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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 REPLY TO RESPONDENT'S COUNTER-MEMORIAL

June 11, 2001

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TABLE OF CONTENTS

Table of Contents (cont.)

INTRODUCTION

1. The Counter-Memorial recognizes the Tribunal's jurisdiction to decide Claimant's Article 1102 (2) claim and admits that Hacienda made IEPS rebates, which it refused to CEMSA, to certain other resellers in "like circumstances." Respondent's sole defense to this claim is that it made those payments by mistake and intends to recover them from the recipients. This defense is implausible and unproven. Given the evidence before the Tribunal of discrimination in breach of Article 1102 (2), Respondent has the burden of proving its defense. But Respondent refuses to provide any documentation showing why it approved rebates for Mercados I and Mercados II while refusing them to CEMSA, and it refuses to provide any documentation supporting its assertion that Hacienda is taking action to recover the rebates to Mercados I and II.

2. Respondent's evidence also shows that at least one other cigarette reseller in "like circumstances" as CEMSA was registered by Hacienda as eligible to export cigarettes and to receive IEPS rebates on cigarette exports. As the Tribunal is aware, Respondent refuses to provide documentation explaining why this company was treated more favorably that CEMSA. The Tribunal should have no difficulty in concluding that Respondent is in breach of NAFTA, Article 1102 (2).

3. Claimant's Article 1110 claim is supported by detailed proofs of an agreement with Hacienda; that evidence stands largely uncontradicted. Respondent's defense to this claim relies mainly on objections to the Tribunal's jurisdiction and on a specious argument that CEMSA could

not make money exporting cigarettes. The Counter- Memorial also argues that the international law principle of estoppel does not apply, because the principle is not recognized in the tax law of the NAFTA Parties. These points are refuted in the Reply. As shown below, Respondent's measures "tantamount to expropriation" were considered by the Competent Authorities, and the legal arguments in the Counter-Memorial are contrary to the language and purpose of NAFTA.

4. Attached to the Reply are supplementary witness statements by Marvin Feldman ("Feldman 2" at Ex. 1) and Oscar Enriquez ("Enriquez 2" at Ex. 2) and further expert opinions by Carlos Loperena ("Loperena 2" at Ex. 3), Professor Alan Swan ("Swan 2" at Ex. 4) and Ernesto Cervera ("Cervera 2" at Ex. 5). The Cervera declaration demonstrates that CEMSA's cigarette business was highly profitable even if one assumes, *arguendo*, that Claimant's IEPS calculations, confirmed by a senior Hacienda official,[1] were incorrect.

1. The Evidence Establishes Discrimination in Breach of Article 1102.[2]

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

NAFTA, Article 1102 (2).

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[1] We understand this official, Mr. Jose Antonio Riquer Ramos, was relieved of his position at Hacienda as of May 31, 2001.

[2] There is no jurisdictional issue with respect to this claim. NAFTA Article 2103 (6) does not apply, and the Tribunal has ruled that the claim is timely under Article 48 of the Rules and NAFTA Article 1119. Interim Decision, ¶¶ 56-59. A similar ruling in the *Metalclad* arbitration was recently sustained by the Supreme Court of British Columbia. *United Mexican States v. Metalclad Corp.*, Reasons for Judgment of the Hon. Mr. Justice Tysoe, Docket: 2001 BCSC 664, L002904, Vancouver Registry, ¶¶ 87-91. Respondent concedes: "The alleged breach of Article 1102 (National Treatment) is a claim that could be brought at this time." (CM ¶ 366.)

A. CEMSA Has Been Given Less Favorable Treatment than Mexican-Owned Exporters In Like Circumstances.

5. CEMSA has been barred from exporting cigarettes since December 1, 1997 by Hacienda's refusal to rebate IEPS taxes and from mid-1998 by Hacienda's refusal to enroll CEMSA in its sectoral registry for cigarettes and alcoholic beverages. (Mem. ¶¶ 119-120, 127, 157.) Absent such registration, Mexican Customs authorities will not issue the pedimento necessary to export such products from Mexico. (Mem. ¶ 127.)

6. Respondent now confirms that Mercados I and Mercados II are owned by named Mexican nationals (CM ¶ 469-470) and that these companies are resellers of cigarettes in "like circumstances" with CEMSA (CM ¶ 486). It further admits that Mercados I and Mercados II were allowed to export more than $ U.S. 3.3 million of Mexican cigarettes in 1998-2000. (CM ¶ 271-272.) Respondent does not deny that IEPS rebates were made to these companies for these exports. Rather, it acknowledges that Hacienda made IEPS rebates of approximately $ U.S. 9.1 million to three trading companies other than CEMSA from September 1996 - May 2000. (Guzman Decl., Mem. App. at 0516.) Moreover, according to Respondent's data, Mercados I and II accounted for nearly all cigarette exports by resellers in 1998-2000. (Garcia Ramos Stmt., Table 7, CM 00142.)[3] Thus, it is both undisputed and proven that Respondent made substantial

[3] For all Claimant knows, the third company listed in the Garcia Ramos table, Int de Nuevo Leon, may have been owned by the same principals.

IEPS rebates to Mercados I and II during the same years it denied such rebates to CEMSA. In addition, documentation submitted on June 1, 2001 (referred to in the CM, Obregon Decl. ¶ 56), shows that at least one other cigarette reseller, unnamed by Respondent, was approved for registration of the sectoral registry in 2000 and, thus, was eligible to export cigarettes and obtain IEPS rebates on these exports.[4]

7 These facts establish discrimination against CEMSA in breach of NAFTA, Article 1102 (2). The Tribunal has ruled that Claimant is "an investor of another Party." (Interim Decision, ¶ 36) Respondent acknowledges that CEMSA is "an investment" (CM ¶ 322), and it cannot be argued that Respondent's denial of rebates and registration as an exporter is "treatment no less favorable" than Respondent's grant of such rebates and registration to other companies. Moreover, a NAFTA tribunal has ruled that a claimant need not prove that discrimination in breach of Article 1102 is motivated by a difference in nationality but need simply show a difference in treatment between domestic and foreign owned investments in "like circumstances."[5] Respondent does not argue that motivation is an element of proof. Indeed, it argues that the Tribunal cannot examine a government's motives. (CM ¶ 277-278; and see CM ¶ 503, recognizing that a claim of breach can be based on *de facto* discrimination).

8. In *Pope & Talbot (Merits)*, the Tribunal stated the test to be "whether there is a reasonable nexus between the measure and a rational, non-discriminatory government policy, whether those

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[4] See document numbered 06257 attached to letter of H. Perezcano to Tribunal, June 1, 2001.

[5] *Pope & Talbot, Inc. v. Canada*, UNCITRAL Arb., (April 10, 2001), Award on the Merits of Phase 2 (hereinafter "*Pope & Talbot (Merits)*"), ¶ 78.

policies are embodied in statute, regulation or international agreement."[6] The tribunal stated:

> R]ecognition that national treatment can be denied through *de facto* measures has always been based on an unwillingness to allow circumvention of that right by skillful or evasive drafting. . . . [which would be] inconsistent with the investment objectives of NAFTA, in particular Article 102 (1) (b) and (c), to promote conditions of fair competition and to increase substantially investment opportunities.[7]

It continued:

> . . . . the Tribunal believes that, as a first step, the treatment accorded a foreign owned investment protected by Article 1102 (2) should be compared with that accorded domestic investments in the same business or economic sector. [fn omitted]. However, that first step is not the last one. Differences in treatment will presumptively violate Article 1102 (2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.[8]

9. Here, Respondent can make no showing of any rational government policy for tax discrimination among resellers or even for discriminating between producers and resellers. The Mexican Supreme Court has authoritatively ruled that such discrimination violates principles of equality and non-discrimination under Article 31 (IV) of the Mexican Constitution. CEMSA 1993 Supreme Court decision (Mem. App. 0526, 0574-0580; LYNX Supreme Court Decision (Mem. App. 0785,0805-0812.)

10. Further, a WTO Panel recently held that the United States violated Art. III:4 of the GATT by discriminating against certain foreign gasoline-refiners on the basis of subjective factors

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[6] *Id.*, ¶ 81.

[7] *Id.*, ¶ 70.

[8] *Id.*, ¶ 78.

concerning their production records. *See United States Standards for Reformulated and Conventional Gasoline* (Venezuela and Brazil v. United States) Report of the Panel, WT/DS2/R, 17 January 1996) aff'd on the point at issue by the Appellate Body, 29 April 1996 and adopted by the DSB, 20 May 1996) (hereinafter the *U.S. Gasoline Rule Case).* Chapter 3 of NAFTA applies the "national treatment" requirement to the sale of goods by expressly incorporating into NAFTA the language of Article III:4 of GATT. Then, Article 1102 of NAFTA applies the identical "national treatment" requirement to "investors" and "investments."

11. In the U.S. Gasoline Rule Case, the United states argued that it had complied with Article III:4 because the standard applied to reformulated gasoline was the same for all refiners, foreign and domestic, that had similar production records or were, as the U.S. expressed it, "similarly situated." The Panel rejected the argument stating:

> Apart from being contrary to the ordinary meaning of the terms of Article III:4, any interpretation of Article III:4 in this manner would mean that the treatment of imported and domestic goods . . . could no longer be assured on the objective basis of their likeness as products. Rather, imported goods would be exposed to a highly subjective and variable treatment according to extraneous factors . . . Even if the U.S. approach were to be followed, [the determination of] . . . 'similarly situated parties' could just as readily focus on . . .many key respects in which [any two] refineries could be deemed the relevant similarly situated parties . . . This consequential uncertainty and indeterminacy of the basis of treatment underlined, in the view of the Panel, the rationale of remaining within the terms of the clear language, object and purpose of Article III:4.

12. This rationale is directly applicable to this case. If Mercados I, Mercados II and other, unnamed companies owned by Mexican nationals are re-sellers exporting cigarettes, and if they are receiving IEPS tax rebates denied to CEMSA, there is a NAFTA violation under the ordinary meaning of the words used in Article 1102. As the Counter-Memorial concedes, the investments are in "like circumstances." Other factors are extraneous.

13. Respondent makes only two arguments in its defense: (1) the rebates made to Mercados I and II were paid automatically and are subject to future review; and (2) Claimant "possibly" may be involved in smuggling cigarettes in combination with Mercados I and II. As explained below, these contentions have no merit.

B. Respondent's "Automatic Payments" Argument is Not Credible.

14. Respondent would have the Tribunal believe that notwithstanding the ten-year dispute over rebate of IEPS taxes to cigarette resellers, Hacienda made such rebates to CEMSA until November 1997 and continued to make IEPS rebates to Mercados I and Mercados II without knowing that these companies were resellers who (1) could not obtain invoices separating the IEPS tax from their vendors and (2) after January 1, 1998, were not eligible for rebates under the IEPS law.

15. This argument is not credible. Hacienda approved rebates for Mercados I and II until Claimant challenged such discrimination in this proceeding. The general statements made by Respondent's witnesses concerning the alleged automatic operation of the rebate system may be true in some cases involving the IVA (not CEMSA), but could not reasonably apply to the smaller universe of IEPS rebates. In fact, these assertions are demonstrably incorrect as regards IEPS rebates to cigarette resellers.

16. Claimant's evidence shows that officials at all levels of Hacienda knew that CEMSA was exporting cigarettes and receiving IEPS rebates on cigarette exports without obtaining invoices stating the IEPS tax separately and expressly. Mem. ¶¶ 79-80, 92-97.[9] In fact, such payments

[9] Respondent offers no more than a general denial of these facts. See Resp. Adm./Den. at 18-19, 22-23.

were challenged by the Regional Administrator acting on CEMSA's rebate application and only proceeded after this official was instructed by his superiors. Mem. ¶¶ 80.

17. Moreover, the IEPS Law was amended, effective January 1, 1998, (1) to preclude IEPS rebates on cigarette exports subsequent to the first sale of cigarettes in Mexico and (2) to require Hacienda approval of all parties seeking to export cigarettes. (Mem. ¶ 115.) After that date, a reseller was not eligible for IEPS rebates even if it could obtain invoices stating the IEPS tax separately and expressly Export-rebate privileges were reserved by law to producers alone, and cigarette exports by others were blocked unless Hacienda registered the party as an approved cigarette exporter. (Mem ¶ 115, Resp. Adm./Den. at 27.) In 1998-2000, when IEPS rebates were made to Mercados I and Mercados II, no one was allowed to export cigarettes without careful vetting by Hacienda. (Obregon Stmt. ¶¶ 56-60, CM 06119 and see Mem. ¶ 120 and Mem. App. 0444-47, 0459-60.)

18. In any event, the Mercados principals (described in the Counter-Memorial as the "Poblano-Gamez-Guemes network") were well known to Hacienda as cigarette resellers. (CM ¶ 452.) LYNX, a company in which Poblano was a principal, won the first Supreme Court decision challenging the producers' monopoly on IEPS rebates. It also won its challenge to Hacienda's denial of rebates under the IEPS law, and later persuaded Hacienda to agree to a large, controversial settlement concerning its cigarette exports.

19. Respondent now denies that Hacienda made any settlement with LYNX, stating: "SHCP did not enter into a settlement of any kind with Lynx, but rather simply complied with the Court's order to 'issue a new resolution granting the IEPS rebate in the amount of $685,186,689.00

(N$685,186.69) for processed tobacco'," with respect to the 1996 Fiscal Court Case. (CM ¶ 190.) Respondent does not address whether Hacienda made IEPS rebates to LYNX without requiring invoices separating the tax, as required by the Court. .[10] Oscar Enriquez testified that Hacienda "made a very large settlement with LYNX without requiring invoices separating the IEPS tax separately and expressly." (Mem. ¶ 78, Enriquez ¶ 19.) Enriquez now clarifies that in 1996 Hacienda paid LYNX nine times the amount ordered by the Court with respect to LYNX's 1992 Supreme Court amparo decision – more than 27 million pesos (about U.S. $ 3 million). (Enriquez 2 ¶ 6.) Thus, the evidence shows that Hacienda, not Claimant, had a questionable relationship with Mr. Poblano. This conclusion is supported by the testimony of Mr. Rafael Obregon Castellanos that Mercados II was registered as a cigarette exporter in 2000 after, supposedly, complying with certain informational requirements under Article 19 of the IEPS Law. Undoubtedly, Hacienda knew then, as Respondent recognizes now, that both Mercados I and II were cigarette resellers "in like circumstances" with CEMSA.

