



**BEFORE THE HONORABLE ARBITRAL TRIBUNAL ESTABLISHED
PURSUANT TO CHAPTER ELEVEN OF THE NORTH AMERICAN
FREE TRADE AGREEMENT (NAFTA)**

**MARVIN ROY FELDMAN KARPA,
CLAIMANT**

VS.

**THE UNITED MEXICAN STATES,
RESPONDENT**

ICSID CASE NO. ARB(AF)/99/1

COUNTER-MEMORIAL

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INTRODUCTION

Most of CEMSA's Claims Have Been Addressed Properly by the Domestic Courts and the Remaining Claims are Not Ripe

1. CEMSA's claim depends upon establishing that the denial by the Secretariat Hacienda y Credito Publico ("SHCP") of CEMSA's tax rebate claims "was contrary to Mexican law as declared by the Supreme Court of Justice"¹.
2. As shall be seen,
 - SHCP fully complied with the ruling of the Supreme Court of Justice (thus disposing of the first claim of expropriation); and
 - CEMSA contested SHCP's denial of rebate claims for October – December 1997 in the Mexican courts and lost (thus disposing of the second claim of expropriation).
3. On these juridical facts CEMSA's claim as presented cannot succeed. CEMSA seeks to avoid these juridical facts by referring to one decision in proceedings that are ongoing. SHCP has assessed CEMSA. In those proceedings, there remain unresolved issues of fact and Mexican domestic law, including:
 - the validity of the IEPS Law's requirement that a party claiming a rebate be in possession of invoices separately stating the IEPS tax paid;
 - verification that qualifying exports actually occurred;
 - proof the amounts claimed were paid; and
 - other issues.
4. Those issues of fact and domestic law are the subject of the ongoing domestic legal proceedings which are not yet concluded.
5. CEMSA can succeed then in this forum only if this Tribunal's jurisdiction ousts the jurisdiction of the domestic courts and resolves these issues in their place. It is respectfully submitted that the Tribunal has no such jurisdiction.

¹ Memorial p. 1.

6. Although the Memorial does not fully disclose the facts, the claimed right to rebates without having invoices separately stating the tax paid was asserted by the Claimant in the court challenge launched after the denial of the IEPS rebates for October - December 1997 (the "1998 Fiscal Court Proceeding"). In that proceeding, the Claimant advanced the same arguments now advanced before the Tribunal, namely:

- The 1993 Supreme Court of Justice ruling gave CEMSA an absolute right to export with IEPS rebates; and
- SHCP's insistence on compliance on invoices was contrary to the Supreme Court's ruling.

7. The Fiscal Court rejected CEMSA's arguments. CEMSA then appealed. An *amparo* court rejected its appeal.

8. There is an oblique reference to this litigation in the Claimant's witness statement where he states that he challenged the October - December 1997 rebate denials. He testifies that after "this Tribunal was constituted. . . I sought to withdraw that proceeding" (sic) but the "court disregarded my motion"².

9. In fact, the court did far more than disregard his motion: it ruled against him on the merits, as did the *amparo* court.

10. These juridical facts are significant to this proceeding. As the NAFTA award in *Azinian et al. v. United Mexican States* points out, the decisions of the domestic courts must be accepted as valid determinations of rights unless the courts themselves are disavowed at the international level³.

11. Thus, one set of Mexican courts upheld the fiscal authorities' position on the invoice requirement. It is correct that another court in proceedings that are not yet complete (the "1999 Fiscal Court Proceedings") decided the question differently. That decision is being appealed by both parties and is the subject of an *amparo* by CEMSA in those ongoing proceedings. The claimed right to rebates has not been finally determined in Mexican law. The first required element of the expropriation claims, *i.e.*, a right, is not yet determined. The Claimant is asking this Tribunal to substitute itself to resolve these issues on the basis of expert evidence of Mexican law on the existence of this right even though the courts rejected it in one case and the decision in the second case is on appeal and *sub judice* in the Mexican courts.

12. The invoice issue is not the only unresolved issue in the ongoing proceedings. At paragraph 247 of the Memorial the Claimant ascribes the lack of invoices separately stating the IEPS tax paid as the "main reason" for SHCP's 1998 tax assessment. This is incorrect. There were other reasons for the assessment. CEMSA failed to maintain adequate financial records as required by law. CEMSA significantly overstated its IEPS rebate claims in 1996-97. CEMSA

² Witness statement of Marvin Feldman at paragraph 84.

³ *Azinian et al. v. United Mexican States*, ICSID Case No. ARB(AF) 97/2 (1 Nov. 1999) at paragraph 97.

also claimed rebates for ineligible exports to a phantom company, Dilosa, in Honduras. SHCP's actions with respect to those issues were affirmed by the Fiscal Court. As noted, this decision is both under appeal and the subject of an *amparo* by CEMSA.

13. The matter is now complicated further by the recent discovery of evidence that, with the exception of two shipments, all of CEMSA's "exports" to the United States in 1997 were transhipped in bond to El Paso, Texas, and the evidence suggests that they could have been shipped back into Mexico⁴. The evidence indicates that wittingly or unwittingly, the Claimant and CEMSA participated in a scheme in which IEPS rebates were claimed on goods that were exported temporarily rather than permanently from Mexico. This raises questions as to whether CEMSA's exports were definitive. No action has yet been taken in respect of this recent discovery.

14. If the Mexican courts were to ultimately rule that CEMSA was entitled to payment of an amount of rebate and Mexico then denied payment and a new NAFTA claim were filed, it would be necessary to decide whether CEMSA's claim to money is an "investment". In doing so, it would be readily apparent that this does not resemble the typical expropriation claim where an investor owns shares in a company or some other pre-existing property right, the ownership or control of which is alleged to be taken by a government measure. The Tribunal would have to analyze the process for the payment of the IEPS tax, including the following steps:

- the cigarette producer (who is unrelated to CEMSA) originally paid the IEPS tax to the Mexican Treasury;
- CEMSA never "owned or controlled" the Mexican Treasury, the recipient of the tax payments;
- the tax was subsumed in the cost of the goods sold by the producer to its distributors; and
- when CEMSA purchased or obtained the cigarettes from re-sellers, there was no privity of contract between it and the producer who originally paid the tax.

CEMSA's entitlement to a rebate of the tax payment is dependent upon the operation of Mexican tax law. The Tribunal would have to consider whether an unsatisfied judgment could give rise to a NAFTA breach.

There Are Restrictions on NAFTA Claims Based on Taxation Measures

15. When applying the NAFTA to this claim, the Tribunal is bound by the special restrictions on the right of access to arbitration for claims against taxation measures. Some articles, such as Article 1105 (Minimum Standard of Treatment) do not apply directly. For expropriation claims under Article 1110, compliance with a mandatory condition precedent is required; a failure to

⁴ This is likely the case for 1996 also. Mexico has documents provided by the U.S. Customs Service for 1997 which detail what happened to CEMSA's shipments once they landed in the U.S.

comply with that requirement precludes the claim from falling within the scope of the submission to arbitration.

16. The Memorial does not address the NAFTA's special rules for Chapter Eleven claims involving taxation measures. When such limiting rules are applied, whole sections of the Memorial raise questions beyond the scope of the submission to arbitration and must be disregarded. Much of the claim is premised on CEMSA's inability to obtain rebates for cigarette exports under the amendments to the IEPS Law that entered into force on 1 January 1998, a measure already found not to be an expropriation. Other key arguments advanced by the Claimant are based on articles of Section A that cannot be advanced in this proceeding by virtue of Article 2103 or because the Claimant failed to comply with the mandatory condition precedent for the submission of expropriation claims involving taxation measures, as is the case for the alleged "creeping expropriation" claim.

17. Accordingly, this Counter-Memorial will first address what claims are properly before this Tribunal.

There Was No Reasonable Reliance on Alleged Oral Representations

18. Article 34 of the Fiscal Code contains a formal means for obtaining advance rulings in the form of written resolutions from SHCP for real and concrete situations involving taxpayers. Such resolutions have legal effects and, once issued, bind the authorities for the tax year in question. The Claimant and his legal counsel were well aware of Article 34 procedure. They used it to file a request on central issues now advanced before this Tribunal. When SHCP refused to issue a ruling authorizing rebate claims without having invoices separately stating the IEPS tax paid, the Claimant challenged the refusal in the 1998 Fiscal Court Proceedings together with SHCP's refusal to pay the rebate claims made in late 1997. As noted above, the Claimant lost at the Fiscal Court and on appeal.

19. Thus, no ruling, in a form that would establish CEMSA's rights and bind SHCP accordingly, was obtained by CEMSA in order to clarify the position it maintains today. Instead, lacking such a written ruling, and omitting to inform the Tribunal what actually happened in the courts, the Claimant alleges an oral agreement was reached. Mexico denies that any oral agreement was reached.

20. Even if there had been an oral agreement, such an agreement could have no legal effect under Mexican law, and the Claimant was or should have been aware of that. When CEMSA challenged SHCP's refusal to issue an Article 34 ruling in the 1998 Fiscal Court proceeding and SHCP's tax audit in the 1999 Fiscal Court proceeding, it made no reference at all to the purported oral agreement, let alone attempt to base its claim on an alleged violation by the fiscal authorities of such an oral agreement. Rather, CEMSA stated its legal position on the basis of its detailed interpretation of the provisions of Mexican law. Under the tax systems of all three NAFTA countries, taxpayers cannot raise an "estoppel" preventing the enforcement of the tax laws, as they are written, through the methods followed by the Claimant.

The Claimant Has Made Incorrect Factual Allegations

21. There are other significant weaknesses in the Claimant's case. Many of the Claimant's factual allegations are simply incorrect

22. For example, a central theme of the Memorial is the allegation that the fiscal authorities sought to protect the Mexican cigarette producers' "export monopoly".⁵ There are two major producers in Mexico (CIGATAM and La Moderna). Due to the Memorial's repeated references to CIGATAM, the Respondent inquired of it what it exported from 1990-99. According to the testimony of CIGATAM's controller, Noe Salazar Martinez, the company did not export any Philip Morris branded cigarettes (including Marlboros) nor did it sell any cigarettes to any third party for the purpose of exporting them⁶. For CIGATAM, therefore, there was no "export monopoly" to be protected because there were no exports of any significance made by it. Although the Respondent did not obtain a statement from La Moderna, it understands that that company also did not export internationally-licensed brands during this period.

23. The Claimant's depiction of the Mexican domestic legal proceedings also contains fundamental errors and omissions. Contrary to his allegations before this Tribunal, the 1993 decision of the Supreme Court of Justice has been implemented since April 1994, to CEMSA's subsequently-stated satisfaction, as it expressly advised the competent Mexican Court. The Claimant also mischaracterizes the Supreme Court of Justice decision, representing that the Court held that CEMSA was entitled to IEPS tax rebates for cigarette exports as if it did not have to comply with the Law's other requirements. In fact, the Court held only that CEMSA was entitled to a 0 % rate on its exports; the Court did not address the separate issue of CEMSA's entitlement to tax rebates. It did not address the application of provisions of the Law setting out specific requirements, for instance, the documentation requirements established by Article 4 of the Law when requesting such rebates.

24. When complying with the Supreme Court's ruling and thereafter, SHCP's position was that to obtain rebates, CEMSA had to possess invoices expressly transferring and separately stating the IEPS tax. When SHCP requested CEMSA to produce such invoices in order for it to implement the Supreme Court's decision, CEMSA complied, admittedly under protest⁷. SHCP was thus able to verify that the tax had actually been paid and transferred, and paid the corresponding rebates. Subsequently, CEMSA advised the Court that SHCP had fully complied with the Supreme Court's ruling and requested that the case be filed as concluded. Until recently, CEMSA did not challenge that aspect of the law as written by the Mexican Congress.

⁵ See, for example, paragraphs 149(b), 157, 165, and 209 of the Memorial. Paragraph 157 is a good example: "Respondent's measures against CEMSA were not ordinary or legitimate regulation. Their sole purpose and effect was to make it impossible for CEMSA to export cigarettes in competition with the producers and their distributors."

⁶ CIGATAM made very small exports of domestic, non-Philip Morris brands: 0.45% of total sales in 1996; 0.53% in 1997, 0.35% in 1998, and 0.04% in 1999.

⁷ Incidentally, those invoices were for purchases of alcoholic beverages, not cigarettes, and the IEPS tax paid had been separately stated on the invoices from the producers or wholesalers.

25. In the 1998 Fiscal Court Proceedings challenging the 1997 rebate denials and SHCP's refusal to issue an Article 34 resolution authorizing CEMSA's activities, the court specifically rejected the argument that CEMSA is advancing before this Tribunal. It held that the Supreme Court's ruling did not have the legal effect ascribed to it by the Claimant.

26. In some cases, documents relied upon do not say what the Claimant says they say. Many allegations are based upon an imperfect recollection, and some are scandalous insinuations and suppositions. For example, prior to the first of their meetings in 1998. The Claimant published an advertisement in a Mexican newspaper accusing Mr. Gómez Gordillo, a senior SHCP official, of criminality in drafting the 1998 amendment to the IEPS Law that was submitted to the Congress for approval by the Federal Executive through the Secretary of SHCP. The transcript of his various meetings with Mr. Gómez Gordillo submitted with the Memorial reveals that when the parties met, while the Claimant persisted in his claim that Mr. Gómez Gordillo was acting criminally, the Claimant's own legal counsel consistently answered "no" when asked by Mr. Gómez Gordillo whether counsel believed that he had acted criminally or even improperly.

27. Mr. Gómez Gordillo was not the first senior Mexican official that the Claimant accused of criminality.

28. The Claimant sought to obtain the results he wanted by filing criminal charges against tax officials, by making frequent (usually unscheduled) visits to tax officials (including officials who had no authority over CEMSA's claims), and by conducting a media campaign calculated to embarrass the Mexican Government. The Claimant's efforts to pressure SHCP not to enforce the law against him do not raise issues within the scope of NAFTA Chapter Eleven.

The Claimant Was Trading in Rebates

29. The facts show that what has been described in the Memorial as CEMSA's "cigarette exporting business" was actually a practice of trading in IEPS rebates.

30. The Claimant's assertions that his business would have been highly profitable if the rebates were made available to it are not borne out by the facts. CEMSA's projected profits for 1997 on cigarette exports are based on significant over-claims of IEPS rebates. Even if CEMSA were properly claiming the IEPS rebates without the required documentation, its claims were far greater than the tax actually paid by the producers. Thus, the profitability of the Claimant's "cigarette export business" was premised on a subsidy from the Federal Treasury as a result of inflated claims.

31. An analysis of CEMSA's rebate claims reveals other irregularities.

Structure of this Counter-Memorial

32. This Counter-Memorial is organized as follows:

- Part I describes the limits on the Tribunal's jurisdiction to consider the claims advanced in the Memorial.
- Part II contains the Respondent's Statement of Facts.
- Part III sets out the Respondent's Statement of the Law on the merits of the expropriation claims, in response to the claims that are properly before the Tribunal.
- Part IV sets out additional facts relevant to the national treatment claim and to an important issue of public policy that should influence the Tribunal's disposal of the claim.
- Part V addresses the national treatment claim.
- Part VI addresses damages.
- Part VII addresses the public policy issue.
- Part VIII sets out the relief requested by the Respondent.

**I. THE TRIBUNAL'S JURISDICTION TO CONSIDER THE CLAIMS
ADVANCED IN THE MEMORIAL**

A. The Limits on the Tribunal's Jurisdiction

33. This Tribunal has only such jurisdiction as has been conferred upon it by Section B of Chapter Eleven and by the disputing parties' consent to arbitration thereunder⁸.

34. This claim involves taxation measures. It is concerned entirely with the application of the Special Tax on Production and Services Law and the claimed right to obtain tax rebates on cigarette exports. As the Claimant acknowledges at paragraph 145 of the Memorial, the word "measure" is not exhaustively defined in the NAFTA's Article 201. It includes not only the taxation law in question, the IEPS Law, but any "regulation, procedure, requirement or practice" related thereto; it may include another form of government action not listed in Article 201's definition of a "measure".

35. As discussed below, Article 2103 of the NAFTA limits the Tribunal's jurisdiction over tax measures.

36. There are additional temporal and substantive limits on the Tribunal's jurisdiction, as follows.

**1. The Tribunal is Not Authorized to Investigate Violations of
Domestic Law**

37. Article 1131 of the NAFTA requires the Tribunal to decide the issues in dispute in accordance with the NAFTA and applicable rules of international law.

38. The Tribunal has already observed in its Interim Decision that:

...its jurisdiction under NAFTA Article 1117(1)(a), which is relied upon in this arbitration, is only limited to claims arising out of an alleged breach of an obligation under Section A of Chapter Eleven of the NAFTA. Thus, the Tribunal does not have, in principle, jurisdiction to decide upon claims arising because of an alleged breach of ...domestic Mexican law. Both the aforementioned legal systems (general international law and domestic Mexican law) might become relevant insofar as a pertinent provision to be found in Section A of Chapter Eleven explicitly refers to them, or in complying with the requirement of Article 1131(1) that "A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and

⁸ The Tribunal has made certain jurisdictional determinations in its Interim Decision on Preliminary Jurisdictional Matters, dated 6 December 2000. The Respondent reserves its position in respect of such matters.

applicable rules of international law.” Other than that, the Tribunal is not authorized to investigate alleged violations of either general international law or domestic law.⁹

39. The Claimant is inviting the Tribunal to determine his enterprise’s entitlement to the rebate of IEPS taxes under Mexican tax law when that issue has been decided against him in one set of proceedings and is *sub judice* in the other proceedings. The whole claim is predicated upon the assumption that the Claimant’s view of his enterprise’s entitlement to rebates should be preferred over that of the fiscal authorities and that, if he prevails, the Mexican authorities will not implement the Mexican court’s declarations in his favour. The courts, not this Tribunal, have the jurisdiction to determine whether CEMSA is entitled to claim a rebate where it does not have invoices separately stating the IEPS tax paid. If CEMSA succeeds, the Mexican authorities will comply.

40. With the exception of the claim for an alleged denial of national treatment, all of the claims advanced in this proceeding would require the Tribunal to apply domestic law in place of the proper judicial body.

41. The Tribunal cannot do so without acting outside the terms of the submission to arbitration. The leading ICSID annulment case of *MINE v. Guinea* stated in this regard:

... the parties’ agreement on applicable law forms part of their arbitration agreement. Thus, a tribunal’s disregard of the agreed rules of law would constitute a derogation from the terms of reference within which the tribunal has been authorized to function. Examples of such a derogation include the application of rules of law other than the ones agreed by the parties, or a decision not based on any law unless the parties had agreed on a decision *ex aequo et bono*. If the derogation is manifest, it entails a manifest excess of power.¹⁰ [Emphasis added]

42. NAFTA Chapter Eleven tribunals differ materially from ICSID Convention tribunals (or tribunals formed under certain Bilateral Investment Treaties), which generally apply the domestic law of the host state as supplemented by applicable rules of international law. For example, according to Article 42 of the ICSID Convention, an ICSID tribunal:

... shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.¹¹ [Emphasis added]

⁹ Interim Decision at paragraph 61.

¹⁰ ICSID Case No. ARB/84/4, *Ad Hoc* Committee Decision of December 22, 1989, 5 ICSID Rev. FILJ 95 (1990) at paragraphs 5.03 and 5.04.

¹¹ For example, in *Liberian Eastern Timber (LETCO) v. Government of the Republic of Liberia*, 2 ICSID Reports 343, an ICSID tribunal considered a dispute arising from a concession contract. The ICSID tribunal found that Liberian law applied to the contractual dispute and, by virtue of Article 42 of the

43. A jurisdiction similar to that conferred by the ICSID Convention is not vested in this Tribunal.

2. The Limits on the Tribunal's Jurisdiction *Ratione Temporis*

44. As noted in the Interim Decision on Preliminary Jurisdictional Issues, there are two temporal limitations on the Tribunal's jurisdiction:

- The Tribunal cannot find that acts or omissions occurring before NAFTA's entry into force on January 1, 1994 violate Chapter Eleven (paragraph 62 of the Interim Decision); and
- The cut-off date of the three-year limitation period prescribed by Article 1117(2) is April 30, 1996, subject to a determination on the merits as to whether the limitation period was temporarily suspended or the Respondent is estopped from invoking it (paragraphs 48-49 of the Interim Decision).

3. The Limits on the Tribunal's Jurisdiction *Ratione Materiae*

45. Since the claim involves taxation measures, NAFTA Article 2103 sets out additional limitations on the Tribunal's subject matter jurisdiction in this case. According to Article 2103(1), except as stated in that article, nothing in the NAFTA shall apply to taxation measures¹².

46. At the time he submitted the NAFTA for approval by the U.S. Congress, the U.S. President published a Statement of Administrative Action setting out the U.S. Government's understanding of the NAFTA's key provisions. The Statement of Administrative Action observes:

Article 2103 limits the extent to which tax measures are subject to the NAFTA. Paragraph one makes clear that only those provisions listed in the article are applicable to taxation measures.¹³

Convention, "such rules of international law as may be applicable". Given a jurisdiction that encompassed national and international law, the ICSID tribunal's award turned principally on a finding of a breach of contract under Liberian domestic law. See *Liberian Eastern Timber (LETCO) v. Government of the Republic of Liberia* at 358. The Iran-U.S. Claims Tribunal also had an unusually broad governing law provision. See George H. Aldrich, The Jurisprudence of the Iran-United States Claims Tribunal at pages 156-157.

¹² Should there be any doubt on any matter relating to the interaction between Article 2103 and Chapter Eleven, Article 1112(1) contains an "under-ride" provision which states that in the event of any inconsistency between Chapter Eleven and any other Chapter of the NAFTA (including Chapter Twenty-one) the other Chapter shall prevail to the extent of the inconsistency.

¹³ U.S. Statement of Administrative Action at page 218.

47. Canada's Statement on Implementation, published on the date of NAFTA's entry into force, is to the same effect:

Article 2103 generally limits the application of the obligations of NAFTA with respect to taxation measures and provides that NAFTA does not affect rights and obligations arising under bilateral tax treaties between the Parties. More specifically:

--Paragraph 1 states that nothing in the NAFTA applies to taxation measures, except as provided elsewhere in the article.¹⁴

48. The only provisions of Chapter Eleven that are listed in Article 2103 are Articles 1102, 1103, 1106 and 1110. No other article in Chapter Eleven can apply to taxation measures.

a. Article 1105 Does Not Apply to Taxation Measures

49. Article 2103's listing of the articles of Section A that apply to taxation measures omitted Article 1105. It is not open to a claimant to advance, nor to a tribunal to consider, a claim that a Party's taxation measure has directly breached Article 1105.

50. The Claimant has emphasized that Article 1110 states that where a Party nationalizes or expropriates an investment of an investor of another Party, it must do so, *inter alia*, in accordance with due process of law and Article 1105(1)¹⁵. Accordingly, Article 1105 can be relevant only if there has been an expropriation.

b. The Right to Allege a Violation of Article 1110 is Subject to Article 2103(6)

51. A condition precedent to the submission of an expropriation claim involving a taxation measure is that the investor must first refer "the issue of whether the measure is not an expropriation" to the competent authorities of the two States involved.

52. Two consequences flow from this condition precedent: First, if the competent authorities agree that the measure complained of is not an expropriation, the claimant cannot advance the claim. It would be beyond the scope of the submission to arbitration.

53. Second, if the would-be claimant does not raise a particular allegation of expropriation with the competent authorities, a tribunal cannot consider that allegation in the subsequent proceeding. All claims of expropriation against a tax measure must first be reviewed by the

¹⁴ Statement on Implementation for the North American Free Trade Agreement, Canada Gazette, Part I, January 1, 1994, at page 215. Mexico did not prepare its own understanding of the NAFTA in the same fashion as its two NAFTA partners.

¹⁵ Memorial at paragraph 197 et seq.

competent authorities before they can be put before a tribunal. This is a condition precedent to the tribunal's jurisdiction over an expropriation claim.

54. Both the United States and Canada confirmed this in their respective statements on the NAFTA. The U.S. Statement of Administrative Action states:

Before an investor may challenge a taxation measure as impermissible expropriation under the investment chapter's arbitration provisions, paragraph six provides for the tax authorities of the two governments to consult on whether the measure amounts to an expropriation. If the two governments decide within six months that the measure is not an expropriation, the investor may not initiate arbitration.¹⁶ [Emphasis added]

55. Canada's Statement on Implementation is to the same effect:

--Paragraph 6 states that the expropriation provisions of article 1110 apply to taxation measures. A taxation measure alleged to be expropriatory must be referred by the investor to the appropriate competent authorities under the relevant tax convention at the same time that it gives notice under article 1119. If such competent authorities determine that the measure is not an expropriation, then article 1110 cannot be invoked as the basis for a claim under articles 1116 and 1117.¹⁷ [Emphasis added]

¹⁶ U.S. Statement of Administrative Action at page 219.

¹⁷ Canadian Statement on Implementation at page 216.

B. Applying the Jurisdictional Limits to the Claim as Presented

56. The Respondent will now apply the limits set out above to the claim as presented.

1. The Limitation Period

57. Unless the Claimant persuades the Tribunal that the fiscal authorities did not comply with the Mexican Supreme Court decision and that some kind of an estoppel arose in relation to that ruling, the cut-off date for the limitation period is April 30, 1996. Mexico cannot be held responsible for any measures attributable to the Mexican State taken prior to that date.

2. The Expropriation Claims

58. In his Notice of his Intent to File a Claim to Arbitration ("Notice"), submitted on 18 February 1998 the Claimant asserted that Mexico had breached "especially 1110 (Expropriation and Indemnification)" (sic). The factual description of the claim recites, in part, CEMSA's alleged right to obtain IEPS rebates on cigarette exports and an allegation that this right had been confirmed by the Mexican courts. It concludes by alleging that:

"...the responsible officials have violated our legitimate rights; they have applied us (sic) illegal, unconstitutional, unequal and unjust treatment, unlike what they give to producers, and they have resorted to measures tantamount to expropriation of an investment that has a value exceeding U.S.\$13,000,000..."¹⁸

59. The Claimant filed a copy of its Notice with the *Subsecretario de Ingresos* of the *Secretaría de Hacienda y Crédito Público*, the Mexican competent authority set out in Annex 2103.6. He subsequently referred the issue to the Assistant Secretary of the Treasury (Tax Policy) of the United States Department of the Treasury, the United States competent authority. On the basis of the Claimant's application, the competent authorities analyzed three measures:

1. Mexico's alleged failure to implement a 1993 decision of the Mexican Supreme Court of Justice in favor of CEMSA concerning the rebate of certain excise taxes imposed on the sale of cigarettes;
2. Mexico's refusal to provide rebates of excise taxes to CEMSA for cigarettes allegedly exported in October and November of 1997; and

¹⁸. Notice of Intent to Submit a Claim, paragraph. 7, p. 4.

3. Mexico's amendment to the relevant law, effective January 1, 1998, which limits the availability of rebates of certain excise taxes to those who purchase cigarettes in the "first sale" of the cigarettes within Mexico¹⁹.

60. The competent authorities agreed that the third measure, *i.e.*, the amendment to the IEPS Act, effective January 1, 1998, is not an expropriation and therefore that claim could not be advanced. The competent authorities did not agree on the information before them that the other two measures submitted for their consideration could not be expropriations.

61. The *Subsecretario de Ingresos* and the Assistant Deputy Secretary stated that no inference should be drawn concerning their views or the views of their governments regarding whether the other two measures amounted to an expropriation under Article 1110. Thus, the Claimant could contend that they violated Article 1110 and it remained open for the Respondent to contend that neither amounted to an expropriation.

62. The claim that the amendment to the IEPS Law, effective January 1, 1998, was an expropriation has been resolved and lies outside this Tribunal's jurisdiction. The Claimant acknowledged this in his Notice of Arbitration²⁰.

63. Only the first two expropriation claims were notified to the competent authorities and are permitted to be advanced before this Tribunal.

a. Compliance with the Supreme Court ruling

64. The Respondent accepts that if the limitation period issue is resolved in the Claimant's favor, the Respondent should respond to the expropriation that the Claimant said was effected by the alleged failure to comply with the 1993 Supreme Court ruling. Accordingly, it will do so.

b. The Refusal to Pay the October-December 1997 Rebates

65. Mexico also accepts that the second alleged expropriation, the refusal to pay IEPS rebates for October-December 1997, was a properly notified expropriation claim under Article 2103(6) and must be addressed.

¹⁹ Letter from Donald C. Lubick to Tomás Ruiz, 17 February 1999. [CM 05769]. [This Counter-Memorial refers to exhibits by citing the sequentially-numbered page on which they are contained in the accompanying exhibit volumes. The letters "CM" are used to avoid confusion with the numbering system for the exhibits in the Memorial, which the Claimant referenced with the prefix "App.".]

²⁰ Claimant's Notice of Arbitration, at p. 4: "In this case, the competent authorities have acted... After detailed discussions, the competent authorities reached an agreement that is set forth in a letter from Donald Lubick, Assistant Secretary for Tax Policy of the United States Department of the Treasury, dated February 17, 1999, and a letter from Tomas Ruiz, Under Secretary of Revenue of the Mexican Ministry of Finance and Public Credit, dated February 18, 1999 (Exhibit D). This agreement bars NAFTA arbitration of claims based on certain Mexican legislation effective January 1, 1998, but allows the other expropriation claims asserted by CEMSA under NAFTA to proceed to arbitration."

c. The New "Creeping Expropriation" Claim

66. At paragraphs 148-149, the Memorial lists the "measures" said to be at issue in this proceeding. The two alleged expropriations discussed above are listed at paragraph 149(a) and (c). In addition, at least one other new allegation of expropriation is made at paragraph 149:

(d) Respondent's decision in November or December 1997, for the benefit to cigarette producers, to terminate future cigarette exports by CEMSA by denying IEPS rebates to CEMSA on exports....²¹

67. This is described throughout the Memorial as a "creeping expropriation" comprising a "pattern of conduct" dating back to 1991 which culminated in "the final extinction of CEMSA's cigarette export business in late 1997"²². At other points the Claimant alleges that, since 1990, senior Mexican officials have engaged in "a sustained campaign to drive CEMSA out of the cigarette export business by illegal and discriminatory manipulation of the IEPS tax law that culminated in the measures taken by Respondent in 1997 to shut down CEMSA's export business for the third time"²³. The Claimant also recasts events occurring prior to January 1, 1994 as part of a "continuing breach" to support the novel proposition that any impediment to CEMSA's ability to claim IEPS rebates on cigarette exports *prior* to NAFTA's entry into force was a "breach of international law" for which the Claimant may now demand compensation under Chapter Eleven of the NAFTA.

68. Putting aside the attempt to make out a breach of international law prior to NAFTA's entry into force (which cannot succeed given the Tribunal's Interim Decision²⁴) this alleged "creeping expropriation" measure (if it can even be called a measure) was not reviewed by the competent authorities pursuant to Article 2103(6).

69. Indeed, it is a palpable attempt to evade the consequences of the competent authorities' decision that the 1998 amendment to the Law was not an expropriation. With its removal from the proceeding, the Claimant developed the "creeping expropriation" theory in which another expropriation is said to have culminated just before the law was amended²⁵. This is an impermissible circumvention of the competent authorities' determination.

70. Due to the failure to comply with Article 2103(6), the Tribunal has no jurisdiction to consider the "creeping expropriation" alleged to have culminated in late 1997. The Respondent

²¹ The rest of the allegations in paragraph 149 either fall outside the scope of the submission to arbitration or are subsumed in and rebutted by the Respondent's substantive defenses.

²² Memorial, paragraph 63.

²³ Memorial, paragraph 46.

²⁴ See Interim Decision at paragraph 62.

²⁵ See paragraphs 149(c), 157, 166-168, 178, 189, 192, 210, 214, 215, and 220 of the Memorial.

has not consented and will not consent to the submission of this claim. It must be dismissed for lack of jurisdiction and consent²⁶.

71. Consequently, the Claimant's submissions commencing at paragraph 150 through to paragraph 187 of the Memorial must be disregarded.

72. Any arguments that may be advanced herein in response to the "creeping expropriation" claim are without prejudice to the Respondent's primary position set out above and in no way constitute an admission that the Tribunal has jurisdiction over this claim.

3. The Article 1105 Arguments

a. Those Bound Up in the "Creeping Expropriation"

73. The denial of justice arguments set out in paragraphs 197-211 of the Memorial are part of the alleged "creeping expropriation". Since the "creeping expropriation" claim cannot be considered by the Tribunal, the alleged breaches of Article 1105 said to arise out of it also are not properly before it.

74. Accordingly, paragraphs 197-211 of the Memorial must be disregarded.

75. Any arguments that may be advanced herein in response to Article 1105 are without prejudice to the Respondent's primary position set out above and in no way constitute an admission that the Tribunal has jurisdiction over this claim.

b. Any Other Article 1105 Arguments

76. By operation of Article 2103(1), Article 1105 does not apply to taxation measures outside the context of evaluating whether an expropriation was consistent with Article 1110. Therefore, no breaches of Article 1105 can be advanced directly.

77. Any arguments that may be advanced herein in response to Article 1105 are without prejudice to the Respondent's primary position set out above and in no way constitute an admission that the Tribunal has jurisdiction over this claim.

²⁶ Had the "creeping expropriation" allegation been put to the competent authorities, Mexico would have asked the U.S. competent authority to agree that it could not have been an expropriation. As the Claimant did not identify this alleged measure for review, the competent authorities of Mexico and the United States were never given the opportunity to address this issue.

