored as a definitive normative statement until such time as it is retracted or modified by another equally authoritative Mexican judicial pronouncement.[118]

Swan ¶ 57.

Claimant Has No Effective Judicial Remedy in Mexico

214. Respondent's failure to respect the 1993 Supreme Court Decision and its excuse based on the *amparo* law raise even more fundamental questions whether the Mexican legal system

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[118] That such retraction or modification must emanate from judicial authority is inherent in the larger purposes of NAFTA including that of promoting the rule of law in the regulation of foreign investment; an object manifest in the unique arrangements established by Part B of Chapter 11

affords a foreign investor an effective legal remedy against malfeasance by administrative officials in a government influenced by nepotism, favoritism and outright corruption. del Rio ¶¶ 20, 29, 42-46. Claimant's experience shows that it does not. Under the existing legal system, it is impossible for an exporter to vindicate in the Mexican courts its right guaranteed by law to obtain IEPS rebates on future cigarette exports. A businessman cannot afford to invest money in cigarettes for export without advance assurance that he will receive IEPS rebates on those exports. If such assurances are not forthcoming, his only remedy is to make test shipments of small quantities of cigarettes, to apply for IEPS rebates and to challenge the government's denial in court.

215. Two or three years later, the investor may win a final judgment from the Supreme Court. Meanwhile, Hacienda, in consultation with CIGATAM, will have taken steps to have the legislature amend the IEPS law annually. If Hacienda then takes position – as it does – that the *amparo* does not apply to the amended statute -- whatever its terms -- the investor has gained nothing but rebates on the test shipments. He can never engage in the business of exporting cigarettes no matter what the law may be. That is why Claimant sought a negotiated settlement of his dispute in 1995 and why he seeks relief from this Tribunal.

216. In the Salinas Administration, Respondent never accepted a legal obligation to allow rebates to CEMSA under the 1993 Supreme Court Decision. First, the government maintained that nothing was required of it to implement that Decision. Facts ¶¶ 30, 32. Later, it took the position that the 1993 *amparo* was made obsolete by changes in the 1992 IEPS law which cannot conceivably be viewed as impairing CEMSA's right to export. Respondent may take the same position before this Tribunal even though Undersecretary Gomez Gordillo told Claimant at

their meetings in December 1997 or January 1998 that the *amparo* protected CEMSA until 1997. Facts ¶ 112. The IEPS law has been amended in various details almost every year since its inception. Loperena § III F; del Rio ¶¶ 21, 39-40. If, in consequence of such routine amendments, an exporter has to bring a new lawsuit every year, he can never win the right to export. Thus, Respondent's interpretation of the *amparo* law is, itself, a denial of justice. It obstructs access to the courts by imposing a tremendous economic and practical burden on Claimant to litigate every year's law in order to obtain a pyrrhic victory.[119] In these circumstances, Claimant has no effective administrative or judicial remedy in Mexico .

217. Carlos del Rio Rodriquez has had a distinguished career, including service in Hacienda, as President of the Mexican Tax Court, and as a member and Chief Justice of the Supreme Court of Justice. Justice del Rio reviews in his Declaration some of the serious problems and abuses in the Mexican legal system that have directly affected Claimant's dispute with Hacienda and which contribute to the denial of justice in this case:

a. Thousands of court cases are filed every year complaining that Executive authorities have failed to comply with judicial amparo orders. Almost half of the cases before the Supreme Court fall in this category. del Rio ¶ 5. The Chief Justice acknowledges that a great number of these cases are due to officials' "personal reasons, corruption, or simple whim . . . ." del Rio ¶ 20.

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[119] *See* Restatement § 711, cmt. a (denial of access to courts and inadequacy of remedy may be denial of justice, and § 712, cmt. j ("Economic injury to foreign nationals is often intertwined with a denial of domestic remedies. If no effective administrative or judicial remedy is available to the alien to review the legality under international law of an action causing economic injury, the state may be liable for a denial of justice, as well as for the violation of economic rights. See § 711, Comment a.")

b. There is a debate in Mexico whether the Executive can disregard an amparo when the law held unconstitutional has been amended in non-substantive respects. Historically, the Executive routinely proposes amendments of the laws "with the objective of eluding compliance with a sentence of the Federal Judicial Power. del Rio ¶ 21. That strategy works to the disadvantage of taxpayers. del Rio ¶¶ 39-40. The taxpayer can only bring a new action to challenge the new law. del Rio ¶¶ 30-33. (This cycle can be repeated without end.)