C. Respondent's Conspiracy Theory is Wholly Unsupported by Evidence.

20. Respondent asks the Tribunal to reject Claimant's Article 1102 (2) claim by piercing the corporate veil and holding that CEMSA, Mercados I and Mercados II are "one enterprise." (CM ¶ 499.) The theory is that the "interconnections between CEMSA and the Mexican-owned companies . . . make them a combination of entities all dedicated to a particular enterprise . . ." -- in effect, pretending to export cigarettes from Mexico, making false claims for IEPS rebates, and smuggling the cigarettes back into Mexico in violation of the customs laws. (CM ¶ 498.)

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[10] Respondent submitted only a general denial (by the absence of an admission) on this portion of Mem. ¶ 90. Respondent's Admissions and Denials at 18.

21. There is no evidentiary basis for this cynical allegation and the implied accusation that Marvin Feldman is guilty of criminal behavior is irresponsible and defamatory Given Claimant's disfavor among senior Hacienda officials, he would have been imprisoned years ago if there was a shred of truth to this malicious conspiracy theory. Leaving aside the point that prior events are irrelevant to Respondent's discrimination in 1998-2000, the strongest statement Respondent can make about CEMSA's 1996 exports is. "The available evidence points to the possibility that the cigarettes were shipped back into Mexico." This is pure speculation.

22. In fact, there is no evidence whatsoever connecting Claimant with any possible shipment of cigarettes to Mexico. It is an undisputed fact that CEMSA was an independent business unrelated to LYNX or any other company in the so-called Poblano-Garnez–Guernes network. Neither Claimant nor CEMSA ever had a legal or financial interest in LYNX, Compania Exportadora Mexicana or any other company in the alleged network. Feldman 2 ¶¶ 1-2. And Claimant affirms without reservation that he has no knowledge and no reason to believe that any cigarettes CEMSA exported from Mexico were ever returned to Mexico for sale. Feldman 2 ¶ 5.

23. Respondent's assertions that Mexican cigarettes could not be imported into the United States and that CEMSA's customers were "fictitious" companies are immaterial. CEMSA's exports and its customers were real whatever names the customers used for business purposes. Brand-name products, including cigarettes, may be legally exported from Mexico and traded in world markets without the consent of the trademark holders. Such sales commonly are effected through intermediaries who may choose, for valid business reasons, not to disclose their customers or even their proper corporate names (See Feldman Decl. ¶ 74.) None of these companies were related to CEMSA and none of the transactions were false. Respondent's

insinuation to the contrary, without any proof, is reprehensible.

24. Cigarette smuggling is a serious problem. There is no dispute on this point. But Respondent fails to advise the Tribunal that legal authorities in several countries blame the major international tobacco companies for this problem.[11] The Tribunal can take judicial notice of this fact. Finally, the evidence in this case shows that Respondent has, through IEPS rebates, been financing cigarette exports by Mercados I and Mercados II, and Obregon testifies that Hacienda approved cigarette exports by Mercados II last year. If, as alleged, the "Poblano-Gamez-Guemes network" may have been shipping cigarettes back into Mexico illegally, Hacienda is part of the alleged "combination." Marvin Feldman is not.

II. The Evidence Establishes Expropriation in Breach of Article 1110.

25. The law supporting Claimant's interpretation of Article 1110 is set out in the Memorial and does not require further treatment here. This Reply addresses Respondent's objections to the Tribunal's jurisdiction, a few of the factual errors in the Counter-Memorial and the international law of estoppel.

A. The Tribunal Has Jurisdiction to Decide The Claims and to Award the Relief Requested.

"Creeping Expropriation"

26. Respondent asserts that much of the Memorial should be disregarded, because Claimant

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[11] *Illegal Tobacco Traffic*, N.Y. Times, Nov. 13, 2000, at A 28; Christopher Dickey and Rod Norland, *Big Tobacco's Next Legal War: Cigarette Makers Are Coming Under Fire as Governments Attack Global Smuggling*, Newsweek, July 31, 2000, at 36. Raymond Bonner and Christopher Drew, *CONTRABAND SMOKES – a Special Report: Cigarette Makers Are Seen as Aiding Rise in Smuggling*, N.Y. Times, Aug. 25, 1997, at A 1. Copies attached at Ex. 6.

has not referred his "creeping expropriation" theory to the Competent Authorities in accordance with NAFTA Article 2103 (6) Specifically, it contends that the Tribunal lacks jurisdiction to review, under Article 1110,

> Respondent's decision in November or December 1997, for the benefit of cigarette producers, to terminate future exports by CEMSA *by denying IEPS rebates to CEMSA on such exports.*

(See CM ¶ 66, quoting Mem ¶ 149. d. (emphasis added).)

27. There is a very simple answer to Respondent's convoluted argument. The specific measures complained of – Hacienda's denial of IEPS rebates to CEMSA for exports in October-November 1997 – were referred to the Competent Authorities. Memorial Paragraph 149 (d) emphasizes the purpose and effect of those measures and supports Claimant's claim for lost profits after December 1, 1997. (See Claimant's Submission A (1), Mem. at 129.)

28. The phrase "creeping expropriation" which troubles Respondent is not a "measure" but a characterization of a measure.[12] Article 2103 only requires that the tax measure complained of be referred to the Competent Authorities. Nothing in Article 2103 (6) requires that a Claimant preview its legal arguments with the Competent Authorities. In fact, of course, Claimant did argue to both authorities that Hacienda denied rebates to CEMSA in order to terminate its exports of cigarettes, and submitted the concept of creeping expropriation in this process. Secretary Lubick's letter is brief and conclusory. It makes no effort to restate the detailed arguments made to the U.S. Treasury Department over several months by Claimant and Hacienda

[12] The phrase "creeping expropriation" applies more precisely to the intermittent measures taken against CEMSA in 1991 and 1993-1996, which culminated with the final termination of its cigarette business in 1997.

nor does it attempt to explain Treasury's reasoning.[13] All that can be discerned from the correspondence between Secretary Lubick and Undersecretary Tomas Ruiz is that the Competent Authorities declined to allow Claimant to bring a NAFTA arbitration based on the Mexican legislation amending the IEPS law as of January 1, 1998.

29. Claimant is allowed to challenge the administrative decisions of Mexican tax authorities, to prove the relevant circumstances and to argue the legal consequences. In any event, the legal analysis which Respondent would have the Tribunal ignore applies to all of the measures alleged to be "tantamount to expropriation" in this case.

The 1996 -1997 Rebates Paid to CEMSA

30. Respondent also objects to the relief requested in respect of Hacienda's tax assessment against CEMSA, contending that Claimant has not submitted a claim to arbitration in respect of the 1998 audit and that the Tribunal lacks authority to make declarations of law under NAFTA. (See CM ¶ 575.) These objections are not meritorious.

31. Claimant has submitted an incidental or additional claim respecting the audit and tax assessment in his Memorial. Rule 48 permits such a claim to be made "not later than in the reply." This claim has been fully documented and is ripe for decision. The issues and the evidence are the same as those in the original claim, and the Tribunal will necessarily decide the new claim when it decides the first.

32. Claimant is not asking the Tribunal for injunctive relief or interim measures of protection. Rather, it asks the Tribunal to adjudge and declare Claimant's rights under NAFTA and to award

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[13] This process was not transparent to Claimant, and we do not know how much of Claimant's position was shared with Hacienda.

damages and costs as provided in Article 1135. Respondent's assertions that "the requested declaration would usurp the jurisdiction of the Mexican courts and would not be enforceable in any event" challenge an Investor's right to impartial arbitration under Chapter 11 and raise questions as to Mexico's commitment to abide by its obligations under NAFTA.

33. Article 1136 clearly provides that "a disputing party shall abide by and comply with an award without delay." If the Tribunal determines that Claimant was entitled to IEPS rebates in 1996-1997, as the evidence shows, that ruling will be binding on Respondent's tax authorities and no judicial proceedings will be necessary in Mexico. All Respondent has to do to comply is to not assert tax claims against CEMSA that are contrary to the Tribunal's decision. If Mexico fails to comply, NAFTA provides a remedy. See Article 1136 (5) and (6).

Litigation in the Mexican Courts - Exhaustion of Local Remedies

34. Invoking the doctrine of exhaustion of local remedies, Respondent argues that this Tribunal cannot exercise the jurisdiction conferred upon it by NAFTA Chapter 11, because there has been litigation in the local courts and there are conflicting decisions on issues of Mexican law that only the local courts can resolve. In effect, Respondent is asking the Tribunal to cede jurisdiction over the dispute to domestic courts who have no competence to address the NAFTA issues that Claimant has placed before the Tribunal. Both the investor and the investment have waived their right to claims damages in the Mexican courts as required by NAFTA Article 1121, and Claimant is precluded by Mexico's Annex 1120.1 from presenting a breach of NAFTA to the Mexican courts.

35. The "exhaustion" argument rests upon false premises, including that (1) the obligation to

exhaust local remedies persists under Chapter 11, and (2) decisions of domestic tribunals on questions of municipal law are binding on an international tribunal deciding a State's responsibility under international law. The Tribunal, acting under NAFTA, will determine Claimant's rights under the agreement and general principles of international law on all the relevant evidence. The Mexican courts addressed only questions of Mexican law on the basis of limited evidence.

36. Respondent's argument that the traditional international law doctrine of exhaustion of local remedies applies to claims under NAFTA Article 1117 (CM ¶¶ 363-378) contradicts the fundamental purpose Chapter 11, Section B, to provide "due process before an impartial tribunal." NAFTA Article 1115. Marvin Feldman alleges a violation of international law and seeks the protection of a NAFTA tribunal. Under NAFTA, Mexico is not entitled to be the judge of its own case. Prior to NAFTA, Mexico asserted that right in investment disputes, but it withdrew from that position to win the enormous economic benefits of NAFTA. In the Counter-Memorial, Respondent seeks to break Mexico's part of the bargain.

37 The *ELSI* case, whatever its merit, is not on point, because NAFTA expressly requires a Claimant to waive his damage remedies in local courts. The election required by Article 1121 is incompatible with an obligation to initiate or to exhaust local remedies. The limited right remaining to a claimant in local courts – to pursue proceedings for injunctive, declaratory or other extraordinary relief – cannot be construed as a barrier to the exercise of jurisdiction by a tribunal duly constituted under Chapter 11.

38. The facts of this case demonstrate the purpose and wisdom of the States Party to NAFTA. Claimant has been struggling for many years to vindicate the principle of tax equality and non-discrimination which is firmly established in Mexican law and was confirmed in CEMSA's favor

by the Supreme Court of Justice. Prior to NAFTA, he could not persuade the Mexican tax authorities to comply with these principles, and he is not required to exhaust those remedies again in order to benefit from NAFTA's protection.

39. In addition, the proceedings in Mexico do not constrain the Tribunal in this case, because:

(1) under Mexican procedure, Claimant was required to challenge Hacienda's actions in the Mexican courts in order to avoid waiving his objections, seizure of property and, likely, imprisonment. His actions were defensive and temporary;

(2) after the Tribunal was constituted, Claimant filed papers seeking to terminate both litigations. The petitions were rejected;

(3) the only appellate decision relied on by Respondent -- the Circuit Court opinion in the Consulta litigation (described further below) -- relies exclusively on the 1998 IEPS law, including particularly Article 11, as amended effective January 1, 1998. In doing so, the Court followed Hacienda's argument. The court did not address, and apparently did not appreciate, that the law changed in 1998. Respondent recognizes that there was no material change in the law from 1992-1997. (*See, e.g.*, CM ¶ 4.) The opinion does not examine CEMSA's entitlement to rebates under the IEPS provisions in force in 1997. Therefore, the decision is not dispositive on that issue. Moreover, a decision denying rebates due for 1997 exports by applying a different standard, found in legislation applicable to a later time frame, constitutes a denial of justice under international law and should be disregarded by the Tribunal; and

(4) the opinion by one Fiscal Court Judge in the Consulta litigation, deemed important by Respondent, has been superseded by the full Fiscal Court, which reached the opposite result in the "Assessment" litigation, holding by 8 - 3 that CEMSA is entitled to IEPS rebates on cigarette

exports without invoices separating the tax. The Circuit Court has remanded the case to the Fiscal Court without prescribing the outcome.

40. Finally, Claimant has no effective legal remedy under Mexican law:

(1) under Mexican law as applied by Hacienda, there is no procedure by which an exporter can hope to enforce a judicially recognized right to conduct an export business with IEPS rebates; (*see* Mem. ¶¶ 212-219, and testimony cited therein; CM ¶¶ 142 b, 186 a.)

(2) the record in this and other cases shows that Mexican authorities repeatedly ignore adverse judicial decisions, including decisions of the Supreme Court of Justice. (Mem., Del Rio ¶¶ 15-29.) Frequently, parties that win litigations against Hacienda do not dare press their rights for fear of retaliation. See, *e.g.*, Mem. Del Rio ¶¶ 23 (tax payers may forgo right to rebates under law or judicial ruling in order to avoid "inquisitorial harassment" in the form of a punitive audit.)

The Relation Between Domestic and International Law In This Case

41. Contrary to Respondent's argument (CM ¶ 361), the Article 1110 claim in this case is not based on Mexico's responsibility for the acts of its judiciary. Nor does Claimant need to establish, as a matter of Mexican procedure, that the amparo issued by the Supreme Court in 1993 would be enforced as such in subsequent years, although it is clear, as Loperena testifies, that the Supreme Court would reach the same result under the legislation in force in 1997. Mem., Loperena § III B at 9.