4. The National Treatment Claim

78. The Tribunal permitted the Claimant to add a claim that Mexico has denied national treatment to his enterprise because, it is alleged, Mexico has not subjected Mexican-owned investments, in like circumstances, to the same treatment.

79. In light of the Tribunal's ruling, the Respondent will address this claim.

80. There is a nexus between the facts relating to the alleged breach of national treatment and an additional defense that will be advanced in Parts VI and VII below.

II. STATEMENT OF FACTS

81. As required by Article 38(3) of the ICSID Additional Facility Rules, the Respondent must set out any additional facts related to the claim in the Counter-memorial. It will do so here.

82. In reviewing the juridical facts set out below (the applicable statute and related court disputes), it is important to note the important distinction between (i) the determination of the tax rate applicable to particular types of transactions and (ii) the ability of a person to obtain a rebate of a tax paid by another person. The 1993 Supreme Court decision dealt only with the former, while the Claimant's subsequent dispute with SHCP involves only the latter.

A. The IEPS Tax²⁷

83. Under Article 1 of the Federal Fiscal Code (the "Fiscal Code"), natural and juridical persons are under an obligation to contribute to public expenditures, as provided for in the specific laws. Article 2 of the Fiscal Code provides:

Taxes are contributions provided for in a law, other than those established under sections II, III and IV of this article [social security and improvement contributions, and user fees], that natural or juridical persons that are in the legal or factual situation determined in the same law shall pay.

84. The special tax on production and services ("IEPS") is such a contribution, *i.e.*, a tax. It is regulated by the Special Tax on Production and Services Law (the "IEPS Law").

85. In 1981, Mexico underwent an important fiscal reform concerning indirect taxes on goods and services. Various taxes with special characteristics and that constituted the most important sources of revenue were all consolidated in the IEPS Law. The general design, the technical structure and operation of the IEPS Law, as it relates to processed tobacco, has basically remained the same since its origins, although the underlying methodology of the tax has changed several times²⁸.

86. Under the 1990 IEPS Law—which incorporates taxes on a number of different types of goods—the activities of selling domestically, importing and exporting the goods listed in Article 2, section I of the Law, as well as providing certain services, triggered the IEPS; that is, carrying out these activities generated liability for the tax.

87. In addition to listing the products subject to the IEPS, Article 2 section I established the applicable tax rate for each product. In the case of domestic sales and imports of cigarettes, the rates were 139.3% from 1990 through 1994, and 85% from 1995 through 1997. The IEPS rate

²⁷ The relevant provisions of the IEPS Law as it existed during the 1990s are in Volume 10 of the exhibits. See also witness statement of Rafael Obregon Castellano [CM 06098].

²⁸ *Ibid.* at paragraph 18.

on exports of cigarettes from 1990 through 1997 was 0%. As from 1992, only exports to countries that were not considered low income tax jurisdictions (tax havens) —in general, countries with an income tax rate above 30%— were eligible for a 0% rate.

88. As a general rule, under Article 11 of the Law the sales price for each transaction in the distribution chain is the taxable base for the calculation of the IEPS —*i.e.* the value upon which the rate is applied. However, for cigarettes the taxable base is always the sales price to the retailer (*i.e.*, the price paid by the retailer to a wholesaler or distributor). This provision additionally establishes that a tax for the sale of cigarettes shall not be paid on subsequent sales. The tax previously paid thereafter becomes a component of the retail price, as cost. Article 8, section IV further confirmed that, in the case of cigarettes, the tax shall not be paid in sales to the general public, unless the seller is a producer or first purchaser.

89. Article 4 (which applied to all of the taxes covered by the IEPS Law, not just the taxes on cigarettes) established who was responsible for paying the tax to the Treasury, where it was to be paid and how it was to be paid or credited, as well as the qualification requirements for a credit. It provided that the taxpayer shall pay at the authorized offices the difference between the tax owed and the tax transferred by others to the taxpayer that was creditable²⁹. In order for the IEPS to be creditable, the following requirements had to be met:

- a) The taxpayer must have performed activities that engage the tax (*e.g.*, importation and domestic sales) which is sought to be credited upon the sale or exportation of goods.
- b) The goods must have been sold or exported without change in their state, form, or composition.
- c) The tax must have been transferred to the taxpayer expressly, and stated separately in the purchase invoices.

90. As stated above, in the case of cigarettes, however, Article 11 provided that a tax shall not be paid in sales subsequent to the sale to the retailer. Thus, the tax assessed at the outset on the basis of the wholesale price to the retailer is triggered by the sales made only by producers and first-hand purchasers.

91. Article 19 set out additional obligations of the taxpayer, including keeping proper accounting records, and issuing invoices transferring the IEPS expressly and separately, except on sales to the general public unless so requested by the purchaser.

92. The purpose of transferring the tax expressly and separately is to allow it to be credited subsequently. Where the purchaser cannot legally qualify for a credit in the tax —such as purchasers like the Claimant's vendors who re-sold the goods domestically— invoices expressly

²⁹ If the tax is "creditable," a person essentially can take credit for having paid the tax, even though it was originally paid to the Treasury by another. The reconciliation (accreditation) is made by subtracting the creditable tax paid on purchases from the full amount of tax owed.

transferring the tax and stating it separately were not necessary, although nothing precluded the purchaser from requesting them. However, in the absence of such invoices, the tax had not been transferred and the purchaser could not transfer it in turn to its customers. The right to request the tax to be transferred expressly and separately lies with the purchaser to whom the tax can be transferred directly. Persons lying further along the commercial chain, such as the Claimant, would have had to ask their vendors to request it from the vendor's suppliers.

93. In 1991, Article 2, section III of the Law was amended in order to specify that a 0% rate applied to final exports, under the terms of the customs legislation, by producers and bottlers of the goods and, by foreign trade companies, as well as by persons entering into contracts with producers and bottlers, including for sale abroad, as long as they complied with certain requirements to be issued by SHCP. In 1992, Article 2, section III was amended again in two relevant respects: it reverted to the system in force in 1990, making all final exports eligible for application of the 0% rate, but it limited the applicability of that rate to final exports to countries that were not considered low income tax jurisdictions. Rule 121-B of the fiscal regulations for 1991 issued by SHCP defined foreign trade companies as those that purchased the products they exported directly from the producers or bottlers.

94. Although the IEPS Law changed in certain respects virtually every year, Article 2, section III did not change in any material respect after 1992. There were also no material changes from 1990 through 1997 to articles 1, 4, 8 and 11 of the IEPS Law. These articles set out the fundamental concepts of the tax, its subjects, object tax base, and the requirements for payment and the accreditation of the tax. They remain in force today.

95. In 1997, the Foreign Trade Miscellaneous Regulations (*Resolución Miscelánea de Comercio Exterior para 1997*) extended the application of the 0% rate to final exports destined to countries considered as low income tax jurisdictions, provided that the goods were imported for final consumption in such countries, and that the exporter notified SHCP that their sales were to non-related parties, *i.e.*, at arms-length³⁰.

96. On 1 January 1998 Articles 11 and 19 of the IEPS Law, among others, were amended. A phrase was added to the third paragraph of Article 11, which clarified that, in the case of cigarettes, the accreditation or the rebate of the IEPS on cigarettes is not allowed on sales subsequent to those made to the retailer. Also, Article 19 section XI imposed an obligation on exporters of certain goods, including cigarettes, of registering in the Sectorial Exporters Registry, in order to be entitled to apply the 0% IEPS rate on exports. Such a requirement is not an export restriction. Registration is only required in order to benefit from the application of the 0% IEPS rate.

B. The Mechanics of Tax Rebates

97. The Federal Fiscal Code (*Código Fiscal de la Federación*) provides that SHCP shall refund any amounts paid in excess by taxpayers, or grant rebates where so allowed by the

³⁰

CM 03782.

specific tax laws (Article 22)³¹. As stated above, Article 4 of the IEPS Law provides that taxpayers shall pay the difference between the creditable taxes transferred and the taxes owed. If, however, the taxpayer ends up with a positive balance, *i.e.*, where the amount of the tax transferred to the taxpayer is greater than the amount of the tax it owes. Article 5 of the Law provides it may request SHCP to rebate that amount, provided that it complies with the applicable requirements.

98. Whether the taxpayer ends up with a positive IEPS balance depends on the amount of taxes owed by reason of domestic sales, imports or taxable exports (to low income tax jurisdictions), and the amount of creditable taxes transferred. A positive balance alone, however, does not establish a right to recover it. Whether a taxpayer is entitled to rebates depends on its compliance with all other applicable requirements, such as having the proper documentation showing that the tax has been expressly and separately transferred.

99. The rebate system, as provided for in the law, is built on trust in the taxpayer. It is a simplified system, requiring only certain information from the taxpayer to be included in a short application (Form 32) which is then submitted to SHCP, accompanied in certain cases by additional documentation. In the case of IEPS rebates for cigarette exports, no additional information must be submitted with the application. The application is then processed and approved or rejected within 50 days, on the basis of the information supplied by the taxpayer. In the case of companies having a highly exporting company (ALTEX) certification from the *Secretaría de Economía (Economía, formerly the Secretaría de Comercio y Fomento Industrial or SECOFI)*, SHCP is required to process applications within five days. This necessarily precludes SHCP from conducting a detailed review of the applicant's entitlement to rebates before paying.

100. For such reason, the Fiscal Code expressly provides that granting a rebate in no way constitutes a favorable resolution as to the applicant's entitlement to the rebates requested and obtained. Moreover, the Fiscal Code vests SHCP, for a period of five years following payment of the rebates, with the authority to verify the correctness of the application and, therefore, whether rebates were properly granted. The Code also provides that requests for or review of additional information prior to granting or rejecting applications does not constitute a formal exercise of a verification (*facultades de comprobación*).

101. The reason why the system operates in this manner is to benefit taxpayers by providing an efficient and expeditious mechanism, especially in the case of ALTEX companies. It would be impossible for SHCP to conduct a thorough review of each application in order to verify at the outset the applicant's entitlement to rebates (in the year 2000 SHCP processed over 1.1 million rebate applications), but more importantly, this could not be done within the legal timeframe for processing applications. Taxpayers, however, are required to provide truthful information and are not exempt from complying with all legal requirements, such as obtaining proper documentation and keeping adequate accounting records that will allow SHCP to subsequently verify whether rebates were properly made.

³¹ First witness statement of Eduardo Díaz Guzmán [submitted by Respondent to Claimant and Tribunal on 5 March 2001; second witness statement of Eduardo Díaz Guzmán [CM 06008].

C. The 1993 Decision of the Supreme Court of Justice: Litigation by Lynx and CEMSA to Challenge the 1991 Amendment³²

102. In February 1991, Lynx and CEMSA initiated separate *amparo* proceedings challenging the constitutional validity of Article 2, section III of the IEPS Law in force during 1991 which limited the person entitled to eligibility for the 0%. Lynx and CEMSA had the same legal counsel³³.

103. The Lynx and CEMSA *amparos* also challenged actions taken by SHCP related to implementation of Article 2, section III: (i) rule 121-B of the fiscal regulations for 1991, applicable to the IEPS Law (*miscelánea fiscal*), which limited the definition of foreign trade enterprises to those that purchased the exported goods directly from the producers and bottlers, and (ii) written instructions issued through an internal telex by SHCP's Technical Director General for Revenue that rebates should be granted only to such persons.

104. The *amparos* essentially alleged that these measures infringed upon the constitutional principle of "equality of taxpayers" by excluding all other exporters from the possibility of obtaining the 0% rate. The *amparos* did not challenge any other part of the governing statute, including the provisions of Article 4 setting forth the documentary requirements for rebates of tax paid by others.

105. In April 1991, the Fifth District Judge in Administrative Matters dismissed CEMSA's *amparo* in part, but granted it in part because he concluded that the Secretary and Undersecretary of SHCP had no authority to issue the implementing fiscal regulations for 1991, including Rule 121-B.

106. On 7 and 8 May 1991, respectively, both SHCP and CEMSA appealed the *amparo* decision, which was heard by the Supreme Court of Justice.

107. On 17 July 1991, the Claimant, on behalf of CEMSA, filed a criminal complaint against the SHCP officials responsible for the enactment of the 1991 amendment to Article 2 section III of the IEPS Law, for abuse of authority and conspiracy. The complaint was later dismissed on the grounds that acts complained of were administrative matters and had been brought before the competent judicial authorities by the Claimant, and they were *sub judice*.

108. On 18 August 1993, the Supreme Court issued its decision in favor of CEMSA. It concluded that the amendment to Article 2, section III breached the principles of fiscal generality and equality because, prior to the amendment, the law allowed the application of the 0% rate to final exports of the subject goods, in an objective manner, regardless of who exported, while under the amended provision the application of the 0% rate depended on persons-based criteria.

³² See generally witness statement of Ramiro Gonzalez Luna. [CM 06085]

³³ Witness statement of Oscar Roberto Enríquez Enríquez at paragraph 3 (submitted with the Claimant's Memorial).

The Court noted that it had arrived at the same conclusion in the *Lynx amparo*³⁴. The Court found no need to review SHCP's arguments regarding its authority to issue Rule 121-B, because the finding of unconstitutionality of Article 2, section III necessarily affected its implementing acts, such as Rule 121-B. The Court modified the District Judge's decision accordingly³⁵.

109. The Supreme Court did not address the entitlement to rebates by CEMSA, because it was not an issue before it. It limited its considerations to the application of the 0% rate. As explained above, the application of the 0% rate means nothing more than assessing a 0% tax on export transactions. This alone says nothing concerning actual tax liability or the ability to obtain rebates. Those issues are regulated *inter alia* under Articles 1, 4 and 5 of the IEPS Law; they are not part of Article 2 at all. Thus, the application of a 0% rate results only in a tax assessment of zero at the border, but it does not automatically result in a positive IEPS balance. Entitlement to rebates in respect of taxes paid by others and transferred required compliance with all other applicable provisions, including Article 4 of the IEPS Law. None of these issues were brought before the Supreme Court, and it did not rule on them.

110. Following the Supreme Court's decision, CEMSA submitted an application to SHCP on 7 September 1993, for rebates in connection with exports made in 1991. However, the Supreme Court had not yet remanded its decision to the District Judge, and the decision had, therefore, not yet been officially notified to the parties. Thus, on 18 October 1993, Rosa María Reza Sosa, the Local Collections Administrator, inquired with the *Administración General Jurídica de Ingresos* (Legal Counsel for Revenue) as to the status of the decision, specifically, whether it was final³⁶.

111. The record was remanded to the District Judge on 27 October by the Secretary of the Court, who requested the Judge to formally notify it to the parties. The Judge then notified it on 8 November, and requested the responsible authorities cited by CEMSA in its *amparo* pleadings (the Congress, the President, the Secretario de Gobernación, and the *Secretario, Subsecretario de Ingresos* and *Director General Técnico de Ingresos* of SHCP) to inform him how they had or would comply with the Supreme Court's decision³⁷.

D. SHCP's Compliance With the Supreme Court Ruling

112. Contrary to the Claimant's allegation that SHCP did not take any steps to implement the 1993 *amparo* judgment "for months", the record shows that when the District Judge, having received the record from the Supreme Court, gave formal notice to the parties³⁸ SHCP responded

³⁴ Lynx had obtained a judgment from the Seventh District Judge and on appeal from the Supreme Court of Justice on similar grounds.

³⁵ CM 02464.

³⁶ CM 02537.

³⁷ CM 02541. The 24-hour time limit is a routine requirement of court orders of this nature, used to indicate that the court desires a prompt response. It should not be construed as indicating that the court was specially concerned about the situation.

³⁸ CM 2540.

promptly to the notices received from the Judge and all complaints, accusations and demands received from the Claimant³⁹.

113. On 24 November 1993, *Procurador Fiscal de la Federación*, Roberto Hoyo D'Addona, informed the District Judge that no acts by the authorities were required to comply with the Supreme Court's judgment⁴⁰. The act of the President complained of by CEMSA was the promulgation of the amendment to the IEPS Law; the acts of the Secretary were passing Rule 121-B and allegedly initialing the amendment prior to promulgation⁴¹. Given the nature of these acts, there was nothing to be done by the President or the Secretary to comply with the judgment. The Tribunal should note that a finding of unconstitutionality does not mean striking down the measure; it simply results in the non-application to the specific claimant of a measure that otherwise continues to exist. Furthermore, the specific provision reviewed by the Supreme Court—the Article 2, section III that was in force in 1991—had subsequently been repealed by Congress on January 1, 1992.

114. On 26 November 1993, the Claimant wrote to SHCP to demand payment of 810,584 pesos for IEPS rebates in connection with positive balances for the months of November 1990 (50,446 pesos), January 1991 (107,440 pesos) and April 1991 (61,713 pesos) plus a "financial cost" and interest⁴². On 8 December he complained to the District Judge that SHCP had not yet complied with the judgment⁴³. On 9 December the Claimant, on behalf of CEMSA, threatened to file a criminal complaint against Lic. Rubén Aguirre Pangburn and to pursue the criminal complaint against Undersecretary Gil Díaz (which had been dismissed) in connection with the 1991 amendment. On 10 December he demanded that SHCP make immediate payment of CEMSA's claim for IEPS rebates on alcoholic beverages and tobacco products exported in 1990 and 1991 in order to comply with the Supreme Court judgment⁴⁴.

115. On 14 December the District Judge again directed SHCP (and other Government organs) to inform the court as to how it would comply with the final judgment of the Supreme Court. On 31 December the *Procurador Fiscal de la Federación* reiterated that no acts by the President or the Secretary were required to comply with the judgment⁴⁵.

³⁹ The 27 October 1993 memorandum cited by the Claimant (Memorial p. 20, paragraph 30) as evidence that SHCP did not intend to comply with the Supreme Court's decision in fact is nothing of the kind. Rather it is an evaluation of public threats by the Claimant and a criminal complaint against SHCP officials accusing them of having submitted to Congress the amendments to the IEPS Law enacted in 1991, as well as the implementing regulations. This criminal complaint was dismissed.

⁴⁰ CM 02546.

⁴¹ SHCP denied that the Secretary had initialed the amendment. Thus, District Judge dismissed the *amparo* in respect of that act. The Supreme Court subsequently confirmed the dismissal on that basis.

⁴² CM 04300.

⁴³ CM 04325.

⁴⁴ As noted, *Economía's* records do not show any exports of cigarettes by CEMSA during this period. Also, as noted further below, CEMSA only applied for rebates in connection with exports of alcoholic beverages.

⁴⁵ CM 02549.

116. On 10 January 1994, Ramiro Gonzalez Luna, *Director de Procedimientos Legales* (SHCP Director of Legal Procedures, Tax Policy) advised the *Procuraduría Fiscal de la Federación* that the Supreme Court judgment related only to the application of the 0% rate, but that did not automatically require granting tax rebates, because CEMSA remained obliged to comply with all other legal requirements established by law, including the requirements stipulated in Article 4 of the IEPS Law. He also advised that the judgment only applied to the law in effect in 1991 because the provision at issue —Article 2, section III— was amended on 1 January 1992⁴⁶.

117. On 13 January 1994, the *Procurador Fiscal de la Federación* informed Local Collections Administrator, Rosa María Reza Sosa, that the judgment of the Supreme Court was final, and that SHCP was required to apply the 0% rate to CEMSA. He also noted CEMSA had to comply with all other applicable legal provisions, including Article 4 of the IEPS Law⁴⁷.

118. The Claimant sent a letter to the *Procurador Fiscal* on 19 January 1994 accusing him of obstruction of justice and abuse of authority for having issued the 13 January letter to Ms. Reza Sosa requesting that CEMSA comply with the applicable legal provisions. He also advised that he had initiated a criminal complaint against Undersecretary Gil Díaz (notwithstanding that it already had been dismissed)⁴⁸.

119. By letter dated 24 January 1994, Ms. Reza Sosa informed the Claimant that to enable SHCP to comply with the Supreme Court judgment, CEMSA should provide purchase invoices —for goods exported in January and April 1991— showing the IEPS transferred expressly and separately in the sum of 107,440 pesos and 61,713 pesos, respectively⁴⁹.

120. By letter dated 24 January 1994, the Claimant protested the requirement to produce invoices, stating that the judgment of the Supreme Court was “absolute, unconditional and unquestionable [and] ... granted me the 0% rate ... period.” He again accused Undersecretary Gil Díaz of being a “criminal”⁵⁰. In his Memorial, the Claimant contends that he “continued to object vigorously to the imposition of impossible conditions on CEMSA by SHCP before SHCP would perform its obligations under the order of the Supreme Court”, and suggests that “CEMSA returned to court and obtained another order requiring evidence of compliance within 24 hours from SHCP dated February 3, 1994”⁵¹.

121. The evidence shows, however, that by letter dated 27 January 1994, the Claimant expressly complied with the legal requirements and produced the requested invoices, with the

⁴⁶ CM 02551.

⁴⁷ CM 02555.

⁴⁸ App. 0264 (exhibit to Memorial).

⁴⁹ CM 02557.

⁵⁰ CM 02558.

⁵¹ Memorial at paragraphs 37 and 38.

IEPS separately stated, albeit stating that he was doing so "under protest"⁵². All of the invoices were for purchases of beer and alcoholic beverages, not cigarettes. He demanded payment of 827,154 pesos: 50,446 pesos corresponding to a positive balance obtained in November 1990, brought to present day value on the date of the application at 72,484.31 pesos, plus interest of 57,480 pesos; 107,440 pesos corresponding to a positive balance obtained in January 1991, brought to present day value on the date of the application at 147,891 pesos, plus interest of 109,513 pesos; and 61,713 pesos corresponding to a positive balance obtained in April 1990, brought to present day value on the date of the application at 82,084.46 pesos, plus interest of 55,243 pesos. He also claimed a "financial cost" in an amount equal to the present day value of the base claim. In other words, he was claiming twice the present day value of his base claim, plus interest⁵³.

122. On 31 January 1994, SHCP informed the District Judge as follows:

In order for the Honorable Judge [to] be informed of the actions taken by the undersigned authorities, identified as responsible [*i.e.* the authorities responsible for the acts challenged in the *amparo*], for purposes of complying with the decision dated 18 August 1993 by the Honorable Supreme Court of Justice acting in full, I hereby inform you of the following circumstances:

By official letter No. 102-A-14-II-1-b-1-910 dated 24 January 1994, notified to the Claimant on the same day that the letter in question was issued, the Local Collection Administration of the East in the Federal District, Local Collection Administration, requested Corporación de Exportaciones Mexicanas, S.A. de C.V. to supply documents evidencing the transfer of the special tax on production and services expressly and separately, and comprising the amounts of rebates for the months of January and April 1991 for which it applied.

In response to such requirement, as evidenced by copies attached hereto as exhibits, citizen Marvin Feldman delivered on 24 January 1994 to the Local Collection Administration of the East in the Federal District a letter whereby he makes several submissions, but failed to comply with such requirement.

The reason why the authority made such requirement to the Claimant is to be able to have the proper documentation showing the transfer of the amounts of rebates that it applied for, since the authority cannot only base its acts on statements by private parties; rather they must demonstrate fully their entitlement and thus have certainty that the tax was effectively transferred to the person applying for its rebate.

⁵² CM 02561.

⁵³ Accordingly, the Claimant's assertions in Memorial paragraphs 37, 39, and 40 that it was "impossible" for CEMSA to comply with the document requests, and that "no invoices separating the tax were required", are contradicted by the record.

The foregoing is so because Article 4 of the Special Tax on Production and Services Act imposes a number of requirements in order to credit the tax and, in section III, it specifically refers to the tax having to be expressly transferred to the taxpayer and stated separately in the supporting documents. Such measure is justified so that the authority may verify that the tax rebate being applied for has been effectively paid to the Federal Treasury, otherwise the authority would be under an obligation to refund amounts possibly not paid to the Treasury based only on the taxpayer's statement requesting a credit balance.

The foregoing is hereby notified so that Your Honor may be fully aware of the acts being undertaken by the authorities in order to comply with the terms of the Decision.⁵⁴ [Emphasis added]

123. By this letter, SHCP stated its view to the District Judge that CEMSA, having been found to have a right to the application of the 0% rate on exports of goods subject to the IEPS, was nevertheless required to comply with Article 4 as written by Congress.

124. On 3 February 1994, the District Judge again directed SHCP (and other Government organs) to inform him as to how it would comply with the final judgment of the Supreme Court. The Judge recorded the information provided by the *Procurador Fiscal de la Federación* regarding compliance by the President and the Secretary of SHCP, and ordered that this be notified to the CEMSA so that it could reply as it saw fit⁵⁵. CEMSA never objected.

125. On 8 February 1994, the *Procuraduría Fiscal* requested Rubén Aguirre Pangburn, *Administrador General Jurídico de Ingresos*, to inform the District Judge regarding compliance with the Supreme Court judgment⁵⁶. The following day it notified Local Administrator, Reza Sosa, of the Judge's order of February 3, and instructed her to fully comply with the Supreme Court's judgment, in connection with CEMSA's application for IEPS rebates, as well as to inform the Judge of actions taken in relation thereto⁵⁷. On the same day the *Procurador Fiscal*, Roberto Hoyo d'Addona, informed the Judge of the instructions given to the Local Administrator⁵⁸.

126. Having reviewed the documentation supplied by CEMSA, on 10 February 1994, Local Administrator, Reza Sosa, requested the Federal Treasurer to issue payment of 428,645 pesos to CEMSA, the sum comprised as follows:⁵⁹

- a) 50,446 pesos for the November 1990 IEPS rebate;

⁵⁴ CM 02577.

⁵⁵ CM 02579.

⁵⁶ CM 02580.

⁵⁷ CM 02581.

⁵⁸ CM 02582.

⁵⁹ CM 02584.

- b) 105,389 pesos for the January 1991 IEPS rebate, plus a 42,208 pesos for inflation adjustments (to bring it to present day value), plus 95,790 pesos for interest; and
- c) 61,712 pesos for the April 1991 IEPS rebate, plus 21,173 pesos for inflation, plus 51,927 pesos for interest.

127. By letter dated 11 February 1994, the *Procuraduría Fiscal* remitted to the District Judge a copy of the letter sent to the Treasurer the day before by the Local Administration.

128. On 21 February 1994, SHCP paid CEMSA 428,645 pesos in settlement of CEMSA's claims for IEPS rebates owing for November 1990 and January and April 1991. Payment was received by the Claimant on that date⁶⁰. On 1 March 1994, the *Procuraduría Fiscal* remitted a copy of CEMSA's receipt to the District Judge⁶¹.

129. On 4 March 1994, SHCP again notified the District Judge that the Treasury had been requested to pay CEMSA 428,645 pesos in settlement of its claims for IEPS rebates in November 1990 and January and April 1991, including adjustments for inflation and interest⁶².

130. On 28 March 1994, the Claimant submitted a letter to SHCP requesting payment of 20,440 pesos for IEPS rebates that had been omitted as follows:

- a) 3,462 pesos for November 1990;
- b) 13,248 pesos for January 1991; and
- c) 3,730 pesos for April 1991.⁶³

131. Having reviewed the above information and supporting documentation provided by CEMSA, on 21 April 1994, Local Administrator, Reza Sosa, instructed the Treasury to issue a further payment to CEMSA in the sum of 20,440 pesos. She explained that SHCP earlier authorized a payment of 428,645 pesos (including applicable amounts for inflation and interest) but the amount should have been 449,085 pesos⁶⁴.

132. As noted in an internal note dated 22 February 1994 from Pablo Chávez Holguín, *Subprocurador Fiscal de Amaros*, to Roberto Hoyo d'Addona, *Procurador Fiscal de la Federación*, the Claimant had insisted that SHCP had not fully complied with the Supreme Court judgment because approximately half of the money claimed was still outstanding.

⁶⁰ CM 02587.

⁶¹ CM 02590.

⁶² CM 02591.

⁶³ CM 02597.

⁶⁴ CM 02599.

133. On 26 April 1994, Local Administrator, Reza Sosa, informed the District Judge that the Treasury had paid CEMSA 428,645 pesos on 10 February 1994 and that the Claimant had requested an additional 20,440 pesos resulting from a difference in the calculations. Payment in that amount had been authorized on 21 April 1994. She further informed the court that the payments included amounts corresponding to adjustments for inflation and interest, but not the Claimant's demand for "financial costs", there being no provision for payment of such costs under the Fiscal Code.

134. On 29 April 1994, the Treasury issued a check to CEMSA for 22,440 pesos, which the Claimant received on 25 May 1994⁶⁵.

135. On 30 June 1994, CEMSA's lawyer, Óscar Roberto Enríquez Enríquez, petitioned the District Judge for an order directing SHCP to allow CEMSA to export cigarettes at the 0% rate in the future. He stated that although SHCP had paid CEMSA's IEPS rebates for 1990 and 1991, it had failed to fully comply with the judgment of the Supreme Court because it refused to recognize CEMSA's right to continue to obtain IEPS rebates⁶⁶.

136. The District Judge responded as follows:

Mexico City the 5th day of July 1994.

Having seen the document in question, signed by the attorney for the plaintiff Corporación de Exportaciones Mexicanas, S.A. de C.V. [...]

Regarding its request for an order directing the responsible authorities to comply with the judgment in the present matter; inform the claimant that said requirement from the responsible authorities in this [*amparo*] proceeding is denied, given that, as can be seen from the documents in the record in the present matter and submitted by the responsible authorities, there exists a principle of compliance with the judgment. Therefore, the claimant should have recourse to appropriate remedies. ⁶⁷

137. It should be noted that, because the decision of the Supreme Court applied only to Article 2, section III as it was in force in 1991, the alleged failure to recognize CEMSA's right to obtain rebates was beyond the scope of the judgment. Thus, the District Judge refused CEMSA's request and rather directed it to pursue appropriate remedies.

138. On 26 June 1996, the District Judge noted there were no records regarding compliance with the Supreme Court's decision by the *Subsecretario de Ingresos* and the *Administrador General Jurídico de Ingresos*, and directed them to inform him as to the steps taken in that regard. He directed this request to the Secretary on 16 August 1996⁶⁸.

⁶⁵ CM 02601.

⁶⁶ CM 02609.

⁶⁷ CM 02610.

⁶⁸ CM 02611.

139. On 7 September 1996, the *Procurador Fiscal de la Federación*, Ismael Gómez Gordillo, responded on behalf of the Secretary. He informed the Judge that:

- a) the act attributed to the *Subsecretario* had been the issuance, in absence of the Secretary, of Rule 121-B. Thus, given its nature as a general, impersonal and abstract legal provision, there were no acts required of him to implement the judgment of the Supreme Court;
- b) similarly, given the nature of the telex issued by the *Administrador General Juridico de Ingresos*, there was nothing to fulfill under the stated resolution; and
- c) as to CEMSA's requests for rebates he reiterated that two checks were paid to CEMSA—one for 428,645 pesos in February 1994 and another one 20,445 pesos in May 1994—for IEPS rebates owing for November 1990 and January and April 1991, including amounts payable for inflation and interest.⁶⁹

140. *Procurador* Gómez Gordillo explained that the court was informed of the payments in a timely manner. He requested the District Judge to note in the court's records that SHCP had in fact complied with the judgment⁷⁰.

141. By letter to the District Judge dated 30 October 1996, Lic. Óscar Enríquez, on behalf of CEMSA, expressly confirmed that SHCP had complied fully with the judgment of the Supreme Court, and requested that the case be closed⁷¹.

142. In summary:

- a) contrary to the Claimant's contention that CEMSA had a "cigarette export business" in that SHCP "shut down for the first time" when the 1991 amendment was enacted, the record shows that CEMSA's requests for IEPS rebates in November 1990-91 related solely to exports of beer and alcoholic beverages;
- b) contrary to the Claimant's contention that the 1993 *amparo* judgment entitled CEMSA to claim IEPS rebates on cigarette exports without restriction in 1994 and thereafter, the record shows that the judgment was restricted to determining the constitutional validity of the 1991 amendment to Article 2, section III which limited the application of the 0% rate to certain exporters, which was repealed in 1992, in a manner consistent with the later ruling of the Supreme Court;
- c) contrary to the Claimant's contention that SHCP refused to pay CEMSA everything it was owed for IEPS rebates, the record shows that SHCP paid the IEPS rebates for 1990-91 in full (including amounts properly owing for inflation

⁶⁹ CM 02613-14.

⁷⁰ Witness statement of Ismael José Gómez Gordillo [CM 06029] at paragraph 16.

⁷¹ Memorial, paragraph 81.

and interest) and declined only to pay the demanded "financial costs" for which there was no provision under the Fiscal Code;

- d) contrary to the Claimant's contention that the 1993 *amparo* judgment entitled CEMSA to claim IEPS rebates on cigarette exports without meeting the requirement in Article 4 to submit invoices with the IEPS separately stated, the record shows that the issue was never put before the Supreme Court or the District Judge;
- e) contrary to the Claimant's contention that when SHCP paid rebates in February and April 1994 "no documentary requirements were imposed" and "no invoices separating the tax were required", the record shows that SHCP expressly required CEMSA to comply the documentary requirements imposed by Article 4 of the IEPS Law, and indeed the Claimant acquiesced to that requirement by submitting the requested invoices expressly separating the tax. This allowed SHCP to approve his rebate applications for 1990 and 1991; and
- f) contrary to the Claimant's contention, SHCP fully complied with the Supreme Court judgment, as early as April 1994, as ultimately admitted by the Claimant in 1996, when he finally gave up the claim for a "financial cost".