c. The problems of non-compliance with judicial orders is most acute in the tax field. In one case, " the Minister of Public Finance and Public Credit himself and some other important officers of the Executive Power personally spoke to members of the Supreme Court and obtained resolutions declaring constitutional thousands of cases that were pending when the amendments came into force." del Rio ¶ 22.

d. The tax authorities frequently use tax audits to intimidate parties entitled to tax rebates by law or judicial sentence. Taxpayers often prefer to forfeit money to which they are entitled than to face "real inquisitorial harassment during many months and even years." del Rio ¶ 23.

e. Hacienda has broad powers of discretion under the law and abuses that discretion. del Rio ¶ 46.

218. Justice del Rio observes that the situation has improved somewhat in recent years but concludes that investors do not have an adequate legal framework to make long-term business projects. He observes

> " Unfortunately, the corruption, the so-called godfatherism and the favoritism have never been totally eradicated as well as many other vices that seriously obstruct or even preclude investments to remain competitive."

del Rio ¶ 42.

219. As shown above, Claimant has suffered directly from all these abuses, and has no effective remedy in the Mexican courts.

D. Respondent Did Not Compensate Claimant or CEMSA for the Indirect Expropriation of CEMSA's Cigarette Export Business.

220. NAFTA Article 1110 (1) (d) requires payment of full compensation of the fair market value of the property taken in accordance with Article 1110 (2) through (6). It is uncontroverted that no compensation has been paid in this case. Judge Brower of the Iran-United States Claims Tribunal has opined:

> By definition, it is difficult to envision a de facto or "creeping" expropriation ever being lawful, for the absence of a declared intention to expropriate almost certainly implies that no contemporaneous provision for compensation has been made. Indeed, research reveals no international precedent finding such an expropriation to have been lawful.[120]

In this case, Respondent's expropriation of CEMSA's cigarette export business is illegal under international law and Claimant is entitled to restitution damages under NAFTA Article 1135 (1) (b). As discussed in Part VII, Damages, below, Respondent is required to make Claimant whole by paying compensation for CEMSA's lost profits for 1994-1995, paying the rebates owed for October-December 1997 with interest and statutory adjustments for inflation, and by providing full compensation for the fair market value of the cigarette export business as of December 1, 1997.

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[120] *Sedco v. National Iranian Oil Co.* (Interlocutory Award), March 27, 1986, separate opinion of J. Brower, n.37, reprinted in 25 I.L.M. 629, 639.

VI. Respondent Discriminated Against CEMSA in Breach of NAFTA Article 1102 (2) By Making IEPS Rebates To Cigarette Exporters Owned By Mexican Nationals.

221. Article 1102, National Treatment, requires NAFTA Parties to accord investors and investments of the other Parties treatment no less favorable than the treatment accorded, in like circumstances, to their own investors and to the investments of their own investors. Respondent violated this provision by making rebates to Claimant's Mexican competitors under the IEPS laws in force after January 1, 1998. Article 1102 applies to taxation measures and claims under that article may be submitted to arbitration under Article 1117 without review by tax authorities of the States Party.

222. The NAFTA policy requiring national treatment in trade and investment (with limited exceptions) derives from European treaties from the Middle Ages.[121] Laing[122] notes that the early treaties included provisions analogous to modern treaty terms providing for national treatment for citizens of parties in matters relating to doing business in the territory of another party,[123] and that, "through the centuries of treaty and municipal law practice, MFN and national treatment have been the standards of international economic law."[124] Regarding national treatment, he explains:

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[121] Laing at 254.

[122] Edward A. Laing sits as Judge on the International Tribunal for the Law of the Seas, and was formerly Ambassador to the U.N. for the Permanent Mission of Belize.

[123] *Id.*, n. 83.

[124] *Id.* at 269.