42. As explained in the Memorial, Claimant's case on the merits, including estoppel, rests on principles of international law (¶¶ 169-170) and a variety of facts that establish CEMSA's entitlement to non-discriminatory treatment under the IEPS law. These facts include two decisions of the Mexican Supreme Court, the IEPS Law in force in 1992 - 1997, administrative

resolutions in writing, oral commitments by senior Hacienda officials that were reaffirmed over time, and a course of conduct by Hacienda on which Claimant relied. (Mem. ¶¶ 170-175, 184.)

43. The Counter-Memorial is wrong in saying that the entitlement asserted by Claimant is "undecided in present Mexican jurisprudence" (CM ¶ 363), and wrong in its narrow construction of the 1993 Supreme Court Decision (CM ¶ 345). In holding the 1991 IEPS amendment unconstitutional, a unanimous Supreme Court ruled in both the CEMSA and LYNX cases that the Mexican government cannot discriminate between producers and resellers in the administration of IEPS rebates on cigarette exports; the 0% tax rate applies to both It may be that the Court did not review the "mechanics" of the IEPS Law, and its decision does not preclude the application of reasonable, non-discriminatory procedures. But the Mexican Constitution as propounded by the Supreme Court prohibits discriminatory manipulation of the IEPS law to favor producers over resellers by both the Mexican Congress and Executive officials.

44 Moreover, CEMSA's entitlement to such non-discriminatory treatment under Mexican jurisprudence was confirmed in the Riquer, Gomez Gordillo and Bravo resolutions and by the agreement Hacienda made with Claimant under Pedro Noyola's direction. In 1994, Gomez Gordillo (then Undersecretary for Income) confirmed to Claimant in writing that CEMSA was entitled by the IEPS Law to have cigarette invoices separating the IEPS tax, so that it could obtain IEPS rebates on its cigarette exports. He now tells the Tribunal that Hacienda had no duty to enforce Cigatam's obligation to provide such invoices, that this was a matter of private law and that CEMSA's only remedy was to sue Cigatam or Sam's Club. (Gomez Gordillo Stmt., ¶ 36, CM 06055.)) As Loperena testifies, this is not correct. Enforcement of the tax laws is a public responsibility, not an issue of private law for civil litigation. Loperena 2. Once Claimant

complained to the tax authorities, they had a duty to enforce Cigatam's statutory obligation to separate the tax on invoices to customers such as Sam's Club.

45. The evidence in this case establishes a pattern of discrimination tantamount to expropriation. Claimant has one Supreme Court decision in CEMSA's favor, and he is not required to seek another in order to claim NAFTA's protection. The case might be otherwise if there were a Mexican Supreme Court decision supporting Respondent's position, but there is not The conflicting decisions of subordinate Mexican courts do not impair the authority of the 1993 Supreme Court decision, and NAFTA eliminates any obligation to exhaust local remedies. The Tribunal is in position to judge Respondent's measures under a norm that is common to Mexican and international law -- the principle of non-discrimination.

The Domestic Litigation

46. There are two recent Mexican proceedings involving CEMSA and IEPS rebates. The first matter, referred to herein as the "*Consulta* litigation,"[14] has been concluded. CEMSA initiated this proceeding in the Federal Fiscal Court on April 24, 1998 to challenge Hacienda's February 25, 1998 resolution denying its entitlement to IEPS rebates in 1997 and 1998. As noted in the Memorial ¶ 118, Claimant believed that a failure to dispute Hacienda's resolutions would, under Mexican law, stand as an admission of wrongdoing and lead to severe penalties for CEMSA's past activities. A single judge decided the case against CEMSA in November 1998 while discussions were pending with the Competent Authorities, but CEMSA was not informed of this result until after those discussions were concluded in February 1999.

47 CEMSA filed an appeal (request for amparo) with the Circuit Court on March 2, 1999.

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[14] Referred to by Respondent as the "1998 Fiscal Court Proceeding." CM ¶ 6.

Once this Tribunal was constituted, however, Claimant sought to withdraw the appeal with respect to the 1997 rebates while preserving his challenge to the 1998 amendments. On August 8, 2000, the Circuit Court issued an opinion which declined, at least formally, to allow a partial withdrawal of the issues, but which, in fact, focused exclusively on the 1998 IEPS law.

48. The second matter, which has not been resolved and could be withdrawn if the Tribunal awards the relief requested, involves CEMSA's challenge to Hacienda's resolution of March 1, 1999 assessing CEMSA more than US $ 25 million for IEPS rebates paid in 1996 and 1997, interest and penalties ("the Assessment case.") At the time, this filing was required to forestall foreclosure and possible criminal penalties that would have otherwise resulted from Hacienda's tax assessment. Under Mexican procedure, Hacienda is not required to sue CEMSA to collect a tax assessment. It was up to CEMSA to challenge the assessment in court.

49. The Assessment case presented issues under the same 1997 IEPS law at issue in the Consulta litigation (which, as noted above, was ultimately decided solely on 1998 law), and was considered by the full bench of the Federal Fiscal Court. When Claimant learned that his former nemesis, Judge Ruben Aguirre Pangburn, now Hacienda's Undersecretary for Income, had been assigned to draft the opinion, Claimant asked the Court to recuse Judge Aguirre from the case. When that request was denied, and despite the risks, CEMSA sought on June 9 and 12 to suspend the proceeding it had initiated. This request was denied on July 13, 2000.

50. On June 16, 2000, the Federal Fiscal Court, by an 8 - 3 vote, ruled in CEMSA's favor on two key points: (1) CEMSA is a taxpayer under the IEPS law entitled to rebates on cigarette exports and (2) Hacienda could not require CEMSA to obtain invoices expressly stating the tax transferred that the producers would not supply. The Court also decided that certain exports to

an allegedly related party were not eligible for IEPS rebates Both parties appealed. On June 11, 2001, the Circuit Court issued an opinion remanding the case to the Fiscal Court for reconsideration without dictating the outcome to the Fiscal Court. While the Circuit Court disagreed with the reasoning of the Fiscal Court on certain points, it did not address the "impossibility" issue on factual or legal grounds.

No Res Judicata Effects

51. In any event, the conflicting decisions of the Mexican courts in the proceedings described above should not be given any preclusive effect by the Tribunal. Domestic court decisions are not *res judicata* for an international tribunal. A Tribunal in an expropriation case filed under the ACCEDE Convention gives the rationale for this rule:

> In any case, an international Tribunal is not bound to follow the result of a national Court. One of the reasons for instituting an international arbitration procedure is precisely that parties - rightly or wrongly - feel often more confident with a legal institution which is not entirely related to one of the parties. If a national judgement [sic] was binding on an International Tribunal such a procedure could be rendered meaningless.
>
> Accordingly, no matter how the legal position of a party is described in a national judgement, an International Arbitral Tribunal enjoys the right to evaluate and examine this position without accepting any res judicata effect of a national Court. In its evaluation, therefore, the judgements of a national court can be accepted as one of the many factors which have to be considered by the arbitral tribunal.[15]

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[15] *Amco Asia Corp. v. Indonesia* (Award, Nov. 21, 1984), 1 ICSID Rep. 413, 460 (1993), excerpted at 24 I.L.M. 1022 (1985), ¶ 177, sustained in relevant part, *Amco Asia Corp. v. Indonesia* (Decision on Application for Annulment, May 16, 1986), ¶¶ 61-61, 1 ICSID Rep. 509, 526-27 (1993), 25 ILM 1441, 1453-54 (1986) ("By acceptance of ICSID jurisdiction without reserving under Article 26 of the Convention a right to require prior exhaustion of local remedies as a condition for obtaining access to an ICSID tribunal, Indonesia must be deemed to have waived any such right.") *See also*, Ian Brownlie, Principles of Public International Law 52 (5th ed. 1998) ("There is no effect of res judicata from the decision of a municipal court so far as an international jurisdiction is concerned . . . ."); Bin Cheng, General Principles of Law as Applied by International Courts and Tribunals, 337, n.6 (1953) ("a decision of municipal law does not constitute res judicata in international law"); *cf. The Phare* (Fr. v. Nicar.), 5 John Bassett Moore, International Arbitrations to which the United States Has Been a Party 4870, 4871 (1898) (court of cassation award of July 19, 1880) (rejecting plea of res judicata on the ground that "it was the common intention of the two governments to invest the arbitral tribunal with all power and jurisdiction . .

Thus, the domestic litigation is no bar to the jurisdiction of this Tribunal.

Additional Facts

52. Marvin Feldman and Oscar Enriquez have testified in detail as to Claimant's 1995 agreement with senior Hacienda officials and the difficulties that had to be overcome before this agreement was implemented by instructions to the Hacienda officials who made the rebates to CEMSA. (Feldman Decl. ¶¶ 39-58, and *see* ¶¶ 62-64; Enriquez Decl. ¶¶ 13-16.) This testimony is supported by documentary evidence that Claimant called this agreement to the attention of senior officials on several occasions. (Mem. App. 0090-99.) An additional letter from Claimant to Undersecretary Tomas Ruiz citing the agreement is included with the declaration of Claimant submitted with this Reply. (Feldman 2, Tab A.) The general denial of this agreement by Fernando Heftye Etienne (CM ¶ 3, 06024 (Span.)) is no more than a legal conclusion and does not contradict any of the particular facts set out in the Memorial.

53. Claiming that Hacienda's records for 1992 have been destroyed, Respondent declines to admit that CEMSA exported cigarettes in 1992. (CM ¶ 144.) But this fact is documented in Respondent's Exhibit CM 4389, as well as in the purchase and sale documents, including documents showing exports, filed with the Memorial at App. 1603-1774.

54. Respondent insinuates at several points – but does not state – that Hacienda suspended IEPS rebates to CEMSA in October - November 1997 because of the 1996 financial statements it received on September 29, 1997. (CM ¶¶ 217-225.) This insinuation is misleading. Gabriel Oliver Garcia testifies only that these statements were "subsequently analyzed" and quotes from a

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independently of what was decided by the judicial authority of Nicaragua . . . .")

Hacienda document generated in 1998. (Oliver ¶ 6, CM 05996 (Span.)) Then, Oliver acknowledges that IEPS rebates to CEMSA were suspended in October - November 1997 (Oliver ¶ 7, CM 05996 (Span.)), but makes no connection between that suspension and Hacienda's analysis of CEMSA's financial statements in 1998.

55. Respondent simply refuses to acknowledge that it changed its policy towards CEMSA in October 1997 at the request of Carlos Slim. All decisions concerning IEPS rebates on CEMSA's cigarette exports, including the decision to terminate the 1995 audit, were made at high levels Mem. ¶¶ 53-64, 67-68, 80), and Respondent's assertion that audits "in no case . . . involve higher levels within SHCP" (CM ¶ 177 (b)) is contradicted by its own evidence. (CM ¶¶ 240-241.)

56. Cigatam states that it did not export Marlboro cigarettes (CM 06080, ¶ 16) but it does not say whether Marlboros were exported from Mexico by its authorized agents or the agents of its affiliate Philip Morris Mexico, S.A. de C.V. ("PMM"). Possibly, Philip Morris may have chosen to supply world markets exclusively with Marlboros made in the United States. That is irrelevant. What is clear is that both Cigatam and Philip Morris fought hard to maintain the trademark owners' exclusive control over exports from Mexico.

(Salazar Stmt. ¶ 15, CM 06080; Gomez Gordillo Stmt., ¶ 36, CM 06054-55) and that Respondent supported that effort by withholding IEPS rebates from CEMSA contrary to the 1993 Supreme Court decision. Gomez Gordillo and other senior Mexican officials defend their actions with reference to Cigatam's contract with Phillip Morris (CM ¶ 163, 231) and Respondent has made the same argument to this Tribunal.

57. Whatever the merits of this argument in economic theory or in some other country, the Supreme Court of Justice has ruled that the Mexican Government may not discriminate between

cigarette producers and resellers in awarding IEPS rebates on exports; both are entitled to the 0% rate. The Government of Mexico recognized this obligation when it agreed to make IEPS rebates to CEMSA without the impossible-to-obtain invoices separating the tax.[16] CEMSA relied on the government's word and that agreement is binding on Mexico as a matter of international law. Furthermore, Respondent is estopped under international law from asserting in this proceeding that it is entitled to deny IEPS rebates to CEMSA because Cigatam will not provide its customers with invoices separating the tax.

58. Since the inception of this arbitration, Respondent has taken numerous steps to exert economic and other pressures on Claimant, including personal harassment and intimidation of potential witnesses in this case. Claimant mentioned some of these in his Memorial. (Mem. ¶¶ 119-121, 127-128, 130-31). He submits additional evidence of this harassment in his current declaration. (Feldman 2 ¶ 10.)

B. Estoppel

59. The Counter-Memorial argues that the international law doctrine of estoppel does not apply because (1) it only operates to bind parties to statements of fact, and (2) international law must follow the contours of domestic law in the NAFTA Parties which, Respondent claims, do not recognize estoppel in the administration of their tax laws. Both points are wrong, as Professor Swan demonstrates in the attached affidavit. (Swan 2, Reply Ex. 4.) The principle of estoppel is not confined to statements of fact and is well established in international law.