143. The judgment of the Supreme Court was fully implemented.

E. Exports of Cigarettes by CEMSA in 1992

144. After the IEPS law was amended in 1992, CEMSA began to export cigarettes. The Claimant alleges that CEMSA claimed IEPS rebates. The Respondent is unable to confirm or deny this, as SHCP no longer has the pertinent records. Under internal guidelines, SHCP keeps records for a period of five years, after which they are regularly destroyed⁷².

145. The IEPS rate was then 139.3%.

146. Economía's export records show that CEMSA exported cigarettes valued at 1,042,302 U.S. dollars during 1992. CEMSA's shipments, sent by air on all but one occasion, went to nine different overseas destinations: Germany, France, Switzerland, Austria and the Netherlands in Western Europe and Bulgaria, Romania, Hungary and the Soviet Union in Eastern Europe⁷³.

147. The Claimant alleges that Lic. José Antonio Riquer, then Regional Tax Administrator, "confirmed CEMSA's eligibility to obtain IEPS rebates" under the 1992 amendment to the IEPS

⁷² Official letter of Ángel Ramírez Castillo to Samuel Magaña Mendoza, dated 16 May 1995, informing the timeframe for keeping records in connection with tax collection. [CM 05987]

⁷³ Witness Statement of Rolando Garcia Ramos [CM 06021], Table 7.

Law. Mr. Riquer denies it, and explains that his 1992 letter to CEMSA essentially restates what the law in force that year said, and that it is impossible to give his letter such a broad reading⁷⁴.

148. On 6 February 1992, CEMSA made a formal inquiry to SHCP pursuant to Article 34 of the Fiscal Code. Article 34 regulates in tax matters the general constitutional right of private persons to make inquiries and the authorities' obligation to reply in writing. It sets out a formal procedure, whereby private persons may make inquiries regarding real and concrete situations in order to obtain the SHCP's authorized opinion⁷⁵. SHCP, thus, responds to the terms on which the private party makes the inquiry.

149. In the February 1992 inquiry, CEMSA made a vague inquiry, essentially requesting confirmation that certain legal provisions said what they said. It did not present particular facts and information that would have allowed SHCP to verify whether it complied with applicable requirements, such as its plans to purchase from a retailer and not to obtain invoices with the tax expressly and separately stated⁷⁶. Rather, in very general terms CEMSA requested confirmation on the plain text of the law, and Lic. Riquer responded accordingly⁷⁷.

150. Specifically, in its 6 February letter, CEMSA transcribed Article 2, section III of the IEPS Law, as it was then in force, and asked whether a person exporting goods under the circumstances described therein would have a right to apply the 0% rate, and thus have a creditable tax in accordance with Article 4, and if that resulted in a positive balance, that person would have a right to claim a rebate in accordance with Article 5 in connection with Article 22 of the Fiscal Code. Lic. Riquer confirmed that CEMSA would have a right to apply for a rebate (not a right to obtain it), but that did not prejudice the entitlement thereto. Specifically, Article 22 of the Fiscal Code, cited by both in their respective letters, provides that payment of rebates in no way implies a favorable resolution as to the entitlement to rebates. Furthermore, Lic. Riquer's letter further specified that it did not prejudice the information supplied by CEMSA, and that SHCP expressly reserved its oversight and verification powers⁷⁸.

151. The Claimant says CEMSA ceased exporting in January 1993 upon being informed by SHCP that rebates would not be paid unless he could produce invoices with the IEPS separately stated⁷⁹. The Respondent has no evidence to confirm or deny this allegation. However, the requirement stipulated in Article 4—to obtain invoices that separately state the IEPS and expressly transfer the tax to the purchaser—was then in effect, as it had been previously.

⁷⁴ Witness statement of José Riquer Ramos [CM 06060] at paragraph 2.

⁷⁵ Witness statement of Eduardo Díaz Guzmán [CM 06008] at paragraph 6.

⁷⁶ As described below, CEMSA made an Article 34 submission to SHCP on 12 December 1997 that set out all of the pertinent details, and to which SHCP made a specific response. Consequently, it is clear that CEMSA knew how to obtain an appropriate ruling from SHCP.

⁷⁷ Witness statement of José Antonio Riquer Ramos [CM 06060] at paragraphs 6-7.

⁷⁸ Witness statement of José Riquer Ramos [CM 06060] at paragraphs 6 through 9. Letter from Lic. José Riquer Ramos to CEMSA, dated 12 March 1992. [CM 04265]

⁷⁹ Memorial at paragraph 22.

152. The Claimant alleges that "at one point [in 1994], SHCP advised CEMSA that it was required to present invoices separating the IEPS tax in order to obtain rebates while simultaneously denying that cigarette manufacturers were obliged to state the taxes separately in their invoices", in reference to Rubén Aguirre Pangburn's letter of 8 April 1994⁸⁰. Lic. Aguirre's letter was issued in response to a written inquiry by CEMSA on 25 March 1994, made in a manner similar to its 1992 inquiry to Mr. Riquer. CEMSA asked whether, in accordance with the IEPS Law, producers, bottlers and manufacturers of alcoholic beverages and tobacco were under an obligation to issue invoices stating the IEPS expressly and separately.

153. Lic. Aguirre responded that, where CEMSA purchased alcoholic beverages, the vendor was under an obligation to issue invoices transferring the IEPS expressly and separately. However, in the case of cigarettes, in accordance with Article 11, only the producers and importers were under an obligation to pay the tax assessed on the basis of the price to the retailer, and consequently were not under an obligation to transfer the tax expressly and separately⁸¹.

154. The Claimant subsequently requested an appointment with Lic. Ismael Gómez Gordillo, then Undersecretary for Revenue, and met with him on 21 April 1994 in order to express his objection. Lic. Gómez Gordillo recommended that the Claimant submit a letter expressly requesting that Lic. Aguirre's opinion be reconsidered. The Claimant did so by letter dated 22 April, arguing that not just in the case of alcoholic beverages, but also in the case of cigarettes, the producers were under an obligation to issue invoices expressly and separately transferring the tax⁸².

155. By letter dated 10 May 1994, Undersecretary Gómez Gordillo replied⁸³. He modified Lic. Aguirre's opinion stating that CEMSA was entitled to be transferred the IEPS expressly and separately when it acquired both alcoholic beverages and processed tobacco. That resolution revoked Lic. Aguirre's letter of 8 April. The Tribunal should note that such decision was not issued pursuant to the Supreme Court's judgment, which was outside Lic. Gómez Gordillo's sphere of competence, and because it related to a legal provision applicable in 1991 only, while CEMSA's inquiry was based on the law in force in 1994. Also, while Lic. Gómez Gordillo was prepared to recognize that CEMSA had a right to obtain invoices stating the IEPS separately, he had no authority to grant CEMSA a waiver from any express legal provisions⁸⁴.

156. The fact that CIGATAM was unwilling to sell to CEMSA directly was an issue involving private rights, and SHCP could not intervene in such matters unrelated to tax law. It had no power to force CIGATAM to sell cigarettes to CEMSA.

⁸⁰ Memorial at paragraph 42.

⁸¹ Letter from Rubén Aguirre dated 8 April 1994. [CM 04318].

⁸² Witness statement of Ismael Gómez Gordillo [CM 06029], paragraph 4. Letter from Marvin Feldman to Undersecretary Gómez Gordillo dated 22 April 1994 [Memorial App. 0292].

⁸³ Letter dated 10 May 1994 from Lic. Gómez Gordillo to Marvin Feldman. [CM 04332]

⁸⁴ Witness Statement of Ismael Gómez Gordillo [CM 06029] at paragraphs 6-11.

157. Also, if CEMSA was able to obtain invoices from its vendors stating the IEPS separately, SHCP was prepared to recognize that it was in compliance with Article 4 of the IEPS Law. Under the law, it is the purchaser who has the ability to request invoices expressly separating the tax. However, SHCP could not force CEMSA's vendors to request such invoices from their suppliers. If they did not request them and therefore were unable to transfer the tax to CEMSA, it was also a matter beyond the fiscal sphere in which SHCP could not intervene.

158. Most importantly, if CEMSA considered that its rights were being breached, it had legal remedies readily available. It later availed itself of those remedies, and the issues are *sub judice*.

159. Lic. Gómez Gordillo's letter clearly stated that in every case CEMSA must have the IEPS transferred to it expressly and separately in its purchase invoices. This was necessary because it was the only means for SHCP to be able to effectively ensure that rebates were for taxes actually paid to the treasury, especially in the case of cigarettes where the taxable base, and therefore the actual tax, were otherwise unknown to the consumer. Allowing the IEPS to be assessed by the purchaser without having proper invoices would have allowed the system to be abused. The Claimant's behavior in grossly over-stating rebates demonstrates the validity of this concern⁸⁵.

160. With the exception of CEMSA's "test exports" in 1994 and 1995, CEMSA did not export cigarettes again until 1996⁸⁶.

F. The Commercial Issue Between CEMSA and CIGATAM

161. The Claimant's financial records show that "Marlboro" cigarettes comprised 70% of CEMSA's cigarette exports in 1996-97 and that "Raleigh" cigarettes comprised about 20% of its exports during the same period. Both are international brands produced and distributed under license in Mexico by CIGATAM and La Moderna, respectively. The remaining 10% of CEMSA's cigarette exports consisted almost entirely of domestic brands, such as "Montana", "Rodeo", "Fiesta", and "Boots", produced by La Moderna, and "Manhattan" and "Broadway" produced by CIGATAM⁸⁷.

162. The central theory of the Claimant's case is that Mr. Carlos Slim, whom the Claimant contends owned 70% of CIGATAM, caused SHCP to illegally manipulate the administration of the IEPS law in order to "put CEMSA out of the cigarette export business" and thereby preserve an "illegal export monopoly" for CIGATAM. The Claimant makes no similar allegation against La Moderna, the producer of almost 30% of the cigarettes CEMSA exported in 1996-97.

163. In fact:

⁸⁵ Ibid., paragraph 11.

⁸⁶ Witness Statement of Rolando Garcia Ramos [CM 06021], Table 7.

⁸⁷ Witness Statement of Noe Salazar Martinez [CM 06070], paragraphs 6-7.

- a) prior to 14 August 1997, CIGATAM was owned by Grupo Carso (71%) and Philip Morris Latin America, Inc. (28.78%);⁸⁸
- b) on 14 August 1997, Philip Morris International Inc. ("PMI") acquired an effective 49.9% interest in CIGATAM and a direct 50.1% interest in a newly incorporated company, Philip Morris Mexico, S.A. de C.V. ("PMM");⁸⁹
- c) PMM then assumed sole responsibility for the sale and distribution of all CIGATAM products, including all Marlboro cigarettes produced in Mexico;⁹⁰
- d) at all material times, CIGATAM and PMM were governed by the terms of licensing agreements that restricted the export (and sale for export) of Philip Morris brands, including Marlboro, produced under license by CIGATAM;⁹¹
- e) neither CIGATAM nor PMM have ever exported (or sold for export) any Philip Morris brands, including Marlboro.⁹²

164. As will be explained in greater detail below, the record clearly establishes that

- a) SHCP's decision to seek the 1998 amendment to the IEPS law,
- b) its resolutions denying CEMSA's applications for IEPS rebates for cigarettes exported in October, November and December 1997, and
- c) its initiation of an audit of CEMSA in July 1998

were all undertaken in accordance with applicable Mexican law and on the basis of genuine fiscal considerations.

165. The Claimant contends that CIGATAM refused to separate the IEPS on the invoices it issued to purchasers of its products, thus preventing Sam's Club from issuing invoices with the IPES separated to CEMSA, and that SHCP refused to compel CIGATAM to issue such invoices. There is no corresponding allegation against La Moderna notwithstanding that it also issued invoices without separating the IEPS.

166. In fact:

⁸⁸ Ibid., paragraph 9.

⁸⁹ Ibid., paragraphs 11-13.

⁹⁰ Ibid., paragraph 14.

⁹¹ Ibid., paragraph 15.

⁹² Ibid., paragraph 16.

- a) On 8 April 1995, in response to a written request from the Claimant, the General Legal Administrator of Revenue sent a letter informing him that producers were under no obligation to transfer the IEPS expressly and separately⁹³.
- b) The Claimant appealed this determination to the Undersecretary of Revenue, Mr. Gómez Gordillo, who reversed the earlier ruling and issued a resolution stating that CEMSA had a right to have the IEPS expressly and separately transferred to it when purchasing cigarettes and alcoholic beverages⁹⁴.
- c) CIGATAM (and latterly PMM) did not separate the IEPS on sales invoices issued to purchasers of their tobacco products because their customers did not require separation of the IEPS for any fiscal purpose. According to CIGATAM, it did not receive complaints from any customers, including Sam's Club. Moreover, none—including Sam's Club—requested CIGATAM or PMM to issue invoices with the IEPS separately stated⁹⁵.
- d) The Claimant did not initiate legal proceedings against Sam's Club or CIGATAM. Instead, he complained that SHCP should take legal action against CIGATAM on CEMSA's behalf.

G. The Alleged Agreement to Exempt CEMSA from the Application of Article 4 of the IEPS Law

167. On 1 December 1994, a new administration took office. The Claimant contends that he got positive responses from the newly appointed officials after briefing them about the history of the dispute. He claims that on 15 March 1995, he met with Dr. Pedro Noyola, then Undersecretary for Revenue and reached an agreement with him that would allow CEMSA to claim rebates on cigarette exports without obtaining invoices expressly transferring the IEPS. He alleges that Dr. Noyola only requested some "cover" for this, in the form of a letter from the U.S. Embassy in Mexico.

168. The Respondent firmly denies that there was any agreement and denies that SHCP acted on the instructions of the U.S. Embassy or otherwise under its "cover".

169. In early December 1995, the Claimant sent a number of letters to the newly appointed officials, where he stated his demands:

⁹³ CM 04318.

⁹⁴ CM 04332.

⁹⁵ Witness Statement of Noe Salazar Martinez [CM 06070], paragraph 22.

- a) On 5 December, he sent Jaime Serra Puche, then Secretary of SHCP, a "red folder" entitled "Fires to be put out" to which he attached "a kilo" of documents relating to the 1993 Supreme Court Decision⁹⁶.
- b) On 6 December, he sent Undersecretary Noyola another letter accusing his predecessor, Lic. Gómez Gordillo of criminal actions relating to an alleged revision to the IEPS law. He also demanded that SHCP:
- i) order CIGATAM and La Moderna to expressly transfer the IEPS in their invoices;
 - ii) allow CEMSA to separate the IEPS itself under the strict supervision of SHCP;
 - iii) order CIGATAM and La Moderna to sell two containers of cigarettes each week without taxes directly to CEMSA, in order to avoid judicial intervention; or
 - iv) order Carlos Slim to designate CEMSA a casino, a bank charter, a securities brokerage firm, or to sell to CEMSA Ocean Gardens, Almacenes Nacionales, or else authorize CEMSA as an electricity plant, a T.V. station, a telephone company, etc.⁹⁷
- c) On 7 December, he sent a letter to Lic. Antonio Lozano Gracia, then the Attorney General (who was affiliated with the National Action Party (PAN), then the opposition political party) claiming to be a good friend of Diego Fernández de Cevallos, the former presidential candidate for the PAN, and referring to the criminal complaint he had filed against former Undersecretary Gil Díaz (which had been dismissed since 1992)⁹⁸.
- d) On 13 December, he sent a letter to Ángel Ramírez Castillo, the *Administrador General de Recaudación*, requesting authorization to separate the IEPS directly in accordance with the Supreme Court Decision⁹⁹.
- e) On 16 January 1995, he sent a letter to Fernando Heftye, then *Administrador General Jurídico de Ingresos*, referring to the 1993 Supreme Court decisions and claiming that Lic. Gómez Gordillo, Rubén Aguirre and Roberto Hoyo had insisted on imposing conditions on compliance. He raised again the issue of CEMSA

⁹⁶ Letter from Marvin Feldman to Jaime Serra Puche dated 5 December 1995. [Memorial App 0174]

⁹⁷ CM 04354.

⁹⁸ Memorial App. 0176.

⁹⁹ CM 04356.

separating the tax itself and referred to the alternatives he had proposed to SHCP to resolve the issue.¹⁰⁰

170. In early 1995 several SHCP officials met among themselves in order to discuss CEMSA's situation. Two conclusions were reached: (1) the 1993 judgment of the Supreme Court referred to the 1991 situation, and had no application in 1995 (the Law in question had been amended); and (2) the IEPS Law required having invoices transferring the IEPS expressly and separately¹⁰¹.

171. SHCP officials met with the Claimant on several occasions in 1995. Lic. Heftye states that they were always willing to try to be helpful, but that could not have been taken as a formal favorable resolution by SHCP, much less an agreement with the Claimant. The Fiscal Code sets out a specific procedure whereby private parties can make inquiries on concrete and real matters, which may lead to SHCP issuing a resolution in writing. Only a favorable resolution in writing issued in accordance with this procedure would create a right for the private party and bind SHCP. Only a favorable resolution issued in this manner would be enforceable against SHCP and could not be subsequently modified or revoked, except by the Federal Fiscal Tribunal¹⁰².

172. The Claimant's written and oral proposals were vague general statements, not specific inquiries on real and concrete situations pursuant to Article 34 of the Fiscal Code. They accordingly were not formulated to obtain official written responses from from SHCP¹⁰³.

173. In any event, even when acting pursuant to Article 34 of the Fiscal Code, SHCP would be bound by the existing legal framework, and had no authority to grant the Claimant a waiver from express legal requirements, especially since the Fiscal Code itself provides that the fiscal law is to be applied strictly. This means that the law can only be applied literally, and no other means of interpretation are allowed¹⁰⁴.

174. Thus, even if there had been an "oral agreement", which is denied, it would not have established a right for CEMSA under Article 34 of the Fiscal Code. In any event, because of the nature and the effects of favorable resolutions under Article 34, the Fiscal Code itself provides that such resolutions are valid only for the fiscal year in which they are issued.

175. The Claimant and his Mexican lawyers were well aware of the nature and scope of Article 34 of the Fiscal Code. Indeed, as early as 1992 they had made an Article 34 submission to SHCP, which led to a formal response from Lic. Riquer as explained above. In 1994 CEMSA made a similar application to Lic. Aguirre Pangburn, which resulted in a resolution dated 8 April 1994. It then formally applied to have the Undersecretary revise and revoke that resolution. This led to Lic. Gómez Gordillo's letter of 10 May 1994. As explained below, the Claimant

¹⁰⁰ Memorial App. 0181.

¹⁰¹ Witness statement of Fernando Heftye [CM 06024] at paragraph 6.

¹⁰² Ibid. at paragraphs 7-8. Witness statement of Eduardo Díaz Guzmán [CM 06008] at paragraph 6.

¹⁰³ Witness statement of Fernando Heftye [CM 06024] at paragraph 9.

¹⁰⁴ Ibid. at paragraphs 11-12.

again made a formal inquiry under Article 34 in December 1997, which resulted in a negative response from SHCP issued on 24 February 1998. CEMSA then initiated a Fiscal Court challenge and then an *amparo* proceeding against SHCP's reply, both of which were ultimately resolved against it.

176. CEMSA did not follow the Article 34 procedure for what the Claimant contends was the most important decision by SHCP, a decision allegedly establishing its right to claim rebates without having proper documentation as required by the law.

177. The Claimant's allegation that there was an agreement that CEMSA could obtain rebates without meeting the express requirements of Article 4 is further contradicted by the written record, as follows:

- a) In response to the Claimant's 20 March 1995 letter to Lic. Juan Carlos Espinosa and Juan Pablo de la Serna from the Local Collections Administration regarding denial of rebates¹⁰⁵, Lic. Espinoza replied on April 4 that his application had been favourably decided in September 1994¹⁰⁶. The Claimant alleges that he "understood this must be a reference to the documents which ordered the September payment for CEMSA's cigarette [test] export and this response encouraged Claimant to believe that he was making progress towards resolving the issue of CEMSA's inability to produce invoices separating the IEPS tax"¹⁰⁷. Yet, on 5 May 1995, he wrote back to Lic. Espinoza clarifying that "There is a misunderstanding regarding the other problem. The I.E.S.P.S. (sic) on cigarettes was not rebated because the invoice did not state it separately because Carlos Slim refuses to do it"¹⁰⁸.
- b) The Claimant contends that on 5 July 1995 SHCP terminated an audit which it began in late June on "instruction from the highest level of SHCP". The record shows that SHCP officials noted inconsistencies stemming from information provided by CEMSA and his suppliers of photographic products: CEMSA's reported purchases were higher than the sales to CEMSA reported by his suppliers, which suggested that either CEMSA or its suppliers could be committing fiscal irregularities. SHCP also noted that the amount of rebates of IEPS and IVA claimed by CEMSA could have been overestimated. An audit of both CEMSA and its suppliers was recommended¹⁰⁹. A verification visit was

105 Letter from CEMSA to Lic. Juan Carlos Espinoza and Juan Pablo de la Serna, dated 20 March 1995. [CM 04362]

106 CM 04369.

107 Memorial, paragraph 61.

108 CM 04371.

109 Memorandum of 10 June 1995. [CM 04390]

conducted on 27 June 1995. However, the audit was terminated on 5 July 1995, because CEMSA was an audited taxpayer¹¹⁰.

An audited taxpayer is one whose financial statements have been audited for tax purposes by an independent registered accountant. Under internal SHCP rules establishing what is known as the "Sequential Procedure", SHCP is first required to request information directly from the registered accountant, and it can only request it from the taxpayer if the accountant does not supply it. These are internal rules binding on SHCP. They are public, and officially notified to the Mexican Institute of Public Accountants. If the procedure is not followed, a formal verification cannot take place¹¹¹.

This was the case for the 1995 verification visit. The audit was accordingly terminated on procedural grounds in accordance with pre-existing rules, where the decisions lie with the responsible authority and in no case do they involve higher levels within SHCP.¹¹²

- c) The Claimant contends that Undersecretary Noyola assured him that the alleged "agreement" would be honored by his successor, and that he left his position in the form of an internal memorandum¹¹³.

The Respondent denies that there was ever such a document. When the Claimant first raised this issue with *Procurador Fiscal* Gómez Gordillo in 1998, he said he was unaware of any such document, but that SHCP would search for it. No such document was found.

As explained above, only favourable resolutions issued pursuant to Article 34 of the Fiscal Code bind SHCP, regardless of the individual occupying a specific position. Thus, it is highly unlikely that Undersecretary Noyola would leave "instructions" to his successor, especially in a document of this type¹¹⁴.

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.

- d) Finally, when CEMSA asserted its position before the Fiscal Tribunal in the nullification proceeding, it did not purport to rely on any "oral agreement" with SHCP. Rather, it defended its case on its interpretation of the specific legal provisions.

¹¹⁰ See CM 04402, 04405.

¹¹¹ Witness statement of Gabriel Oliver [CM 05994] at paragraphs 27 through 29. [CM]

¹¹² Ibid. at paragraphs 29 through 31.

¹¹³ Memorial at paragraph 74.

¹¹⁴ Witness statement of Fernando Heftye [CM 06024] at paragraph 16.

178. CEMSA did not begin to export cigarettes on a commercial level until 21 June 1996, a full year after the Claimant says he reached an oral agreement with SHCP, and only then after attempting what he describes as several "test exports". The Claimant's contention that he spent that year "ramping up" —contacting old customers, seeking sources of financing and making arrangements with suppliers— is contradicted by CEMSA's financial records and the Claimant's testimony.

179. CEMSA did not export cigarettes to any of its former customers. In 1992 CEMSA's exports went to nine different countries in Europe. In 1996-97, none of its exports were shipped overseas. Rather, about half of its exports went by air to a group of related parties in the United States and were forwarded by land to a Foreign Trade Zone in El Paso, Texas and most of the rest were sent by land to three related companies in Central America, of which at least two have been determined not to exist.

180. CEMSA did not "ramp up" its operations. Beginning in July 1996, CEMSA began exporting substantial quantities of cigarettes to Lynx, a company that until then had been CEMSA's competitor. Of CEMSA's 1.6 million dollars of cigarette exports in 1996, over 50% was apparently sold and exported to Lynx, a Mexican company based in Monterrey, Nuevo León.

181. CEMSA did not have any form of conventional financing. The Claimant says that based on oral, "handshake agreements", purported lenders (Dr. Ariel Zagorin, Cesar Poblano, and Gustavo Gámez) charged interest averaging 14% on each transaction and that CEMSA repaid the loans upon receiving the IEPS rebate relating to the goods purchased with the borrowed funds. CEMSA's records indicate that the IEPS rebates were normally received about six weeks after the application was submitted, indicating an annualized interest rate of about 120%.

182. All of CEMSA's cigarettes were purchased by it or others from Sam's Club. Of all the purchase invoices found by SHCP upon conducting an audit of CEMSA in 1998, all but four were issued by Sam's Club. The other four were issued by Price Club de Mexico and name either Lynx or Compañía Exportadora Mexicana as the purchaser. SHCP found that CEMSA had not itself purchased many of the cigarettes for which it claimed tax rebates.

183. In late 1996 and early 1997, the Claimant wrote three letters to SHCP:

- a) A letter dated 13 December to 1996 addressed to Alejandro Garay, then personal assistant of the Secretary of SHCP, in which he contended that, by virtue of the 1993 *amparo* judgment, CEMSA is the only company in the entire country that is entitled to IEPS rebates on cigarette exports. He proposed to close CEMSA at the end of 1997 and discontinue exporting cigarettes if the Secretary would order SHCP officials to continue respecting the judgment of the Supreme Court throughout 1997.¹¹⁵

¹¹⁵

CM 05991.

- b) A letter dated 23 January 1997 to Mario De La Vega, the new personal assistant to the Secretary of SHCP, in which he purported to inform Mr. De La Vega that CEMSA had a Supreme Court judgment in its favor that enabled it to claim IEPS rebates on cigarettes exported in 1996. He contended that with the changed IEPS law, SHCP would still have a basis to continue complying with the Supreme Court judgment. He asked Mr. De La Vega to inform him "what SHCP intends to do, since we continue to export cigarettes";¹¹⁶
- c) A letter dated 28 January 1997 to Tomas Ruiz, the Undersecretary of SHCP, in which he requested a *lineamiento* (directive) "over what is going to be done regarding the IEPS, CEMSA, the Supreme Court of the Nation and SHCP". He contended that the Undersecretary ordered SHCP to respect the Supreme Court judgment and refund the IEPS for cigarette exports in 1996. He asked if SHCP policy in 1997 would be the same, noting that CEMSA was continuing to export cigarettes and that there were IEPS rebates outstanding.

184. None of the three letters purports to inform SHCP that CEMSA was exporting cigarettes pursuant to an oral agreement or understanding that it would be exempted or otherwise relieved from compliance with Article 4 or any other legal requirement. SHCP responded to the Claimant's 28 January 1997 letter by official letter dated 16 March 1997, issued by Miguel Gómez Bravo, then *Administrador General Juridico de Ingresos*. The Claimant relies on a single sentence in this letter, taken out of context, as confirmation that his alleged agreement with the previous administration remained in effect.¹¹⁷

185. The text of the letter bears reading in its entirety:

I refer to your letter dated 28 January 1997, by which you asked to be informed of the mechanisms that will apply to IEPS rebates in fiscal year 1997. This question arises because of the reforms by the Congress to the IEPS law, as well as the favorable resolution that you obtained from the Supreme Court of the Nation.

To that matter, this General Administration, according to subparagraph XIV of Article 57 of the Internal Regulation of SHCP, hereby informs you as follows:

I. Until 1990, the IEPS law permitted the application of the 0% rate to all exports that were made according to the Customs Law.

II. Beginning in 1991, subsection III of Article 2 was reformed with the purpose of establishing that the 0% rate would apply to producers, bottlers and *empresas de comercio exterior*.

¹¹⁶ CM 04543.

¹¹⁷ Memorial at paragraph 97.

III. This reform motivated you to commence an *amparo* proceeding and to obtain a favorable judgment from the Supreme Court and, on the basis of that judgment, rebates of this tax were granted for the 1991 fiscal year.

IV. Beginning in 1992, the above mentioned subsection was again reformed, opening the possibility for any exporter to apply for the 0% rate.

V. From all the above, it can be deduced that the *amparo* referred to the legislation in force in 1991 and therefore whatever rebate that is sought, be it denied or granted, will have to be based on the regulations in force.¹¹⁸

186. On any reasonable interpretation of this letter, two things are apparent:

- a) Having fully complied with the 1993 *amparo* judgment, SHCP did not consider the decision of the Supreme Court to have any continuing force or effect. Rather, as SHCP correctly explained, the decision of the Supreme Court was limited to declaring the 1991 amendment to the IEPS law to be invalid (a provision which was repealed in 1992); and
- b) SHCP expected CEMSA to comply fully with the IEPS law currently in force in seeking IEPS rebates on any products subject to the IEPS tax that it exported.

187. The Respondent submits that if SHCP officials by their words or conduct gave the Claimant any cause to believe that the provisions of Article 4 would not be enforced against CEMSA, which is denied, the existence of the alleged oral agreement (or the alleged making of any associated statement) is not relevant to any point of Mexican law that is a juridical fact in this proceeding.

188. Indeed, when CEMSA challenged the findings of the 1998 audit, it did not purport to rely on the alleged oral agreement of June 1995, nor could it. Mexican tax law, like the tax law of Canada and the United States, does not give any legal effect to statements or representations by taxation authorities that are inconsistent with the law as written by the legislature and as interpreted by the courts of competent jurisdiction¹¹⁹

H. The 1996 Fiscal Court Decision in the Lynx Case

189. The Claimant states that in February 1996 the Fiscal Court decided a case in favor of Lynx to challenge SHCP's denial of rebates for cigarette exports made in 1992. He argues that the decision is consistent with the Supreme Court's earlier rulings in the Lynx and CEMSA *amparos*. He asserts that SHCP did not appeal the decision and that it eventually entered into a

¹¹⁸ CM 04548.

¹¹⁹ See Part III.

settlement with Lynx allowing it to collect rebates without requiring invoices separating the IEPS¹²⁰.

190. SHCP did not appeal the Fiscal Court's decision in that case. However, 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"¹²¹.

191. Two aspects of the Fiscal Court's ruling are noteworthy. First, it held that the decision of the Supreme Court (in the 1991 Lynx *amparo*) was issued in respect of a specific provision that was only in force in 1991 and which was not under review by the Fiscal Court, and therefore that the Supreme Court decision had no application to the case before it. Second, in respect of evidence adduced by Lynx showing that SHCP had complied with the Supreme Court decision by making a payment to Lynx, the Fiscal Court observed that the making of the payment could not be considered as not constituting SHCP's opinion on the issue; therefore SHCP's subsequent denials of rebates were in no way contradictory. The Fiscal Court held for Lynx on other grounds, limited to the specific circumstances of that case¹²².

I. CEMSA's Exports and Applications for IEPS Rebates in 1996

192. The application form for tax rebates of every kind (Form 32) requires the applicant to indicate whether it is an ALTEX company and to give its registration number. It does not require the applicant to indicate whether the rebate request relates to cigarettes, nor does it require the applicant, if an ALTEX company, to attach supporting documentation. Rather, the form simply requires the applicant to state the amount requested, subject to the condition provided by Article 22 of the Fiscal Code that that granting a rebate in no way constitutes a favorable resolution as to the applicant's entitlement to the rebates¹²³.

193. As explained by Lic. Eduardo Díaz Guzmán, every year SHCP receives over 1 million requests for tax rebates of every kind using Form 32. Requests for IEPS rebates are submitted to a *Módulo de Atención Fiscal* in all 78 regional tax administrations located throughout the country. Applications are then processed or rejected within 50 days, except in the case of ALTEX companies, the applications of which are processed within five days¹²⁴.

194. CEMSA's records show that it made one sale in February 1996 (10 mastercases of Marlboro cigarettes) to a customer in Mexico city, and a total of three exports in May and June (220 Marlboro mastercases in total) to a customer in Panama.

¹²⁰ Witness statements of Marvin Feldman at paragraph 57 and Oscar Roberto Enriquez Enriquez at paragraph 19.

¹²¹ CM 05983.

¹²² CM 05962.

¹²³ Form 32 [Memorial App. 0524]

¹²⁴ First Witness statement of Eduardo Diaz Guzman (submitted 5 March 2001), p. 4.

195. CEMSA did not begin exporting in significant quantities until July 1996 when it began series of export sales to Monterrey-based Lynx Exportadora Mexicana, S.A. de C.V. (Lynx), CEMSA's ostensible competitor in the "cigarette export business". There were 18 transactions wherein Lynx is named as the purchaser, amounting to 50% of CEMSA's cigarette exports in 1996.

196. During this five month period (July-December 1996) CEMSA made 14 other export transactions of which 8 were made to two companies in Central America —Dilosa, S.A. de C.V. (in Hondouras) and Corporinves. S.A. (in Nicaragua). These entities, and a third, INPEXSA (in El Salvador), to whom CEMSA apparently exported cigarettes in 1997, have the same legal representative —Raul Gutierrez Maradiaga¹²⁵. At least two of the three, Dilosa and INPEXSA, were later determined not to exist in the countries where they were purporting to receive shipments of cigarettes from CEMSA.