> Under the standard of national treatment, which has been described as requiring 'inland parity,' each party promises to treat the citizens of the other party as nationals for purposes of business transactions, in a variety of non-trade areas, and in various domestic relations.[125]

Examples of non-trade areas are the property rights of aliens, including their access to judicial and administrative agencies, and their subjection to taxation.[126]

223. To determine the meaning of "like circumstances" in Article 1102, the tribunal in *S.D. Myers* considered the overall legal context in which the phrase appears.[127]

> The Tribunal considers that the interpretation of the phrase "like circumstances" in Article 1102 must take into account the general principles that emerge from the legal context of the NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns. The assessment of "like circumstances" must also take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest. The concept of "like circumstances" invites an examination of whether a non-national investor complaining of less favorable treatment is in the same "sector" as the national investor. The Tribunal takes the view that the word "sector" has a wide connotation that includes the concepts of "economic sector" and "business sector".[128]

The tribunal continues, applying this analysis to the facts, which are analogous to the facts in the instant case:

> From the business perspective, it is clear that SDMI and Myers Canada [the Investor's Canadian subsidiaries] were in "like circumstances" with Canadian operators . . . . They all were engaged in providing PCP waste remediation services. SDMI was in a position to attract customers that might otherwise have gone to the Canadian operators because it could offer more favorable prices and because it had extensive experience and credibility. It was precisely because SDMI

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[125] *Id.* at 274 (footnotes omitted.)

[126] *Id.*, n. 135.

[127] *S.D. Myers*, ¶ 245.

[128] *Id.*, ¶ 250.

> was in a position to take business away from its Canadian competitors that [two Canadian competitors] lobbied the Minister of the Environment to ban exports when the U.S. authorities opened the border.[129]

224. So, in the instant case, CEMSA is in "like circumstances" with Mexican-owned resellers of cigarettes for export, including Mercados I, Mercados II and MEXCOBASA. (Under the 1993 Supreme Court Decision and *S.D. Myers*, CEMSA was also in "like circumstances" with the authorized distributors of CIGATAM and other producers of Mexican cigarettes who exported.) It was precisely because CEMSA was in a position to take business away from its Mexican competitors, including the producers, that Carlos Slim lobbied Hacienda to reject the 1993 Supreme Court Decision and to ban exports by CEMSA.

225. Respondent discriminated against CEMSA when it permitted at least three resellers of cigarettes to export cigarettes and to receive rebates under the same tax law by which it denied the rebates to CEMSA. Facts ¶¶ 128-135. If, as Respondent contends, CEMSA was not entitled to rebates because it was engaged in grey market sales, *i.e.*, legal exports not authorized by a producer, it should have taken the same position with regard to all other independent resellers. Respondent confirms that five trading companies other than CEMSA applied for IEPS rebates on cigarette exports, and that rebates of 91 million pesos (approximately US $ 10 million) were awarded to three of these companies including payments in 1998, 1999 and 2000.[130]

226. Respondent does not identify these companies or explain its disparate treatment of them. Claimant has identified three trading companies owned by Mexican nationals that he understands

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[129] *Id.*, ¶ 251.

[130] Declaration of Eduardo Enrique Diaz Guzman, General Large Taxpayers' Administrator, undated. App. 0506, 0516 (trans.).

received IEPS rebates on cigarette exports and has presented evidence of such payments to Mercados Regionales, S.A. de C.V. Facts ¶¶ 129-133, App. 0470-505. Moreover, Claimant has good reason to believe that CEMSA was the only trading company exporting cigarettes owned by persons who are not Mexican citizens. Facts ¶ 135.

227. As noted above, discriminatory measures aimed at particular aliens violate the nondiscrimination provisions of Article 1110. Such measures also violate Article 1102 when they involve manifestly unequal treatment of one alien investor as compared to the national competitors. A GATT case cited by Professor Swan illustrates the concept. The *Section 337 Case* was brought to the GATT against the United States by the European Economic Community, which alleged that a U. S. procedure directed against unfair trade practices[131] violated the "national treatment" provisions of GATT Article III:4. The United States defended on the ground that overall (*i.e.*, on the average) foreign exporters were as much advantaged as disadvantaged by being subjected to a "Section 337" unfair competition hearing before an administrative law judge rather than answering to the same charge in a Federal district court. For this reason, the United States contended, treatment under this procedure was no less favorable to foreign exporters than the treatment accorded domestic firms that had to answer only before the federal courts. The GATT Panel rejected this argument, holding that if there was any possibility *that even one foreign exporter* would be disadvantaged by an administrative proceeding compared