60. On the first point, Respondent denies that its officials made any statements of fact, only "statements about how the law as enacted by Congress would be applied." It does not explain

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why a statement about how the law is applied is not a fact. In any event, as Professor Swan's discussion makes clear, the distinction is not valid under international law. Swan 2 ¶¶ 6, 22-25. Professor Swan explains:

> Observe that, in the *Temple Case*, there were *facts* in the form of statements made, or not made, by Thailand when the Map was promulgated and in the form of subsequent conduct especially official visits to the Temple. What these *facts* represented – their only relevance – was their *legal purport*. They were tantamount to a statement by Thailand that irrespective of any boundary prescribed by the 1904 treaty, the Map defined the *legal* boundary between Thailand and Cambodia. What the Court concluded, therefore, was that Thailand was "stopped" from denying this *legal conclusion*. The estoppel did not just bar Thailand from denying the *fact* of the official visits or the *fact* that it had uttered or failed to utter certain words. It was stopped from denying the legal implications of those events.

Swan 2 ¶ 6, emphasis in original. As Thailand was estopped in the *Temple* case[17] from denying both official statements and the legal consequences of its statements, so Respondent is estopped from denying the fact of Hacienda's commitments to Claimant and the legal consequences of its commitment. (Swan 2 ¶¶ 5-7.) Professor Swan summarizes the point thus: "As the cases make amply clear at international law estoppel works not only on the facts but also to preclude a denial of the legal implications or purport of the facts." Swan 2 ¶ 25.

61. Moreover, assuming *arguendo*, that Respondent's view of the law is correct – that invoices stating the IEPS tax separately and expressly were required for rebates and that Respondent had no obligation to compel the manufacturers to issue such invoices – Respondent is still estopped by its conduct from asserting the correctness of this legal position under international law. Swan 2 ¶ 8. As Judge Fitzmaurice, in his concurrence in the *Temple* case explained, estoppel in international law:

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[17] *Case Concerning the Temple of Preah Vihear* (Cambodia v. Thailand), 1962 I.C.J. 6 (June 15).

> is essentially a means of excluding a denial that might be *correct – irrespective of its correctness*. It prevents the assertion of what might in fact be *true*. Its use must in consequence be the subject of certain limitation. The real field of operation, therefore, of the rule of preclusion or estoppel, *stricto sensu*, in the present context, is where it is possible that the party concerned did not give the undertaking or accept the obligations in question (or there is room for doubt which it did), but where that party's subsequent conduct has been such, and has had such consequence, that it cannot be allowed to deny the existence of an undertaking or that it is bound.[18]

Thus, the alleged clarity of particular provisions of the IEPS law regarding invoices which Respondent now asserts against Claimant (although it ignores the clear obligation of the manufacturer to provide such invoices and denies its own obligation to compel issuance of same) must be read in the context of Respondent's actions in reaching an agreement with Claimant to overcome the problem of impossibility. Swan 2 ¶¶ 9-10. In this context, Respondent is estopped from denying its agreement.

62. Respondent asserts that principles of domestic tax law dictate against an estoppel. (CM ¶¶ 408-409.) Claimant does not have the means to research and analyze the complex tax laws of the three NAFTA jurisdictions on short notice. As Professor Swan points out, Respondent's characterization is not necessarily accurate. (See Swan 2 ¶¶ 16-19.) In any case, such research and analysis would not be relevant. Respondent concedes (CM ¶ 410), and Claimant agrees, domestic statutory and common law is not a source of international law, and internal law should not be utilized to interpret NAFTA. Thus, domestic laws and cases are not the rules of decision in this case. The Tribunal is bound to apply NAFTA and the rules and principles of international law.

63. The principle of estoppel is a critical element of international law, particularly in the

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[18] *Temple* Case at 63, (emphasis in the original).

context of state responsibility for injury to foreign investment, because it is based on fundamental legal interests in predictability and the equitable principle of reliance that are essential for international economic intercourse. This general consideration is all the more important in the context of NAFTA, an international legal regime specifically designed to promote and protect trade and investment among the NAFTA Parties. Foreign investors depend on open and honest communication with host government authorities, and the rule of law requires that government officials be held to their commitments to foreign investors. Whatever the peculiarities of tax procedure in the States Party, NAFTA imposes a common regime, founded on minimum standards of international law, for the benefit of investors of another Party and their investments. (*See* Swan 2 ¶¶ 20-21.) No domestic rule or practice can justify arbitrary and discriminatory treatment of Claimant's investment in Mexico, and Respondent is bound by Hacienda's commitments.

64. In this discussion of the role of municipal law, it is worth noting the hypocrisy of Respondent's insistence on the relevance of its domestic Fiscal Code Article 34 to support its view that Claimant could not rely on any oral representations made by responsible tax officials since only written resolutions "can have legal effects." (*See, e.g.*, CM ¶¶ 411-414.) Respondent ignores the fact that it failed or refused to respond, in writing, as required by Article 34, to numerous written inquiries from Claimant regarding real and concrete situations.[19] (*See* Mem. ¶¶ 48, 56, 58, 94 and documents cited therein.) And Respondent fails to disclose its own responsibility, under Article 18 of the same Fiscal Code, to inform Claimant if an application he

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[19] Mr. Heftye does acknowledge that, in 1995, Claimant raised a "concrete case" to Hacienda. (Heftye Stmt. ¶ 12, CM 06026 (Span.))

made was defective, in form or otherwise, and give him an opportunity to rectify the defect. No such information or opportunity was ever given to Claimant. (Feldman 2 ¶ 6.)

65. Respondent also fails to explain, in the cases where it did respond in writing to Claimant's *consultas*, that it must have considered the inquiries to be about "real and concrete" situations, otherwise it would not have issued a written response. These cases include:

- the March 1992 letter from Administrator Riquet, confirming CEMSA's entitlement to IEPS rebates for cigarette exports (Mem. ¶ 19; Mem. App. 0062-69);
- the May 1994 letter from Undersecretary Gomez Gordillo confirming CEMSA's right to invoices with the IEPS stated expressly and separately (Mem. ¶ 44; Mem. App. 0087-89); and
- the March 1997 confirmation from Administrator Gomez Bravo that there was no material change in the IEPS law relating to rebates on cigarettes from 1992 through 1997 (Mem. ¶ 21; App. 0100-104.)

66. Claimant was entitled to rely on these responses and he did so rely. Since Hacienda confirmed that the law had not changed, each of these resolutions remained an accurate statement of CEMSA's rights as an exporter under the IEPS law. These written resolutions also provided the framework for Claimant's reliance on the oral assurances given, and agreement made, by Hacienda officials under which he exported in 1996 and 1997.

C. Denial of Fair Treatment

67. The numerous steps of harrassment taken by Respondent against Claimant and CEMSA since the beginning of this arbitration process have been designed to wear him down, intimidate him, consume his assets as well as his time and effort, and to hinder his ability to pursue this case. The actions are punitive and retaliatory, and are a clear breach of due process and the fair and equal treatment required by Article 1110 (c). As in *Pope & Talbot (Merits)*, the State relied on

"naked assertions of authority and on threats"[20] to force Claimant into submission. These actions are a breach of NAFTA Article 1110 (c) in that they deny due process to this Claimant in the course of his arbitration against the State.[21]

III. CEMSA Has Incurred Damages as a Result of Respondent's Breaches of NAFTA.

68. Respondent argues that CEMSA's cigarette export business was worthless and that CEMSA incurred no loss or damage from Hacienda's measures terminating its cigarette exports, because (1) CEMSA over-claimed IEPS rebates and (2) no profits could be made exporting cigarettes from Mexico. The first point is wrong. The second is ridiculous. Respondent would have the Tribunal believe that Claimant has been fighting against Carlos Slim and his friends in high office for ten years and has spent very large sums in this litigation to protect a business that offers no financial opportunity.

A. Sales to Dilosa and INPEXSA

69. One argument that CEMSA overstated its claim for IEPS rebates is that two of its customers in Central America allegedly are "fictitious companies." Without explaining what is meant by "fictitious," Mexico asserts that these sales were not *bona fide* (CM ¶ 446) and that "any award of damages for CEMSA's shipments to fictitious companies would be contrary to public policy." (CM ¶ 447.) Claimant agrees that no rebates would be due for fictitious sales. CEMSA has never claimed any. All of its sales were real, *i.e.*, *bona fide* exports to real

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[20] *Pope & Talbot (Merits)*, ¶ 174

[21] *Cf. Pope & Talbot (Merits)*, ¶¶ 156-181 (finding post-filing harassment of investor by Canada to be a violation of Article 1105.)

customers, unrelated to CEMSA. (Feldman 2 ¶ 01- 04.) There is no shred of evidence to the contrary, and no Mexican authority has charged that CEMSA failed to make any of the exports for which it claimed IEPS rebates.

70. The question of whether and where CEMSA's customers were incorporated and under what names they did business is wholly irrelevant. An individual, or a company, generally may do business under any name or legal form that it chooses.

71. This issue arose in the Mexican legal proceedings only because regulations issued under the IEPS Law permit rebates on exports to low tax countries if those exports are made to unrelated customers. It is asserted that, under this regulation, such exports must be destined for final consumption in the low tax countries (CM ¶ 220), but the IEPS Law itself only bars rebates for cigarettes exported for consumption in low tax countries. In any event, CEMSA's exports were made to foreign customers to points prescribed by them, generally in bond, for sale by such customers in international markets. CEMSA demonstrated that it was unrelated to Dilosa, not only with its own filing, but by a filing made directly by that company's representative. (Mem App. 0360-72, 0373-75.) As noted in the Memorial (Mem. ¶ 99), on the basis of information supplied by the government of Honduras (Mem. App. 0124-26), it appears that CEMSA's exports to Dilosa did not enter the customs territory of Honduras but were held in bond until shipment to third countries.

B. IEPS Calculation

72. The parties agree that, for cigarettes, the IEPS Law imposes a tax of 85% on "*el precio de venta al detallista*" or price to the retailer (the "detallista price"). Respondent contends that CEMSA claimed more IEPS rebates than those to which it was entitled, because it claimed more

than the tax actually paid by Cigatam. Yet, Respondent acknowledges that Claimant did not, and could not, know the tax paid by Cigatam because the "detallista price," established by Cigatam for purposes of the IEPS tax, was never disclosed by Cigatam or the government. (*See, e.g.* Oliver Stmt. ¶ 21.) Claimant repeatedly asked Cigatam to declare the tax it paid as the IEPS law required, and repeatedly petitioned the government to compel Cigatam to comply with its obligation under the IEPS law. (Mem. ¶¶ 48-49.) Respondent refused to do that, despite its obligation to respond to written inquiries concerning this real and concrete situation under its Fiscal Code as noted above. It, alone, is responsible for any mistake CEMSA may have made in its calculation of the IEPS tax.

73. Moreover, it is not established that CEMSA claimed more rebates than it was entitled to.[22] Respondent's witnesses confirm that Sam's Club, CEMSA's vendor, was a wholesaler for purposes of the IEPS tax. (Salazar Stmt, ¶ 27, CM 06082.) CEMSA purchased cigarettes from Sam's for resale, and Claimant reasonably determined that CEMSA was a retailer for purposes of the IEPS law. Thus, he reasonably concluded that the IEPS tax transferred to CEMSA by Sam's was 85% of the price that Sam's charged CEMSA for the cigarettes.

74. In late 1996 or early 1997, Claimant confirmed this calculation in a long, detailed discussion with a senior tax official, Jose Antonio Riquer Ramos, who was (1) responsible for major corporate taxpayers, including Cigatam, and (2) was thoroughly familiar with CEMSA's history with Hacienda concerning cigarette exports and IEPS rebates. (Mem. ¶ 89, Feldman Decl. ¶ 70.) Mr. Riquer's testifies that, "I do not recall him [Claimant] having commented with detail

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[22] It is not even clear that Cigatam paid all the IEPS tax that it should have paid under Mexican law. Hacienda had to approve the detallista price set by Cigatam that determined the tax to be collected. No evidence is submitted showing the actual prices charged to Cigatam's retailers.

regarding the procedure mentioned [the IEPS calculation] because my position was irrelevant towards an official response." (Riquer Decl. ¶ 21.) Claimant's recollections of this conversation are vivid, and Riquer's weak response -- undoubtedly under extreme pressure from his employers -- is no rebuttal.

75. In any event, for the reasons discussed above (¶¶ 59-66), Respondent is estopped, as a matter of international law, from challenging the IEPS formula that it encouraged CEMSA to use and that CEMSA did use to its detriment when it purchased and sold cigarettes. Not only did Hacienda confirm Claimant's IEPS calculation, it paid the rebates requested by CEMSA with full knowledge of CEMSA's exports and the amount of IEPS requested. At no time did any Hacienda official suggest to Claimant that CEMSA's applications for IEPS rebates were overstated or in any way deficient. Hacienda may be entitled to set new rules for future transactions, but it cannot, consistent with international law, punish CEMSA by changing the rules retroactively.

C. Lost Profits

76. Even if CEMSA did not calculate the amount of IEPS rebates correctly, as argued in the Counter-Memorial, it is entitled at a minimum to damages (using Respondent's IEPS calculation) including (1) IEPS rebates for cigarette exports in October - December 1997; (2) lost profits on cigarette exports that were blocked by Respondent's discriminatory measures in 1994-1996; and (3) lost profits after December 1, 1997. The parties agree that CEMSA was pricing cigarettes below market. If any Hacienda official had ever challenged Claimant's IEPS calculation, CEMSA could easily have adjusted its export price to maintain a high level of profitability. (Cervera 2 ¶ 5)

Claimant could also have sought to reduce the finance charges it paid to cover IEPS outlays. As Respondent acknowledges, these charges were extraordinarily high (*See* CM ¶ 181.) In the circumstances created by the Respondent, however, Claimant did not have compelling reason to bargain more vigorously. He was able to pay these fees and to make large profits.

77. The damage claims asserted in the Memorial are conservative. First, CEMSA's cigarette exports and related profits are significantly understated, particularly for 1996, because a number of invoices cannot be located. To avoid controversy and to assist the Tribunal, in calculating Claimant's damages the Memorial relies solely on exports that are fully documented. (*See* Mem. ¶¶ 84-85; Mem. App. 1603-1974.) Also, the parties agree on the amount of IEPS rebates received by CEMSA for 1996 exports.[23] But Respondent understates CEMSA's cigarette purchases in calculating the IEPS at 103% (CM ¶ 206). The invoices produced to Respondent show cigarette purchases of 36 million pesos in 1996, and these may be incomplete. (These documents are available to the Tribunal on request.)