J. The Claimant's Change in Methodology for Estimating the IEPS

197. The Claimant testifies that "a review of the record shows that, in 1996, I calculated the IEPS tax on the basis of a formula applied to my purchase price using the statutory IEPS rate of 85%."¹²⁶ The formula he refers to appears in Tab A of the witness statement of CEMSA's auditor, Jaime Zaga Hadid. It shows that in 1996, CEMSA divided its acquisition cost by 1.85, then performed a series of unexplained calculations to arrive at a IEPS rebate amount. This methodology was also used in 1992; only the factor differs —CEMSA's acquisition cost was divided by 2.39 because the statutory IEPS rate was then 139%.

198. The Claimant's valuation expert, Ernesto Cervera, also uses these factors in Attachment 2 to his report, although he fails to note in his chart that in 1992 and 1996 the Claimant divided by a factor of 2.39 and 1.85, respectively, but multiplied CEMSA's cost by 0.85 in 1997. The method stated for 1996 results in IEPS rebates equal to 54.95% of CEMSA's acquisition cost. Multiplying by 0.85 results in IEPS rebates equal to 85% of acquisition cost.

199. The methodology the Claimant says he used to estimate the IEPS in 1996 is incorrect for two reasons. First, he based the calculation on CEMSA's acquisition cost, not the price that a retailer (*detallista*) would pay to acquire the subject goods. Second, to calculate the IEPS it is necessary to first divide the price paid by the retailer by 1.85, then subtract that amount from the price paid by the retailer to determine the amount of IEPS paid by the producer of the goods.

200. However, as the Respondent will demonstrate below, the total IEPS rebates claimed by CEMSA in 1996 was equal to 85% of the Claimant's actual cost of sales (*i.e.*, the price paid to Sam's Club multiplied by 0.85) for the year, resulting in a massive over-claim for that year, as well as for the period January to September 1997.

¹²⁵ CM 04948.

¹²⁶ Witness statement of Marvin Feldman, paragraph 70.

201. The Claimant testifies that in early 1997 he paid a visit to Lic. Riquer Ramos, then *Administrador Especial de Recaudación* (Special Collections Administrator). He contends that he discussed his idea that “the tax should be calculated as 85% of the cost of cigarettes”. Reasoning that CEMSA’s cost was below ordinary retail prices because he was buying in volume from a discount vendor (Sam’s Club), the Claimant says “I showed Mr. Riquer that I calculated the IEPS by multiplying CEMSA’s purchase price by 85%” and that “Mr. Riquer agreed that this was the correct method under the law”¹²⁷.

202. Lic. Riquer agrees that he met informally with the Claimant in early 1997. The Claimant sought to convey his ideas regarding CEMSA’s ability to obtain rebates for cigarette exports. Lic. Riquer recalls that the Claimant explained CEMSA’s general situation but does not recall that Claimant explained his methodology for calculating the IEPS¹²⁸.

203. Lic. Riquer explains in his witness statement that he was responsible for a completely different subject area involving 300 special taxpayers, such as federal entities, estates, municipalities and political parties. He further explains that he had no authority to advise CEMSA or the Claimant because the issues raised by them were outside of his sphere of legal competence (jurisdiction) and that he informed Mr. Feldman at least twice he should direct his inquiries concerning the IEPS law to the competent agencies, the *Administración Local de Recaudación del Oriente* and ultimately to the *Administración General* or the *Administración Local Jurídical de Ingresos*.

204. The Respondent submits that anything Mr. Riquer may have said in this meeting that the Claimant now claims to have relied on had no legal effects in Mexican law and does not create any legal basis for the Claimant to say that CEMSA was entitled to claim IEPS rebates according to his new formula.

205. The Claimant further testifies that “I told Riquer that Hacienda owes CEMSA money because I had calculated lower amounts of the IEPS in the past. After this meeting, I adjusted this formula for calculating CEMSA’s IEPS rebates and calculated the tax on CEMSA’s subsequent applications by the method which Mr. Riquer and I agreed on”¹²⁹. CEMSA’s financial records show that this statement is false.

206. CEMSA’s actual requests for IEPS rebates in 1996 23,079,998 pesos. Its cigarette purchases as determined from its purchase invoices were 23,431,338 pesos. The requested rebates amount to 103% of cost of sales. Even if some of CEMSA’s purchase invoices have been lost, as the Claimant has intimated, the fact that CEMSA claimed rebates totalling 23 million pesos (3.04 million U.S. dollars) in 1996 is reflected in CEMSA’s audited financial statement for that year¹³⁰.

¹²⁷ Ibid., paragraph 70.

¹²⁸ Witness statement of Jose Antonio Riquer [CM 06060] at paragraph 21.

¹²⁹ Witness statement of Marvin Feldman, paragraph 70.

¹³⁰ Witness statement of Rolando Garcia Ramos [CM 06021], Tables 5 and 6.

207. Accordingly, it is clear that the Claimant did not start claiming IEPS rebates according to his new methodology in "early 1997", after he met with Mr. Riquer. CEMSA claimed and received payment for an amount exceeding 85% of its cost of sales for all of 1996, an over-claim of approximately 12.7 million pesos (1.68 million U.S. dollars)¹³¹. This over-claim was detected when SHCP reviewed CEMSA's audited financial statement for 1996 that Mr. Zaga filed with SHCP on 29 September 1997.

208. The correct methodology for calculating the IEPS is explained in the witness statement of Noe Salazar Martinez, the Controller of CIGATAM¹³². In order to comply with the IEPS law, the producer (in this case CIGATAM, the licensed manufacturer in Mexico of Marlboro cigarettes) establishes a *precio al detallista* for each product, comprised of the producer's base price plus a margin for the *mayorista* (wholesaler). The IEPS to be remitted to the Treasury is calculated by applying the statutory rate of 85% to the total. The producer's liability to pay the IEPS arises upon a domestic sale or transfer of the goods and is remitted on the 17th day of the following month.

209. Mr. Salazar's statement includes a chart setting out the prices and IEPS for Marlboro and other brands of cigarettes in 1996-1997. It shows the prevailing price paid by the wholesaler, the retailer and the consumer and the amount of IEPS paid on the goods, which remains constant in the price paid at each level.

210. Using the price of Marlboro cigarettes in effect from 21 February 1997 to 17 November 1997, it can be seen that the IEPS remitted was 29.4698 pesos per carton. During this period, CEMSA paid Sam's Club 64 pesos per carton. A IEPS rebate based on 85% of cost (64 multiplied by 0.85) results in an over-claim of 24.93 pesos per carton.

211. The following chart from Mr. Salazar's witness statement illustrates the difference between the Claimant's methodology and the correct methodology, and shows that on the example given, CEMSA claimed a rebate 84.59% greater than the IEPS actually remitted by the producer. The calculation is made by (i) dividing the price paid by the retailer by 1.85 ($64.14 \div 1.85 = 34.76$) and then (ii) subtracting that amount from the price paid by the retailer ($64.14 - 34.67 = 29.47$) to arrive at the amount of IEPS paid by the producer (29.47).

¹³¹ Ibid.

¹³² See also the witness statements of Rafael Obregon Castellano, Rolando Garcia Ramos, and Fausto Garcia and Associates.

	CEMSA's Method		Correct Method
Detallista Price	64.14		64.14
CEMSA's Acquisition Price from Sams' Club net of IVA	64.00		64.00
Sam's "Discount to CEMSA"	0.14		0.14
Acquisition Price x 0.85	54.40	Acquisition Price plus Sam's "Discount to CEMSA" /1.85	34.67
IEPS Claimed by CEMSA	54.40	IEPS Paid by CIGATAM	29.47

K. CEMSA's Exports and Applications for IEPS Rebates in 1997

212. CEMSA did not make further sales to Lynx after January 1997. Instead it started exporting to Compania Exportadora Mexicana, S.A. de C.V, GTO Produce Co., also known as "GTO International Trade Co.", J & E International Sales, Inc. and an entity called "International Commerce Co.", which the Respondent describes collectively as the "Poblano-Gámez-Guemes network".

213. A fuller description of the interrelationship between CEMSA and the Poblano-Gamez-Guemes network is given in Part IV of this Counter-Memorial.

214. In brief, virtually all of CEMSA's exports to the United States, approximately one half of its total exports in 1997, went to one of these five names. In each case the cigarettes were transported by air from Mexico City to either Houston or Dallas-Fort Worth and were then transferred by truck to a bonded warehouse at "FTZ 68"¹³³ in El Paso, Texas.

215. CEMSA also exported to Dilosa, INPEXSA, Corporinves and Corporinbes, S.A. in Central America. These customers, all apparently related to each other, accounted for almost one half of CEMSA's exports in 1997. In each case CEMSA's export pediment states that 450 mastercases of cigarettes were transported by truck through the Chiapas border crossing.

¹³³ Foreign Trade Zone 68.

216. CEMSA received payment of 60.6 million pesos for cigarettes apparently exported between 1 January 1997 and 30 September 1997. The over-claim was about 28.5 million pesos¹³⁴.

L. SHCP's Resolutions to Deny CEMSA's Rebate Claims for October, November, and December 1997

217. A confluence of events occurred in the latter part of 1997.

218. On 29 September 1997 the Claimant filed his audited financial statements for fiscal year 1996 with SHCP. SHCP subsequently reviewed them and preliminarily determined that CEMSA had committed irregularities in applying for and obtaining IEPS rebates for that year. In a document entitled "Observations to the 1996 Fiscal Statement", SHCP observed:

During the 1996 fiscal year CEMSA purchased processed cigarettes (taxed at a IEPS rate of 85%) for a total of \$27,152,939 and credited an amount equal to \$23,079,998 (which represents 566% of the amount that was considered to be the purchase price) of IEPS, representing 85% of the total payments for purchases of cigarettes. For another part, CEMSA requested IEPS rebates in an amount equal to \$10,171,551. Thus, a \$12,908,447 difference between the amount credited and the rebates requested, is shown as a positive balance (see balance sheet).

It should be noted that, had the IEPS been correctly transferred and credited, it would be \$12,475,675, therefore, there is a difference of \$10,604,323 credited in excess, representing 46% of the total that could be credited.

219. Thus, in October 1997 SHCP officials began a review of CEMSA's applications. Since the IEPS rebates claimed involved cigarettes, SHCP had reason to assume that it did not have a right to obtain them. Accordingly, further rebates to CEMSA were suspended in order to investigate its operations¹³⁵.

220. By letter filed with SHCP on 6 November 1997, CEMSA notified the General Direction of International Tax Matters that its importer in Honduras, Dilosa, S.A. de C.V. and its importer in INPEX, S.A., "were not and had never been a related party" to CEMSA. CEMSA attached two letters purportedly signed by the legal representatives of each company, attesting to this fact. Because Honduras was a country considered a low income tax jurisdiction, such a notice was required under Rule 6.1.1 of the Foreign Trade Miscellaneous Regulations for 1997 (*Resolución Miscelánea de Comercio Exterior*) in order to benefit from a 0% IEPS rate on exports to that

¹³⁴ Witness statement of Rolando Garcia Ramos [CM 06021], Tables 5 and 6.

¹³⁵ Memorandum of 4 February, 1998, paragraph 4. [CM 04684]

country. Rule 6.1.1 also required that exports be for final consumption in the country of importation¹³⁶.

221. On 1 December 1997 the Claimant published a newspaper advertisement in *Reforma* accusing *Procurador Fiscal* Gómez Gordillo of criminal activity in submitting the amendments to the Law that entered into force on January 1998 to Congress¹³⁷.

222. CEMSA also directed a letter to the Office of the Presidency requesting the President's intervention in order to obtain rebates for which it applied. The *Coordiadora de Atención Ciudadana* (Office of Community Affairs) remitted that complaint to SHCP. These events would lead to a series of meetings between SHCP officials, the Claimant and the Claimant's Mexican lawyers, presided over by *Procurador Fiscal* Gómez Gordillo¹³⁸.

223. On 7 November, SHCP resolved to deny CEMSA's request for rebates submitted on 3 November 1997, for cigarettes exported in October, because it lacked invoices showing that the IEPS had been transferred expressly and separately¹³⁹. (This resolution was issued to CEMSA on 4 April 1998.)

224. By letter dated 27 November 1997, SHCP requested the following information from CEMSA in connection to the application for rebates submitted for the month of October 1997:

- provisional and supplementary tax declarations with original date stamp for the month of October 1997;
- copy of the invoices for the goods or services purchased, supporting the amounts requested;
- copy of the check manifest for payments to suppliers of goods and services, and bank statements showing the checks were cashed;
- copy of the import pediments;
- copy of the IEPS taxpayer registry; and
- name, address and identification number of the foreign suppliers of goods and services.

225. On 5 December 1997, SHCP resolved to deny CEMSA's rebate application submitted on 1 December 1998 for cigarettes exported in November. Similarly, on 9 January 1998, SHCP resolved to deny CEMSA's rebate application submitted on 5 January for cigarettes exported in

¹³⁶ Memorial App. 0369-72; CM 03782.

¹³⁷ Witness statement of Ismael Gómez Gordillo [CM 06029] at paragraph 20.

¹³⁸ CM 04643, CM 04662, and CM 04663.

¹³⁹ CM 03609.

December. Both resolutions were in the same terms as the resolution of 7 November 1998. All three were formally notified to CEMSA on 4 April 1998, after the meetings with *Procurador Fiscal Gómez Gordillo*¹⁴⁰.

226. On 12 December 1997 the Claimant, acting for CEMSA, submitted a formal inquiry under Article 34 of the Fiscal Code to the *Administración Local Jurídica de Ingresos* to request confirmation that CEMSA was a contributor of the IEPS tax and entitled to the application of the 0% rate on exports of alcoholic beverages and cigarettes, and thus to recover the tax paid, notwithstanding that its purchase invoices did not state the IEPS separately. The Claimant explained CEMSA's position in detail: he alluded to the Supreme Court's decision of 1993; he described the company's marketing process, stating that it did not buy directly from producers, but rather from Sam's Club, and therefore the IEPS was not transferred expressly and separately in its invoices (he attached a copy of an invoice); he referred in detail to relevant provisions of the IEPS Law; he also referred to Lic. Gómez Bravo's letter of 16 March 1997. As explained below, SHCP responded to this inquiry on 24 February 1998.

M. The 1998 Amendment

227. On 1 January 1998, Articles 11 and 19 of the IEPS Law were amended. Article 11 clarified that the accreditation or the rebate of the IEPS on cigarettes is not allowed on sales subsequent to those made to the retailer. Article 19 section XI imposed an obligation on exporters of certain goods, including cigarettes, of registering in the Sectorial Exporters Registry, in order to be entitled to apply the 0% IEPS rate on exports.

N. The Feldman-Gómez Gordillo Meetings

228. At the Claimant's request, he was afforded an opportunity to meet with *Procurador Fiscal de la Federación*, Ismael Gómez Gordillo, in early 1998. There were a series of three meetings, held on 20 January, 22 January and 4 February. The Claimant was accompanied by legal counsel on each occasion. The meetings were taped recorded and transcribed by both parties.

229. The Claimant has selectively quoted two remarks made by Lic. Gómez Gordillo, and a brief exchange between Lic. Gómez Gordillo and the Claimant. These are quoted out of context, in a manner calculated to mislead the Tribunal. The transcripts of the meetings bear reading in their entirety. The following summarizes the salient points discussed.

230. Lic. Gómez Gordillo summarizes the first meeting, held on 20 January 1998, as follows:¹⁴¹

¹⁴⁰ CM 03609, 03610, 03611, 03615, 03616, and 03619.

¹⁴¹ Witness statement of Ismael Gómez Gordillo [CM 06029] at paragraphs 25-31.

As to the situation of the rebates prior to the entry into force of the 1998 reform, CEMSA's lawyer expressed that the "permanent problem" was the taxation accreditation situation and the calculation of the rebate, given that the producers were not selling with the tax separated. He recognized that it was a control problem: "in order to avoid the problems that you [Hacienda officials] have stated to us that might create tax diversion situations, inappropriate accreditations, cross-accreditations, situations of this type." He proposed alternatives to resolve this "control problem" through miscellaneous regulations that dealt with three points: collection, customs office, and the calculation of the tax.

I suggested that this matter be dealt with at a second meeting for two reasons: I did not know the details of the events prior to the amendment, and so that the appropriate officials of the Secretariat could be present where I would have the opportunity to hear both sides so as to give an objective opinion to the Secretariat. I clearly warned that I had the obligation to deal with the matter with complete objectivity, and to treat Mr. Feldman with decency and respect (although I had not received the same treatment from him), although that I could not be a mediator as I was a party, and my obligation was to defend the Federal treasury. Nevertheless, I specified that if from our analysis the SAT officials had committed an irregularity, I would make the appropriate recommendations, in addition to CEMSA having at its disposal the corresponding defensive measures. I also left it clear that if we did not come to a solution, he could assert his rights via the appropriate channels, including an *amparo*.

As to the amendment of the law that entered into force on the 1st of January, 1998, Mr. Feldman asserted that it was trying to terminate his company. He indicated that its real authors were Carlos Slim, CIGATAM, and Phillip Morris, and that the amendments had been pre-negotiated and agreed to with the producers and that they were expressly directed against him. In this context we discussed the agreement that had been reached with him in 1994, through the issuance of the *oficio* of the 10th of May, and Mr. Feldman referred to a purported internal agreement within the Secretariat. Mr. Feldman referred to it as an agreement to respect the judgment of the Supreme Court of Justice, and that Dr. Pedro Noyola (who succeeded me as Undersecretary), and Tomas Ruiz, who succeeded him and continued employed as such at that time, knew of it. Also in this context we discussed, albeit tangentially, the judgment the Court had issued in 1993 in favour of CEMSA.

In respect of the amendment, I responded that I considered it legally appropriate, and correct, independent of Mr. Feldman personally and his company. As to it being directed at putting the end to his company, I only said that that was his feeling and opinion, and nothing else – an opinion that I respected, but that only amounted to a legal difference, and that if CEMSA was considering challenging the constitutionality of the amendment, that it would be my role within the Secretariat to defend it. I insisted that my actions as Attorney General had always been within the framework of the law. Indeed, I expressly asked Mr. Feldman's lawyers

on various occasions if they saw in my actions anything illegal or criminal, to which they responded that they found none, and that that had been an expression of anger of Mr. Feldman. I even asked his lawyers if they had warned him of the crime of making false accusations, and they responded that indeed, they had mentioned it to him.

As to Carlos Slim, I commented that I had known him for twenty years as I had worked for a long time as a public servant in the area of finance, and he was a stockbroker, but that we had never dealt with the subject.

As to the *amparo*, I admitted that as a lawyer and citizen I was not in agreement with the Court's judgment, but that as a public servant I was obligated to obey it. And the Secretariat had in fact fully complied with it, as was expressly acknowledged by CEMSA itself before the Fifth District Court in 1996 (see *supra*, paragraph 17). Finally, I am not aware of any internal agreement of the Secretariat to comply with the Court's judgment that Dr. Noyola and Mr. Ruiz supposedly knew of. In any event, as I have already indicated, the referred to judgment had already been fully complied with since 1994, although the process had not concluded in 1995 (when Dr. Noyola was Undersecretary), nor the greater part of 1996. I only want to reiterate that it could not have been any other way, that is, although we were not in agreement with the judgment, we were obligated to comply with it and did so.

231. Lic. Gómez Gordillo summarizes the second meeting, held on 22 January 1998, as follows:¹⁴²

Various subjects were likewise discussed. Of them, the most important and time consuming was whether CEMSA was or was not an IEPS taxpayer and, consequently, if he had the right to the application of the 0% rate in accordance with the amendments that came into force in 1998. We concluded that this was the fundamental difference between CEMSA and the Secretariat. I concluded the meeting by stating the desire of the Secretariat to come to a solution, and again indicated that if that was not possible we should pursue our differences via legal channels, to which CEMSA's lawyer responded that he was aware of such.

I began by briefly explaining the Secretariat's position as to CEMSA not being a taxpayer of the tax and that the law did not give him the right to the 0% rate. I explained that for the purposes of the law as it relates to cigarettes, CEMSA was not in a different position that a final consumer to which the tax becomes an underlying charge, that is, a cost.

In this context we discussed the problem of the transferring "scheme". Mr. Feldman's lawyer commented that the problem was that CEMSA's suppliers did not break down the tax because the producers were not breaking it down for them. He indicated that CEMSA could not apply

¹⁴²

Ibid. at paragraphs 32-39.

with the accreditation requirement because it depended on third parties, be they producers or distributors who, according to CEMSA's lawyers were prepared to attempt to come to an agreement, but not at the cost of having their franchises cancelled. As I mentioned earlier, this was a problem of private law between CEMSA and its suppliers, on the one hand, and cigarette producers on the other, in which it sought resolution from the Secretariat. The Secretariat could not force producers to sell directly to CEMSA, nor could it force distributors to demand that producers break down the tax in their invoices. We thus entered into a discussion about the rights of producers which they had a legitimate interest in defending, just like the rights of CEMSA. The intention was not, of course, that the Secretariat adopt the producers' position, but for it to be clear that these were matters of private rights, not of public law, and, therefore, that the Secretariat could not meddle therein and differently treat producers and distributors on the basis of their private contracts as they were not acting illegally nor was it a matter of tax evasion. In sum, it was not a problem of the Treasurer. We made specific reference to CIGATAM and Phillip Morris, given that it was the principal producer identified by Mr. Feldman. Moreover, he had a predominant interest in acquiring Marlboro brand cigarettes. I mentioned that the producers had franchising contracts that gave them exclusivity rights to exploit the brand names, publicity, packages, etc., but that also imposed private law limits. For example, that they could only sell within certain geographical regions. The reality is that these limitations to which the producers were subject were causing CEMSA's problem.

CEMSA's argument was that there was free trade of "transnational brandnames" and that the producers had no right to approach the Secretariat to impede such. That reminded me that what I had said to Mr. Feldman in the previously meeting was not correct in respect of never having discussed the subject with Mr. Slim. I specified that we had informally discussed the point in a meeting undertaken for other reasons with representatives of CIGATAM and LA MODERNA in respect of cigarette contraband and in which he had suggested that we impede CEMSA's operations. I was clear that Mr. Slim had approached me in the same way that CEMSA did so. This makes perfect sense. CEMSA and Mr. Feldman were not the only ones who had the right to state their opinions to the Secretariat, nor is CEMSA the only taxpayer who was receiving the attention of public officials. Given that the Secretariat is obligated to act in accordance to law, my response to Mr. Slim was similar to those that I gave to Mr. Feldman, to wit, that I could not do so. This was because the purchases and exports that CEMSA was undertaking were not illegal. It all came down to the question of the accreditation of the tax. While the Secretariat was prepared to recognize a right to obtain invoices with the tax broken down so that it could be accredited, it could not exempt him from compliance with express legal requirements, nor meddle in the in the private rights of the producers or distributors. CEMSA's lawyer commented that they had had a meeting with the lawyers of CIGATAM and Phillip Morris in which CEMSA threatened to sue them for many millions of dollars. My response was

that he was within his right to do so, and that, indeed, this was the channel that CEMSA should have taken in order to ascertain its legal situation under private law. As far as I know, it never did so.

* * *

The other relevant subject that we touched upon in this meeting, albeit, was CEMSA's calculation of the tax. I stated, independent of whether CEMSA had the right to rebates, and indeed supposing that he had for the purposes of the argument, that CEMSA had calculated it incorrectly, but we had to carefully review the numbers to better explain things. We deferred this subject to the following occasion.

232. Lic. Gómez Gordillo summarizes the third meeting, held on 4 February, 1998, as follows:¹⁴³

There again arose the theme of the supposed internal agreement of the Secretariat to respect the judgment of the Court. The only other thing that Mr. Feldman argued was that the agreement had been between Mr. Tomas Ruiz and Dr. Pedro Noyola, and that Mr. Emilio Romano (who had the position of Fiscal Attorney General for two or three months, from December 1994 to February or March 1995 and then later left the Secretariat) knew of it. Neither Mr. Feldman nor his lawyers had a copy of this supposed document, and none of the Secretariat's officials that were present knew of the supposed agreement or any document relative thereto. I offered to look for the document and to ask around about it. We did not find anything. Beyond that, I refer back to what I have already said in this respect (see *supra* paragraph 31).

We also touched the subject of the difference between the regime applicable to alcoholic drinks and that applicable to tobacco. This in fact had arisen from the first meeting from a doubt that CEMSA's lawyers had asserted. They acknowledged that there existed a difference, but asserted that they did not know why. In the meeting of February 4 Mr. Feldman argued that it was due to an anomaly. Mr. Mario Gabriel Budebo explained that they were different taxes, with a different taxable base and that they touched upon different points of the chain, and, for this reason, received differential tax treatment. This in fact was CEMSA's situation in respect of the *amparo* of 1991 since the rebates that it sought for fiscal year 1991 for which it submitted invoices with the tax duly broken down referred to, in all cases, alcoholic drinks (see *supra* paragraph 6.b). As such, CEMSA and its lawyers knew the difference perfectly well.

The balance of the meeting was primarily a discussion as to the calculation of the tax for 1996 and 1997 for which CEMSA had requested IEPS rebates for cigarette exports. I advised Mr. Feldman and

¹⁴³

Ibid. at paragraphs 40-44.

his lawyers that the Secretariat was conducting a review, and suggested that we do it together: that CEMSA provide us its calculations and we provide him ours. We entered into a discussion as to the taxable base, which, according to the law, was the price to retailer. Mr. Feldman suggested that it was the price from the retailer, that is, the price that CEMSA was buying at. He indicated that his formula was from the point of the price at which CEMSA's supplier sold to CEMSA, without the IVA, minus the 85%. Mr. Feldman explained it in the following way: "Sam's sells to me at 100 Ok, and I request 85". He stated that he had the information on CIGATAM's exports that confirmed his formula. The officials of the Secretariat explained in great detail how the law defines taxable base, and how to do the correct calculation. We stated that if our and CEMSA's calculations coincided, then things were fine, and for this reason we needed to make the comparison. We agreed that we would conduct a review in respect of the entire process and not only compare the results. Mr. Feldman admitted that if the Secretariat concluded he had over-requested, then there was "something odd, a multibusiness at one place or another".

CEMSA's lawyer asserted his optimism as he knew that if we were reviewing the calculations it meant that the rebates were going to be paid to the company. I clearly responded that we had a presumption that the company's calculations were incorrect, and that after analyzing them and assessing such under the law, we would see if the rebates were valid. I was very clear that I would not prejudge the result, but again warned that, obviously, my client was the Secretariat and that I could not compromise its position. We were investigating the matter in detail because it could have an impact on the treasury that we were obligated to protect. In response to Mr. Feldman's inquiry as to the application of the Supreme Court's judgment, we were also clear that we were speaking of the 1996 and 1997 period - on the basis of the law then in force - and that CEMSA had the right to resort to the courts against the amendment that entered into force in 1998 and against the Secretariat's position in respect of the calculations and the validity of the rebates.

O. SHCP's Response to CEMSA's Inquiry of 12 December 1997

233. On 24 February 1998, the *Administración Local Jurídica de Ingresos* responded to CEMSA's 12 December 1997 Article 34 submission. SHCP in essence concluded:

- a) CEMSA was not entitled to IEPS rebates on the cigarettes it purchased from Sam's Club because it was a second-hand purchase, which was not taxed by the IEPS Law and, thus, Sam's Club did not transfer the tax to CEMSA.
- b) The export of cigarettes by CEMSA was equally not taxed because it involved a third-hand sale.

- c) As a result, there were not grounds for CEMSA to claim IEPS rebates because CEMSA legally could not have a positive balance if no tax had been transferred to it.
- d) For that reason, it could not comply with Article 4, section III, as evidenced by the invoice it had attached, which did not state the IEPS separately.
- e) It also confirmed that Article 11—which provided that the tax shall not be paid on sales subsequent to those to the retailer and, therefore, in no case could the tax be credited or rebates granted—applied to CEMSA.
- f) As regards Lic. Gómez Bravo's letter of 16 March 1997, it explained that the letter was issued in general terms, since the terms of the letter from CEMSA it responded to were equally general, and only requested SHCP's position as to rebates under the IEPS Law in force in 1991, in light of the Supreme Court decision and specifically Article 2, section III. It noted that the letter concluded that the *amparo* referred to a provision that was in force in 1991 and, consequently, the approval or denial of any current application for rebates should be based on the law in force at the time. Accordingly, Lic. Gómez Bravo's letter had no effect in the instant case, and, as stated therein, any concrete application for rebates would have to be considered in light of the legal provisions in force.

P. The 1998 Fiscal Court Proceedings: CEMSA's Legal Challenge to the Denial of the 1997 Rebate Applications and the Response to its 12 December 1997 Inquiry

234. On 24 April 1998 CEMSA filed an action in the Fiscal Court challenging the rebate denials by SHCP for the months of October through December 1997 and January 1998, as well as SHCP's 24 February 1998 resolution in response to CEMSA's inquiry of 12 December 1997. In this challenge, CEMSA set out the facts and its arguments with specificity, including a description of its marketing operations; a detailed comparison of how it believed the law should be applied to sales for domestic consumption and sales for export; an argument that the law should be interpreted broadly to achieve what CEMSA claimed was its general purpose; an argument that the fact that SHCP had previously granted it rebates during the 1996-1997 meant that it had tacitly issued a favorable resolution regarding CEMSA's entitlement to rebates; a claim that Lic. Gómez Bravo's 16 March 1997 letter had confirmed every exporter's right to a 0% rate; and that revocation of the tacit favorable resolution breached Article 36 of the Fiscal Code¹⁴⁴. CEMSA also complained that SHCP's application of the law gave manufacturers an export monopoly, and argued that the 1993 Supreme Court decision obtained by CEMSA and the 1996 Fiscal Court decision in the *Lynx* case compelled SHCP to grant CEMSA rebates.

¹⁴⁴ Article 36 of the Fiscal Code provides that written, individual, favorable resolutions issued in accordance with Article 34 of the Code, cannot be modified or revoked by the fiscal authorities. This can only be done by the Fiscal Court pursuant to an application by SHCP.

235. The Fiscal Court rendered its decision on 24 November 1998 against CEMSA. It decision confirmed SHCP's resolution of 24 February 1998 and the legality of the rebate denials. The decision was unanimous. The Court concluded that:

- a) as for the rebate denials for October through December 1997 and January 1998, it confirmed that the record did not show that SHCP had resolved favorably the rebate of the IEPS tax to CEMSA in the 1996-1997 period, that is, there was no individual, favorable resolution made on CEMSA's behalf; rather, the only resolution—the one issued on 24 February 1998—was resolved unfavorably;
- b) Lic. Gómez Bravo's letter of 16 March 1997 did not constitute a resolution favorable to CEMSA, as it had been granted in general terms and had no applicability to the concrete situation in question, because as the letter itself stated, a specific rebate application would have to be analyzed in light of the provisions in force at the time;
- c) the Fiscal Court rejected the applicability of the 1993 Supreme Court decision and the 20 February 1996 decision in the *Lynx* case, stating that they were irrelevant to the case before it since they related only to a specific provision of the law applied in 1991 and 1992, respectively;
- d) the Fiscal Court confirmed that fiscal law is to be interpreted strictly, in accordance with Article 5 of the Fiscal Code, and therefore, the broad interpretation sought by CEMSA was unavailable.
- e) as for exports made in 1998, although exports generally triggered IEPS at a 0% rate, the exception provided for in Article 11 of the Law in force in 1998—stating that the tax shall not be paid on sales subsequent to those to the retailer, and in no case shall there be accreditation or rebate of the tax—applied to CEMSA's cigarette exports; and
- f) applying the relevant provisions of the Law in a comprehensive manner, SHCP had correctly concluded that CEMSA was not entitled to obtain rebates because it could not comply with the requirements of Article 4 to have IEPS transferred to it expressly and separately, as Article 11 expressly precluded transferring the tax and any rebates for sales subsequent to those to the retailer.

236. CEMSA subsequently filed an *amparo* proceeding before a Federal Circuit Court. The Court issued its unanimous decision on 24 August 2000. It initially noted that CEMSA had attempted to withdraw its arguments concerning the IEPS rebate denials for October through December 1997 and January 1998. The Court, however, stated that that was not permissible because those issues had been already raised before, and resolved by, the Fiscal Court. It left the Fiscal Court's holdings regarding the denial of the 1997 applications for rebates undisturbed.

237. Regarding the 1998 law, the Circuit Court confirmed the Fiscal Court's findings that Article 11 precluded transferring of the IEPS in sales subsequent to those to the retailer, something which is necessary in order to qualify for rebates, and that CEMSA did not meet the requirements of Article 4. The Circuit Court concluded that the existing provisions did not

breach the constitutional principles of tax equality, that CEMSA's ability to export was not restricted under the law, and it rejected the contention that the law created an export monopoly, finding that the legal provisions applied generally to all taxpayers attempting to obtain rebates for taxes transferred to them.

238. The Court therefore affirmed the decision of the Fiscal Court in its entirety. This decision was final, and there is no further appeal available.

239. The Claimant's treatment of this litigation in his submissions is oblique:

- a) Paragraph 118 of the Memorial states that CEMSA filed a proceeding in the Mexican courts challenging the resolution of 24 February 1998, in order to preserve its legal position and avoid admissions of illegality under Mexican Law, and to challenge the constitutionality of the amendment effective in 1998. This paragraph does not disclose that CEMSA specifically challenged the rejection of its rebate applications for October, November and December 1997.
- b) In paragraph 84 of his witness statement, the Claimant states that the legal action involved the 1997 rebate denials, but does not provide any information about the arguments presented or the outcome of the litigation.
- c) The Claimant's Mexican tax lawyer, Lic. Enriquez Enriquez, does not mention this litigation at all.
- d) At page 20 [English version] of the statement of the Claimant's expert witness Lic. Loperena Ruiz, he refers to the fact that the Circuit Court decided a case adversely to CEMSA, but incorrectly states that the litigation involved only the application of the 1998 law. Further, Lic. Loperena's argumentation regarding such issues as the alleged export monopoly, the alleged implied agreement by SHCP to grant CEMSA rebates, and the relevance of the 1993 Supreme Court decision completely omits to mention that those issues were considered and resolved by the Fiscal Court and the Circuit Court in the 1998 litigation.