[131] United States - Section 337 of the Tariff Act of 1930, GATT Document L/6439, BISD 36th Supp. at 345, para 5.14 (adopted 7 November 1989) (the "*Section 337 Case*").

with a district court proceeding, the procedure was discriminatory and a violation of the "national treatment" requirement of GATT Article III:4.[132]

228. Moreover, Respondent cannot claim that the substantive provisions of the post-1998 IEPS laws were non-discriminatory when its enforcement of those provisions so clearly discriminated in favor of export trading companies owned by Mexican nationals. One recent GATT panel adopted this view in relation to a claim under Article III:2:

> In the Panel's view, enforcement procedures cannot be separated from the substantive provisions they serve to enforce. If the procedural provisions of internal law were not covered by Article III:4 [the national treatment Article of GATT], contracting parties could escape from the national treatment standard by enforcing substantive law, itself meeting the national treatment standard, through procedures less favorable to imported products than to like products of national origin.[133]

So in the instant case, the substantive IEPS law and the procedural enforcement of that law must comply with the national treatment standard of NAFTA Article 1102. Respondent cannot escape its treaty obligations by discriminatory enforcement.

VII. Damages: CEMSA "has incurred loss or damage by reason of, or arising out of" Respondent's breach of NAFTA Chapter 11, Section A.

229. International law has long recognized a state's right to expropriate alien property for legitimate reasons and by fair procedures provided that the expropriation is accompanied by payment of just compensation. For many years prior to NAFTA, however, there was intense

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[132] *See* Swan note 82, discussing the *Section 337 Case*. Professor Swan also notes that Article 301 of NAFTA expressly makes Article III of GATT applicable to trade in goods between NAFTA parties and expressly incorporates the text of GATT Article III into the NAFTA text. The only difference between Article 301 and Article 1102 of NAFTA, is that Article III applies to goods and Article 1102 applies to investments and investors. *Id.*

[133] Argentina - Measures Affecting the Export of Bovine Hides and the Import of Finished Leather, 2000 WTO DS LEXIS 33 (December 19, 2000), n. 188 and n. 194, quoting and adopting as pertinent to Article III:4 the view of the Panel report on United States - Section 337 of the Tariff Act of 1930 (adopted 7 November 1989, BISD 36S/345, at para. 5.10).

debate over the international law standard of compensation for expropriated property. Capital-exporting states, such as the United States, supported payment of "prompt, adequate and effective" compensation equal to the fair market value of the property concerned. Capital-importing states, such as Mexico, supported a less demanding standard or resisted international accountability altogether. National and international tribunals decided the issue differently, but there was broad consensus on one point: in the case of an unlawful expropriation, *e.g.*, one that violated international law principles of non-discrimination, the victim should be made whole by restitution, where possible, and by equivalent damages where restitution was not possible.[134]

230. NAFTA essentially adopts in Article 1110 the "prompt, adequate, and effective" standard of compensation, known as the Hull doctrine,[135] and in Article 1135 authorizes a tribunal to award restitution damages where appropriate. Under Article 1110, "Compensation shall be equivalent to the fair market value of the investment immediately before the expropriation took place ... [and] shall be paid without delay and be fully realizable."[136] Valuation criteria "shall include going concern value, asset value including declared tax value, and other criteria, as appropriate, to determine fair market value."[137] Under Article 1135, a tribunal may award "restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and applicable interest in lieu of restitution."

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[134] Case Concerning the Factory at Chorzów (Merits) 1928 PCIJ, ser. A, No. 17, at 47.

[135] Tali Levy, *Note: NAFTA's Provision for Compensation in the Event of Expropriation: A Reassessment of the "Prompt, Adequate and Effective" Standard*, 31 Stan. J. Int'l L. 423, 441-443 (1995)

[136] Art. 1110 (2) and 4.

[137] Art. 1110 (2)

231. Respondent's discriminatory expropriation of CEMSA's cigarette export business and its discrimination against CEMSA on the basis of nationality were unlawful under established principles of international law. Thus, Claimant is entitled to restitution damages resulting from Respondent's breaches of Articles 1110 and 1102 as provided in Article 1135 (1) (b). Whatever NAFTA provision the Tribunal uses as the basis for its damage calculations, Respondent is required to make Claimant whole by paying compensation for CEMSA's lost profits for 1994-May, 1996, paying the rebates owed for October-December 1997 with interest and statutory adjustments for inflation, and by providing full compensation for the going concern value of the cigarette export business as of December 1, 1997.