78. Second, using the understated export numbers, Claimant relies on Cervera's "intermediate" projections for lost profits for both the 1994-1996 and post December 1, 1997 - periods. (Mem. ¶ 240, 245). Assuming, *arguendo*, that the profit margins for 1997 should be adjusted because CEMSA, through no fault of its own, claimed more IEPS than Cigatam allegedly paid, Claimant would still be entitled to damages on the order of twenty million dollars. Cervera 2 ¶ 15, Summary Chart.

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[23] IEPS figures are used in the Memorial for one purpose only: to calculate gross margins on documented cigarette exports.

SUBMISSIONS

In view of the facts and law set out in Claimant's Memorial and in this Reply, Claimant respectfully requests that the Tribunal:

A. Adjudge and Declare in Claimant's favor on his previous submissions, stated in the Memorial[24] and incorporated herein; and further

B. Adjudge and Declare that:

1. There is no bar to the jurisdiction of this Tribunal on the basis of NAFTA Article 2103.

2. There is no bar to the jurisdiction of this Tribunal on the basis of a principle of exhaustion of local remedies.

3. There is no bar to the jurisdiction of this Tribunal on the basis of any domestic litigation.

4. There is no other bar to the jurisdiction of this Tribunal to decide all the claims submitted.

5. Claimant has timely filed his claim relating to Respondent's 1998 tax assessment against CEMSA.

6. Respondent's allegations that Claimant was involved in cigarette smuggling or fraud in the conduct of CEMSA's cigarette export business are wholly unsupported and must be rejected.

7. Any error made by Claimant in his calculation of IEPS rebates was made in reasonable reliance of the representations of Respondent.

8. Claimant has demonstrated Respondent's breach of Articles 1110 and 1102.

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[24] Mem. at 129-30.

9. CEMSA's cigarette-export business was profitable, and Claimant is entitled to damages for CEMSA's losses due to Respondent's breach of its NAFTA obligations.

Respectfully submitted,

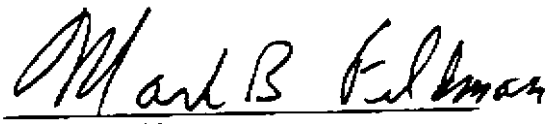

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TABLE OF EXHIBITS
TO
CLAIMANT'S REPLY TO RESPONDENT'S COUNTER-MEMORIAL

Arbitration of Marvin Roy Feldman Karpa v. United Mexican States
(ICSID Case No. ARB (AF)/99/1)

DECLARATION OF CLAIMANT MARVIN FELDMAN IN SUPPORT OF CLAIMANT'S REPLY TO RESPONDENT'S COUNTER-MEMORIAL

I, Marvin Roy Feldman, make this declaration in support of Claimant's Reply to Respondent's Counter-Memorial in the above captioned matter and hereby declare the following statements are true and are based on my personal knowledge, information and belief.

1. I do not have, never had, and CEMSA does not have, and never had, any financial interest in LYNX, Compania Exportadora Mexicana, Mercados Regionales, Mercados Extranjeros, or any other company owned by Cesar Poblano, or alleged in the Counter-Memorial as belonging to the so-called "Poblano-Gamez-Guemes network." My business relations with Cesar Poblano are discussed in my Declaration filed with and referenced in the Memorial, ¶ 132.

2. I never had, and CEMSA never had, any financial interest in any company owned by Gustavo Gamez or Luis Guemes. My business relations with Mr. Gamez are limited to the loans discussed in my Declaration filed with and referenced in the Memorial, ¶¶ 101-02. I do not have, and have never had, any business relationship with Mr. Guemes.

3. I never met Eduardo Silva. My only contact with him was by telephone for the purpose of purchasing cigarettes. He first contacted me in late spring or early summer of 1996. He told me that he found CEMSA on the internet.

4. As I stated in my previous Declaration, CEMSA and DILOSA were wholly unrelated businesses. See Mem. ¶ 99. I do not know whether or where DILOSA was incorporated, but it was not a "fictitious" business. Mr. Raul Gutierrez Maradiaga bought cigarettes from CEMSA on behalf of entities that he identified as DILOSA and INPEXSA. Neither I nor CEMSA had a financial interest in either business, and neither Mr. Gutierrez nor his companies had any financial interest in CEMSA.

5. All of CEMSA's cigarette sales were for definitive export from Mexico. I have no knowledge that any cigarettes exported by CEMSA were ever returned to Mexico. None of CEMSA's customers ever said anything to me suggesting (1) that cigarettes purchased from CEMSA would, or had been, returned to Mexico or (2) that they or any enterprise in which they were involved was engaged in smuggling cigarettes into Mexico. I would have halted sales immediately if I had any such suspicion.

6. No one at Hacienda ever told me, or advised me in writing, that any of my numerous written inquiries about the impossibility for CEMSA to obtain invoices stating the IEPS tax separately or expressly, or proposing solutions to this impossibility, or addressing the problem of IEPS calculations without such invoices, was not in the proper form or did not involve a real and concrete situation, so as to require a responsive resolution, or otherwise mentioned Article 34 to me. No one at Hacienda ever informed me of the proper format for such an inquiry.

Undersecretary Gomez Gordillo did ask me to put my request for revocation of the April 8, 1994 resolution from Mr. Aguirre in writing, which I did.

7. Respondent has alleged, regarding the agreement I reached with Hacienda in 1995: " The Claimant did not raise this issue directly with Undersecretary Ruiz in order to ensure that he was aware of an alleged 'oral agreement' with his predecessor, and to assert his position in respect of it." (CM ¶ 177. d.) This is not the case. In addition to the letter I sent to Mr. Ruiz on January 28, 1997 asking if there would be any change in the policy under which Hacienda had paid IEPS rebates to CEMSA in 1996 (Mem. ¶ 95; Mem. App. 0097-99), and the letter I wrote to the personal secretary to Hacienda's Secretary Guillermo Ortiz the previous day referring to the agreement with Hacienda and Mr. Ruiz's knowledge of same (Mem. ¶ 94; App. 0095-96), I wrote to Mr. Ruiz at the very outset of CEMSA's resumption of the cigarette export business in May 1996. A partial copy of this letter (the first page only) is attached to this declaration at Tab A. I do not have a full copy and I did not see this letter in the documents produced by Respondent.

8. In any event, I wrote to Mr. Ruiz because of abnormalities that occurred in one of CEMSA's first shipments of cigarettes for export. I found that the Customs Broker CEMSA had used for this 20 case shipment had created a false air-bill – the airline named in the air-bill told me that it had not handled this export. I suspected that the broker had not exported the cigarettes but sold them on the black market in Mexico. I sent Mr. Ruiz a copy of the air-bill and the pedimento for the export that had been faxed to CEMSA by the broker. In the letter, I started by reminding Mr. Ruiz that CEMSA "is entitled to the same treatment regarding the export of cigarettes as the producing companies" on the basis of "the anterior agreement with SHCP" and in compliance with the 1993 Supreme Court Decision. Mr. Ruiz did not answer.

9. This letter shows that I advised Mr. Ruiz, from the outset, that CEMSA was exporting cigarettes in reliance on my agreement with Hacienda. I believed then, and still believe, that he was well aware of this agreement from the time he took office as Undersecretary. I copied the General Administrator of Customs office and the office of General Administrator of Tax Collection, Angel Ramirez, as is evidenced by the stamps on the copy of the letter.

10. In addition to the harassment of CEMSA since the commencement of this NAFTA arbitration mentioned in the Memorial, Hacienda continues to harass me and my business. I mention a few instances:

a. For the past three years, since the CEMSA's application to be registered on the sectoral registry at Hacienda was rejected, Hacienda has repeatedly demanded that we file a quarterly IEPS declaration. CEMSA always responds in writing with a request for a correction due to the fact that it has no obligation to file under the amended law. Hacienda ignores this answer, and proceeds to impose a fine on CEMSA for not filing, and then withholds the amount of the fine from CEMSA's next application for IVA rebates. One official at Hacienda told me, when I objected to this harassment, that I had the recourse of suing Hacienda in tax court for the improperly deducted amounts. While the fines are not large, they cost me a great deal in time and effort expended in disputing them repeatedly, on a monthly

basis. Of course a suit to recover them would require a much greater expense.

b. In another case, Hacienda withheld an amount equal to approximately US $ 15,000 from CEMSA's IVA rebates as a fine for supposedly failing to export an item CEMSA imported under a temporary import permit. On March 13, 1996, CEMSA imported, under a temporary import permit, a mechanical "Elsie" cow for use at food show to promote its Borden milk import business. After the show, CEMSA returned the cow by re-exporting to its owner on April 3, 1996, and I thought no more about it. In October 2000, Hacienda imposed a fine of over US $ 15,000 against CEMSA and deducted it from IVA rebates due CEMSA in November, 2000. I am still disputing this improper deduction with Hacienda. In early January, 2001, I submitted a written request for review and reconsideration with all documents demonstrating that the cow was re-exported, including the import and export pedimentos. I have received no response to date. This incident, and the improper fine, has had a significant impact on CEMSA's business in terms of cash flow and time and effort available to conduct business.

c. After Hacienda issued an assessment of approximately US $ 25,000,000 against CEMSA in March 1999, Hacienda officials appeared at CEMSA offices at various times to require a bond for this amount under threat of seizure, with police enforcement, of whatever CEMSA property and assets they wished. Such a seizure would have rendered CEMSA inoperable. However, because CEMSA had appealed the assessment by initiating litigation, it was entitled to and had requested an "administrative embargo" or lien against the company in lieu of seizure. The appearance of these officials was designed purely to harass, punish and intimidate me. Ultimately, Hacienda registered the administrative embargo.

d. Hacienda issued a tax assessment of approximately US $ 50,000 against CEMSA on February 27, 1998 relating to the 1991 tax year, more than 5 years earlier. This assessment was issued the week after I filed a Notice of Intent to Arbitrate under NAFTA. I filed an appeal in the Regional Tax Court, which declared the assessment a nullity on September 22, 2000 because the audit inspection lacked grounds. SAT finally issued a resolution on March 2, 2001 rendering the resolution containing the tax assessment null and void. Hacienda had no basis to issue this assessment in the first place. This was another instance of punishment designed to use up my funds and energy.

e. An example of interference with potential witnesses in this case involves a very knowledgeable attorney, Mr. Luis Ortiz Hidalgo, who is a tax specialist with a prominent firm of attorneys which is among the most well regarded in Mexico. In October 2000, Mr. Ortiz accepted the representation of CEMSA to submit an opinion as a tax expert in this NAFTA arbitration. At that time, he told me that he had been personally appointed by Francisco Gil Diaz to represent Aventel, a large Mexican telephone company (the Mexican affiliate of MCI) in a major case against the Government of Mexico. Mr Gil Diaz, at the time, was President of Aventel.

Mr. Ortiz commenced work for CEMSA and produced a draft opinion for CEMSA's use in this arbitration. However, on about January 31, 2001, I learned that Mr. Ortiz was attending a meeting with Mr. Gil Diaz, who was by then Secretary of the Treasury (Hacienda). A colleague of Mr. Ortiz's from his law office, who was working on CEMSA's case, told me it was almost certain that Secretary Gil Diaz and Mr. Ortiz were discussing my case. Only a few days later, Mr. Ortiz advised me that he and his firm would no longer continue to represent CEMSA and that CEMSA could not use his opinion in this arbitration. Mr. Ortiz told me that Secretary Gil Diaz had called me a "*hampon*" or "thief" and that he was going to put me in jail.

Each of these instances were intended by Hacienda to intimidate me, to make it difficult for CEMSA to do business, and to interfere with the presentation of my claim to this Tribunal.

Date: June 8, 2001

Marvin Roy Feldman, Claimant

Courtesy Translation

[CEMSA Letterhead at top left.]
[Stamped received by SHCP and various other agencies of the Mexican Government.]

5/9/96
SHCP
Lic. Tomas Ruiz
Under Secretary for Income

Correspondence via Fax and
Return Receipt

As you know, on the basis of the previous agreement of the SHCP and in compliance with the judgment of the Supreme Court of the Nation 1241/91, our business gets the same treatment in the export of cigarettes as producing businesses.

In compliance with our debt as a Foreign Trade Business relating to our exports of cigarettes, this letter is to report what we suspect is an anomaly on the part of Customs Agent Lic. Elias Contreras Alvarado with National Patent 3075, operating as Customs Corporation JHAIR International with registration ID. CAJ950728TI9, with place of business in Moctezuma, Second Section Blvd. Airport, No 320, Mexico, DF, Tel.: 784-6513 and 784-7503

I personally sent 20 boxes of cigarettes referred to in our invoice attached 275 that supposedly were exported by Pacific International Airlines, Air bill No 987-001-4370, copy attached, which is false in virtue of the fact that they were not exported by this line

Also attached, a copy of the *pedimento de exportación* 3075-6000713, File 0014854 that we received by fax manifesting the export of the cigarettes referred to in our invoice 275

CEMSA

CORPORACION DE EXPORTACIONES MEXICANAS S.A. DE C.V.

9.5.96.
SHCP
Lic. Tomas Ruiz.
Subsecretario de Ingresos
512-0064.228-2880.Fax.
Presente.

Correspondencia Via Fax y
Acuse de Recibo.

Como tu sabes, en base del acuerdo anterior de la SHCP y en cumplimiento del fallo de la Corte Suprema de la Nacion 1241/91 nuestra Empresa tiene el mismo tratamiento en la exportacion de cigarros que las Empresas fabricantes.