Q. The Decision to Initiate an Audit¹⁴⁵

240. By memorandum dated 5 June 1998, Eduardo Gonzalez Gonzalez, *President of the Servicio de Administración Tributaria (SAT-Tax Administration Service)*, informed Undersecretary Tomás Ruiz that CEMSA had claimed IEPS rebates on cigarettes exported to Honduras, a low income tax jurisdiction, but the Honduran Government had informed the SAT that the purported importer of the goods, Dilosa, was not registered as an importer or as a taxpayer in Honduras, and that the address and phone number given for Dilosa did not exist.

¹⁴⁵ Witness statement of Gabriel Oliver [CM 05994] at paragraphs 4-19.

241. By memorandum dated 8 June 1998, Eduardo Gonzalez further informed Undersecretary Ruiz that upon analysis of documents submitted by CEMSA it had been determined that, in 1997:

- a) CEMSA failed to meet the fiscal requirements for a significant number of its applications for IEPS rebates;
- b) CEMSA claimed and obtained IEPS rebates that were 46% greater than the law permits; and
- c) 24% of CEMSA's exports went to Honduras, a low income tax jurisdiction, and for such purpose CEMSA had submitted false documentation and information.

242. By letter dated 7 July 1998, SAT's *Administrador General de Auditoria Fiscal Federal* informed CEMSA that because the Honduran government had informed SAT that Dilosa was not registered as an importer or as a taxpayer, that the name Dilosa was unknown in Honduras, and that Dilosa's address and phone number did not exist in Honduras, the documentation provided by CEMSA did not meet the legal requirements in effect in 1997 and CEMSA was not eligible for any corresponding IEPS rebates.

243. By letter dated 14 July 1998, SAT's *Administrador General de Auditoria Fiscal Federal* notified CEMSA that he had ordered a verification visit by an audit team (*visitadores*) to attend at CEMSA's business premises for the purpose of verifying CEMSA's compliance with its obligations under the IEPS law. He further noted that CEMSA would be required to provide the *visitadores* with access to its financial and export records for the period 1 January 1996 to 31 December 1997. The letter concluded with a warning that obstruction of the verification visit or failure to produce the requested records could be perceived as a breach of Articles 40 and 45 of the Fiscal Code.

R. The Conduct and Findings of the 1998 Audit¹⁴⁶

244. The *visitadores* first attended at CEMSA's business premises on 15 July 1998 but did not enter because CEMSA's legal representative, Marvin Feldman, was not present. They left a copy of the 14 July 1998 order with a CEMSA employee. A record was drawn up and its content approved and signed by those involved¹⁴⁷.

245. The *visitadores* returned on 16 July 1998. The Claimant was present, but he refused to give them access to the premises or to CEMSA's financial records. The Claimant was informed that his refusal could result in the sanctions under Article 40 of the Fiscal Code, or the

¹⁴⁶ Ibid. at paragraph 20.

¹⁴⁷ CM 1197.

involvement of the police. A record was drawn up and its contents approved and signed by those involved, including the Claimant¹⁴⁸.

246. The *visitadores* requested the attendance of the police and returned again on 17 July 1998, at which time the Claimant gave them access to CEMSA's financial records for the fiscal years 1996 and 1997. The police did not enter the premises and left shortly after the *visitadores* entered. The *visitadores* began photocopying CEMSA's fiscal records, in CEMSA's premises and in the presence of the Claimant, using three photocopying machines that they brought with them for that purpose. At the end of the day they made an inventory of the 48 files he presented and sealed them in a secure room under the Claimant's custody. A record was drawn up and its content approved and signed by those involved, including the Claimant¹⁴⁹.

247. The *visitadores* returned again on 20 July 1998 to finish copying CEMSA's financial records. They concluded that certain records had not been produced—including CEMSA's consecutive sales invoices for the period in question. The Claimant refused to produce further documents, stating that he would produce them in the NAFTA proceeding against Mexico. He stated that SHCP now had all his accounting and other records. A record was drawn up and its content approved and signed by those involved, including the Claimant¹⁵⁰.

248. On 19 August 1998, the *visitadores* met the Claimant to inform him of two matters:

- a) that Sam's Club had confirmed that it did not receive invoices with IEPS separated when it purchased cigarettes and did not separate or otherwise purport to transfer the IEPS in its sales invoices to CEMSA; and
- b) that the Honduran government had confirmed that Dilosa does not exist¹⁵¹.

249. On 20 August 1998, the *visitadores* met the Claimant at CEMSA's premises to inform him more fully of the preliminary findings of the audit¹⁵², so that CEMSA could respond accordingly. The final audit report describe in detail the numerous violations identified during the audit. The following is an illustrative summary:

- a) CEMSA's accounting records were incomplete and were not maintained according to generally accepted accounting practices. (See the list of missing accounting records—including bank statements and 134 specified items)¹⁵³;
- b) CEMSA's fiscal financial statements (corporate tax returns) for 1996 and 1997 were incomplete¹⁵⁴;

¹⁴⁸ CM 1197-1201.

¹⁴⁹ CM 1202-1210.

¹⁵⁰ CM 1211-1220.

¹⁵¹ Audit Report, page 12, para 5. [CM 1480]

¹⁵² Audit Report, page 13, para 6. [CM 1481]

¹⁵³ Audit Report, page 13 et seq [CM 1481]

- c) the IEPS was not separately stated in any of CEMSA's purchase invoices, a requirement necessary to identify the amount of IEPS paid on goods purchased and to claim IEPS rebates¹⁵⁵;
- d) some of CEMSA's purchase invoices named Compañía Exportadora Mexicana, not CEMSA, as the purchaser of the goods¹⁵⁶;
- e) CEMSA did not maintain methodical, chronological sales records capable of verification, as required by law¹⁵⁷;
- f) CEMSA could not claim IEPS rebates on its exports to Honduras because (i) Dilosa did not exist and (ii) CEMSA had not submitted proof that it was not related to the other importer, Corporinbes¹⁵⁸;
- g) none of CEMSA's rebate claims resulting in payments during 1996 and 1997 were supported by the documents and accounting records required by law to justify them¹⁵⁹;
- h) using CEMSA's rebate claim for September 1997 as an example, the Claimant's method for calculating the IEPS (85% of CEMSA's cost) would equate to a IEPS tax rate of 566%¹⁶⁰;

250. By letters dated 24 August and 18 September 1998, CEMSA responded to certain of the preliminary findings¹⁶¹ which SAT considered and responded to in the 1 March 1999 resolution (the Audit Report).

251. The final findings and results of the audit were notified to CEMSA on 26 February 1999.

252. On 1 March 1999, SHCP issued its determination by which it concluded the audit. The findings may be summarized under the following headings as follows:¹⁶²

- a) **Absence of Accounting Records.** CEMSA lacked the essential documents constituting the accounting records that every taxpayer is under an obligation to keep and precluded SHCP from fully verifying CEMSA's transactions.

¹⁵⁴ Ibid.

¹⁵⁵ Audit Report, page 21 et seq [CM 1488]

¹⁵⁶ Ibid.

¹⁵⁷ Audit Report, page 28 et seq [CM 1497]

¹⁵⁸ Ibid.

¹⁵⁹ Audit Report, page 42 et seq [CM 1511]

¹⁶⁰ Audit Report, page 52 et seq [CM 1521]

¹⁶¹ Audit Report, page 56 et seq. [CM 1525]

¹⁶² Witness statement of Gabriel Oliver [CM 05994] at paragraphs 21-23.

- b) **IEPS Accreditation (purchases).** The documentation obtained during the verification visit showed that for all of CEMSA's cigarette purchases the IEPS had not been transferred expressly and separately, which precluded identification of the exact IEPS amounts CEMSA would have been able to claim, assuming it had the right to do it, and more importantly, the verification of the tax actually paid to the federal treasury. Additionally, it was observed that many of CEMSA's invoices had been issued to a different company.
- c) **Exports to Honduras (sales).** CEMSA had exported to Honduras applying a 0% IEPS tax rate, instead of the 85% rate that applied since such country was a low income tax jurisdiction. During 1996 and 1997, CEMSA allegedly exported to Dilosa, S.A. de C.V. and Corporinves, S.A. in Honduras. For such purpose, CEMSA presented false documentation. The Honduran Government confirmed that Dilosa did not exist. As for Corporinves, it never presented the notice required by Rule 6.1.1. of the Miscellaneous Tax Resolution for 1997. Thus, it unduly benefited from the 0% rate.
- d) **Over-statement of Rebates (rebates).** SHCP found that CEMSA had claimed rebates by calculating the 85% on the total amount of each invoice, thus applying an effective rate of 566%. It applied for and obtained rebates much in excess of the IEPS actually paid.

The following example illustrates CEMSA's incorrect methodology:

Cost of production per packet of cigarettes	\$2.60	
Profit made by the producer	\$0.61	
IEPS (3)	\$2.95	(average IEPS paid during the 1997, pursuant to the records of the Revenue Policy [department])
Profit made by a wholesale distributor	\$0.24	
Unit price (2)	\$6.40	(price invoiced by the wholesale distributor)
Amount of IEPS requested by CEMSA (1)	\$5.44	(corresponds to 85% of the invoice value issued by the wholesale distributor)
IEPS rate applied by CEMSA	566.67%	(Obtained by dividing (1) by the difference between (2) and (1), expressed as percentage)
Percentage of IEPS claimed in excess	46%	(Obtained by dividing the difference between (1) and (3) by (1) expressed as percentage)

253. SHCP assessed a fiscal liability of 250,551,635 pesos against CEMSA, comprised as follows:

IEPS omitted (<i>i.e.</i> exports to DILSOA), with inflation:	10,659,318
IEPS rebates wrongfully obtained, with inflation:	110,983,348
Interest on (a)	5,206,727
Interest on (b)	58,098,035
Fines on (a)	7,461,523
Fines on (b)	58,121,161
Interest on Supplemental Tax Return of 7 October 1997	21,420
Fines re: accounting	103

S. The 1999 Fiscal Court Proceedings: CEMSA's Legal Challenge of the 1998 Audit¹⁶³

254. CEMSA challenged the results of the audit before the Fiscal Court of the Federation and sought the nullification of the resolution of 1 March 1999.

255. CEMSA initially argued that SHCP had not complied with certain procedural requirements.

256. As to the merits, CEMSA argued:

... only those obliged to pay the tax [taxpayers], the producers, manufacturers, and bottlers of processed tobacco (cigarettes) have the obligation to issue invoices in which the transfer of the tax is expressly and separately stated, when the purchaser is himself a taxpayer of the same tax for the good or service and he so requests.

¹⁶³

Witness statement of Eduardo Díaz Guzmán [CM 06008] at paragraphs 11-21.

In the same vein, as is expressly acknowledged by the defendants, my client [CEMSA] did not directly acquire the goods (cigarettes) in question from the manufacturers, producers and bottlers, but rather on second-hand sale from vendors that are not taxpayers of the special tax on production and services (and for such reason, it should be said in passing, there was no tax transferred expressly and separately to them). Therefore, CEMSA's invoices can not be required to have the tax transferred expressly and separately in each transaction given that legally and physically it is impossible to do so, and it is well known that no one is obliged to the impossible...

[T]he claimant [CEMSA] paid the special tax on production and services by covering the price on processed tobacco that it later exported to jurisdictions that are not considered as low tax imposition; said export being accredited, it has the right to the rebate of the tax paid, although it has not been transferred expressly and separately...¹⁶⁴

257. Thus, CEMSA conceded that it bought cigarettes from vendors that were not taxpayers and to whom the tax was not transferred expressly and separately, but that CEMSA still was entitled to rebates of the tax incorporated into the price of the cigarettes it had purchased.

258. As to its exports to Honduras, CEMSA denied having made them on the following basis:

as to the claimant [CEMSA] omitting to pay to the Federal Treasury the special tax on production and services at the 85% rate for sales and exports to the company Dilosa, S.A. de C.V., of the Republic of Honduras, considered as a low tax jurisdiction, the best evidence that this did not occur, that is, that the claimant [CEMSA] did not make any export to the mentioned Central American country, is in the information contained in *oficio* No. DEI-OA-167-98 of the 3rd of April, 1998, in which in response to the request for information by the Deputy General Direction of International Auditing, through *oficio* 337-SAT-I-964 of the 16th of March, 1998, the Executive Direction of Collections of the Secretariat of Finances of the Republic of Honduras makes known that there are no imports in the name Dilosa, S.A. de C.V. to the mentioned country, so that with such assertion the defendants should submit proof to the contrary. If the information provided by the Executive Direction of Collections is accepted, that "[i]n the registry of taxpayers the name of Dilosa, S.A. de C.V. or simply Dilosa is non-existent", it should also be admitted in that regard that "[t]he company in reference is not found in the database of the Automated Customs Systems of the Data Entry Department and therefore there are no imports in the name of that company...

Consequently, as is correctly reasoned in folio 324-SAT-1764-71 of the last and partial report, if in its exports "Corporación de Exportaciones Mexicanas, S.A. de C.V. did not transfer the special tax on production

and services, such cigarette exports must have been made, undoubtedly, to countries that do not have a income tax rate on legal persons below 30%[Emphasis added]¹⁶⁵

259. Thus, CEMSA admitted that Dilosa did not exist and that it did not make such exports. It only attempted to justify its alleged right by arguing that if the company did not exist and the government of Honduras denied that the imports took place, those goods must have been exported to countries other than low tax jurisdictions, notwithstanding that its export *pedimentos* and invoices indicated Dilosa as the customer and Honduras as the country of destination. CEMSA did not reply to the finding in respect of its failure to present the notice referred to in Rule 6.1.1.

260. By letter dated 9 August 1999, SHCP refuted the arguments regarding procedural matters and argued to the Fiscal Court that compliance with the express requirements contained in the IEPS Law could not be excused on a discretionary basis. SHCP claimed that CEMSA had no right to rebates since it did not comply with the express legal provisions set out in the IEPS Law, and that CEMSA could not be allowed to fabricate the IEPS in its favor through invoices that did not comply with the legal requirements.

261. On 16 June 2000 the Fiscal Court issued a decision holding in favor of SHCP on some points and in favor of CEMSA on others. The Fiscal Court confirmed the correctness of the authorities' conduct in respect of procedural matters. It also determined that CEMSA only had the status of taxpayer for final cigarette exports made to countries not considered as low tax jurisdictions. But the Fiscal Court resolved that SHCP could not require invoices with the IEPS expressly transferred and stated separately, on the basis that it was a requirement with which it was impossible to comply in the case of cigarette exports. Nevertheless, the Court clearly specified that CEMSA only:

has the right to recover the tax that the producer actually paid on the first sale, which is the only taxable sale prior to exportation. Thus, it has the right to accredit the tax that results from applying the determined tax as a function of the sale price to the retailer that has been declared by the producer or manufacturer to tobacco products actually exported to a country that is not considered as a "low tax jurisdiction..."¹⁶⁶

262. As to Dilosa, the Court rejected CEMSA's arguments and granted full probative value to the documents issued by the Government of Honduras and CEMSA's own *pedimentos* and invoices. The Court confirmed that the rebates obtained for exports made to Honduras were improper.

263. Thus, the Fiscal Court nullified the resolution, but only:

¹⁶⁵ CM 05089-90.

¹⁶⁶ CM 05418.

for the purpose that the authority issue a new one that recognizes the right of CEMSA to accredit the tax that results from applying the tax as determined, as a function of the price to the retailer that the producer or manufacture has declared for tobacco actually exported to countries that are not "low tax jurisdictions" without this impeding the authority from verifying that the other requirements established in article 4 of the Special Law on Production on Services for the said tax to be accreditable have been complied with.

In addition, as to the determination of the omitted 85% tax rate, the nullification of the challenged resolution is for the purpose that the new resolution issued by the authority consider that the zero rate does not apply to final exports of processed tobacco to countries considered as "jurisdictions of low tax imposition", and that the 85% rate corresponds exclusively to the first sale of said goods within the national territory or their importation.

Finally, the authority is correct in considering as improper those rebates for exports made to Honduras, since said country is considered as being of "low tax imposition", as has already been indicated, and that these exports do not benefit from the zero rate.¹⁶⁷

264. The resolution of 1st of March, 1999, accordingly, remains in force as to the other findings, including the finding that CEMSA did not have proper accounting records, kept in accordance with generally accepted accounting principles.

265. Both CEMSA and the authority were dissatisfied with the Fiscal Court's ruling and have challenged it through different means.

266. On 6 September 2000, CEMSA filed an *amparo* proceeding before the *Tribunales Colegiados de Circuito* (Circuit Courts) in which it primarily attacked the full probative value that the Fiscal Court conferred to CEMSA's *pedimentos* regarding exports to Honduras. It argued that CEMSA's own documents were "completely lacking in probative value" and asserted, as it had to the Fiscal Court, that the Honduran Government's statement that Dilosa did not exist proved that CEMSA has made no exports to Honduras. In addition, it challenged the determination of the Fiscal Court that the rebates for exports to Honduras were improper. In this respect, notwithstanding having denied making exports to Honduras and having admitted that Dilosa did not exist, it argued that CEMSA had established that it was not related to Dilosa, and therefore had complied with the requirement in Rule 6.1.1. Lastly, it advanced an argument, made for the first time, that the law should not distinguish in respect of whether the country of destination is or is not considered a low tax jurisdiction, notwithstanding that it abided by the provision requiring notice pursuant to Rule 6.1.1.

267. On 18 September 2000, SHCP appealed the Fiscal Court's ruling (*recurso de revisión*) before the *Tribunales Colegiados de Circuito*. In essence, SHCP argued that the requirement to

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CM 05433.

have invoices that transfer the IEPS expressly and separately stems from a clear legal provision (article 4, section III of the IEPS Law), compliance with which is mandatory. In addition, it argued that this requirement is not impossible to comply with, as nothing prevents CEMSA from acquiring the goods directly from the producers or manufacturers. Whether producers and manufacturers sell directly to CEMSA is a matter between private parties that cannot be attributed to SHCP.

268. Thus, the Fiscal Court's decision is presently *sub judice*, that is, is subject to appellate review, and to a direct *amparo*. Both proceedings are currently before the competent federal courts.

T. Cigarette Exports by Mercados I and Mercados II in 1999-2000

269. Article 69 of the Fiscal Code prohibits SHCP from disclosing confidential taxpayer information. The two witness statements of Eduardo Diaz Guzman provide information concerning payments of IEPS rebates to certain unidentified taxpayers that SHCP considers can be disclosed without violating the law.

270. The following facts concerning exports by Mercados Regionales, S.A. de C.V. (Mercados I) and Mercados Extranjeros, S.A. de C.V. (Mercados II) were obtained from *Economia's* databank of export records. The information pertains to exports of specific products in specific years by specific exporters. It does not indicate that IEPS rebates were claimed or paid on those exports, nor is it confidential taxpayer information. The values shown, in U.S. dollars, are derived from the declared value of the exported goods.¹⁶⁸

271. Mercados I (formerly known as Compania Exportadora Mexicana, S.A. de C.V) exported cigarettes as follows:

- a) in 1998 —138,239 U.S. dollars to the United States (recorded under the name Compania Exportadora Mexicana, S.A. de C.V.);
- b) in 1999 —743,659 U.S. dollars to the United States; and
- c) in 2000 —4,053,023 U.S. dollars to the United States¹⁶⁹.

272. Mercados II exported cigarettes valued at 574,200 dollars to the United States in 2000¹⁷⁰.

273. The *Economia* data base does not indicate cigarette exports by an exporter called "MEXCOBASA, S.A. de C.V." or any similar name¹⁷¹.

¹⁶⁸ Witness statement of Roland Garcia Ramos [CM 06021] at paragraph 11 and Table 7.

¹⁶⁹ Ibid.

¹⁷⁰ Ibid.

¹⁷¹ Ibid, paragraph 12.

III. RESPONSE TO THE SURVIVING CLAIMS: STATEMENT OF THE LAW ON THE MERITS

274. The only claims that still must be answered are the following:

- the allegation that Mexico failed to implement the 1993 decision of the Supreme Court of Justice in favor of CEMSA concerning the rebate of certain excise taxes imposed on the sale of cigarettes with the result that Mexico violated Article 1110¹⁷²;
- the allegation that Mexico's refusal to provide rebates of excise taxes to CEMSA for cigarettes allegedly exported in October, November, and December 1997 amounted to an expropriation contrary to Article 1110¹⁷³; and
- the allegation that the Claimant's enterprise has received less favourable treatment than Mexican-owned enterprises in like circumstances, contrary to Article 1102.

275. Each will be addressed below. The national treatment claim will be addressed after the Respondent introduces certain additional facts in Part IV.

276. Before doing so, the Respondent wishes to make certain observations about the legal context of this dispute and the sources relied upon by the Claimant.

A. Recent Jurisprudential Developments

1. A NAFTA Panel Has Recently Held That it is Inappropriate to Examine Motivation or Intent

277. The Claimant repeatedly alleges that the measures at issue were motivated by an intent to 'protect the producers' export monopoly' or 'at the urgings of Carlos Slim'. The Respondent says that these allegations are incorrect.¹⁷⁴ In any event, they are legally irrelevant. Consistent with WTO practice, a recent NAFTA Panel refused to examine the motivation or intent of challenged measures.

278. In the Chapter Twenty Panel decision *In the Matter of Cross-border Trucking Services*, due to the extraordinarily abrupt reversal of the United States' plan to liberalize trucking services

¹⁷² CM 05769.

¹⁷³ Ibid.

¹⁷⁴ As the witness statement of Mr. Salazar Martinez notes, during the relevant period CIGATAM did not make any exports of Philip Morris branded cigarettes, nor did it sell cigarettes to any third party for the purpose of export. Simply put, there was no "export monopoly" for Marlboros.

trade as scheduled in the NAFTA, Mexico adduced evidence of the Teamsters' influence on U.S. policy making¹⁷⁵.

279. Relying upon settled WTO practice, the Panel addressed this issue at the outset of its findings, stating:

214. In this analysis, the Panel declines to examine the motivation for the U.S. decision to continue the moratorium on cross-border trucking services and investment; it confines its analysis to the consistency or inconsistency of that action with NAFTA. The Panel notes that this approach is fully consistent with the practice of the WTO Appellate Body, which in *Japan - Taxes on Alcoholic Beverages*, at 28, and in *Chile - Taxes on Alcoholic Beverages*, para. 62, has declined to inquire into the subjective motivations of government decision-makers, or examine their intent. As the Appellate Body observed in analogous circumstances, in *Chile-Alcoholic Beverages*, "The subjective intentions inhabiting the minds of individual legislators or regulators do not bear upon the inquiry, if only because they are not accessible to treaty interpreters."¹⁷⁶ [Emphasis added]

2. The Findings in *Metalclad* Relied Upon by the Claimant Have Been Set Aside by a Reviewing Court

280. At paragraphs 149, 172-174, 176, and 186 of the Memorial, the Claimant relies heavily upon the authority of the NAFTA arbitral award in *Metalclad Corporation v. United Mexican States*¹⁷⁷.

281. As noted above, much of the present claim invokes Article 1105 and due to the operation of Article 2103, that article cannot be invoked in this case. In any event, even if Article 1105 could apply, the Memorial's reliance upon the authority of *Metalclad* is misplaced.

282. At the time that the Memorial was submitted, *Metalclad* was under judicial review by the court of the place of arbitration, the Supreme Court of British Columbia. On May 2, 2001, Mr. Justice Tysoe set aside the central parts of the *Metalclad* award upon which the Claimant has relied.

¹⁷⁵ *In the Matter of Cross-border Trucking Services*, Secretariat File No. USA-MEX-98-2008-01, Final Report of the Panel, February 6, 2001. See paragraphs 80-81, 102, and 115.

¹⁷⁶ The Panel cited additional sources at the footnote following the passage quoted above: "See also Hersch Lauterpacht, *The Development of International Law by the International Court* 52 (1958) ("Interpretation as a juristic process is concerned with the sense of the word used, and not with the will to use that particular word."); Charles C. Hyde, *International Law* 531 (1945) ("The final purpose of seeking the intention of the contracting states is to ascertain the sense in which terms are employed. It is the contract which is the subject of interpretation, rather than the volition of the parties.")"

¹⁷⁷ ICSID ARB/97/1, issued 30 August 2000.

B. The Acts of the Domestic Courts Must be Given Appropriate Effect

283. The Memorial exhibits a tendency to pick and choose between the findings of the Mexican courts, selecting certain statements or findings that assist the Claimant without noting other findings that hurt his case or paying attention to the legal significance of the whole of the legal process or to the special nature of the relationship between an international arbitral body and the courts of the State whose measures are being challenged.

284. The most significant omission is the Memorial's failure to inform the Tribunal that the Claimant specifically made all of the central arguments advanced in his Memorial to the Fiscal Court and then an *amparo* court and lost at both levels.

285. Those proceedings are of juridical significance to this international tribunal. The point was made in *Azinian et al. v. United Mexican States* where the acts of officials were upheld by the courts:

97. With the question thus framed, it becomes evident that for the Claimants to prevail it is not enough that the Arbitral Tribunal disagree with the determination of the Ayuntamiento [the Municipal Council]. A governmental authority surely cannot be faulted for acting in a manner validated by its courts *unless the courts themselves are disavowed at the international level*. As the Mexican courts found that the Ayuntamiento's decision to nullify the Concession Contract was consistent with the Mexican law governing the validity of public service concessions, the question is whether the Mexican court decisions themselves breached Mexico's obligations under Chapter Eleven.¹⁷⁸ [Emphasis in original]

286. The Respondent will make submissions below on the proper relationship between this proceeding and the past and current proceedings in the domestic courts. It suffices to say that fundamental issues of law arise; they relate to the different jurisdictions of the municipal and international legal bodies and to the deference and effect to be given to the domestic courts' jurisdiction and determinations by this Tribunal. There must be due recognition of the respective competencies and jurisdictions of the domestic courts and the international arbitral tribunal.

C. The Expert Evidence Submitted by the Claimant

287. For two reasons (quite apart from defects in its reasoning) the Respondent objects to the testimony of Professor Swan which was tendered as expert evidence. First, it is argument, not opinion. Second, it is argument based upon Professor Swan's assumption that the "ultimate issues" before the Mexican courts have been conclusively established and will remain unchanged on appeal. While under Article 41 of the Arbitration Rules it is for the Tribunal to determine the testimony's admissibility, it is respectfully submitted that, even if admissible, it lacks any

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Azinian et al. v. United Mexican States, ICSID Case No. ARB(AF/97/2), 1 November 1999 at para. 97.

probative value, given its erroneous reliance upon domestic law findings that are *sub judice* and its failure to address the key findings in other domestic proceedings¹⁷⁹.

D. General Observations on the IEPS Tax and the Expropriation Claims

288. The Respondent also wishes to comment on taxation law in the context of the international law of expropriation. It is appropriate to point out what the Claimant is and is not alleging about the IEPS Law. This is necessitated by the Claimant's reliance upon writings that suggest that a "confiscatory tax" can amount to an expropriation¹⁸⁰.

289. It is trite learning that States have the jurisdiction to impose and collect taxes in the lawful exercise of governmental powers. Such lawful exercise of powers may commonly have "far-reaching interference with private property, including that of aliens"¹⁸¹, without giving rise to international responsibility, even if a foreign national suffers loss as a consequence.

290. Some scholars, such as Professor Brownlie, have suggested that taxation with the "precise object and effect of confiscation" should "probably" be considered contrary to international law¹⁸². Assuming that this is a correct statement of principle, it does not apply in the instant case, because there is no allegation that the IEPS is a confiscatory tax.

291. To the contrary, the Claimant's case rests on his enterprise's desire to use the IEPS Law to facilitate the marketing of cigarettes outside the normal distribution channels. The Claimant does not suggest that the IEPS tax on cigarettes must be eliminated. He originally complained to the competent authorities that the 1998 amendment's preclusion of IEPS rebates to re-sellers was expropriatory.

292. The legality of the IEPS Law itself at international law is thus not at issue; it is a *bona fide* general taxation measure adopted and administered by the Respondent in the lawful exercise of its jurisdiction to tax. The other NAFTA Parties impose similar taxes on cigarettes¹⁸³. It is

¹⁷⁹ This is also the case for the expert testimony of Carlos Loperena Ruiz.

¹⁸⁰ See Memorial, paragraphs 151 and 155-156.

¹⁸¹ *Restatement of the Law (Third) of the Foreign Relations Law of the United States* at §712, comment g, at page 200. The Restatement is part of a series published by the American Law Institute; although intended primarily as a summary of U.S. domestic practice and the U.S. view of international law, the Restatement includes influential commentary on many principles of international law. See also Oppenheim, *International Law*, at pp. 911-912. See also Brownlie, *Principles of Public International Law*, p. 535: "State measures, *prima facie* a lawful exercise of powers of government, may affect foreign interests considerably without amounting to expropriation. Thus foreign assets and their use may be subjected to taxation, trade restrictions involving licenses and quotas, or measures of devaluations. While special facts may alter cases, in principle such measures are not unlawful and do not constitute expropriation." (footnotes excluded).

¹⁸² Ian Brownlie, *Principles of Public International Law* (5th ed. Oxford University Press 1999) p. 535. See also Oppenheim, pp. 911 et seq.

¹⁸³ The current U.S. federal excise tax on cigarettes is \$19.50 per thousand (\$.39 per 20). 19 U.S.C. § 5701(b)(1). State excise taxes on cigarettes currently range from \$.025 to \$1.11 per pack. Federation of

not, to use Professor Brownlie's words, a law with the "precise object and effect of confiscation"¹⁸⁴.

293. Accordingly, the Memorial's unfocused discussion of the possibility that a tax measure could be a means for effecting an expropriation has no persuasive value.

294. Having made these introductory comments, the Respondent will now address the claims properly before the Tribunal.

E. Response to the Allegations of Expropriation

295. The expropriation claims can be disposed of on both legal and factual grounds. The Respondent will address the issues of law first.

296. The first alleged expropriation (the alleged failure to comply with the Supreme Court's ruling) can be disposed of summarily. There was full compliance with the ruling. As for the second (the refusal to pay IEPS rebates in 1997) CEMSA challenged the rebate denial in the Fiscal Court and lost. It took an *amparo* against the Fiscal Court's decision and lost again. No claim has been made that either the Fiscal Court or the *amparo* court acted in any way such as to deny justice to CEMSA.

297. On the authority of the *Azinian* award, therefore, no international claim can be made out against the refusal to pay the 1997 rebates. Even if those proceedings are ignored, it is not open to the Claimant to have this Tribunal act on the basis of the as-yet unfinished legal proceedings where the principle of impossibility was accepted in relation to the invoice issue.

298. An international claim based on how the authorities may respond to court decisions not yet made is not ripe. Nor have the courts concluded examining other factors that may dis-entitle CEMSA from claiming such rebates.

299. If the claim were ripe (*i.e.*, all the elements of an unqualified right to the rebates at domestic law, a failure to pay such rebates without legal justification, etc. were present), the Tribunal would then have to consider whether the right to rebates was an "investment" and not a claim to money under Article 1139 and whether a failure to pay such rebates could be an expropriation within the meaning of Article 1110.

Tax Administrators, "State Excise Tax Rates on Cigarettes," March 2001. Imported cigarettes are also subject to customs duties of \$1.05 per kilogram plus 2.3% of their value. U.S. Harmonized Tariff Schedules (2001), item 2402.20.80.

¹⁸⁴ This places it into the taxation exception recognized by the U.S. *Restatement* commentary on Section 712: "A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory, Comment f, and is not designed to cause the alien to abandon the property to the state to sell it at a distress price. As under United States constitutional law, the line between "taking" and regulation is sometimes uncertain. See Reporter's Note 6."

300. It is respectfully submitted that the Tribunal need not make any such determinations on these questions at this time. However, in the interests of completeness, the Respondent will make submissions on these questions.

1. The Interest At Issue Must Be A Defined Investment

301. Article 1139 of the NAFTA defines what is and is not an investment for the purposes of Chapter Eleven. If the Tribunal was presented with a ripe claim, it would have to determine whether the "cigarette export business" was an "investment" or whether it was simply a claim to money that is also excluded from the Article 1139 definition. If the interest alleged to have been expropriated is not an investment, Article 1110 does not apply.

302. As both the Notice of Intent and Notice of Claim constituting this arbitration show, the Claimant retains complete control and virtually full ownership over his enterprise CEMSA. Nowhere in the Claimant's notices or pleadings does he allege that the ownership or control of CEMSA has been taken by a measure attributable to the Respondent.

303. The Claimant has consistently asserted that he owns and has direct control over CEMSA:

- In his Notice of Intent, the Claimant asserted that "The company that I own and represent and over which I have direct control is Corporación de Exportaciones Mexicanas, S.A. de C.V.", a "foreign trade company that I own and represent"¹⁸⁵.
- The Notice of Arbitration, affirmed that "Marvin Roy Feldman Karpa owns all the stock of the enterprise, Corporacion de Exportaciones Mexicanas, S.A. de C.V....". The Claimant consented to arbitration on his own right and on behalf of CEMSA. CEMSA's consent and waiver were granted by The Claimant himself, as the sole administrator of the company¹⁸⁶.
- In his First Declaration, the Claimant stated: "I own the stock of Corporacion de Exportaciones Mexicanas, S.A. de C.V. ("CEMSA") and am the

¹⁸⁵ Notice of Intent, at pp. 2-3.