A. Expropriation

232. Restitution damages are the standard for compensation when there has been an unlawful expropriation. In what has become a classic opinion, the Permanent Court of International Justice in the *Chorzow Factory* case found that the primary duty in the case of unlawful interference is one of restitution in kind:

> The essential principle contained in the actual notion of an illegal act - a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals - is that reparation must, as far as possible, wipe out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed. Restitution in kind, or, if this is not possible, payment of a sum corresponding to the value which a restitution in kind would bear together with the award, if need be, of damages for loss sustained which would not have been covered by restitution in kind or payment in place of it.[138]

The Court noted that, in the case of a lawful expropriation, the obligation would be to pay "the just price of what was expropriated" and "the value of the enterprise at the moment of

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[138] *Chorzow Factory* at 47.

dispossession, plus interest, to the day of payment."[139] This value is that established by Article 1110 (1) (d), and (2) - (6) – *i.e.*, the compensation to be paid in a lawful taking shall be "equivalent to the fair market value." However, as the *Chorzów Factory* judgment made clear, in the case of unlawful takings, there is an additional obligation, if restitution is not possible, to compensate for the owner's consequential loss.

B. Discrimination

233. CEMSA's damages for Respondent's unlawful discrimination under Article 1102 are identical to those claimed for the unlawful expropriation. The same principles of international law apply. Both expropriation and discrimination are violation of international standards, and the State responsible is required to make the claimant whole.

234. In *S.D. Myers,* a NAFTA tribunal found that Canada's measures constituted unlawful discrimination in breach of Article 1102 . It did not find expropriation, because the temporary suspension of exports merely delayed establishment of a new business, but it made clear its intention to make the claimant whole for the losses suffered as a result of Canada's breach of Article 1102. The hearing was bifurcated and the second stage regarding the amount of damages has not been completed. In its initial award, however, the tribunal addressed the principles of compensation to be applied under general principles of international law. Citing *Chorzow Factory*[140] and the *Draft Articles on State Responsibility,*[141] the tribunal declared that the compensation to be awarded "should reflect the general principle of international law that

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[139] *Id.* at 46-47.

[140] *S.D. Myers,* ¶ 311.

[141] *Id,* ¶ 312.

compensation should undo the material harm inflicted by a breach of an international obligation."[142]

235. CEMSA has suffered loss and damages due to Respondent's measures in breach of both Article 1110 and 1102. These measures constitute both an unlawful expropriation and unlawful discrimination under established principles of international law, and the Tribunal should require Respondent to make Claimant whole.

C. Valuation.

236. The material harm caused to CEMSA by Respondent's breach of Article 1102 is described in detail in the Declaration of Ernesto Cervera Gomez, a partner in Grupo de Economistas y Associados (GEA) of Mexico City. Exhibits, Tab 4. The main elements of damage derive from Respondent's (1) denial of CEMSA's application for rebates of IEPS taxes relating to cigarette exports in October- November 1997 (and one shipment in December 1997), (2) refusal to allow CEMSA IEPS rebates on cigarette exports from January 1, 1994 until May 1996, and (3) termination of IEPS rebates to CEMSA, and of its cigarette export business, on or before December 1, 1997. Cervera ¶ IV at 17; Swan ¶ 17.

(1) Payment of IEPS rebates for October-November 1997.

237. This claim involves cash laid out by CEMSA when it purchased cigarettes for export in reliance on Hacienda's promises that the IEPS tax included in CEMSA's purchase price would be rebated. If Hacienda had given Claimant notice that it intended to discontinue such rebates, Claimant would not have made these purchases and would not have suffered the out-of-pocket loss. Hacienda's unexpected denial of CEMSA's applications for rebate of 18,978,361 pesos (US

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[142] *Id.*, ¶ 315.

$ 2.35 million) was a direct taking of that money. In contrast with CEMSA's claims for lost profits, past and future, this is a claim for a tax refund. The Mexican Fiscal Code provides that refunds owed to a taxpayer, as well as taxes owed to the state by a taxpayer, shall be adjusted in accordance with a statutory formula for inflation and surcharges. Cervera ¶ IV.1 and Attachment 1. Applying this formula, Cervera has determined that Hacienda owes CEMSA 64,582,645 pesos (U.S. $6,458,264) as of June 2001. *Id.* at 17. The amount will increase over time.