En cumplimiento de nuestro deber como Empresa de Comercio Exterior relacionado con nuestras exportaciones de cigarros, esta carta es para reportar lo que nosotros sospechamos que es una anomalia por parte del Agente Aduanal Lic. Elia Contreras Alvarado con Patente Nacional 3075 operando como Corporacion Aduanal JHAIR Internacional con Cedula de Registro CAJ950728TI9, con Domicilio en : Moctezuma Segunda Seccion Blvd. Aeropuerto No. 320, Mexico, D.F. Tel: 784-6513 y 784-7503.

Yo personalmente entrego 20 cajas de cigarros referida en nuestra Factura anexo 275 que supuestamente iván a ser exportados por Pacific International Airlines Guia No. 987-00104370 copia anexo, que es falsa en virtud de que no fue exportada por esa linea.

Tambien anexamos copia del pedimento de exportacion 3075-6000713, Folio 0014854 que nosotros recibimos via fax manifestando la exportacion de los cigarros referida en nuestra factura 275.

Manuel Gutiérrez Nájera No. 249 Col. Tránsito México D.F. C.P. 06820
(52) (5) 740-7512 280-1113 740-6240 280-3207 Fax. 280-6464

Bufete
Enríquez
Paz y Puente, s.c.

Arbitration of Marvin Roy Feldman Karpa
vs.
United Mexican States
(ICSID Case No. ARB(AF)/99/1)

COMPLEMENTARY DECLARATION OF OSCAR ROBERTO ENRIQUEZ ENRIQUEZ IN SUPPORT OF CLAIMANT'S MEMORIAL

1 bis. In addition to my prior affidavit, I would like to declare to the honorable Tribunal the following:

2 bis. Excess and illegal rebates paid to "Lynx Exportadora, S.A. de C.V.". On the 10th of March,1993 the Local Administrator of Tax Collection in Monterrey, using official communication number 102-A-01-III-02-9896, authorized the IEPS rebate in favor of the company Lynx for the total amount of $8'709,371.50 ($1'108,626.70 U.S. at the rate currency in December, 1996, that was $7.856 pesos per dollar) in compliance with the amparo resolution dictated by the Supreme Court of Justice in the amparo revision case 1177/91.

3 bis. The company considered that the compliance with the finding of the court was defective because the SHCP did not quantify

correctly the actualized amounts to be rebated nor the corresponding interest and there existed a pending credit in its favor for the approximate amount of $900,000.00 ($114,562.12 U.S. at $7.856 pesos per dollar) plus the actualized amount and interest that corresponded to the mentioned amount.

4 bis. For that reason the company Lynx decided to appeal and make the complaint for defective compliance with the sentence, calculating that the SHCP continued to owe the amount of $3'652,251.08 ($464,899.57 U.S. at $7.856 pesos per dollar) including actualization and respective interest.

5 bis. The complaint appeal and the complaint of the complaint that the SHCP replied to before the Supreme Court was resolved partially in favor of the company.

6 bis. But surprisingly, when the SHCP authorized the rebate (in supposed compliance with the reasoning of the judgment) in the document number 322-A-VIII-3-A-b-115230, dated December 5th, 1996, and signed by the Local Administrator for Tax Collection of the Southern District of Mexico City, Mr. Luis Enrique Marín Bañales, who authorized a total amount of $27'011,322.00 ($3'438,304.70 U.S. at $7.856 pesos per dollar).

7 bis. The official document service person, Francisco del Angel Rosas, went directly to the company's office and gave the corresponding check to Mr. Cesar Poblanno Gonzalez, legal representative of the company.

8 bis. For unknown reasons but easily imaginable, at the end of December of 1996 or the beginning of 1997, the stockholder of the company decided to close the company and formed a new company called "Cemex Compañía Exportadora Mexicana, S.A. de C.V."

9 bis. I became aware and discovered all of the above because during the middle of December of 1996, I went to the Seventh District Administrative Court in Mexico City and reviewed the file in order to know the existing state of the process that the case was in and the compliance of the judgment and found that the SHCP had remitted the pending documents to the district Judge as proof that they had complied with the mentioned finding.

10 bis. In January of 1997, after the executives of Lynx returned from the December holidays, I spoke with them about the facts described above and I encouraged them to return to the SHCP the amounts they had collected in excess.

11 bis. They refused to do so arguing that it was *"an eye for an eye and a tooth for a tooth"* because the SHCP had caused them serious financial damages with the whole actions that they had settled to prevent their export activities of alcoholic beverages and tobacco through the denial of the IEPS rebates. Damages that were not satisfied enough with the amounts they would received under normal corresponding conditions.

12 bis. Because I was not in agreement with what they had done, they became very angry with me and took this disagreement as justification for not paying my corresponding fees for my

professional services and in addition, they tried to stop me from obtaining copies of the documents that incriminated them, presenting a promotion to the Seventh District Judge by which they revoked my authorization as the representing attorney.

13 bis. Non the less, I obtained without trouble copies of the total judicial file and because I was afraid that as representing attorney I could become involved in the problem of excess and illegal rebates and for the reason that the evidencing documents were exhibited by the SHCP before the District Judge and after intensive reasoning meditation and thinking and even off-the-record consultations with high officials of the SHCP and the General Attorney of the Republic office, decided to present a formal accusation before the General Attorney dated on June 20th, 1997 and as well asked for an appointment with Ismael Gómez Gordillo, who was at that time General Attorney for the Treasury, who listened carefully to me receiving a written description of the specific facts that he personally suggested to me not to sign and told me that he would proceed immediately to investigate the case with the most possible discretion and confidentiality.

14 bis. Several months later, when we finished our first meeting with Ismael Gómez Gordillo for the discussion and possible resolution of the CEMSA's and Mr. Feldman's problem, the General Attorney for the Treasury himself asked me to remain in the conference room because he needed to talk to me in private. When we were alone, he told me that they had initiated an audit against Lynx and they had established the truth of all the facts denounced by me. After this, I never again heard a single word about the case.

Signed this day in Mexico City, Mexico, June 8th, 2001.

Mr. Oscar Roberto Enríquez Enríquez.
Attorney at Law.

(This page is part and the last one of the whole document with a total of five).

SECOND EXPERT OPINION OF CARLOS LOPERENA RUIZ CONCERNING MEXICAN LAW

I. Conclusion.

Having reviewed the laws discussed below, and based on my general knowledge of Mexican law and practice, it is my opinion that the Secretaria de Hacienda y Crédito Público ("SHCP") is obliged to enforce compliance of individuals and corporations with tax laws, and that compliance with those is not a matter subject to litigation between private parties.

II. Discussion.

A. *Relevant Tax Legislation*.

Article 29-A of the Federal Tax Code establishes a general duty for taxpayers to grant invoices with all the legal requirements mandated by the laws. Furthermore, it states that invoices shall state the unitary value with numbers; the total price with numbers and words; as well as the tax amounts that according to the applicable tax provisions must be stated.

The IEPS Law states that taxpayers who engage in activities covered by such law, such as selling cigarettes in Mexico must fulfill certain obligations. Among these obligations article 19, subsection II indicated since January 1st, 1984 that it was an obligation to issue invoices passing expressly and separately the applicable tax. It was not until April 1s, 1999 when the policy reversed and the IEPS Law requested for the issuance of receipts without passing expressly and separately the tax established in the IEPS Law. Certain exceptions were made but not for tobacco products.

B *SHCP's duty to enforce tax legislation.*

I have been told that CEMSA informed SHCP on several occasions of third parties refusals to provide invoices with separate and express tax even though the IEPS law clearly mandated so. Once the SHCP was aware of these refusals it must had acted in order to enforce the abovementioned provision.

The Federal Public Administration Organic Law establishes the duties of the different entities that form the Executive Branch of the Federal Government, including those of the Ministry of Finance and Public Credit. Article 31, subsection XI imposes a double duty on SHCP Firstly, to ensure the compliance of tax laws On the other hand it provides that such objective must be achieved through surveillance

The legal relation between Sam's and Cigatam with CEMSA is not of civil or private nature, regarding the separation of the IEPS tax. It arises from a tax (fiscal) law. The one entitled to request the separation is the authority. The private relations are governed by the civil and commercial codes These relations are known as "obligations" which are the relations between a creditor and a debtor. CEMSA has not standing to sue for the separation of the IEPS tax in a commercial suit. It is similar to the obligation of the employer has to withold a tax from the salaries of the employees and then to pay said tax to the authorities. If the tax witheld is not paid to the authorities, the employee is not entitled to sue for that payment. The employee is not the creditor of said payment. In summary, it is my opinion that CEMSA acted correctly according to the Mexican laws and that SHCP was empowered by the law to compel third parties to comply with the applicable legislation.

I declare that the foregoing is true to the best of my knowledge.

June 7, 2001

Carlos Loperena Ruiz

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
(Claimant)

v.

THE UNITED MEXICAN STATES
(Respondent)

AFFIDAVIT

of

PROFESSOR ALAN C. SWAN

Professor Alan C. Swan being duly sworn, hereby states as follows:

Purpose of Affidavit and Summary Conclusions

(1) This Affidavit is in response to Respondent's argument that, contrary to Claimant's position, Respondent cannot be estopped from imposing upon CEMSA certain documentary requirements as a condition of obtaining rebates of taxes paid under the Impuesto Especial Sobre Produccion y Servicios ("IEPS") law.

(2) In his Memorial, Claimant contends that, even if *arguendo* it is conceded that under the IEPS law, CEMSA was not entitled to rebates unless it produced vendor invoices breaking-out the amount of taxes paid under that law, Respondent is estopped, under international law, from requiring that break-out for cigarettes exported in October, November and December, 1997. The estoppel rests, according to the Memorial, on two sets of circumstances: (1) a series of written and verbal statements starting in March of 1995, continuing through May/June of 1996 and episodically thereafter (Memorial, para 56-98) assuring Feldman that rebates would be forthcoming upon CEMSA's certification of the IEPS taxes paid, and (2) the fact that Respondent, without any vendor invoice

break-outs and solely on the strength of CEMSA's certifications, did, in fact, rebate IEPS taxes paid on all CEMSA exports beginning in early 1996 and continuing through September 1997. Only thereafter did Respondent reverse itself and deny rebates for exports made in October, November and December 1997.

(3) In answer, Respondent in its Counter-Memorial contends that no such estoppel can operate, for two reasons.

First, it contends that under international law "estoppel" only operates to foreclose a party from denying the truth of "statements of fact." It does not operate to bind a party "on matters involving the interpretation of law". (Counter-Memorial para., 401). Presumably, Respondent intends to characterize the assurances given Feldman that CEMSA's certification would suffice and the fact that rebates were made on the basis of those certifications as "matters involving the interpretation of law."

Second, Respondent argues that under the domestic law of all three NAFTA Parties — Mexico, Canada and the U.S. — the "estoppel" doctrine cannot be applied to interpretations, rulings, and presumably other pronouncements by tax officials on tax law. This is based, Respondent claims, upon a "need to preserve the broad flexibility necessary to the administration of the tax laws." (Counter-Memorial para., 427). Thus, according to Respondent, the position taken by the Parties' domestic law is of "relevance" to international law and should presumably inform, indeed be adopted by, international law.

(4) In your Affiant's opinion Respondent is simply wrong when it contends that under international law "estoppel" is limited to "statements of fact". It is also your Affiant's view that Respondent has greatly over-simplified the extent to which, under United States' law, the "estoppel" doctrine cannot be used against tax officials acting under the tax law. The question is far more complex than Respondent allows. Because of complexity and because of the unique objectives of NAFTA, it is your Affiant's view that this Tribunal would be ill-advised to bar the use of the estoppel doctrine, as practiced at international law, to official actions cognizable under the NAFTA Agreement.

Estoppel Under International Law — the Precedents

(5) The leading case on the doctrine of estoppel at international law is the ICJ decision in the *Case Concerning the Temple of Preah Vihear* (Cambodia v. Thailand)[1] (hereinafter the *Temple Case*). The Temple, an ancient sanctuary of religious, archeological and artistic interest, stands on the border between Thailand and Cambodia. In 1904, in order to resolve the much disputed boundary between then Siam and French Indochina, France and Siam, by treaty, stipulated that in the area of the Temple the boundary was to follow the "watershed" between the basins of two named rivers. The treaty also provided for a Mixed Commission to more precisely delimit the boundary prescribed by the treaty. The Commission did its work and in 1908 produced a map — the so-called "Annex I Map" — showing the Temple on the Cambodian side of the border.

In 1959 a dispute over which country owned the Temple was submitted to the ICJ. At that point Thailand argued that the Annex I Map erred because it failed to follow the "watershed" line of the treaty and that under the treaty line the Temple was located in Thai territory. The Court noted that the Map had no official status, never having been formally approved by the Mixed Commission. It then assumed *arguendo* that Thailand was correct and that the Mixed Commission did not have authority to deviate from the "watershed" line of the treaty. Nevertheless, the Court concluded that the Map was controlling and that the Temple belonged to Cambodia. It noted that when first promulgated, Thailand, with ample opportunity, failed to issue any reservation or protest against the Map. Then after noting other actions by Thailand especially visits to the Temple by high-ranking and knowledgeable Thai officials always on the assumption that they were entering Cambodian territory, the Court stated:

> Even if there were any doubt as to Siam's acceptance of the map in 1908 . . . the Court would consider, in the light of the subsequent course of events, that Thailand is now precluded by her conduct from asserting that she did not accept it. She has, for fifty years, enjoyed such benefits as the Treaty of 1904 conferred on her, if only by benefit of a stable frontier. France, and through her Cambodia, relied on Thailand's acceptance of the map. . . . [I]t is immaterial whether or not this reliance was based on a belief that the map was correct. It is not now open to Thailand, while continuing to claim

[1] ICJ Reports 1962 at page 6.