¹⁸⁶ Although CEMSA's consent and waiver are purported to be given by the Board of Directors, CEMSA is managed by The Claimant alone, according to its deed of incorporation and the corporate bylaws, which provide that "the company shall be [directed/managed] by a Sole Administrator, Mr. Marvin Feldman Karpa being hereby designated to that effect, and who will enjoy all corporate powers established in Article Eleven of the Corporate Bylaws" (deed No. 12032, dated 23 May 1988, granted by Federico G. Lugo Molina, Notary Public No. 19 of the District of Tlalnepantla, Mexico: Second Transitory Clause of the corporate bylaws). Indeed, The Claimant alone signed and notarized CEMSA's consent and waiver (deed No. 74,888, dated 23 April 1999, granted by Joaquín Talavera Sánchez, Notary Public No. 50 of the Federal District, First Clause and references to The Claimant's legal entitlement to act on behalf of the company).

sole person empowered to act on the company's behalf as Administrador Unico (sic) under CEMSA's articles of incorporation¹⁸⁷.

- In his Second Declaration, the Claimant asserts that he owns "nearly all the shares (299,490 of 300,000) of a Mexican import/export company, Corporacion de Exportaciones Mexicanas S.A. de C.V."¹⁸⁸

304. The Claimant remains the owner of the majority of CEMSA's stock. The Respondent does not interfere with the Claimant's activities as a shareholder. The Claimant continues to be in control of the company; he directs its day to day operations. The Respondent has not interfered with the appointment of directors or the company's management, and does not supervise the work of its officers and employees. The Respondent has not taken any of the proceeds of the company's sales (apart from taxation) and does not prevent the company from paying dividends to its shareholders.

305. Nowhere in the Claimant's notices or pleadings does he allege that the ownership or control of CEMSA has been taken by a measure attributable to the Respondent.

306. In short, Mexico has not nationalized or expropriated, directly or indirectly, or taken a measure tantamount to the nationalization or expropriation of CEMSA.

a. Article 1139 Is An Exhaustive Definition

307. The NAFTA Parties set out a broad *but not limitless* definition of investment in Chapter Eleven. If the expropriation claim involves an expectation (of whatever nature) that has not been defined as an "investment" under Article 1139, a Party's measure that may affect the investor's expectation cannot fall within the scope of Article 1110.

308. Article 1110 provides:

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

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1); and
- (d) on payment of compensation in accordance with paragraphs 2 through 6.

¹⁸⁷ Declaration of Marvin Feldman, paragraph 1.

¹⁸⁸ Second Declaration of Marvin Feldman, paragraph 9.

[Emphasis added]

309. At paragraph 145 of the Memorial, the Claimant observes that the NAFTA used certain drafting techniques when setting out definitions of terms. The Respondent agrees. Where the drafters intended to set out an illustrative definition, they used the word "includes". For example, Article 201, which sets out the general definitions used in the Agreement, states that:

measure includes any law, regulation, procedure, requirement or practice; [Emphasis added]

310. As the Claimant points out at paragraph 145 of the Memorial, where the Parties intended that a defined term have a specific meaning, they used the word "means". This was done in Article 1139 which provides:

investment means:

- (a) an enterprise;
- (b) an equity security of an enterprise;
- (c) a debt security of an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the debt security is at least three years,

but does not include a debt security, regardless of original maturity, of a state enterprise;

- (d) a loan to an enterprise
 - (i) where the enterprise is an affiliate of the investor, or
 - (ii) where the original maturity of the loan is at least three years,

but does not include a loan, regardless of original maturity, to a state enterprise;

- (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;
- (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);
- (g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under

(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or

(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

b. The NAFTA Parties and Commentators Agree That It Is Exhaustive

311. Antonio Parra, Deputy Secretary General of the International Centre for the Settlement of Investment Disputes (ICSID), has contrasted NAFTA's definition of investment with that used in other investment treaties:

In addition, in contrast to the all-inclusive definitions of covered investments found in most of the other treaties, the NAFTA's definition provides an exhaustive (though admittedly very broad) enumeration, rather than an open-ended, illustrative list, of covered assets or investments that the NAFTA requires be related to an "enterprise," to "business purposes" or to a "commitment of resources" to "economic activity" in the host State. In addition, the definition in the NAFTA specifically excludes from the scope of covered investments commercial contracts for the sale of goods or services. More than most of the other treaties, the NAFTA can in other words be seen as providing a definition of covered investments, and hence of covered investment disputes, that attempts clearly to distinguish them from trade and other non-investment assets and disputes.¹⁸⁹ [Emphasis added]

312. The three NAFTA Parties have expressly recognized the definitive scope of the article. For example, in their recent filings in another Chapter Eleven case, *Methanex Corporation v. United States of America*, the three NAFTA Parties agreed that the definition of "investment" in Article 1139 for the purposes of Chapter Eleven proceedings is exhaustive. At issue in *Methanex* is the Canadian claimant's contention that its U.S. customer base and its expectation of future profits, *i.e.*, "market share", are "investments" within the meaning of Article 1139. That claimant had based this argument (as has the Claimant in this case) on one of the *Pope & Talbot v. Canada* awards¹⁹⁰.

¹⁸⁹ Antonio R. Parra, "Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment" (1997) 12 No. 2 ICSID Rev. 287, pp. 355-356.

¹⁹⁰ Memorial at paragraph 142. *Pope & Talbot Interim Award* at para. 96.

313. In its Memorial on Jurisdiction and Admissibility in *Methanex*, the United States correctly pointed out that:

“Article 1139 of the NAFTA identifies an exhaustive list of property rights and interests that may constitute an ‘investment’ for purposes of Chapter Eleven.¹⁹¹” [Emphasis added]

314. Accordingly, in the context of that claim, the United States contended that neither a customer base, nor an expectation of future profits, was covered by Article 1139, and thus such interests were not protected by Chapter Eleven. As to the customer base:

Thus, a customer base does not fall within the definition of “investment” according to that definition’s plain meaning. Moreover, extending Chapter Eleven’s protections of investments to a non-property interest that cannot be bought or sold does nothing to further the NAFTA’s objective of “increas[ing] substantially investment opportunities in the territories of the Parties.” NAFTA art. 102(1)(c)¹⁹²

315. As to expectations of profit:

The definition in Article 1139 was intended to reflect and, in some cases, limit the customary international law notion of “property” that could be the subject of expropriation. That definition, however, does not list a mere expectation of future profits as an “investment” protected under Chapter Eleven. Nor does customary international law recognize maintenance of a certain rate of profit as property or a property right that can be expropriated.¹⁹³

316. In a subsequent pleading, and in response to Methanex’s assertion that its “investments” included intangibles such as “goodwill, market share, market access, operations and customer base”, the United States again rejected the contention that these additional attributes could amount to investments under Article 1139:

As the United States demonstrated in the Memorial, however, attributes such as market share, customer base, and goodwill do not constitute “investments” within the meaning of Chapter Eleven, and are, thus, not protected by Article 1110.¹⁹⁴

¹⁹¹ Memorial on Jurisdiction and Admissibility of Respondent United States of America at p.31.

¹⁹² Ibid, p.33.

¹⁹³ Ibid, p. 36.

¹⁹⁴ Reply Memorial of Respondent United States of American on Jurisdiction, Admissibility and the Proposed Amendment, at p. 40.

And while such intangibles [goodwill and customer base] can certainly be the fruits of an investment, they cannot in themselves be considered investments in any sense meaningful under Articles 1139 and 1110.¹⁹⁵

317. Exercising its right under Article 1128 of the NAFTA to intervene on questions of interpretation of the Treaty, Canada agreed with the United States on the scope of Article 1139 and the exhaustive definition set out therein, pointing out, *inter alia*:

58. Only those legal interests listed in the definition of the word "investment" at Article 1139 are protected through the observance by the NAFTA Parties of their obligations set out in Section A of NAFTA Chapter Eleven.

59. The definition of "investment" in NAFTA Article 1139 provides a list of investments covered by Chapter Eleven and, more particularly, NAFTA Article 1110. This definition is exhaustive, not illustrative...

62. Acquisition, ownership and exclusion of others from use are fundamental characteristics of property, be it tangible or intangible. Canada submits that the tribunal arbitrating *Pope & Talbot, Inc. v. Canada*, by ignoring these fundamental characteristics of property, erred in equating "access to the...market [of a NAFTA Party]" to intangible property.¹⁹⁶ [Emphasis added]

318. Mexico concurred with the other NAFTA Parties and stated:

23. The point is obvious: where treaty drafters intended that investment protections would extend to "every kind of asset", including such notions as "goodwill", they have expressly said so. In Chapter Eleven of the NAFTA, there was no such intention and claims in relation to the intangibles such as "market share" and "goodwill" are not arbitrable.

24. Mexico adds that to the extent that the decisions in *Pope & Talbot* and *S.D. Myers* can be interpreted as supporting Methanex's position, they are incorrect and should not be followed because they failed to interpret Article 1139 correctly¹⁹⁷.

319. Accordingly, under Article 31(3)(a) and (b) of the Vienna Convention on the Law of Treaties, there is a clear subsequent agreement and practice between the Parties to the Treaty regarding the interpretation of the treaty or the application of its provisions.

¹⁹⁵ Ibid, at p.42.

¹⁹⁶ Article 1128 Submission of the Government of Canada.

¹⁹⁷ Article 1128 Submission of the United Mexican States.

c. Article 1139 Also States What Is Not An Investment

320. NAFTA's drafters also stated in Article 1139 what was *not* an investment "[f]or purposes of this Chapter":

...but investment does not mean,

- (i) claims to money that arise solely from
- (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
- (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or
- (j) any other claims to money,

that do not involve the kinds of interests set out in subparagraphs (a) through (h);

321. Thus, any type of interest that is not included in the definition of investment in Article 1139(a)-(h) is *not* an investment and any interest that is a claim to money that does not involve the kinds of interests set out in subparagraphs (a) through (h) is not an investment.

2. The Attempted Grafting on of Article 1139's Definitions to the Claimant's Investment, CEMSA

322. At paragraph 144 of the Memorial, the Claimant asserts that he is an investor and CEMSA is his investment. The Tribunal agreed in its Interim Decision. The Claimant goes on to assert that CEMSA and CEMSA's "cigarette export business" are property acquired in the expectation or used for the purpose of economic benefit or other business purposes. It is asserted further that the Claimant has committed capital and other resources to contracts and other economic activity within Mexico where remuneration depends substantially on CEMSA's revenues. "CEMSA and CEMSA's business activities, therefore, including its business of exporting cigarettes, are claimed to constitute "investment" by claimant under NAFTA".¹⁹⁸

323. While the Tribunal has found that the Claimant is an investor and CEMSA is his investment, the Claimant's attempt to then graft on other definitions of investment onto CEMSA itself in order to reach the ultimate conclusion that the "cigarette export business" is the investment (*i.e.*, the investment of the investment of an investor) does not succeed. This is what the claimant in the *Methanex* claim is attempting to do. It is a case of the investment of the investor pleading that some of its activities, plans, and expectations are "the investment." In

¹⁹⁸

Memorial at paragraph 144.

Mexico's submission, this attempt to cumulate definitions to create an Article 1139 property interest that can then be claimed to be protected overreaches, particularly when the transactions at issue in this dispute are considered.

324. The logic of the Claimant's position is that not only is CEMSA "the investment", but CEMSA's film products exporting business is itself "the investment", as is its contact lens exporting, alcoholic beverages exporting, and its canned milk importing business. In short, the Claimant ends up having at least five different investments when the reality is that he has one investment that sells different products.

325. If the interest at issue is not an investment as defined by Article 1139, a Party's measure alleged to expropriate that interest cannot be an expropriation within the meaning of Article 1110. This is the consequence of a plain reading of the Agreement.

3. In Article 1110, the Tribunal Has Jurisdiction Over Expropriation, Nothing More

326. If the Tribunal were presented with the need to apply Article 1110, it would then have to consider whether the impugned action (*e.g.*, the hypothetical example of SHCP insisting on reclaiming all of the 1996-97 rebates even though the Court of Appeal reviewing the tax assessment decided that CEMSA was entitled to retain some amount of money) could be an expropriation.

327. The *Azinian* award is of relevance to such inquiry. That Tribunal pointed out that there may be many acts of a State that are objectionable to an investor and may cause it to become disappointed with the State; this does not mean that the investor has a claim for a breach of an international treaty¹⁹⁹: "NAFTA was not intended to provide foreign investors with blanket protections for this kind of disappointment and nothing in its terms so provide."²⁰⁰

328. The Memorial shows insufficient regard for the jurisdiction that is conferred on a NAFTA tribunal when presented with expropriation claims. This defect in his pleadings raises an issue of general application, not unique to taxation measures.

a. The Jurisdiction Of the Iran-U.S. Claims Tribunal Differs in Scope and Content From Article 1110

329. When the Claimant presses the Tribunal to rely upon the decisions of the Iran-U.S. Claims Tribunal²⁰¹, he does not point out that that tribunal had a much broader jurisdiction than this Tribunal.

¹⁹⁹ *Azinian et al. v. United Mexican States*, ICSID ARB(AF)/97/2 at paragraph 83.

²⁰⁰ *Ibid.*

²⁰¹ See footnote 51, paras. 155, 161, footnote 61, paragraph 220, and footnote 120.

330. The Algiers Accord granted the Iran-U.S. Claims Tribunal jurisdiction over expropriation and other interferences with property or contractual rights. The NAFTA Parties have pointed this out to various NAFTA tribunals²⁰².

331. Thus, mere interferences with property or contractual rights that would have been subject to the jurisdiction of the Iran-U.S. Claims Tribunal do not fall within the jurisdiction of a NAFTA Tribunal under Article 1110.

332. The governing law of the Iran-U.S. Claims Tribunal was also far broader than Chapter Eleven's governing law (Article 1131). Article V of the Claims Settlement Declaration stated:

The Tribunal shall decide all cases on the basis of respect for law, applying such choice of law rules and principles of commercial and international law as the Tribunal determines to be applicable, taking into account relevant usages of the trade, contract provisions and changed circumstances.

333. The breadth of this governing law clause led one of the former American judges of that Tribunal to comment:

The freedom accorded the Tribunal by this provision inspired the Tribunal to a creative and eclectic approach—one might almost conclude a variety of approaches—to its selection of the law applicable to each claim before it. Consequently, it is impossible to define any coherent set of choice of law rules followed by the Tribunal, but there are a few general conclusions that appear to flow from the Tribunal's practice.

...many of the largest claims before the Tribunal were claims for compensation for properties expropriated by Iran or properties of which the claimants were deprived by actions for which Iran was responsible. In such cases, the choice was obvious, as the law was readily available in the form of the Treaty of Amity of 15 August 1955 between Iran and the United States, a treaty that was simultaneously international law, American law and Iranian law.²⁰³ [Emphasis added]

²⁰²

This was accepted by the *Pope & Talbot* Tribunal in one of its awards which held:

104. No authority cited by the Investor supports a contrary conclusion. References to the decisions of the Iran-U.S. Claims Tribunal ignore the fact that the tribunal's mandate expressly extends beyond expropriation to include "other measures affecting property rights". And, to the extent the Investor is correct in urging that the comments of Dolzer and Stevens suggest that measures "tantamount" to expropriations can encompass restraints less severe than expropriations itself (creeping or otherwise), those comments would not be well-founded under a reasonable interpretation of the treaties that the authors analyse.

²⁰³

George H. Aldrich, The Jurisprudence of the Iran-United States Claims Tribunal (Oxford University Press, 1996) at pages 156-157.

334. A NAFTA tribunal's governing law is narrower and does not extend to the domestic law of the host State²⁰⁴.

b. The U.S. Restatement Also Differs in Scope and Content From Article 1110

335. In the Respondent's view, the *Restatement of the Law (Third) of the Foreign Relations Law of the United States* is an important source of learned commentary of American views of international law. However, it is not necessarily indicative of the state of international law accepted by the international community. It combines American views of *lex lata* with views of *lex ferenda*.

336. Those qualifications aside, the Memorial pays insufficient attention to the differences between the *Restatement's* treatment of general international law on economic injuries to aliens and what the NAFTA Parties actually provided in the treaty. They are not one and the same.

337. For example, at paragraph 151, when referring to Section 712 of the *Restatement*, the Memorial omits to inform the Tribunal that Section 712 addresses three different types of governmental actions that U.S. commentators consider could cause economic injury to aliens. Section 712 addresses:

- "takings" in paragraph 1,
- a repudiation or breach by the state of a contract with a national of another state in paragraph 2, and
- "other arbitrary or discriminatory acts or omissions by the state that impair property or other economic interests" in paragraph 3.

338. Paragraph 151 of the Memorial first mislabels paragraph 3 of Article 712 (calling it paragraph 2) and then incompletely quotes comment g to section 712. The entire quote with the omitted part included changes its meaning, especially when it is considered that the Claimant sees a "striking" similarity between Article 1110 and Section 712 of the *Restatement*:

g. Expropriation or regulation. Subsection (1) applies not only to avowed expropriations in which the government formally takes title to property but also to other actions of the government that have the effect of "taking" the property, in whole or in large part, outright or in stages ("creeping expropriation"). A state is responsible as for an expropriation of property **under Subsection (1)** when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an

²⁰⁴

See also Wayne Mapp, *The Iran-United States Claims Tribunal: The first ten years, 1981-1991* (Manchester University Press 1993) at page 104 and Aida Avanesian, *Iran-United States Claims Tribunal in Action* (Martinus Nijhoff 1993) at pages 248-250.

alien's property or its removal from the state's territory. Depriving an alien of control of his property, as by an order freezing his assets, might become a taking if it is long extended. [Omitted part bolded]

339. While the Respondent agrees with the Memorial (at paragraph 151), that subsection (1) of Section 712 of the *Restatement* bears some resemblance to Article 1110(1), NAFTA's expropriation provision does not contain provisions equivalent to subparagraphs (2) and (3) of Section 712.

340. Thus, the Memorial's statement that "Section 712 states, in language strikingly similar to Article 1110 (1)" is incorrect when the Claimant goes on to include the separate form of economic injury to aliens contained in Section 712(3) in NAFTA Article 1110(1).

341. The separateness of these different forms of economic injury to aliens is made clear in the commentary to the *Restatement*. At paragraph 151, the Memorial quotes the commentary to Section 712(3) even though it has no NAFTA equivalent. The Reporter's Note of the *Restatement* points out that subsection (3) is directed to a different form of state action:

11. "Arbitrary" economic injury. "Arbitrary" in Subsection (3) is used in a sense analogous to its use in connection with repudiation of contracts, Reporters' Note 8. It refers to an act that is unfair and unreasonable, and inflicts serious injury to established rights of foreign nationals, though falling short of an act that would constitute an expropriation under Comment g. [Emphasis added]

342. By merging a separate form of economic injury into expropriation, the Memorial attempts to expand the scope and meaning of Article 1110. With respect, the language of Article 1110 is not "strikingly similar" to the whole of Section 712.

343. With these legal considerations in mind, the Respondent will now turn to the facts.

F. Response to the Allegation That Mexico Failed to Comply With the Ruling of the Supreme Court and Thereby Violated Article 1110 of the NAFTA

344. It has been alleged that the Respondent flouted the decision of the Mexican Supreme Court which declared CEMSA's entitlement to the zero rate for the purposes of the IEPS tax. In fact, SHCP fully complied with the Supreme Court's ruling.

345. It is of seminal importance for this Tribunal to understand what the Supreme Court did and did not do. The Supreme Court's decision was limited to an evaluation of Article 2, Section III of the IEPS law to determine its consistency with the principle of equality. The Court did not address the mechanics of claiming an IEPS rebate and specifically did not consider the constitutionality of Article 4 of the law, which required that the person claiming the IEPS rebate possess invoices from the vendor that separately stated how much IEPS had been paid previously.

346. This fact is of critical importance: The Claimant seized upon the Supreme Court's decision on the equality of taxpayers and argued that by virtue of that decision, his enterprise acquired a unique status under Mexican law. According to the Claimant's theory, CEMSA was relieved of the need to comply with Article 4 of the Law, which requires that the tax be separately stated on the invoices used to claim the rebate. But CEMSA never raised this issue with the Supreme Court, nor did the Court address it.

347. In fact, in implementing the Supreme Court's decision, SHCP required CEMSA to provide invoices with the tax stated expressly and separately, and CEMSA acceded to that requirement, albeit under protest. Moreover, SHCP explained to the District Judge that it needed such invoices. The judge accepted the explanation and CEMSA did not object to it.

348. SHCP thus requested and obtained invoices from CEMSA, paid the rebates because the invoices separately stated the tax, and the only outstanding issue litigated thereafter concerned CEMSA's "financial costs" claim (on which SHCP prevailed).

349. As noted earlier, the very same arguments now being advanced in this Tribunal about the effect of the Supreme Court's ruling were advanced and rejected in the Fiscal Court's 1998 proceeding.

350. It also warrants noting that SHCP did not amend the law after the Supreme Court's ruling in order to establish paperwork requirements that were impossible to meet. At paragraph 149(a) of the Memorial, the Claimant accuses SHCP of "imposing an arbitrary requirement impossible for CEMSA to fulfil that it obtain vendor invoices stating the IEPS tax separated, and expressly." Article 4 was a part of the law as written and, in Mexico's view, SHCP's insistence on compliance with it was neither "arbitrary", nor "imposed by SHCP". It was stated in the law and not imposed by some kind of arbitrary administrative fiat. Moreover, from the perspective of good tax policy, having invoices with the actual amount paid ensured that a purchaser like CEMSA could not inflate its claims. CEMSA's substantial over-claims themselves are evidence of the wisdom of the Law and its underlying policy.

351. At paragraph 170(c), the Claimant admits that there is a "formal requirement of the IEPS law that a taxpayer seeking a IEPS rebate obtain a vendor's invoice stating the IEPS tax separately and expressly". This is an admission of an indisputable fact: the Mexican Congress enacted Article 4; it was not an arbitrary measure invented by SHCP.

352. The Memorial goes on to say that Article 4 "is not opposable to CEMSA as a matter of Mexican or international law because that requirement was impossible for CEMSA to fulfil for reasons beyond its control".²⁰⁵ At domestic law, to the extent that the current litigation is relevant, as it is on appeal, the claim is not ripe. At international law, since the "right to rebates without invoices" is not established under domestic law, it cannot be said that the Law's formal requirement is "not opposable" to CEMSA.

²⁰⁵

Memorial at paragraph 170(c).

353. The fact remains that in 1996 when the District Judge closed the file regarding the *amparo* resolved by the Supreme Court, SHCP's position on the need for compliance with the requirements of Article 4, which had been communicated to the Judge, was left undisturbed.

354. It is also a fact that by his conduct, the Claimant acknowledged that the Supreme Court had not settled this issue. When in December 1997 he applied to SHCP for a written ruling confirming his right to claim rebates without the tax separately stated on the invoice, the Claimant was admitting that the invoice issue was separate from the 0% rate status accorded to CEMSA by the Supreme Court ruling.

355. This evidence fully answers the Claimant's first claim, namely, that by failing to implement the Supreme Court's ruling the Respondent expropriated the Claimant's investment. There is no basis for the allegation that the authorities failed to comply with the Court's judgment.²⁰⁶

356. In the Respondent's submission, that the District Judge accepted that SHCP had complied with the Supreme Court decision, knowing that SHCP had required the invoices, is a dispositive juridical fact for purposes of this proceeding. The Claimant concurred that SHCP had indeed complied fully.

357. It is respectfully submitted that the first claim of expropriation must be dismissed.

G. Response to the Allegation That the Denial of Rebates Relating to Exports Made in October, November, and December 1997 Amounted to an Expropriation

1. Article 1139

358. The arguments made earlier regarding the scope of Article 1139 apply equally to this claim. It is observed that at paragraph 137 of the Memorial the Claimant admits that "this is a claim for a tax refund" (in contrast to CEMSA's other claims for lost profits).

2. CEMSA's Court Challenge of the Rebate Denials was Dismissed

359. As noted earlier, CEMSA's challenge was rejected at two levels of Mexican courts. SHCP's action was therefore lawful as a matter of domestic law²⁰⁷. On the authority of the *Azinian* award, the Tribunal must accept these juridical facts unless it disavows the acts of the judiciary itself. There is no basis for doing so.

²⁰⁶ Accordingly, the authorities cited at paragraphs 200-204 are inapplicable.

²⁰⁷ The expert opinion of Carlos Loperena Ruiz does not address the full factual and legal basis of SHCP's and the courts' actions in this case.

3. The Existence of the Alleged Right is Being Considered by the Mexican Courts and is *Sub Judice*

360. The issue of CEMSA's claimed right to claim IEPS rebates without being in possession of invoices separately stating the tax paid is again before the courts, having arisen in CEMSA's challenge of the 1999 tax assessment before the Fiscal Court. Both sides are appealing aspects of the Fiscal Court's decision (and in CEMSA's case, it is taking an *amparo* against that decision).

361. It is well established in international law that when examining state responsibility for the acts of its judiciary, the judicial system as a whole must be examined. Courts operate in self-correcting appellate tiers, which only together constitute a judicial system²⁰⁸. Just as a private party is entitled to seek corrective justice in the courts, so too is the State.

362. This Tribunal cannot base international responsibility upon findings or actions that are at issue here until the Mexican courts have finally spoken on the matters that are before them. This point was recognized in a recent ICSID arbitral award considering a dispute arising out of a concession agreement in light of the Argentine-France Bilateral Investment Treaty²⁰⁹.

363. The juridical fact necessary to establish the existence of something that could be expropriated at international law, *viz.*, a right established by domestic law (assuming it is an investment protected by Article 1139), is undecided in present Mexican jurisprudence. Mexico should have the opportunity to appeal and to obey the judgment if not overturned.

364. Mexico recognizes that a domestic court decision on a matter at issue cannot preclude an international tribunal from finding a breach of international law; however, where the elements of the international wrong require the denial of a right recognized in domestic law, the domestic court's resolution as to whether of the alleged right exists is authoritative because the domestic courts are best equipped to interpret domestic law.

4. The Relationship Between the Judicial Proceedings and the Local Remedies Rule

365. In the Respondent's view, this issue is of fundamental importance to the proper operation of the NAFTA. It raises issues not only as to the proper limits on the Tribunal's jurisdiction, but also in relation to the interaction between Section B of Chapter Eleven and the local remedies rule at international law.

²⁰⁸ Edwin M. Borchard, *Responsibility of States at the Hague Codification Conference*, 24 Am. J. Int'l L. 517, 532 (1930), *Jennings, Laughland & Co. v. Mexico*, (U.S. v. Mexico 1874) reprinted in 3 John B. Moore, *History and Digest of International Arbitrations*, 3135, 3136 (1898).

²⁰⁹ See *Compañía de Aguas del Aconquija, S.A. and Compagnie Generale des Eaux v. Argentine Republic*, ICSID Case No. ARB/97/3 at paragraphs 79-81.

366. Mexico does not take the position that NAFTA Article 1121 precludes this claim in its entirety. An investor is entitled to commence a claim for damages for an alleged breach of Section A so long as it complies with Article 1121. The alleged breach of Article 1102 (National Treatment) is a claim that could be brought at this time²¹⁰.

367. Article 1121 preserves the investor's right to commence a NAFTA claim for damages and take concurrent proceedings for "injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party". This is what CEMSA did in challenging SHCP's tax assessment before the Fiscal Court and in then taking an appeal and an *amparo* against that Court's decision.

368. In Mexico's view, this is not only appropriate but necessary, because the determinations that will be made in the domestic courts ultimately will establish definitively what CEMSA's rights, if any, were in relation to the IEPS Law (prior to the 1998 amendment) and allow Mexico to respond to that determination. It is recalled in this respect that, unlike ICSID tribunals and the Iran-United States Claim Tribunal, NAFTA tribunals are not vested with the jurisdiction to apply the domestic law of a Party.

369. It is a well established rule of customary international law that all available local remedies must be exhausted before a claim can brought to the international plane. The International Court of Justice has so confirmed:

The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law.²¹¹

²¹⁰ Given the Tribunal's decision to allow the amendment of the claim.

²¹¹ *Interhandel Case* (Switzerland v. United States) I.C.J. Rep. 1959. See also Brownlie: "A Claim will not be admissible on the international plane unless the individual alien or corporation concerned has exhausted the legal remedies available to him in the state which is alleged to be the author of injury." pp. 496-497; Malanczuk, Peter: *Akehurst's Modern Introduction to International Law*. "An injured individual (or company) must exhaust remedies in the courts of the defendant state before an international claim can be brought on his behalf", 7th Revised Ed., Routledge, 1998, p. 268; Oppenheim: "It is a recognized rule that, where a state has treated an alien in its territory inconsistently with its international obligations but could nevertheless by subsequent action still secure for the alien the treatment (or its equivalent) required by its obligations, an international tribunal will not entertain a claim put forward on behalf of that person unless he has exhausted the legal remedies available to him in the state concerned." (footnotes excluded), pp. 522-523; *Restatement (Third)*: "Under international law, ordinarily a state is not required to consider a claim by another state for an injury to its national until that person has exhausted domestic remedies..." § 713, comment f, p 219 and § 902, comment k, p. 348. Gómez Robledo Verduzco, Alonso: *Temas Selectos de Derecho Internacional*. "Parece incontestable, actualmente, el reconocimiento del carácter de regla consuetudinaria de derecho internacional la norma que postula la necesidad del agotamiento de los recursos internos, como fase previa para que pueda ser iniciado un procedimiento de tipo internacional: acción diplomática, arbitral o judicial. Así y en principio, en toda hipótesis en la que nos encontremos frente a reclamaciones internacionales que tienen por objeto daños causados a personas privadas, la regla del previo agotamiento de los recursos deberá encontrar su aplicación", 1st ed., Ed. UNAM/Instituto de Investigaciones Jurídicas, México, D.F., 1986, pp.

370. As noted above, at the international plane, the conduct of the State has to be viewed not in respect of isolated acts, but rather comprehensively, considering "the whole system of legal protection as provided by municipal law"²¹².

371. Generally, the international responsibility of a State cannot be engaged unless the measure complained has been tested at municipal law and thus become final by pronouncement of the highest competent authority. As Oppenheim states:

So long as there has been no final pronouncement on the part of the highest competent authority within the state, it cannot be said that a valid international claim has arisen.

372. Sørensen explains:

The rule's function is granting the respondent State an opportunity, before being declared internationally responsible, to do justice in accordance with its own legal system, and to forward an investigation and obtain a declaration by its own courts on the legal and factual questions contained in the claim. From an international tribunal's point of view, the requirement that local remedies be exhausted is a wise measure of judicial limitation because, if this is done, it may be that the need for a proceeding before an international tribunal and its consequent determination may never arise.²¹³

373. Failure to exhaust local remedies results in the Claim being inadmissible. The rule is strictly applied²¹⁴. Where a claimant has failed to comply with the rule, his claim must be dismissed.

374. In the *ELSI* case, the International Court found that it is not to be lightly presumed that the local remedies rule has been done away with in an investment treaty. It stated:

50. The United States questioned whether the rule of the exhaustion of local remedies could apply at all to a case brought under Article XXVI of the FCN [Friendship, Commerce and Navigation] Treaty. That Article, it was pointed out, is categorical in its terms, and unqualified by any reference to the local remedies rule; and it seemed right, therefore, to

²¹² *Ambatielos Case* (Greece v. United Kingdom), 1951, 12 R. Int'l Arb. Awards.

²¹³ Sørensen, Max: "Responsabilidad Internacional" in *Manual de Derecho Internacional Público*. 1st ed., Ed. Fondo de Cultura Económica (Max Sørensen, Ed.), 3rd reprint, México, D.F., 1985, p.552.

²¹⁴ See Malanczuk, *loc cit.*:

"But apart from cases where local remedies are obviously futile, the rule is to be applied very strictly. For instance in the *Ambatielos* case, a Greek ship owner, Ambatielos, contracted to buy some ships from the British government and later accused the British government of breaking the contract. In the litigation which followed in the English High Court, Ambatielos failed to call an important witness and lost, his appeal was dismissed by the Court of Appeal. When Greece subsequently made a claim on his behalf the arbitrators held that Ambatielos had failed to exhaust local remedies because he had failed to call a vital witness and because he had failed to appeal from the Court of Appeal to the House of Lords."

conclude that the parties to the FCN Treaty, had they intended the jurisdiction conferred upon the Court to be qualified by the local remedies rule in cases of diplomatic protection, would have used express words to that effect; as was done in an Economic Co-operation Agreement between Italy and the United States of America also concluded in 1948. The Chamber has no doubt that the parties to a treaty can therein either agree that the local remedies rule shall not apply to claims based upon alleged breaches of that treaty; or confirm that it shall apply. Yet the Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an intention to do so. This part of the United States response to the Italian objection must therefore be rejected²¹⁵. [Emphasis added]

375. *ELSI*, like the instant case, involved allegations of expropriation and violations of other investment protections (although a Friendship, Commerce and Navigation Treaty was applicable in that case).

376. On the facts of this case, the Tribunal cannot displace what is actually occurring in the Mexican courts and decide the issue in their place nor decide what Mexico will do in response to a final judgment. There is no international delict that can form the basis of a ripe claim.