(2) Lost Profits January 1, 1994- May 1996.

238. As shown above, Respondent withheld IEPS rebates from CEMSA in breach of Mexican and international law beginning in January 1993. This action prevented CEMSA from resuming cigarette exports until mid-1996. Claimant seeks to recover the profits CEMSA lost due to Respondent's measures from January 1, 1994, the date NAFTA entered into force, through May 1996 when CEMSA began to export in earnest. While Hacienda first agreed to allow CEMSA to export cigarettes in 1995, Claimant could not confirm that this agreement would hold when Tomas Ruiz replaced Dr. Pero Noyola at the end of that year, and Claimant did not dare make substantial investments in cigarettes without making small test shipments in early 1996. Also, it took CEMSA several months to reestablish the business that had been illegally suspended by Respondent in 1993. Feldman Decl. ¶¶ 48, 52, 53, 55, 56. Accordingly, Claimant claims CEMSA's lost profits on cigarette exports from January 1, 1994 through May 1996.

239. Cervera has calculated CEMSA's lost profits for these months by projecting the exports CEMSA would have made, calculating the profits that it would have earned on such exports, and applying an interest factor to determine the value of such profits as of June 2001. Cervera

¶ IV.2 at 18. The calculation of exports CEMSA would have made is based on (1) official Mexican statistics for cigarette exports, and (2) CEMSA's export data for 1992, 1996 and 1997. The latter numbers were based on CEMSA's incomplete records of sales invoices and are understated significantly. Zaga Decl. Cervera then makes three projections of CEMSA's lost exports -- conservative, intermediate and aggressive -- depending on the projected rate of growth. Cervera ¶ IV.2 at 19-20.

240. To calculate lost profits, Cervera uses CEMSA's profit margin on cigarette sales for 1997, the only full year of operations. Cervera ¶ IV.2 at 20-21. CEMSA's profit margin in 1997 (after deducting finance charges) was 62.4% compared to profit margins of 75.4% in the Mexican cigarette industry. For interest, Cervera uses the 28 day CETES rate (short term Treasury rate) which is the most accurate rate and the one most commonly used in Mexico. *Id.*, at 22. Using the three projections of lost exports noted above, Cervera makes three projections of CEMSA's lost profits ranging from 72,064,702 pesos (US $ 7,206,470) to 115,934,048 pesos (US $ 11, 593,405). *Id.*, at 22-23. Claimant's bases his claim on the intermediate projection of 90,350,605 pesos (US $ 9,035,060).

(3) Value of theCigarette Export Business as of December 1, 1997.

241. As shown above, Respondent's measures (1) denying CEMSA's applications for IEPS rebates for October-November 1997, and (2) refusing to allow CEMSA IEPS rebates on future cigarette exports constituted a constructive taking of CEMSA's cigarette export business because they were intended to and had the effect of terminating cigarette exports by CEMSA. As spelled out in NAFTA Article 1110 (2), the compensation to be paid shall be equivalent to the fair market value of the expropriated investment "immediately before the expropriation took place (date of

expropriation)." Here the expropriation occurred in November 1997 when Hacienda issued (but did not communicate) resolutions denying CEMSA's applications for rebates and certainly no later than December 1, 1997. Facts, Part H; Feldman Decl. ¶ 83. For convenience, Claimants adopts December 1, 1997 as the date of expropriation.

242. As Article 1110 (2) makes clear the value of expropriated property is calculated as of the date of expropriation. Measures taken by the expropriating government to reduce the value of the property after the date of the expropriation, whether legislative or administrative, are not to be taken into account. Otherwise, a State could always take action after the fact to reduce its liability. This point is so obvious that it is not spelled out in NAFTA , but Article 1110 (2) makes the further point, based on general principles of international law, that the compensation owed "shall not reflect any change in value occurring because the intended expropriation had become known earlier." *A fortiori*, legal measures taken after the fact to confirm an expropriation are irrelevant.