> and enjoy the benefits of the settlement, to deny that she was ever a consenting party to it.[2]

(6) Observe that, in the *Temple Case*, there were *facts* in the form of statements made, or not made, by Thailand when the Map was promulgated and in the form of subsequent conduct especially official visits to the Temple. What these *facts* represented — their only relevance — was their *legal purport*. They were tantamount to a statement by Thailand that irrespective of any boundary prescribed by the 1904 treaty, the Map defined the *legal* boundary between Thailand and Cambodia. What the Court concluded, therefore, was that Thailand was "estopped" from denying this *legal conclusion*. The estoppel did not just bar Thailand from denying the *fact* of the official visits or the *fact* that it had uttered or failed to utter certain words. It was estopped from denying the legal implications of those events.

(7) Likewise, in the instant case, there was the *fact* of the assurances given Claimant, the *fact* that Respondent accepted and made rebates against CEMSA's certification of the taxes paid for over 16 months (May 1996 — September 1997) and the *fact* of Claimant's reliance on that conduct. Thus, as in the *Temple Case*, Respondent is not simply "estopped" from denying that these *facts* took place. It is also "estopped," by those *facts*, from asserting the legal proposition that CEMSA's certification is inadequate to support a rebate claim on exports.

(8) Consider, at this point, the concurring opinion in the *Temple Case* of Judge Sir Gerald Fitzmaurice. The Judge's opinion has been much noted as of seminal importance.[3] Fitzmaurice starts by emphasizing that the pre-1904 context of the case — the unsettled state of the boundary line between Siam and French Indochina — was important in assessing later events[4] Then, when he turns to the principle of "estoppel" the Judge first notes that a certain careless usage has sometimes entered common speech. One sometimes finds it said that a party who has an obligation under a treaty or a contract, is "estopped" from denying that obligation. This, he says, is not the province of the principle of "estoppel." To the contrary, a "plea" of estoppel:

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[2] Id., at page 32.
[3] See: Jennings, COLLECTED WRITINGS, VOL 2, at page 975 (Kluwer Law International, 1998)
[4] ICJ Reports 1962, at page 53.

> . . . is essentially a means of excluding a denial that might be *correct — irrespective of its correctness.* It prevents the assertion of what might in fact be *true.* Its use must in consequence be the subject of certain limitation. The real field of operation, therefore, of the rule of preclusion or estoppel, *stricto sensu,* in the present context, is where it is possible that the party concerned did not give the undertaking or accept the obligations in question (or there is room for doubt which it did), but where that party's subsequent conduct has been such, and has had such consequence, that it cannot be allowed to deny the existence of an undertaking or that it is bound." (emphasis in the original.)[5]

(9) Much of Respondent's Counter-Memorial is taken-up with asserting the clarity with which the IEPS law requires that vendor invoices break-out the taxes paid as a condition of rebates. Despite that clarity, however, there is the context in which Respondent acted and, as Judge Fitzmaurice emphasized, context can be important.

> First, Claimant faced a dilemma; a dilemma Respondent well understood. Claimant was, by law, entitled to rebates, but could not, according to Respondent, obtain those rebates without the invoice break-outs. Yet, Respondent denied that it had any official responsibility for obtaining those break-outs from either CEMSA's vendors or from the producers and both Claimant and Respondent knew, very well, that Claimant could not realistically expect vendors or producers to heed his request for breakouts.
>
> Second, at the same time Respondent's tax authorities had a problem. There was Claimant's legal right to rebates and his continuing demand, aided by the American embassy, that Respondent recognize that right.

It is in this context then that Respondent reached an accommodation with Claimant and for 16 months or more accepted CEMSA's certifications and made the rebates Claimant sought.

(10) This is classically the setting described by Fitzmaurice. It may be conceded *arguendo* that Respondent's officials were legally correct in concluding that under the IEPS law vendor invoices had to break-out the taxes paid. It may be conceded *arguendo* that Respondent's officials had no legal obligation to compel vendors to make that break out. But, as Fitzmaurice puts it, "irrespective of this correctness," under international law, the Respondent is "estopped" by its conduct, and by the fact of Claimant's reliance

[5] Id., at page 63.

on that conduct, from denying Claimant's right to a rebate of the taxes paid on the October-December exports by reason of CEMSA's certifications. This is the critical cutting edge of the estoppel doctrine under international law, a point to which your Affiant will return later in discussing the doctrine under U.S. law.

(11) A further definition of the nature, normative underpinnings and sources of the estoppel doctrine at international law, is to be found in the concurring opinion of Vice President Alfaro in the *Temple Case*. The Vice President, after declaring that he would not use the terms "estoppel" or "preclusion," because he thought they "did not fit exactly the principle or doctrine applied in international cases," continues:

> . . . [W]hen compared with definitions and comments contained in Anglo-American legal text we cannot fail to recognize . . . that there is a very substantial difference between the simple and clear-cut rule adopted and applied in the international field and the complicated classifications, modalities, species, sub-species and procedural features of the municipal system.[6]
>
> * * * *
>
> Whatever term or terms are employed to designate this principle such as it has been applied in the international sphere, its substance is always the same; inconsistency between claims or allegations put forward by a State, and its previous conduct in connection therewith, is not admissible. . . Its purpose is always the same; a State must not be permitted to benefit by its own inconsistency to the prejudice of another State. . . Finally, the legal effect of the principle is always the same; the party which by its recognition, its representation, its declaration, its conduct or its silence has maintained an attitude manifestly contrary to the right it is claiming before an international tribunal is precluded from claiming that right.[7]

The Judge then goes on to quote Lauterpacht to the effect that "estoppel" or "prescription" are an:

> . . . essential requirement of stability — a requirement even more important in the international than in other spheres; it is a precept of fair dealing inasmuch as it prevents states from playing fast and loose with situations affecting others; and it is in accordance with equity inasmuch as it protects a State from the contingency of incurring responsibilities and expense, in reliance on the apparent acquiescence of others, and being subsequently confronted with a challenge on the part of those very States."[8]

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[6] Id., at page 39.
[7] Id., at page 40.
[8] Id., at page 41. The quotation from Lauterpacht, is from *Sovereignty Over Submarine Areas*, [1950] BYIL.

Vice President Alfaro then concludes by observing:

> In my judgment, the principle is substantive in character. It constitutes a presumption *juris et de jure*. . . . In short, the legal effects of the principle are so fundamental that they decide by themselves alone the matter in dispute and its infraction cannot be looked upon as a mere incident of the proceedings.[9]

Your Affiant will return to reflect on some of the implications of Vice President Alfaro's opinion for Respondent's suggestion that the estoppel doctrine should not operate against officials acting under domestic tax laws.

(12) There is, of course, a good deal of additional authority on estoppel under international law. Consider, for example, the *Nottebohm Case* (Liechtenstein v. Guatemala).[10] The first issue addressed by the ICJ was Liechtenstein's assertion that statements and actions by Guatemalan officials "recognized the naturalization which [Guatemala] now challenges." Guatemala could not, according to Liechtenstein "be heard to put forward a contention which is inconsistent with its former attitude."[11]

(13) Note the way Liechtenstein's argument is phrased. The words the "naturalization which [Guatemala] now challenges" were not a reference to Guatemala's assertion of *fact* that Nottebohm lacked Liechtenstein nationality. The "naturalization" being challenged refers to Guatemala's legal position that Liechtenstein lacked "the right to seize the Court of a claim on Nottebohm's behalf." In other words, the statements and other actions by Guatemalan officials — the *facts* — were not being used simply to estop Guatemala from denying the *fact* that Nottebohm was a Liechtenstein national. They were being used to estop Guatemala from denying Liechtenstein's *legal right* to extend diplomatic protection to Nottebohm before the ICJ. This is confirmed expressly by the Court when, after reviewing all the evidence relied upon by Liechtenstein, it concluded:

> There is nothing to show that before the institution of proceedings Guatemala had recognized Liechtenstein's title to exercise protection in favor of Nottebohm and that it is thus precluded from denying such a title.[12]

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[9] Id., at pages 41-42.
[10] ICJ Reports, 1955 at page 4.
[11] Id., at page 17.
[12] Id., page 19.

(14) In the *North Sea Continental Shelf Case* (Denmark/Federal Republic of Germany)[13] the question was whether, as Denmark and the Netherlands both argued, Germany was bound to the 1958 Geneva Convention on the Continental Shelf, especially the delimitation principles of Article 6, even though it was not a signatory to the Convention. The Court answered the question as follows:

> [I]t appears to the Court that only the existence of a situation of estoppel could suffice to lend substance to this contention — that is to say if the Federal Republic were now precluded from denying the applicability of the conventional regime, by reason of past conduct, declarations etc., which not only clearly and consistently evinced acceptance of that regime, but also had caused Denmark or the Netherlands, in reliance on such conduct, detrimentally to change position or suffer some prejudice. Of this there is no evidence whatever in the present case.[14]

Again, the "estoppel," if any, was a bar to the denial of a legal conclusion; that Germany was bound by the terms of the 1958 Geneva Convention.

(15) While serious questions exist as to when a recognition of sovereign title to territory will work an estoppel, especially when the recognition is by a third party not a claimant to the territory, *de jure* recognition by a rival claimant almost always works a decisive estoppel.[15] Thus, in the *Eastern Greenland Case*[16] the Court thought it very significant that certain treaties between Norway and Denmark contained exclusion clauses by which Norway had effectively recognized the Danish claim over Eastern Greenland. The Court then stated:

> In accepting these bilateral and multilateral agreements as binding upon herself, Norway reaffirmed that she recognized the whole of Greenland as Danish; and thereby she has debarred herself from contesting Danish sovereignty over the whole of Greenland, and, in consequence from proceeding to occupy it.[17]

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[13] ICJ Reports, 1967 at page 3.
[14] Id., at page 26.
[15] Jennings, COLLECTED WRITINGS, VOL 2, (Kluwer Law International, 1998) Id, at page 976.
[16] PCIJ Reports, Series A, No., 53.
[17] Id., at page 68.

Estoppel Under U.S. Tax Law and Under International Law.

(16) The U.S. law of estoppel against tax authorities is not quite as simple as the Respondent's Counter-Memorial avers (Counter-Memorial para., 421-427). Where, under the law, there is a substantial element of executive discretion, estoppel can indeed work against the taxing authorities under U.S. law as the case of *Interstate Fire Insurance Company v. United States*[18] illustrates. That case arose under Section 482 of the Internal Revenue Code which vests a discretion in the Secretary of the Treasury to require the reallocation of expenses and income as between affiliated taxpayers when necessary to avoid tax evasion or clearly reflect income. Only the government can demand a reallocation under Section 482. The taxpayer cannot use that Section to change whatever allocation principles were employed in preparing its return. In the *Interstate Fire Insurance Case*, taxpayer for the years 1951 through 1955 had used a contractual formula to allocate income and expenses between it and its affiliated life insurance company. In an audit of its 1955 return the IRS invoked Section 482 and demanded that taxpayer reallocate according to certain cost accounting principles. By 1957, the taxpayer had developed a new formula which the court characterized as "sound and correct." It was, however, a formula which, at least as applied to 1955, favored the taxpayer over the government. Whereupon the IRS effectively withdrew its reallocation order for 1955 and then denied taxpayer's demand that all prior years 1951-1954 be opened to the new formula. Taxpayer sued. The court held that by reason of its conduct in ordering a Section 482 reallocation for the year 1955, the IRS was "estopped" from denying the resulting reallocation for that year, even though the result was unfavorable to it. It was not estopped from denying a reallocation for the years prior thereto because it had never engaged in any inconsistent conduct to which it could be bound; it had never invoked the Section 482 authority for those years and its 1955 action did not implicitly relate back to the prior years. In holding that the Government was estopped from denying the results of the 1955 reallocation, the court stated:

> It is sometimes stated as a general rule that estoppel cannot operate against the government [cases cited]. . . . The cases appearing to so hold can generally be distinguished as stating one or more of the many exceptions to the application of the doctrine of estoppel as against the government as for

[18] 215 F. Supp. 586 (E.D. Tenn., 1963) *aff'd by unpublished order* 339 F. 2d 603 (CA 6., 1964).

> example [examples listed] . . . . The rule that estoppel may apply against the government in appropriate situations, however, is well stated in the case of *Smale & Robinson, Inc. v United States*, D.C., 123 F. Supp. 457 where the court, after a full discussion of the above exceptions, in a well reasoned opinion states the rule to be as follows:
>
> > The United States has long consented to respond to liability for and to be sued on claims for tax refunds [cases cited] . . . and the authorities cited lead to the conclusion that a taxpayer should be permitted to invoke the doctrine of equitable estoppel against the government in cases where (1) there has been a waiver of sovereign immunity both as to liability and as to suit, [cases cited] . . . (2) the agent whose conduct is relied upon to work an estoppel acted within the scope of his authority lawfully conferred, and (3) application of the doctrine would not bring a result that is either inequitable or contrary to law."

(17) A number of conclusions would seem to follow from this example. First, the question of estoppel against taxing authorities under United States law is complicated. Admittedly, the *Interstate Fire Insurance Case* may be a narrow exception because it dealt with Section 482. Under that Section the executive has a great deal of discretion. This means that a rule holding the executive to the legal implications of its prior conduct poses less of a threat to the integrity of the law itself. But if so, the circumstances that distinguish the case only add a further complication to the US law and further complicate the basic issue of whether assimilation of US law into international law would be wise.

(18) Second, if the IEPS law is either ambiguous or confers on Respondent's taxing authorities a substantial discretion to prescribe the documentation required for rebates, and if the Tribunal is to follow United States law, it would appear that the Tribunal should estop Respondent from denying the efficacy of CEMSA certifications. All the conditions for an estoppel laid down by the court in the *Interstate Fire Insurance Case* will have been met.