377. NAFTA Article 1121 deals with “the measure of the disputing Party that is alleged to be a breach”. If the measure has not yet come into existence, a breach of Chapter Eleven has not come into existence either.

378. The point was made by Bin Cheng in his General Principles of Law as applied by International Courts and Tribunals:

... where local remedies have not yet failed either by insufficient action or by their absence, there is no internationally unlawful act and hence no claim to be presented²¹⁶.

5. The Claimant's Argument Requires This Tribunal to Find That SHCP Acted Unlawfully Under Mexican law

379. With respect to the IEPS rebates that were denied in 1997, CEMSA lost its challenge of their denial. The Mexican courts have found that the authorities were right in law to deny the rebates. At Mexican law, SHCP has acted lawfully and no “right” has been taken under domestic law. Were the Tribunal to accede to the Claimant's arguments, it would be explicitly or implicitly ousting the jurisdiction of two domestic courts and finding that SHCP acted contrary

²¹⁵ *Case Concerning Elettronica Sicula, S.p.A.* (United States of America v. Italy) [1989] I.C.J. Reports p. 4 at paragraph 50.

²¹⁶ Bin Cheng, General Principles of Law as applied by International Courts and Tribunals (1987) at p. 179-180.

to Mexican law. For the October-December 1997 rebates to have been "expropriated", CEMSA had to have a domestic legal right to them²¹⁷. The courts have ruled against it.

380. In the context of challenging the tax assessment, CEMSA has again argued the invoice point. In that case, CEMSA prevailed at the court of first instance on the basis of the principle of impossibility.

381. However, the matter is still not closed. SHCP disagrees with this decision of the Fiscal Court and as the Claimant's Mexican law expert, Mr. Loperena Ruiz, has recognized but failed to discuss, SHCP and CEMSA have both appealed²¹⁸. CEMSA has also filed an *amparo*.

382. There is no question at international law that it is entirely lawful for SHCP to seek the assistance of the superior courts to correct what it views as errors in the Fiscal Court's decision, particularly when SHCP prevailed on the same point in the rebates litigation. Therefore, state responsibility cannot arise for SHCP's decision to dispute the issues in the first place and to appeal. This *sub judice* appeal involves questions of domestic law that are prerequisites to the international claim and cannot yet support an allegation of a breach of Section A.

383. As this issue is *sub judice*, for obvious reasons, including the limits on this Tribunal's jurisdiction and the embarrassment that could occasion were the international tribunal to make premature determinations that were inconsistent with those made by the domestic courts, no finding of expropriation can be made.

384. In *Interhandel*, the International Court of Justice held that the exhaustion of local remedies rule must be observed *a fortiori* when domestic proceedings, as here, are still pending²¹⁹.

385. In the instant case, the fiscal authorities have good policy reasons for the position that they have taken in relation to CEMSA and other like taxpayers. CEMSA's legal situation under Mexican law has not yet been finally determined. Therefore, "it cannot be said that a valid international claim has arisen"²²⁰.

6. In Any Event, the Claimant's Claimed Entitlement is also Affected by the Over-Claims and Fictitious Sales

386. As noted at the outset, CEMSA's claimed right to IEPS rebates is a legal question that involves more than having invoices with the tax separately stated.

²¹⁷ This argument leaves aside the Article 1139 definition of investment issue.

²¹⁸ See pages 17-18 of Mr. Loperena Ruiz's report.

²¹⁹ *Interhandel Case, supra*.

²²⁰ The Respondent does not concede that if the Mexican courts were to find against the Claimant, he would then have a valid NAFTA claim *ipso facto*.

387. In SHCP's view, the Claimant's sales to a fictitious company in Central America disentitled IEPS rebates for the Honduras sales. He also over-claimed the IEPS in 1996-97. Thus, for the Claimant to succeed in this proceeding, he must convince this Tribunal not only that the "doctrine of impossibility" overrides the plain language of the law (the issue on appeal), but that SHCP's and the Fiscal Court's determination that the fictitious sales to Honduras were impermissible was wrong, that SHCP's and the Fiscal Court's determination that the rebate claims were inflated was wrong, and that SHCP's and the Fiscal Court's determination that CEMSA failed to keep adequate financial records was wrong, and that these have no effect on his claim at international law. *Azinian* shows this is unsustainable.

388. Were the Tribunal to accede to this claim, it would be explicitly or implicitly overruling acts of the fiscal authorities that have been upheld by the domestic courts.

389. In any event, the evidence is that after the inadequate records, fictitious sales, and rebate overclaims came to light, SHCP did not act without notice. SHCP acted on reliable information (an analysis of CEMSA's sales activity, its rebate calculations and lack of documentation, and the written advice of the Government of Honduras) according to law. It gave the Claimant the opportunity to be heard, first in August 1998, in three separate meetings with Mr. Gómez Gordillo and other officials before finally resolving to deny the October-December 1997 rebates, in August of 1999 when the audit was concluded, and then in CEMSA's Fiscal Court challenge. It willingly defended its actions in a court of law. In substance it prevailed; on some points, the court ruled against it. It is now appealing certain determinations, as is CEMSA.

H. The Claimed Entitlement and Estoppel

390. The Memorial devotes paragraphs 169-187 to a discussion of the CEMSA's alleged entitlement to IEPS rebates and the application of principle of estoppel, both of which are said to establish the claim. This argument is made in the context of the argument that Article 1110 protects a "right to export", an argument that is unsupported by the plain reading of Article 1139.

391. In any event, even assuming for purposes of argument, that some official orally expressed his view that CEMSA could file rebate requests without having the invoices separately state the IEPS, in Mexico's respectful submission, the argument still fails for two reasons.

1. *Metalclad's Reasoning Relied Upon by the Claimant Has Been Set Aside*

392. As noted earlier, this section of the Memorial relies heavily upon the *Metalclad* award's discussion of the minimum international standard of treatment and its reliance upon the "persuasive authority" of the arbitral award in *Biloune v. Ghana Investment Centre*²²¹.

²²¹ *Biloune v. Ghana Investment Center*, 95 I.L.R. 183, 208 (1993).

393. The Supreme Court of British Columbia has set aside the parts of the *Metalclad* award relied upon by the Claimant. In particular, the Court found that the Tribunal's reliance upon NAFTA's principles of "transparency" was outside the scope of the submission to arbitration by the parties. This was due to the fact that transparency is a conventional international law concept found in NAFTA Chapter Eighteen, in particular, and subject to the jurisdiction of a Chapter Twenty Panel, but not subject to the jurisdiction of a Chapter Eleven tribunal authorized to apply customary international law only under Article 1105.

394. The Supreme Court:

- quoted the approach to Article 1105 taken in the NAFTA Tribunal award in *S.D. Myers* with approval²²²;
- stated that "treatment may be perceived to be unfair or inequitable but it will not constitute a breach of Article 1105 unless it is treatment which is not in accordance with international law"²²³;
- agreed with the three NAFTA Parties that Article 1105 refers to only "customary international law which is developed by common practices of countries" and is to be "distinguished from conventional international law which is comprised in treaties entered into by countries (including provisions contained in the NAFTA other than Article 1105 and other provisions of Chapter 11)"²²⁴;
- agreed with Mexico and Canada (as intervenor) that the *Metalclad* Tribunal made decisions on matters beyond the scope of the submission to arbitration by relying upon transparency provisions that were part of conventional, not customary international law²²⁵;
- expressed his disagreement with a recent award in *Pope & Talbot, Inc. v. Canada*, (a view also shared by all three NAFTA Parties) on the meaning of Article 1105, but stated that even if he had agreed with that Tribunal's analysis, the *Metalclad* Tribunal "still made a decision on a matter outside the scope of the submission to arbitration by basing its findings of breach on the concept of transparency"²²⁶; and
- agreed with Mexico that the *Metalclad* Tribunal's analysis of Article 1105 "infected its analysis of Article 1110" and therefore set aside the cumulation of

²²² Reasons for Judgment of the Honourable Mr. Justice Tysoe in the *United Mexican States v. Metalclad Corporation*, Docket: 2001 BCSC 664, L002904, Vancouver Registry, at paragraphs 61-62.

²²³ *Ibid.* at 62.

²²⁴ *Ibid.*

²²⁵ *Ibid.* at paragraphs 66-74.

²²⁶ *Ibid.* at paragraph 74.

events that the *Metalclad* Tribunal found constituted a measure tantamount to expropriation and an indirect expropriation²²⁷.

395. Thus, *Metalclad* has been set aside on the legal findings upon which paragraphs 149, 172-174, 176, and 186 of the Memorial rely.

2. *Metalclad's* Reliance on *Biloune* Was Also Criticized by the Supreme Court of British Columbia

396. At paragraphs 176-177 of the Memorial, the Claimant relies upon an award mentioned by the *Metalclad* Tribunal (at paragraph 108 of that award) as "persuasive authority".

397. Mexico found the *Metalclad* Tribunal's comment to be highly objectionable. It displayed insensitivity to the understandable reaction of the municipality of Guadalcázar which had suffered the unlawful dumping of over 20,000 tons of hazardous waste (an amount equivalent to that involved in the Love Canal disaster) at the site in question. The municipality continuously objected to *Metalclad's* plan to construct a hazardous waste landfill there. It then defended its actions in court and also commenced a challenge against an action of the federal authorities. The municipality's reaction was modest and law-abiding, unlike the actions of the military dictatorship at issue in *Biloune*.

398. At the British Columbia Supreme Court, Mexico objected to the Tribunal's characterisation of the municipality's reaction to the proposed hazardous waste landfill and its view that *Biloune* was "persuasive authority." Mexico pointed out that the facts of *Biloune* were significantly different from the facts in *Metalclad*:

563. The only similarity between the two cases is that they both involved construction permits, although in very different contexts. *Biloune* and *Metalclad* are easily distinguishable. In *Biloune* the investor and his company had obtained a right to construct a tourist facility. The site concerned had been leased by the Government of Ghana to the Ghana Tourist Development Company (GTDC, a corporation owned by the Ghanaian Government) for a period of 50 years. Mr. Biloune's company entered into a lease with GTDC to renovate, expand and operate a restaurant resort at the site. His company obtained financial and other benefits from the Ghana Investment Centre (another Government corporation), which contractually undertook not to expropriate the investment. The company commenced work on the project before a building permit was applied for. In fact, the earlier construction on the site had taken place without a permit on the personal instructions of the former dictator of Ghana, President Nkrumah "whose instructions were not subject to examination". One year after construction commenced, a demand for the production of the building permit was made of the investor. When it could not be produced, a stop

227

Ibid. at paragraph 78.

work order was issued and five days later the project was partially demolished.

Biloune at pp. 197, 195

564. In *Biloune*, the circumstances included

... the conjunction of the stop work order, the demolition [of the construction works], the summons [of Mr. Biloune], the arrest [of Mr. Biloune late at night by plain-clothes para-military police when, by Ghanaian law, arrest should take place by day-light], the detention [of Mr. Biloune for 13 days without charge], the requirement of filing assets declaration forms [imposed upon Mr. Biloune and others by Ghana's "National Investigations Committee"], and the deportation of Mr. Biloune without possibility of re-entry had the effect of causing the irreparable cessation of work on the project. Given the central role of Mr. Biloune in promoting, financing and managing MDCL, his expulsion from the country effectively prevented MDCL from further pursuing the project. In the view of the Tribunal, such prevention of MDCL from pursuing its approved project would constitute constructive expropriation of MDCL's contractual rights in the project...

Biloune, at p. 209

565. It was these acts cumulatively which had the effect of causing "the irreparable cessation of work on the project". The expropriation in *Biloune* was premised on a finding of the "irreparable cessation" of the project. In *Biloune*, it was not in dispute that earlier construction on the site had not benefited from a construction permit, from which the Tribunal drew the conclusion that "a permit was not indispensable" even if it was required by the letter of the law (at p. 208). By contrast, in *Metalclad*, the municipality had been consistent in asserting its permitting authority. Metalclad knew of the refusal when it acquired COTERIN. Metalclad was sufficiently aware of the contingency to condition the payment of three-quarters of the purchase price upon the resolution of the permit issue. Moreover, in *Metalclad* there was no question of the investors being arrested, held without bail, searched for their assets, and then being summarily deported from Mexico, a combination of facts which evidently weighed heavily for the Tribunal in *Biloune* and were indispensable to its finding of a "constructive expropriation".²²⁸

399. The Supreme Court agreed with Mexico:

80. ... there are substantial differences between the situation in the present case and the circumstances in *Biloune*. The main two distinctions

²²⁸

Excerpt from Mexico's Outline of Argument filed with the Court.

are that in *Biloune* (i) the building was partially destroyed and then closed by government officials, and (ii) the investor was deported from the country and was not allowed to return. Apart from the Ecological Decree, the circumstances in the present case fall considerably short of those in *Biloune* and it would not logically follow that *Biloune* could be an independent basis for concluding that the actions in this case prior to the issuance of the Decree amounted to an expropriation²²⁹.

400. In Mexico's submission, *Biloune* is equally inapplicable to the facts of this case.

3. An Estoppel Does Not Arise

401. Just as *Metalclad* has been found to be unsound for the points relied upon by the Claimant, the estoppel argument is also unsustainable. A review of the authorities cited by the Claimant shows that estoppel has a particular meaning in international law, a meaning that is shared by the municipal courts on matters involving the interpretation of law: namely, that estoppel has effect in relation to statements of fact, not to statements on the meaning of a law²³⁰.

402. This is stated in the excerpt from Professor Bowett quoted at paragraph 181 of the Memorial, where he notes that a party cannot deny "the truth of a statement of fact made previously by that party" and that a party cannot benefit from his own inconsistency where another has relied in good faith upon a representation of fact made by the former.

403. Professor Brownlie cites Bowett in his Principles of Public International Law:

Professor Bowett has stated the essentials to be: (1) a statement of fact which is clear and unambiguous; (2) the statement must be voluntary, unconditional, and authorized; and (3) there must be reliance in good faith upon the statement or to the advantage of the party so relying on the statement. [Emphasis added]

404. As noted by the Memorial (at paragraph 183), the *Pope & Talbot* Tribunal quoted Bowett's formulation of the principle (including the essential element that it involves a statement of fact).

405. While Brownlie cites Bowett without disapproval, he adds a cautionary comment:

It is now reasonably clear that the essence of estoppel is the element of conduct which causes the other party, in reliance on such conduct, detrimentally to change its position or to suffer some prejudice. Without dissenting from this as a general and preliminary proposition, it is necessary to point out that estoppel in municipal law is regarded with

²²⁹ Judgment of Mr. Justice Tysoe in *Metalclad* at paragraph 80.

²³⁰ The comments in the *Schufeldt Claim* are inapposite as that claim involved a contractual dispute and the statements made by the arbitrator concerned "acts performed in pursuance of that contract" that went to the validity of the contract.

great caution, and that the 'principle' has no particular coherence in international law, its incidence and effects not being uniform ²³¹.
[Emphasis added]

406. The Respondent will return to Professor Brownlie's comment below. For present, it warrants noting that a review of the allegations made at paragraph 184 of the Memorial shows that the estoppel allegedly results not from statements of fact but rather from alleged statements as to the meaning of the IEPS law, SHCP's alleged approach to enforcing Article 4, an alleged agreement as to the method of calculating the IEPS, and so on. They can only be characterized as statements about how the law as enacted by Congress would be applied.

407. They are not statements of fact that can give rise to an estoppel as described by Professor Bowett or for the reason set out in further detail below.

4. Estoppel Under Municipal Law

408. Professor Brownlie's comment that municipal law regards estoppel with "great caution" has particular resonance in the area of municipal taxation law. The NAFTA's recognition of the need to preserve the tax authorities' administrative, investigatory and enforcement flexibility is paralleled in municipal law by the limits of the principle of estoppel in relation to the acts and statements of the tax authorities.

409. In matters of tax law administration and enforcement in all three NAFTA Parties, under domestic law the taxpayer is not entitled to rely on "administrative guidance", to use the Claimant's term, or other oral statements by tax authorities.

410. The Respondent recognizes that under Article 38 of the Statute of the International Court of Justice, ordinary statutory and judge-made law is not a source of international law. It also recognizes that generally the internal law of a State should not be utilized for the interpretation of NAFTA²³². However, the consistent approach taken by the courts and legislatures of the three NAFTA Parties to the issue of estoppel is of relevance to a consideration of estoppel in international law.

a. Mexico

411. Messrs. Gómez Gordillo, Heftye, Diaz Guzman, and Riquer all refer to Article 34 of the Fiscal Code's provision for the issuance of a written resolution by SHCP to resolve a real and concrete issue of tax law for a taxpayer. It is well established in Mexican law that only such a written resolution can have legal effects and bind the authorities.

²³¹ Brownlie, Principles of Public International Law, (5th ed.) at page 646.

²³² *In the Matter of Cross-border Trucking Services* at para. 224.

412. Once such a resolution is issued for the tax year in question, it is binding on SHCP to such an extent that only the Fiscal Court can vary its terms.

413. A text on Mexican taxation law, *Derecho Fiscal*, by Francisco Ponce Gomez and Rodolfo Ponce Castillo, reviews the operation of Article 34 of the Fiscal Code. The authors dealt specifically with whether oral statements can be given legal effect:

The article is clear that the consultation must be in writing. These consultations are often oral and as a result there is no obligation to respond. This frequently occurs before the fiscal authorities of the Department of the Federal District.

This provision is related to the right to petition established in article 8 of the Constitution of the United Mexican States, under which officials and public employees are obliged to respond to the petitions submitted to them, provided that they are made in writing, and in a peaceful, and respectful manner. In such case, the fiscal authorities have the obligation to respond to consultations from private parties provided that the situations are real and concrete".²³³ [Emphasis added]

414. As noted earlier, by his conduct, the Claimant acknowledged this legal fact: he applied specifically for a ruling under Article 34 on the very issue before this Tribunal. He was denied. He then challenged the denial in the Fiscal Court (without pleading the existence of any oral argument) and lost. His further appeal was rejected.

b. Canada

415. The Canadian courts have also had occasion to consider the type of issue raised by the Claimant.

416. In *Sturdy Truck Body (1972) Limited v. Minister of National Revenue*, the Federal Court considered the following facts similar those asserted by The Claimant:

In 1981, the taxpayer relied upon written and oral statements made by the federal tax authorities, Revenue Canada (as it then was), to the effect that its production of certain truck bodies was exempt from sales tax levied under the Excise Tax Act.

In 1986, the taxpayer received a Notice of Assessment from Revenue Canada confirming that there was no outstanding tax owed by the taxpayer.

In 1987, the taxpayer received a letter from Revenue Canada

²³³

Francisco Ponce Gomez and Rodolfo Ponce Castillo, *Derecho Fiscal* (2000) at 169.

advising it of a reversal in the Department's interpretation of the relevant provision of the Excise Tax Act. As a result the taxpayer was reassessed as owing \$60,000 in unpaid taxes.

When the taxpayer objected to the reassessment, Revenue Canada rejected its objection.

417. The taxpayer appealed first to the Canadian International Trade Tribunal and subsequently to the Federal Court (Trial Division), respectively. In both *fora*, the taxpayer's appeal was dismissed on the basis that the Crown could not be estopped from reassessing the tax liability found pursuant to the Excise Tax Act²³⁴.

418. A more recent Tax Court of Canada case shows that estoppel has no role to play where the taxing statute's interpretation is at issue²³⁵. The Court stated that the rationale for this approach was summarized by Bowman J. in *Goldstein v. The Queen*:

It is sometimes said that estoppel does not lie against the Crown. The statement is not accurate and seems to stem from a misapplication of the term estoppel. The principle of estoppel binds the Crown, as do other principles of law. Estoppel in pais, as it applies to the Crown, involves representations of fact made by officials of the Crown and relied and acted on by the subject to his or her detriment. The doctrine has no application where a particular interpretation of statute has been communicated to a subject by an official of the government, relied upon by that subject to his or her detriment and then withdrawn or changed by the government. In such a case a taxpayer sometimes seeks to invoke the doctrine of estoppel. It is inappropriate to do so not because such representations give rise to an estoppel that does not bind the Crown, but rather, because no estoppel can arise where such representations are not in accordance with the law. Although estoppel is now a principle of substantive law it had its origins in the law of evidence and as such relates to representations of fact. It has no role to play where questions of interpretation of the law are involved, because estoppels cannot override the law²³⁶. [Emphasis added]

419. The argument that the Canadian court rejected is precisely what is being advanced in the instant case. The Claimant is alleging that taxation officials agreed with him as to the interpretation of the IEPS Act. Even if they did, which is denied, the doctrine of estoppel does not assist the claim because a government official cannot create an estoppel in relation to the interpretation of legislation.

420. This is a task that is assigned to the courts in all three NAFTA Parties.

²³⁴ *Sturdy Truck Body (1972) Limited v. Minister of National Revenue*, [1989] C.I.T.T. No. 12, appealed to Federal Court (T.D.), [1995] F.C.J. No. 720.

²³⁵ *Panar v. Canada* [2000] T.C.J. No. 592.

²³⁶ 96 D.T.C. 1029 at 1034.

c. The United States

421. It has been long established in U.S. law that the tax statutes themselves take precedence: neither the tax authorities nor taxpayers may rely on regulations or administrative guidance (either written or oral) that is inconsistent with the statutes. The U.S. Supreme Court held in the nineteenth century that:

The Secretary of the Treasury cannot by his regulations alter or amend a revenue law. All he can do is to regulate the mode of proceeding to carry into effect what Congress has enacted²³⁷.

422. Consistent with this principle, an erroneous interpretation of the law by the tax authorities does not estop them from asserting an appropriate tax, even though a taxpayer may have been misled by the interpretation. Thus, in Dixon v. United States, the Supreme Court stated:

[T]he Commissioner is empowered retroactively to correct mistakes of law in the application of the tax laws to particular transactions. He may do so even where a taxpayer may have relied to his detriment on the Commissioner's mistake.... This principle is no more than a reflection of the fact that Congress, not the Commissioner, prescribes the tax laws²³⁸.

423. This same principle applies not only to interpretations contained in regulations, but also, for example, in tax forms and publications,²³⁹ and in oral advice²⁴⁰. Indeed, the U.S. tax code expressly states that oral opinions and advice are not binding on the tax authorities²⁴¹.

424. Even further, the holding of a U.S. court on an issue including a particular tax payer may be disregarded by the U.S. tax authorities in applying the law to other taxpayers²⁴².

²³⁷ Morrill v. Jones, 106 U.S. 466, 467 (1882).

²³⁸ 381 U.S. 68, 72-73 (1965). Moreover, the Supreme Court has consistently upheld the authority of legislatures to give retroactive effect to changes in the tax laws. See, e.g., Welch v. Henry, 305 U.S. 134, 146-47 (1938) ("Taxation is neither a penalty imposed on the taxpayer nor a liability which he assumes by contract. It is but a way of apportioning the cost of government among those who in some measure are privileged to enjoy its benefits and must bear its burdens. Since no citizen enjoys immunity from that burden, its retroactive imposition does not necessarily infringe due process.")

²³⁹ Manocchio v. Commissioner of Internal Revenue, 78 T.C. 989 (1982); see also Houlberg v. Commissioner of Internal Revenue, T.C. Memo 1985-497, 1985 Tax Ct. Memo LEXIS 136, at *n2 (1985) ("With respect to their citation to Publication 1035 as authority for their position, we point out to petitioners that the authoritative sources of Federal tax law are in the statutes, regulations, and judicial decisions and not in such informal publications").

²⁴⁰ See e.g., Garner v. U.S., No. 91-2872, 1992 U.S. Dist. LEXIS 12048, at *10 (E. D. PA. 1992) ("[T]he plaintiff cannot rely on the oral advice given it by representatives of the IRS."); United Block Co, Inc. v. Helvering, 123 F.2d 704, 705 (2d Cir. 1941) ("[O]ne accepts the advice of a revenue official at his peril.")

²⁴¹ See 26 C.F.R. § 601.201(k).

425. The clear law and practice of the courts and legislatures of all three NAFTA Parties shows that an estoppel cannot arise in the circumstances of this case. At paragraph 199 of the Memorial the Claimant states that:

... a retroactive reversal of tax policy is arbitrary, harsh and oppressive and constitutes a clear denial of justice and violation of due process.

426. Under the law of all three NAFTA Parties this statement is simply incorrect. Moreover, the U.S. case authorities cited for this proposition (at footnote 100 of the Memorial) involve the attempted retroactive application of a civil rights statute and claimed health benefits under the *Coal Act*. They have nothing to do with the well-established and voluminous jurisprudence dealing with the administration of tax laws.

427. The courts of all three NAFTA Parties have recognized the need to preserve the broad flexibility necessary to the administration of the tax laws. They have upheld the power of officials to reverse prior oral and written statements as a necessary part of the administration of their nations' tax laws. Such flexibility is a necessary feature of tax law enforcement and cannot give rise to an estoppel. In any event, the fiscal authorities' conduct is exempted from scrutiny under Article 1105 by a NAFTA tribunal. The Parties were not prepared to have their taxation measures subjected to allegations of being contrary to customary international law, including fair and equitable treatment.

5. There Could Be No Agreement to Over-Claim the IEPS Tax Originally Paid

428. Even if there were an agreement to permit CEMSA to be relieved of the obligation under Article 4 of the IEPS Law, it cannot be presumed that any fiscal official would agree in the ordinary and proper discharge of his official duties that CEMSA could overstate the amount of the IEPS claimed, so that it would receive more money from the Treasury than was paid by the original taxpayer.

429. The official alleged to have "approved" the Claimant's methodology denies the allegation. He was not responsible for the IEPS Law's administration and told the Claimant so²⁴³.

430. The evidence of Gabriel Oliver is that SHCP realized that there was a serious problem in 1997 when the global figures for IEPS payments and rebates did not match. It became evident that something was wrong and it soon became clear that the problem was the Claimant's claims

²⁴² See Internal Revenue Service, Cumulative Bulletin 1999-2000 C.B. XVI: "Nonacquiescence signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers." CM 05753.

²⁴³ Witness statement of Jose Antonio Riguer Ramos [CM 06060] at paragraph 20.

which had grossly miscalculated the IEPS tax paid –and therefore the size of the rebate to be paid out²⁴⁴.

431. The evidence shows that in 1996 at the end of the year, the Claimant applied for and obtained a “top-up” of approximately 12 million pesos (more than the total amount previously claimed that year). Then in 1997, CEMSA changed its method of calculating the IEPS from dividing the assumed purchase price by 1.85% to multiplying it by .85. The result was a virtual doubling of the rebate claimed.

432. It is stating the obvious to say that in such circumstances, the tax authorities were fully entitled to take all necessary steps to halt the rebates to CEMSA.

433. It is respectfully submitted that both expropriation claims properly before this Tribunal must be dismissed.

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Witness statement of Gabriel Oliver [CM 05994] at paragraph 16.

IV. ADDITIONAL FACTS RELATING TO THE NATIONAL TREATMENT CLAIM AND TO PUBLIC POLICY

434. As noted earlier, CEMSA's repeated exports of cigarettes to fictitious companies in Central America was one of the bases for the tax assessment resulting in the 1999 audit report.

435. In addition, an analysis of CEMSA's U.S. shipments shows that they were either sent to a "name of convenience" that evidently does not exist (in the case of sales to "International Commerce Co." c/o Kintetsu World Express, in Irving, Texas²⁴⁵) or to companies affiliated with Mexican-owned cigarette re-sellers. Cigarettes shipped by air to the companies listed on CEMSA's invoices were all trucked from the Dallas and Houston international airports to the border crossing of El Paso, Texas. They remained in bond throughout the time they were in the United States and then were exported. The available evidence points to the possibility that the cigarettes were shipped back into Mexico.

436. For the 1996-97 period, Mexico's import statistics record no imports of cigarettes through Ciudad Juarez, the Mexican city adjoining El Paso on the Mexico - United States border, although the U.S. export statistics show that cigarettes valued at approximately 8 million U.S. dollars were shipped to Mexico from El Paso in 1996-97²⁴⁶. There are similar statistical disparities for other border crossings, such as Laredo - Nuevo Laredo.

437. In concluding the NAFTA, the Parties contemplated the liberalization of trade in full compliance with each Parties' respective domestic law. NAFTA did not authorize schemes by private parties to evade a Party's customs and fiscal laws.

438. The discovery of these additional facts may be a separate basis to review CEMSA's claim to IEPS rebates claims under Mexican law. At present, no action has been taken.

439. Chapter Eleven awards are subject to the curial jurisdiction of the court of the place of arbitration, in the instant case, Ottawa, Ontario. Under the law of Ontario, a Chapter Eleven award can be set aside on the ground that it is contrary to public policy²⁴⁷.

440. To introduce the context for the national treatment and public policy defenses to this claim, the Respondent will describe CEMSA's participation in the two different cigarette export schemes. By way of introduction, the Tribunal should be aware that due to sharp differences in

²⁴⁵ Kinketsu World Express is a freight forwarding and customs brokerage company.

²⁴⁶ Witness Statement of Rolando Garcia Ramos [CM 06021], Table 8.

²⁴⁷ If the Ontario court were to follow the B.C. Supreme Court decision in *United Mexican States v. Metalclad*, the applicable Ontario statute would be the *International Commercial Arbitration Act*, R.S.O. 1990, c. 19, which is based upon the UNCITRAL Model Law on International Commercial Arbitration. Section 34(2) of the Act permits the Court to set aside an award that is in conflict with the public policy of Ontario.

taxation regimes at the national and state/provincial levels, cigarette smuggling is a lucrative and widespread practice in all three NAFTA Parties²⁴⁸.

A. The Central American Sales

441. In 1998, the Mexican fiscal authorities discovered that two of CEMSA's customers, Dilosa, allegedly of Honduras, and INPEXSA, allegedly of El Salvador, were fictitious companies. After the Governments of Honduras and El Salvador confirmed that these companies did not exist (and that neither was registered as an importer nor did its address stated on the CEMSA invoice exist), SHCP investigated the matter further.

442. In doing so, it gave CEMSA an opportunity to respond. SHCP found CEMSA's response unreliable and took action against it. For reasons of Mexican tax law, only the sales to the fictitious Honduran company formed one of the bases for the tax assessment against CEMSA²⁴⁹. In the result, SHCP ruled that the IEPS tax rebates had been wrongly paid.

443. In its 1998 Fiscal Court challenge CEMSA argued that since SHCP had filed only certified copies of the Dilosa invoices in the proceedings, its failure to file the originals showed that the fiscal authorities had no proof of such exports and therefore the exports must never have occurred. The Fiscal Court rejected CEMSA's objection²⁵⁰.

444. As part of his evidence of sales in this proceeding the Claimant has filed 13 copies of invoices to Dilosa as proof of CEMSA's exports—the sales that in the Fiscal Court proceedings CEMSA denied having made. (See Volume 4 of the Memorial²⁵¹.)

445. The witness statement of Lic. Rolando Garcia Ramos contains tables recording CEMSA's shipments. All of the sales that are shaded in yellow in Table 1 were made to the fictitious Central American companies and one other related to Mr. Raul Gutierrez.. These sales amount to 26.41% of CEMSA's sales by number and 40.21% of its sales by volume.

²⁴⁸ For a discussion of the Canadian and U.S. experiences see the Statement of Robert A. Robinson, Director, Food and Agriculture Issues, Resources, Community, and Economic Development division, United States General Accounting Office (GAO), December 9, 1997, GAO/T-RCED-98-50.

²⁴⁹ The Government of El Salvador also informed SHCP that INPEXSA did not exist: There were no records of that company in the Internal Tax D.G., Customs or in the Commerce Registry. The address was also fictitious. SHCP did not pursue the INPEXSA transactions because El Salvador was not a "low income tax jurisdiction" under the IEPS law, and therefore was not an issue for the audit; this does not mean that the INPEXSA sales could not attract liability.

²⁵⁰ See Statement of Eduardo Díaz Guzmán [CM 06008] at paragraph 15.

²⁵¹ CEMSA's Dilosa invoices are reproduced at Memorial App.s 1830, 1831, 1843, 1863, 1869, 1910, 1916, 1918, 1930, 1936, 1940, 1951, and 1961. SHCP photo-copied Dilosa invoices during its audit of CEMSA. They are reproduced at CM 02684, 02694, 02701, 02708, 02712, 02742, 02759, 02785, 02820, 02864, 02951, 03027, and 03051.

446. In Mexico's submission, CEMSA's sales to such companies were not *bona fide* and SHCP's action against it in the tax assessment was entirely justified. In any event, this is for the Mexican courts to decide.

447. Mexico also respectfully submits that any award of damages for CEMSA's shipments to fictitious companies would be contrary to public policy.

B. The U.S. Shipments

448. The U.S. shipments are of particular relevance to the national treatment claim because they involve companies related to companies that are alleged to have received more favorable treatment than that accorded to CEMSA.

449. The bulk of CEMSA's shipments in 1996-97 were to the United States. Mexican cigarettes cannot be sold in the United States because of labelling and other legal requirements²⁵². Thus, all of CEMSA's shipments were entered "in-bond"; that is, they were received in a bonded warehouse, transported by a bonded carrier, and then stored in another bonded warehouse from which they could be shipped back to Mexico.

450. In connection with CEMSA's audit, SHCP obtained documents from the United States Customs Service pertaining to the treatment of CEMSA's shipments of cigarettes once landed in that country²⁵³. When the U.S. documents are pieced together with CEMSA's records, a clear pattern of shipments emerges.