243. Moreover, as Professor Swan points out:

> The "no expropriation" decision by the Mexican Finance Ministry and the U.S. Treasury pertains only the 1998 legislation. It does not pertain to any independent action taken by the Mexican executive on or before December 1, 1997 to drive Claimant out of the cigarette exporting business (see Paragraph (34) above). It is that executive action, and that action alone, that is the basis of the instant claim so that the ministerial agreement cannot be used to deny Claimant the full relief to which he is otherwise entitled under NAFTA Article 1110 (2).
>
> There is more than enough evidence in the record of this case to support a finding by the Tribunal that, irrespective of what Mexican law might require, the Mexican executive was and is still determined to deny CEMSA rebates and thereby drive it permanently out of the business of exporting cigarette's from

> Mexico. It is that policy, not the 1998 legislation, that the Tribunal is being asked to judge and for which relief is requested.

Swan ¶ 35 (B) and (C).

244. Cervera has determined the fair market value of CEMSA's cigarette export business as of December 1, 1997 by calculating its "going concern value" based on the present discounted value of the future cash flow. This is the only proper method for evaluation of a commercial enterprise. Cervera ¶ IV.3 at 24. The asset value method has been largely discredited because it bears no relationship to the real value of a business (*Id.*, at 24) and it cannot be used in the case of a service business, such as CEMSA's cigarette export business, where few tangible assets are involved. Finally, only the going concern value is appropriate in a case of unlawful expropriation where the law requires that Claimant be made whole.

245. Accordingly, Cervera determines the future cash flow expected from the business for three years (1998-2000) using three scenarios based on different growth rates (Cervera ¶ IV.3 at 6-27), determines the rate to be used to discount those flows back to December 1, 1997 (the 28 day CETES rate) (*Id.*, at 26), and makes three calculations of the going concern value of CEMSA's cigarette export business as of December 1, 1997 ranging from 71,753,332 pesos (US $ 8,819,239) to 77,238,457 pesos (US $ 9,493,419). *Id.*, at 26-27. Claimant bases his claim on the intermediate projection of 74,039,677 pesos (US $ 9,100,255). With interest, using the 28 day CETES rate, the compensation owed Claimant for the final expropriation of CEMSA's cigarette export business, as of June 30, 2001, is 148, 886,141 pesos (US $ 14,888,614). *Id.*, at 27.

246. Thus, the total compensation owed CEMSA is U.S. $ 30,381,939 plus interest from the date of the award as follows:

	Pesos	U.S. Dollars
(1) October -December 1997 IEPS due	64,582,645	6,458,264
(2) Lost profits January 1, 1994- May 1996	90,350,605	9,035,060
(3) Cigarette business December 1, 1997	148,886,141	14,888,614
Total Damages	303,819,390	30,381,939

Cervera at 28.

D. Hacienda's Tax Assessment

247. As discussed above (Facts ¶¶ 121-123) in March 1999, Hacienda assessed CEMSA 250,551,635 pesos (approximately U.S. $ 25 million) claiming that CEMSA was not entitled to the IEPS rebates it received on cigarette exports in 1996-1997. If Respondent continues to assert this claim, the amount will grow in accordance with the formula described above. The main reason given for this retroactive change of tax policy is that CEMSA did not have invoices stating the IEPS tax separately and expressly. In making the claims stated above, Claimant is asking the Tribunal to rule that Respondent is estopped from challenging CEMSA's right to IEPS rebates on cigarette exports in 1996-1997 and that CEMSA was, in any event, entitled to such rebates. If the Tribunal rules in Claimant's favor on these issues, Respondent whether it presents counter-claims in this proceeding or not, should be barred from asserting those claims against CEMSA either in the Mexican courts or as a set-off against execution of an award by this Tribunal.

248. As NAFTA does not allow the Tribunal to order Respondent to conform its conduct to the award in this case, and Respondent has not agreed to do so, Claimant requests (1) a

declaration that Respondent is not entitled to recover IEPS rebates paid to CEMSA in respect of cigarette exports in 1996-1997, and (2) a contingent award of damages in the amount of any tax assessment by Respondent against CEMSA in connection with the IEPS rebates it received on cigarette exports in 1996-1997.