(19) Third, even if the IEPS law is clear on the required documentation for rebates, there is still the context in which the Respondent not only gave assurances to Claimant but for 16 months accepted CEMSA's certification of the taxes paid on exports. Not only did Claimant face a dilemma but Respondent had a problem. Claimant's rights were being frustrated. Claimant aided by the American embassy was demanding that his

rights be vindicated. In this context Claimant and Respondent reached an accommodation. In lieu of a break-out in vendor invoices, Respondent agreed to accept CEMSA's certification of the taxes paid. It is this context, irrespective of what the domestic law of the NAFTA parties might be, that gives international law its special normative force.

(20) When a State reaches an accommodation with a foreign investor on the mechanics for securing to the investor that to which he is legally entitled, points made in the *Temple Case* speak with particular force. In that context, it is particularly important, as Judge Fitzmaurice put it, that international law "exclud[e] a denial that might be correct," or in Lauterpacht's words that international law prevent "states from playing fast and loose with situations affecting others;" or, as Alfaro says:

> "a party which by its conduct has maintained an attitude contrary to the right it is claiming before an international tribunal [be] precluded from claiming that right

This is the normative simplicity and urgency which Vice President Alfaro ascribed to international law.

(21) This case arises under NAFTA. The overriding purpose of NAFTA is to fashion an international legal order characterized by stability in legal institutions, transparency in the formulation of law and equity and predictability in the interpretation and application of the law. This is particularly so in the matter of foreign investors, where Chapter 11 vests the power to enforce NAFTA's rules in the private investors most directly affected by their breach. As such, NAFTA, while only a regional enterprise, is a model — a template — for a new global legal order. From that perspective, the traditional international law of estoppel must be fully integrated into NAFTA jurisprudence. It is the functional aspects of the traditional international law emphasized by Fitzmaurice, the values underscored by Lauterpacht and the simple reliability demanded by Alfero that must be preserved if NAFTA is to be the pattern for advancing the rule of law in international economic intercourse. Whatever domestic legal systems might think necessary to protect their own treasuries against their own citizens who, in democracies such as the NAFTA countries, have political access to the instruments of governmental power, those protective policies have no place in NAFTA.

Estoppel on Statements of Fact vs. Legal Interpretations

(22) In support of its contention that "estoppel" works only to bar a party from denying its own "statements of fact" and not from disavowing its own legal conclusions, the Counter-Memorial (para., 403) relies on a statement quoted by Brownlie from a seminal article written by Bowett in 1957[19] In his reference to the Bowett statement, Brownlie, as Respondent quite accurately notes, offers a caution (Counter-Memorial para., 405). What Respondent ignores, however, is that Brownlie, in cautioning against reading Bowett too broadly, drops a footnote questioning Bowetts use of the reliance principle to explain the doctrine and then adding:

> Nor does his [Bowett's] distinction as to statements of fact have much viability.

All the cases discussed above offer ample grounds for Brownlie's skepticism.

(23) Bowett's article was written from a very particular common law perspective. He was arguing that the "estoppel" principle under international law had its origins in the common law. In making this argument he sets out several forms of estoppel as practiced at common law, most notably "estoppel in pais,"[20] what he calls "estoppel by conduct."[21] He then goes on to make clear that it is "estoppel by conduct" which is of principal concern to him and for which he is being cited by Brownlie.[22] At common law, however, "Estoppel in pais" had a very narrow compass. It barred or estopped a person from denying the truth of a statement made or conduct taken, or denying that no statement was made or conduct taken, only with regard to an *existing state of facts*.

(24) The common law has long since abandoned the idea that traditional "estoppel in pais" is the exclusive form of estoppel by conduct. As one example, Anglo-American jurisprudence today has uniformly adopted the concept of "promissory

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[19] Brownlie, PRINCIPLES OF PUBLIC INTERNATIONAL LAW, 5th Edition at page 646. The article by Bowett is *Estoppel Before International Tribunals and Its Relation to Acquiescence* [1957] BRITISH YEARBOOK OF INTERNATIONAL LAW 176.

[20] Bowett, *Estoppel Before International Tribunals and Its Relation to Acquiescence* [1957] BRITISH YEARBOOK OF INTERNATIONAL LAW 176 at page 180.

[21] Id., at page 181.

[22] Id., at page 183.

estoppel," which was not recognized under the traditional "estoppel in pais." "Promissory estoppel" bars or estops one from denying the *legally* binding quality of a promise to do something, or refrain from doing something, in the future. Observe, that one may assume that these are some of the complicated refinements at common law that Judge Alfaro was referring to when he contrasted the simplicity of the principle under international law.

(25) In all events, Bowett effectively gives up the point upon which Respondent relies. He states:

> The relation of estoppel to the sphere of fact and law is that it operates in the former only, but in so doing it may determine the context within which the legal rights and duties of the parties have meaning and application; a nice distinction, but a necessary one.

A "nice distinction" indeed, but hardly a necessary one. As the cases make amply clear at international law estoppel works not only on the facts but also to preclude a denial of the legal implications or purport of the facts. In short, not only has the common law outgrown Bowetts' "nice distinction," but, as the cases demonstrate, that distinction never was part of international law.

Further your Affiant saith not.

SWORN AND SUBSCRIBED TO THIS 8th DAY OF JUNE, 2001

Professor Alan C. Swan

Notary Public

Aurora Gonzalez

Aurora Gonzalez
MY COMMISSION # CC852972 EXPIRES
October 3, 2003
BONDED THRU TROY FAIN INSURANCE INC

Aurora Gonzalez
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October 3, 2003
BONDED THRU TROY FAIN INSURANCE INC

June 6, 2001

ADDENDUM TO THE ANALYSIS OF DAMAGES TO CORPORACION DE EXPORTACIONES MEXICANAS S.A. DE C.V.

ERNESTO CERVERA GOMEZ

1. In the valuation of the damages to CEMSA, I was asked to consider only a specific line of business, namely the cigarette export business. Therefore, I did not take into account neither the Balances nor the Income Statements of CEMSA, because they were irrelevant to the purposes of the task I was assigned.

2. In order to analyze a specific line of business it is always useful to consider the background of the sector in which it operates. Therefore we included the general environment of the cigarette production, marketing, distribution, and foreign trade chain in Mexico.

3. As stated in the analysis, the cigarette export operations have negligible operation costs (transport from a retail store –SAMS CLUB– to airport and airfreight charges). Therefore the gross margin minus financial costs serves a good proxy for the profits of that specific line of business.

4. In order to calculate the profits of CEMSA's cigarette export business I was given information on total exports, costs of goods and IEPS rebates (calculated by CEMSA and paid by the SHCP). I was not asked to, nor could I, express an expert opinion on legal issues relating to the IEPS Law.

5. The fact is that CEMSA asked for and obtained those IEPS rebates over a period of 16 months (June1996-September 1997). Thus, the entrepreneurial decision of setting the export price assumed that those IEPS rebates were going to be collected in time. In any case, if the rebates were lower than the actual paid rebates, then the export price could have been higher, assuming entrepreneurial rationality.

6. In such a case, a relevant question is whether there was a positive difference between CEMSA's cigarette export price and the average export market price of the countries to which CEMSA actually exported cigarettes. According to FGA's analysis, CEMSA should have shown a loss of 7.3% in 1997. With an increase in its export price higher than that magnitude, CEMSA would have made profits.

7. In 1997 CEMSA's export price was between 10% and 63% lower than the average implicit price of overall Mexican cigarette exports[1], to the countries that CEMSA and other Mexican companies exported to. It is clear from this data that, even if a different IEPS rebate is used to calculate profits, CEMSA could have sold at higher prices, and thus make substantial profits.

[1] The average implicit price is calculated dividing the value of exports by the volume of export for each country. The data comes from official sources (Ministry of The Economy).

Export prices of cigarettes, 1997
(Dollars per carton and percentages)

	Average implicit export price */	Difference w/r to Cemsa's export price
Cemsa's average export price	4.09	
HONDURAS	6.67	63.1
PANAMA	4.65	13.7
EL SALVADOR	6.16	50.6
GUATEMALA	6.45	57.8
Non declared countries	7.33	79.3
NICARAGUA	4.53	10.8

*/ Obtained from Secretaria de Economia official data

8. Assuming that CEMSA would have asked for and received the IEPS calculated by FGA for 1997 ($39,570,663 pesos instead of $70,466,307 calculated by CEMSA and paid by SHCP), and at the same time assuming that CEMSA raised its export price from $4.09 dollars per carton to $6.14 per carton (which is in the range of the price differential between CEMSA's export price and average implicit export price of total Mexican exports), the profit margin would have reached 34.8% in that year.

9. With those assumptions, for the conservative scenario, the calculation of damages for lost profits of CEMSA, during the January 1994-May 1996 period, results in a total of 42,183,914 pesos ($4,218,391 USD with an average exchange rate of 10 pesos per dollar).

CALCULATION OF DAMAGES FOR FOREGONE PROFITS CONSERVATIVE SCENARIO
(Pesos)

	Actual exports	Annualized exports	Actual profits	Lost profits	Interest rate factor	Damages in June 2001 pesos
1992	1,365,115		210,003			
1994	-	7,280,491	-	2,536,226	4.97	12,616,692
1995	-	16,601,724	-	5,783,364	4.36	25,215,171
1996	11,631,362	22,916,477	1,527,155	1,481,695	2.94	4,352,052
1997	66,495,032	71,562,470	23,164,157	1,765,289	2.24	3,946,238
Total Jan. 1994-May 1996						42,183,914

10. Again, using the above mentioned assumptions, for the intermediate scenario, the calculation of damages for lost profits of CEMSA, during the January 1994-December 1997 period, results in a total of 53,513,228 pesos ($5,351,323 USD with an average exchange rate of 10 pesos per dollar).

CALCULATION OF DAMAGES FOR FOREGONE PROFITS INTERMEDIATE SCENARIO

(Pesos)

	Actual exports	Annualized exports	Actual profits	Lost profits	Interest rate factor	Damages in June 2001 pesos
1992	1,365,115		210,003			
1994	-	8,732,500	-	3,042,047	4.97	15,132,944
1995	-	20,744,022	-	7,226,371	4.36	31,506,610
1996	11,631,362	29,455,185	1,527,155	2,340,203	2.94	6,873,674
1997	66,495,032	71,562,470	23,164,157	1,765,289	2.24	3,946,238
Total Jan. 1994-May 1996						53,513,228

11 Finally, for the aggressive scenario, the calculation of damages for lost profits of CEMSA, during the January 1994-May 1996 period with the above mentioned assumptions, results in a total of 69,363,845 pesos ($6,936,385 USD with an average exchange rate of 10 pesos per dollar).

CALCULATION OF DAMAGES FOR FOREGONE PROFITS AGGRESSIVE SCENARIO

(Pesos)

	Actual exports	Annualized exports	Actual profits	Lost profits	Interest rate factor	Damages in June 2001 pesos
1992	1,365,115		210,003			
1994	-	10,763,976	-	3,749,730	4.97	18,653,382
1995	-	26,539,428	-	9,245,254	4.36	40,308,838
1996	11,631,362	38,603,362	1,527,155	3,541,326	2.94	10,401,625
1997	66,495,032	71,562,470	23,164,157	1,765,289	2.24	3,946,238
Total Jan. 1994-May 1996						69,363,845

12. Again, in order to project the profits (which approximate the future net cash flows expected for the business), we assumed that the new average profit margin calculated for CEMSA in 1997 (34.8%) actually would have been sustained in 1998-2000, at the same level, for the three scenarios.

VALUE OF THE EXPORTING CIGARETTE BUSINESS

	Conservative scenario			Intermediate scenario			Aggressive scenario		
	Nominal profits	Interest rate	Discounted profits	Nominal profits	Interest rate	Discounted profits	Nominal profits	Interest rate	Discounted profits
1998	16,619,631	24.76	13,321,103	16,619,631	24.76	13,321,103	16,619,631	24.76	13,321,103
1999	20,540,821	21.41	13,560,702	21,225,398	21.41	14,012,648	22,183,175	21.41	14,644,956
2000	22,925,408	14.59	13,207,634	24,358,285	14.59	14,033,097	26,362,910	14.59	15,187,985
Total (pesos)			40,089,440			41,366,848			43,154,045
Total (dollars)			4,927,414			5,084,421			5,304,086

13. Hence according to the discounted-cash-flow methodology, in the conservative scenario, the value of the cigarette exporting business as of December 1, 1997 would

amount 40,089,440 pesos ($4,927,414 dollars), in the intermediate scenario 41,366,848 pesos ($5,084,421 dollars); and in the aggressive scenario 43,154,045 pesos ($5,304,086 dollars).

14. Those calculations have a value as of June 30, 2001 of 80,615,722 pesos ($8,061,572 dollars) in the case of the conservative scenario; 83,184,457 pesos ($8,318,446 dollars) in the case of the intermediate scenario; and 86,778,325 pesos ($8,677,832 dollars) in the case of the aggressive scenario

15. In conclusion, even we use a lower profit margin due to a different calculation of the IEPS rebates, CEMSA's damages fall in the range of U S. $18,738,228 - $22,072,481

SUMMARY OF DAMAGES TO CEMSA

Conservative scenario	Pesos	Dollars
October-December 1997 IEPS due	64,582,645	6,458,264
Lost profits for the Jan 1994-May 1996 period	42,183,914	4,218,391
Value of the cigarette export business as of December 1997	80,615,722	8,061,572
Total damages conservative scenario	187,382,281	18,738,228
Intermediate scenario	**Pesos**	**Dollars**
October-December 1997 IEPS due	64,582,645	6,458,264
Lost profits for the Jan 1994-May 1996 period	53,513,228	5,351,323
Value of the cigarette export business as of December 1997	83,184,457	8,318,446
Total damages intermediate scenario	201,280,330	20,128,033
Aggressive scenario	**Pesos**	**Dollars**
October-December 1997 IEPS due	64,582,645	6,458,264
Lost profits for the Jan 1994-May 1996 period	69,363,845	6,936,384
Value of the cigarette export business as of December 1997	86,778,325	8,677,832
Total damages aggressive scenario	220,724,814	22,072,481