E. Costs.

249. Finally, Claimant asks the Tribunal to award it costs, including attorney fees and expenses for expert witnesses, in accordance with NAFTA Article 1135 and Article 59 of the Additional Facility Arbitration Rules. The case for award of costs is strong in view of the merits of Claimant's case, Claimant's prior request for an agreement on costs, and Respondent's conduct of this matter. First, Respondent refused, before and during this proceeding, to discuss settlement of the claim through consultation or negotiation as required by NAFTA Article 1118. Both Undersecretary Tomas Ruiz and Mr. Perezcano ignored Claimant's and counsel's initiatives in this regard. Respondent is in breach of Article 1118.

250. Second, consistent with its practice in other cases, Respondent has raised every possible legal issue regardless of the merits. This was evident in Respondent's unmeritorious objections to the Tribunals' jurisdiction. Third, Respondent unnecessarily invokes formalities to complicate and delay the proceedings. Its refusal to have meaningful telephone exchanges with the Tribunal to expedite resolution of procedural issues is one example. These delays have increased Claimant's direct expenses and consequential damages. Fourth, Respondent has resisted and, finally, flouted the Tribunal's clear directions concerning the production of documents and written statements by designated individuals. It failed to produce even one statement requested by Claimant and has not

managed to locate specific documents identified by Claimant, including documents of which we have copies.

251. Mexico's new President Vicente Fox has recently urged small investors to invest in Mexico under the protection of NAFTA.[143] Claimant, a small investor, has incurred tremendous expenses to present to this Tribunal grievances for which he has no effective legal remedy in Mexico. Claimant hopes that the Tribunal will appreciate this extraordinary financial burden and require Respondent to bear all the costs of the proceeding.

SUBMISSIONS

In view of the Facts and the Law set out in this Memorial, Claimant respectfully requests that the Tribunal

A. Adjudge and Declare that

(1) Respondent's measures withholding and denying IEPS rebates on CEMSA's cigarette exports after January 1, 1994 are measures tantamount to expropriation under, and in breach of, NAFTA Article 1110;

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[143] See transcription of remarks by President Fox at the ceremony opening the Centro de Negocios de Mexico, Santa Ana, California, March 22, 2001, as reported on the "Sitio de Internet de las Presidencia, http://www.presidencia.gob.mx. President Fox's remarks include the following comments on NAFTA:

> However, we are talking about the opportunities for the small businesses, for the entrepreneurial spirit, opportunities to develop a *changarro* [a very small enterprise]. NAFTA, as I have mentioned, has been a great success, more than (inaudible). Trade between Mexico and the United States means millions of jobs. NAFTA has been successful, but we still have a challenge. We have to act with wisdom and intelligence; we should make the benefits of NAFTA available to the small businesses and to the *changarros*. We should assure ourselves (inaudible). This is exactly what this office represents, that is, to connect and effect strategic alliances, to amplify the small businesses of both countries. That is our dream; we want NAFTA to be an opportunity for an indigenous family in Chiapas (inaudible). To connect means to build partnerships between the businesses of California and the businesses of Mexico

(2) Respondent's measures withholding and denying IEPS rebates on CEMSA's cigarette exports after December 1, 1997, and its refusal to register CEMSA as an approved exporter of cigarettes and alcoholic beverages, together with Respondent's payment of IEPS rebates after December 1, 1997, on cigarette exports by trading companies owned by Mexican nationals, are also measures in breach of NAFTA Article 1102;

(3) Respondent is estopped by its representations, promises and conduct from denying its obligation to rebate IEPS taxes on CEMSA's cigarette exports in 1996 and 1997;

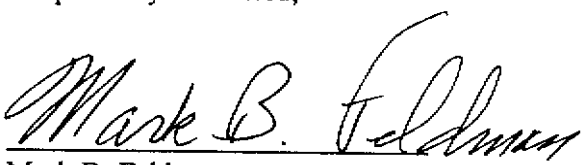
(4) Respondent's 1999 assessment, and any future assessment, against CEMSA or Claimant of a liability for repayment of IEPS taxes rebated to CEMSA on cigarette exports in 1996 and 1997 constitutes a measure tantamount to expropriation under, and in breach of, NAFTA Article 1110.

B. Award Claimant damages in the amount of:

(1) US $ 30,381,939 plus interest from the date of the award, and

(2) any tax liability (including interest, adjustments and penalties) that Respondent has assessed or may assess against Claimant or CEMSA in respect of IEPS taxes paid to CEMSA in 1996 and 1997 plus interest from the date of any such assessment.

Respectfully submitted,



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Signed this 30 day of March, 2001

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