451. Table 2 in Lic. Garcia Ramos' statement sets out all of CEMSA's shipments to the United States. The available data shows that all of the cigarettes that CEMSA air-freighted to either Dallas or Houston international airports were then trucked to El Paso, Texas. Although CEMSA's invoices varied by customer name, the U.S. Customs Service documents show that cigarettes which the invoices record as being sold to six different companies all ended up in the same warehouse in El Paso.

452. The Tribunal will recall that the Claimant has complained that CEMSA has been treated less favorably than certain Mexican companies owned and operated by Messrs. Cesar Poblano, Luis Guemes, Gustavo Gámez and their colleagues (the "Poblano-Gámez-Guemes network"). Over the years, those individuals have also engaged in cigarette re-selling²⁵⁴.

453. In 1996-97, CEMSA exported cigarettes from Mexico to the United States with the aid of the IEPS rebate. The cigarettes were sent to the Poblano-Gámez-Guemes network. Mr. Poblano later re-named one company (Compañía Exportadora Mexicana) "Mercados

²⁵² See CM 05737 for a description of the legal and tax obligations that apply to the sale of cigarettes in the United States.

²⁵³ This information was disclosed to CEMSA in response to its documents request.

²⁵⁴ Including Compañía Exportadora Mexicana S.A. de C.V., Lynx Exportadora S.A. de C.V., Mercados Regionales S.A. de C.V., and Mercados Extranjeros, S.A. de C.V.

Regionales”²⁵⁵. Mercados Regionales itself was then succeeded by Mercados Extranjeros. This company was also established by Mr. Poblanno and his colleagues.

454. The Claimant’s prospects of success in this proceeding depend upon a finding that CEMSA was entitled to receive the IEPS rebates. It is obvious that a party with a legal right may be disentitled from its enjoyment if it abuses it or acts unlawfully. Even if CEMSA is found to have a right to collect IEPS rebates without the tax separately stated on the invoice, if it over-claimed or otherwise improperly claimed the tax, it still does not have an entitlement.

455. The Tribunal is being asked to award damages based upon an unalloyed right without regard to the other acts that may dis-entitle CEMSA to the rebates. There are existing domestic proceedings and could be further proceedings. It would be premature and unfair for the Tribunal to find any breach of Article 1110 until the existence of the Claimant’s rights *and duties* under Mexican law are conclusively determined.

456. The Respondent will now set out additional facts relating to CEMSA’s U.S. shipments. They are relevant to both the alleged violation of Article 1102 and to public policy.

C. The Purchasers Listed in CEMSA’s Invoices for Shipments to the United States

457. During the 1996-97 period, CEMSA’s invoices recorded export sales to the United States to the following companies:

- Lynx Exportadora of Monterrey, Nuevo Leon,
- Compañía Exportadora Mexicana of Mexico City, D.F.,
- J & E International Sales, Inc. of El Paso, Texas,
- International Commerce Co. of Irving, Texas,
- “GTO International Trade Co.”, which is a “doing business as” (DBA) of GTO Produce Co. of McAllen, Texas,²⁵⁶ and
- Vianney SA, of Hacienda Heights, California.

²⁵⁵ See CM 05280 for copies of the corporate records.

²⁵⁶ See CM 03302.

D. The Consistent Pattern of CEMSA's U.S. Shipments

458. With the exception of two shipments to Vianney SA²⁵⁷, all of CEMSA's shipments to the United States in 1997—regardless of the party listed as the purchaser on the CEMSA invoice—ended up being shipped in bond to a foreign trade zone, FTZ 68, in El Paso²⁵⁸.

459. For present purposes, it is appropriate to set out three sample transactions.

460. The first sample transaction was a sale to Compañía Exportadora Mexicana:

- By invoice #437 dated April 3, 1997, CEMSA recorded the sale of 465 cases of Raleigh cigarettes to Compañía Exportadora Mexicana of Mexico City for \$111,135 U.S. dollars.
- *Pedimento* #3528-7000719 was issued to CEMSA on April 4, 1997. The *pedimento* listed the consignee as "Compañía Exportadora Mexicana c/o J&E Int. Sales". (J & E International Sales, Inc. is a small company run in El Paso by one Eduardo Silva.)
- The goods were air shipped by CEMSA via DHL Airways, waybill #423-3006 5545, dated April 4, 1997, to Houston, Texas.
- The goods entered in bond under US Customs Entry #235034785.
- A copy of the DHL waybill was then sent by CEMSA to Compañía in Mexico City. Compañía's Director-General, Luis Guemes Cabrera, then faxed the waybill to Eduardo Silva of J & E International Sales on October 8, 1997.
- The goods were entered in-bond in Houston by U.S. Brokers and, at Silva's instruction, then shipped by Kintetsu World Express to its warehouse in FTZ 68 in El Paso on April 10, 1997.²⁵⁹

461. The second sample trade involves CEMSA's shipment to GTO Produce Co.:

- By invoice #455 dated May 28, 1997, CEMSA recorded the sale of 125 cases of Marlboro cigarettes to GTO Produce Co. of McAllen, Texas, for \$34,125 U.S. dollars.

²⁵⁷ Vianney SA is not a company. It is a "doing business as" (DBA) registered by Guillermo Marin and his wife Lourdes Marquez (Marin) and Jesus Acosta. The address listed in CEMSA's invoices was the Marin's home address in SHCP Heights, California. See CM .

²⁵⁸ The documents obtained by the United States Customs Service that allow the shipments to be traced were for calendar year 1997 only.

²⁵⁹ See CM 02732 - 02741, which contain the documents pertaining to this transaction.

- *Pedimento* #3546-7000740 was issued to CEMSA on May 29, 1997. The consignee was identified as GTO Produce Co.
- The goods were air shipped by CEMSA via DHL Airways, waybill #42312017095, dated May 29, 1997, to Houston, Texas.
- The goods entered in bond under US Customs Entry #235034704.
- On May 30, 1997, Maria Luisa Hernandez of "GTO Produce Inc." (also a Director of Compañía Exportadora Mexicana of Mexico City, D.F.) sent a fax to Mike Aguilar of U.S. Brokers in Houston, Texas, stating that: "With respect to the 125 boxes of Marlboro cigarettes that in commercial invoice 455 form (sic) Corporacion Exportaciones Mexicana S.A. de C.V. and that were transported by DHL with bill number 42312017095, we inform you that this shipment belongs to J & E Intl Sales Inc. and is consigned to U.S. Brokers, Inc. Without any mor (sic) for the monent (sic) we are here to serve you in any respect."
- The goods were then shipped to FTZ 68 in El Paso²⁶⁰.

462. The third transaction was as follows:

- On August 5, 1997, Compañía Exportadora Mexicana is recorded to have purchased 100 cases of Montana and 100 cases of Fiesta cigarettes from Price Club de Mexico S.A. de C.V. in Mexico City.
- On August 7, 1997, Luis Guemes Cabrera of Compañía Exportadora Mexicana faxed two Price Club invoices (one for 100 cases of Fiestas and another for 100 cases of Montanas) to Marvin Feldman.
- By invoice #027 dated August 11, 1997, Compañía Exportadora Mexicana is recorded to have sold 200 cases of Montana and 100 cases of Fiesta cigarettes to CEMSA for NP\$971,760.00 (approximately \$124,265 U.S. dollars)²⁶¹.
- By invoice #490 dated August 12, 1997, CEMSA records a sale of the same cigarettes to GTO International Trade Co.. of McAllen, Texas, for \$42,600 U.S. dollars. (GTO is affiliated with Compañía Exportadora Mexicana; the documents show that GTO invoices were routinely sent by Ms. Hernandez and Mr. Guemes of Compañía Exportadora Mexicana).
- *Pedimento* #3546-7001168, issued to CEMSA on August 13, 1997, listed the consignee as GTO International Trade Co.

²⁶⁰ See CM 02806 - 02819, which contain the documents pertaining to this transaction.

²⁶¹ According to official statistics the exchange rate at the time was 7.82 pesos to the U.S. dollar.

- The goods were air shipped to Houston, Texas on DHL Airways, waybill #12846212, dated August 13, 1997, with the notation "Ship to: J & E International Sales, Inc.".
- They entered in bond under U.S. Customs Service Entry #235034520.
- By invoice #17009, dated August 14, 1997, GTO International Trade Co. recorded a sale of the cigarettes to J&E International Sales, Inc. for \$56,000 U.S. dollars.
- On August 14, 1997, Maria Luisa Hernandez sent a fax to Eduardo Silva of J&E enclosing the invoice and air waybill #423-12846212 relating to the 200 cases of Montanas and 100 cases of Fiestas and stating that "this merchandise must already be in Houston, as it was already sent yesterday."
- U.S. Brokers then arranged for them to be shipped by truck by J & E International Sales, Inc. to Kintetsu World Express' warehouse in FTZ 68 in El Paso.²⁶²

463. The above examples are typical of CEMSA's U.S. shipments.

E. The Relationships Between the Various Companies

464. Lynx Exportadora and Compañía Exportadora Mexicana were linked by management and control. Both have been involved in the same practice of exporting Mexican cigarettes. As the Claimant points out at paragraph 78 of his Memorial, Lynx also brought an *amparo* against the 1991 action by SHCP and later on engaged in further litigation with the authorities²⁶³. From July 1996 until January, 1997, Lynx was CEMSA's only purchaser of cigarettes exported to the United States.

465. A number of individuals were common to two or more of the Mexican cigarette re-sellers. Their names are in boldface in the below paragraphs.

466. Lynx was owned and controlled by **Gustavo Gamez Acuna** and four other shareholders²⁶⁴.

467. According to corporate documents, Compañía Exportadora Mexicana was owned and managed as follows:

The shareholders are **Cesar Poblanno Gonzalez** and **Gustavo Gámez Acuna**.

²⁶² See CM 02985 – 02999, which contain the documents pertaining to this transaction.

²⁶³ Memorial at paragraph 78. Witness statements of Marvin Feldman and Oscar Enrique Enrique at paragraphs 57 and 19, respectively.

²⁶⁴ María Luz Gómez Acuna, Captain Rafael Huarte Gonzales, Alberto Mario Dovalina Garcia, and Carlos Medina Erhard. CM 04165.

President:	Gustavo Gámez Acuna
Treasurer and CEO	Cesar Poblanno Gonzalez²⁶⁵
Secretary:	Herlinda Josefa Zapata Leal
Director:	Luis Medardo Guemes Cabrera
Director:	Maria Luisa Hernandez Martinez
Controller:	Fernando Guerra Rocha²⁶⁶

468. Paragraphs 128-132 of the Memorial note that two other companies have also been involved in the cigarette exporting-IEPS rebate claiming practice: Mercados Regionales (Mercados I) and Mercados Extranjeros (Mercados II).

469. Mercados Regionales, S.A. de C.V. (Mercados I) is Compañía Exportadora Mexicana simply re-named. Its name was changed on June 25, 1999. On that same date, the company's domicile was changed from Mexico City to Monterrey, Nuevo Leon²⁶⁷.

The shareholders remained **Cesar Poblanno Gonzalez** and **Gustavo Gámez Acuna**.

President:	Gustavo Gámez Acuna
Secretary:	Cesar Poblanno Gonzalez
Treasurer:	Herlinda Josefa Zapata Leal
Special Delegate:	Maria Luisa Hernandez Martinez
Director:	Luis Medardo Guemes Cabrera
Controller:	Fernando Guerra Rocha
Legal Representative:	Gustavo Gámez Acuna

470. At paragraph 130, the Memorial notes that Mercado's owners made "efforts to substitute a new corporation as the exporter of record" after SHCP refused to grant rebates to Mercados Regionales. According to corporate documents, Mercados Extranjeros, S.A. de C.V. was incorporated in Monterrey, N.L. on October 10, 1999. It is organized as follows:

The shareholders are **Cesar Poblanno** and **Luis Medardo Guemes Cabrera**.

President:	Cesar Poblanno Gonzalez
Treasurer:	Luis Medardo Guemes Cabrera
Secretary:	Maria Luisa Hernandez Martinez
Director General:	Luis Medardo Guemes Cabrera
Manager:	Guillermo Silva Hernandez

²⁶⁵ NOTE: Poblano is variously spelled with one "n" and two "n"s in the documentation.

²⁶⁶ CM 05281.

²⁶⁷ CM 05272.

Controller: Agle Catalina Bello Ramirez
Legal Representative: Cesar Poblanno Gonzalez²⁶⁸

471. As noted above, GTO International Trade Co. and GTO Produce Co. are affiliated with the Compañía/Lynx group. **Maria Luisa Hernandez** and **Luis Guemes Cabrera**, both officers of Compañía Exportadora Mexicana, repeatedly communicated on behalf of GTO with the American party who arranged for the goods shipped to the United States by CEMSA to be sent to the Kintetsu warehouse in FTZ 68, El Paso.

472. On the available documentary evidence, discussed below, Ms. Hernandez and Mr. Guemes sent 16 faxes to Eduardo Silva of J & E International Sales, Inc. informing him (or an American customs broker, Mike Aguilar) that the true owner of the cigarettes was not the party recorded in the CEMSA invoice but rather J & E International Sales, Inc. J & E would then arrange for the cigarettes to be trucked to FTZ 68 in El Paso.

F. CEMSA's Shipments to These Companies

473. As noted earlier, for 1996 and until March 1997, Lynx Exportadora of Monterrey, Mexico was CEMSA's sole U.S. "customer."

474. After Lynx stopped receiving cigarettes, CEMSA's invoices record four U.S. sales to Compañía Exportadora Mexicana of Mexico City.

475. Then, as of April 1997, CEMSA began to ship to "International Commerce Co." of Irving, Texas, J & E International Sales, Inc. of El Paso, and GTO Produce Co., also known as "GTO International Trade Co.", both of McAllen, Texas²⁶⁹.

476. Mexico has performed corporate records searches of International Commerce Co. at the addresses listed in the CEMSA invoices. There are two addresses:

- the first address (used in all but one of CEMSA's invoices) turns out to be the warehouse of Kintetsu World Express in Irving, Texas, in 1996-97²⁷⁰.
- the second address was in Inglewood, California. A search of State of California records for the address and telephone listed on CEMSA's invoice shows that that address was for a small trucking firm (now apparently defunct) called Mercantile Transport Company, Inc., whose officers and directors were Javier and Janet Pachecos²⁷¹.

²⁶⁸ CM 05281.

²⁶⁹ The available evidence indicates 22 shipments to International Commerce Co., 3 to J & E International Sales, Inc., 5 to GTO Produce Co., and 13 to "GTO International Trade Co."

²⁷⁰ See, for example, CEMSA invoice #460 [CM 02836]. See also CM 05755.

²⁷¹ See CEMSA invoice #442 [CM 02748]. See also CM 05756 - 62.

477. J&E International Sales, Inc. of El Paso is the common denominator for virtually all of CEMSA's U.S. shipments²⁷². Regardless of what company was named as the purchaser on CEMSA's invoices for goods shipped to Dallas-Fort Worth and Houston, Eduardo Silva of J&E International Sales, Inc., ("J&E") always took possession of the goods and facilitated their shipment to FTZ 68 in El Paso.

478. On numerous occasions, the party stated in the CEMSA invoice was not the consignee of the cigarettes, J & E. This led Mike Aguilar, the American customs broker who registered the goods with U.S. Customs (in order to obtain their in-bond status) and their forwarding to FTZ 68, to write to Eduardo Silva of J & E on June 26, 1996, and state:

PLEASE SEE ATTACHED AWB/SHIPMENT THAT HAS ARRIVED
IN. CONSIGNEE SHOWS GTO INTERNATIONAL. PLEASE DO
AS LAST TIME AND GET ME A LETTER FROM THESE GUYS
SHOWING THAT YOU ARE THE OWNER OF THE GOODS.
THANKS. ...²⁷³

479. In response to this type of request, on at least 16 occasions, Maria Luisa Hernandez or Luis Guemes of Compañía/GTO sent faxes to Mr. Silva or to the customs broker informing them that J & E, rather than the customer listed on the CEMSA invoice, was the actual owner of the goods. The following were sent by Compañía Exportadora Mexicana's office:

- April 28, 1997 a "packaging list"(on blank paper signed by Ms. Hernandez) with Compañía Exportadora Mexicana, S.A. de C.V. typed below²⁷⁴,
- April 29, 1997 (on Compañía Exportadora Mexicana letterhead to Eduardo Silva, signed by Ms. Hernandez and copied to Mike Aguilar, the U.S. customs broker, directly),
- May 30, 1997 (on blank paper to Mike Aguilar of U.S. Brokers from Maria Luisa Hernandez, with "GTO Produce Co." typed below),
- June 4, 1997 (on blank letterhead to Mike Aguilar of U.S. Brokers signed by Ms. Hernandez with the name "GTO Produce Co." typed below),
- June 26, 1997 (on GTO International Trade Co.. letterhead to Mike Aguilar of U.S. Brokers from Luis Guemes Cabrera),
- July 3, 1997 (on blank paper to Eduardo Silva from Maria Luisa Hernandez and copied directly to Mike Aguilar) and including invoice #17005 dated July 2, 1997,

²⁷² CM 03298F.

²⁷³ "AWB" stands for "air waybill". See CM 02880.

²⁷⁴ Note although the fax date reads January 12, 1989, this is due to the fact that J&E apparently did not keep accurate transmission dates on its fax machine header. The actual date, April 29, 1997, is shown on the attached DHL waybill and Compañía's memorandum of the same date to Eduardo Silva.

from GTO International Trade Co. to J&E International Sales for 93,900 U.S. dollars,

- July 11, 1997 (on GTO International Trade Co. letterhead to U.S. Brokers from Luis Guemes Cabrera),
- July 24, 1997 (on blank paper to Eduardo Silva signed by Maria Luisa Hernandez and copied directly to Mike Aguilar), including invoice #17007 dated July 23, 1997 from GTO International Trade Co. to J&E International Sales, Inc. for 59,706 U.S. dollars,
- August 7, 1997 (on blank paper to Eduardo Silva and signed by Maria Luisa Hernandez, faxed on to Mike Aguilar by Mr. Silva), including invoice #17008 dated August 6, 1997, from GTO International Trade Co. for 19,775 U.S. dollars,
- August 14, 1997 (on blank paper to Eduardo Silva signed by Maria Luisa Hernandez), enclosing invoice #17009, dated August 14, 1997, from GTO International Trade Co. to J&E International Sales for 56,000 U.S. dollars,
- October 6, 1997 (on blank paper to Eduardo Silva from Maria Luisa Hernandez and then faxed by Mr. Silva on to Mike Aguilar), enclosing invoice #17012 dated October 3, 1997, from GTO International Trade Co. to J&E International Sales, Inc. for 105,669 U.S. dollars,
- October 16, 1997 (on blank paper to Eduardo Silva from Maria Luisa Hernandez and then faxed by Mr. Silva on to Mike Aguilar),
- October 28, 1997, invoice #17014 from GTO International Trade Co. to J&E International Sales, Inc. for 53, 730 U.S. dollars,
- November 6, 1997, invoice #17015 from GTO International Trade Co. to J&E International Sales, Inc. for 59,700 U.S. dollars,
- November 11, 1997, invoice #17016 from GTO International Trade Co. to J&E International Sales, Inc. for 29,850 U.S. dollars, and
- November 18, 1997, on blank paper from "Ma. Luisa" to Eduardo Silva, referring to the shipment of 317 cases of cigarettes that previous day, together with invoice #17018, dated 17 November 1997 for 58,730 U.S. dollars, from GTO to J&E.²⁷⁵

480. CEMSA's shipments to these companies amounted to the following over the 1996-97 period:

- Lynx Exportadora: 14 transactions over the period July 1996 to January 1997,

²⁷⁵

These documents are collectively found at CM 03270 - 03292.

- Compañía Exportadora Mexicana: 4 transactions in March-April 1997,
- International Commerce Co.: 22 transactions in the period April 1997 to November 1997,
- J & E International Sales, Inc. ("J&E"): 3 transactions in the period July 1996 to 30 December 1997,
- GTO Produce Co.: 5 transactions in the period April 1997 to July 1997,
- "GTO International Trade Co.": 13 transactions in the period June to November 1997, and
- Vianney SA: 2 transactions in October 1997.²⁷⁶

481. During 1996-97, on available evidence, CEMSA issued at least 10 invoices to ostensible U.S. purchasers that were matched by invoices for the same goods sent by Lynx, Compañía or their affiliates to J&E International Sales, Inc. ("J&E"):

- CEMSA's July 5, 1996 invoice #303 for 160 cases to Lynx Exportadora was matched by Lynx's July 5, 1996 invoice #1601 to J & E,
- CEMSA's July 2, 1997 invoice #473 for 300 cases to GTO Produce Co. was matched by GTO's July 2, 1997 invoice #17005 to J & E,
- CEMSA's July 21, 1997 invoice #484 for 200 cases to GTO International Trade Co. was matched by GTO's July 23, 1997 invoice #17007 to J & E,
- CEMSA's August 5, 1997 invoice #488 for 100 cases to GTO International Trade Co. was matched by GTO's August 6, 1997 invoice #17008 to J & E,
- CEMSA's August 12, 1997 invoice #490 for 300 cases to GTO International Trade Co. was matched by GTO's August 14, 1997 invoice #17009 to J & E,
- CEMSA's September 30, 1997 invoice #510 for 354 cases to GTO International Trade Co. was matched by GTO's October 3, 1997 invoice #17012 to J & E,
- CEMSA's October 24, 1997 invoice #521 for 180 cases to GTO International Trade Co. was matched by GTO's October 28, 1997 invoice #17014 to J & E,
- CEMSA's November 5, 1997 invoice #525 for 200 cases to GTO International Trade Co. was matched by GTO's invoice #17015 to J&E,

²⁷⁶

See witness statement of Rolando Garcia Ramos [CM 06021], Table 2.

- CEMSA's invoice #528 dated November 10, 1997 for 100 cases to GTO was matched by GTO's invoice #17016 dated November 11, 1997 to J&E,
- CEMSA's invoice #534 dated November 14, 1997 for 317 cases to GTO was matched by GTO's invoice #17018 dated November 17, 1997, to J&E.²⁷⁷

482. As noted above, 98% of CEMSA's shipments to the United States were consigned to J & E and forwarded by truck to FTZ 68, El Paso.

483. The cigarettes did not remain in the United States. They could not be sold there. Indeed, Eduardo Silva of J & E wrote to U.S. Customs on 4 June 1997 stating:

Every single case of cigarettes we purchase in Mexico IS PURCHASED IN BOND, TRAVELS IN-BOND, AND IS WAREHOUSED IN A BONDED FACILITY AT KINTETSU WORLD EXPRESS WAREHOUSES UNTIL THE TIME THAT OUR COMPANY ARRANGES FOR EXPORTING THEM OUT OF THE UNITED STATES. Never have any cigarettes been ever removed from a bonded warehouse without the proper EXPORT DOCUMENTS beeing (sic) prepared by the warehouse, with guard/escort service being provided to the U.S. border or exporting point.

Since these cigarettes are NOT FOR SALE OR CONSUMPTION IN THE U.S., they are never "imported" into the U.S. because of the permanent "IN-BOND" status they are maintained in until the time of exporting²⁷⁸. [Capitalization in original]

484. Mexico does not yet have the U.S. Customs permits stating the export destination of the cigarettes once removed from FTZ 68. Mr. Silva's statement to U.S. Customs that the cigarettes were taken to the U.S. border suggests that they were shipped back into Mexico. This raises questions as to whether the cigarettes, marked on CEMSA's invoices as "for export only", were exported definitively.

G. There Was No Denial of National Treatment

485. The Claimant has alleged that his enterprise has been the object of discrimination contrary to NAFTA Article 1102(2) because it has made rebates "to Claimant's Mexican competitors under the IEPS laws in force after January 1, 1998"²⁷⁹. Article 1102 provides:

²⁷⁷ CM 02631 and 02634; 02892 and 02904; 02937 and 02950; 02956 and 02971; 02985 and 02997; 03068 and 03088; 03130 and 03139; 03149 and 03160; 03170 and 03181; 03185 and 03196.

²⁷⁸ CM 02819.

²⁷⁹ Memorial, at paragraph 221.

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.

486. The Respondent agrees with the Claimant that CEMSA is in "like circumstances" with Mexican-owned resellers of cigarettes for export: Mercados Regionales and Mercados Extranjeros²⁸⁰.

1. The Incorrect Factual Predicate of the National Treatment Claim: CEMSA's So-Called "Competitors"

487. At paragraphs 129-134 of the Memorial, the Claimant complains that since 1998 SHCP has made rebate payments to CEMSA's "competitors" who are Mexican-owned. It specifically identifies Mercados Regionales as one such company.

488. It is misleading to describe the companies established by Cesar Poblano, Gustavo Gámez and Luis Guemes ("Mercados I and II") as "competitors" of CEMSA. In light of the evidence just reviewed, they are more accurately described as "successors to CEMSA's collaborators".

489. At paragraph 132, the Claimant asserts:

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

490. This pleading, while technically correct as far as it goes, is misleading. While it may or may not be the fact that neither "Claimant nor CEMSA has or ever had a financial interest in or business relationship with either Mercados I or Mercados II", the Claimant and CEMSA did have extensive financial interests and business relationships with Mercados I when it was known as Compañía Exportadora Mexicana, and with Lynx.

491. And while the Respondent is not yet in a position to confirm or deny whether Claimant's "sole business relationship with Mr. Poblanno since December 1997 is the debt described at Paragraph 102", the Claimant and CEMSA did have extensive business dealings with Mr. Poblanno, Mr. Gámez and their colleagues in 1996-97.

492. In addition to Mr. Poblanno and Mr. Gámez's apparently loaning the Claimant money to purchase cigarettes, the Poblanno-Guemes-Gámez network:

²⁸⁰ At paragraph 224 of the Memorial, the Claimant adds "MEXCOBASA". The Respondent has not found any evidence of any such company.

- supplied CEMSA with cigarettes for shipment to the United States; and
- either directly, or through their affiliates, received all of CEMSA's cigarettes shipped to the United States²⁸¹.

493. The Poblano-Gómez-Guemes network companies were not CEMSA's competitors; they were its financiers, sometime suppliers, and sometime purchasers of virtually all of CEMSA's U.S.-destined cigarettes.

494. The U.S. Customs documents also put the lie to the Memorial's assertion at paragraph 69 that as a result of the claimed agreement with SHCP, CEMSA "took months to develop suppliers, customers and financing to re-establish the business that CEMSA had closed down three years before"²⁸². The evidence shows that the destination of the 1996-97 shipments were completely different from CEMSA's 1992 exports.

495. The documents also contradict the Claimant's testimony about how he did business in 1996-97. At paragraph 7 of his statement, he testifies:

7. I advertised cigarettes by word-of-mouth, letters, and phone calls to potential customers. In the 1996-97 period, I also maintained a web site for CEMSA. I would receive an inquiry from a potential foreign customer about an inquiry from a potential customer about brand, price, quality and the like. This inquiry usually came by mail, telephone, or, in the 1996-97 period, by e-mail or Internet link. I would send the potential customer a sample carton, if requested, and a statement of CEMSA's terms, *i.e.*, the price in US dollars per master case of cigarettes (50-60 cartons per master case), payment in US dollars in advance, and shipment on payment.

496. The implication of the Claimant's testimony is that he did business at arms' length with previously unknown customers. The fact is that for its shipments to the United States during 1996-97, CEMSA did business with, and only with, the Poblano-Gómez-Guemes network²⁸³. It is also the case that at least three of the Central American companies that he did business with were affiliated with the same two individuals²⁸⁴.

497. By Mexico's calculation, some 92.76 % of CEMSA's 1996-97 shipments were to these two groups of customers²⁸⁵.

²⁸¹ Except apparently for two shipments to Vianney SA.

²⁸² Memorial at paragraph 69.

²⁸³ With the exception of two shipments to Vianney SA.

²⁸⁴ Raul Gutierrez Maradiaga and Nelson Rigoberto Lopez Vazquez.

²⁸⁵ Of CEMSA's total sales in 1996-97, 49.28% were to the Poblano-Guemes-Gómez network and 43.49% to the Gutierrez network. Of CEMSA's shipments to the United States, the Poblano-Guemes-Gómez network accounted for 98.02% of its shipments.

498. The inter-connections between CEMSA and the Mexican-owned companies to which it seeks to be compared make them a combination of entities all dedicated to a particular enterprise, to wit, the apparent temporary export of cigarettes from Mexico with the assistance of the IEPS tax.

499. To the extent, therefore, that the Article 1102 claim is premised upon a comparison of the treatment accorded to CEMSA in comparison to its so-called competitors, the claim must fail if the corporate veil is pierced and CEMSA and its collaborators are considered to be one enterprise.

500. Alternatively, if the various cigarette re-sellers are considered to be in like circumstances, then the evidence shows that Mexican-owned companies have also been denied IEPS rebates and where payments have been made to companies not in possession of invoices separately stating the tax, SHCP has re-assessed other companies too.

2. Features of the IEPS Law That Bear Upon the Issue of "Like Circumstances"

501. An allegation of denial of national treatment requires the Tribunal to focus upon distinctions made in the law or regulations as written (to see if there is *de jure* discrimination on the basis of nationality) or as applied (to see if there is *de facto* discrimination based on nationality)²⁸⁶.

502. There has not been, and cannot be any allegation of *de jure* discrimination in this case. The IEPS Law does not differentiate between rebate claimants based upon the nationality of the would-be claimant or its owner.

503. The allegations made in this proceeding appear to be based upon an alleged *de facto* denial of national treatment.

504. The Tribunal should be mindful of the following features of the IEPS Law's administration when considering this allegation:

- First, by SHCP's calculation, over one million Form 32 tax rebates are claimed on average a year. Like other national tax authorities, SHCP relies upon computers to process, approve and pay rebates. At any given time, SHCP does not know who is claiming the tax in relation to what product. Thus, for example, at all material times CEMSA could have lawfully collected IEPS tax rebates for exports of alcohol or cigarettes if it had invoices separately stating the tax paid by the producer.

²⁸⁶

In the Matter of Cross-border Trucking Services, Secretariat File No. USA-MEX-98-2008-01, Final Report of the Panel, February 6, 2001 at paragraphs 248 and 257 discusses *de jure* discrimination.

- Second, like the fiscal authorities of other NAFTA Parties, SHCP relies upon the taxpayer's good faith. It presumes an entitlement to the tax rebate and rebates will be paid as a matter of course. However, each time that a tax rebate is claimed, the taxpayer is warned by the rebate form that the claim is subject to audit and reassessment.
- Third, it is not until the taxpayer files its annual return certified by its accountant that SHCP analyses how the tax rebates have been claimed and for what products.
- Fourth, it is only if the tax payments, gross exports and rebates paid do not appear to be balanced, that as a matter of administration, SHCP becomes aware of any manipulation of the tax. In fact, as Gabriel Oliver testifies, this is what happened in 1997 when officials began to realize that the size of IEPS rebates being claimed did not comport with the estimated IEPS revenues based on annual projections of the producers²⁸⁷.

3. The Granting of IEPS Rebates in 1999

505. SHCP's policy was to deny IEPS rebates to all cigarette re-sellers not in possession of invoices separately stating the IEPS tax. Once it detected such activity, it refused to pay rebates to such claimants, regardless of their nationality or the nationality of their shareholders. Such treatment is not more favorable than the treatment accorded to CEMSA.

506. SHCP's evidence is that five companies applied for IEPS rebates for cigarettes since 1998; of those, two were refused. Of the three that were initially paid, one was assessed by SHCP and is presently litigating the assessment, and the other two are in the process of being assessed²⁸⁸.

507. The evidence discloses that CEMSA has not been accorded less favorable treatment than that accorded to Mexican-owned enterprises.

508. It is respectfully submitted that the claim of an alleged breach of Article 1102 must be dismissed.

509. The submission on public policy will follow the submissions on damages.

²⁸⁷ Witness statement of Gabriel Oliver [CM 05994] at paragraphs 1-6.

²⁸⁸ Ibid. at paragraphs 7-10.

V. DEFENSE TO THE CLAIM FOR DAMAGES

A. Additional Facts

1. CEMSA's Audited Financial Statements 1991-1998

510. The Claimant makes no reference to CEMSA's annual audited financial statements, notwithstanding their central importance to evaluating the "fair market value" of CEMSA and its so-called cigarette export business.

511. CEMSA's financial statements indicate, *inter alia*, that:

- a) CEMSA's gross sales between 1992 and 1998 ranged between 2.2 million and 6.06 million dollars, with the exception of 1996 and 1997 when gross sales were stated at 9.9 million and 10.3 million dollars, respectively;
- b) CEMSA recorded a substantial profit only once—in 1997—and recorded modest profits or losses in all other years;
- c) CEMSA suffered a loss in 1992—the only other full fiscal year that it exported cigarettes;
- d) CEMSA's auditor issued a negative opinion on CEMSA's 1997 and 1998 financial statements, stating that they did not reasonably reflect the financial affairs of the company and specifically cautioning that the amounts stated for IEPS rebates could not be confirmed;
- e) CEMSA continued to carry on business after 31 December 1997, recording sales of 6.6 million dollars in 1998, 10% higher than any year prior to 1996.

512. The valuation report of Fausto Garcia and Associates (FGA), submitted by the Respondent, concludes CEMSA would have suffered a substantial loss in 1997 if it had calculated its claims for IEPS rebates properly. CEMSA's so-called cigarette-export business had no value because (among other things) the actual amount of IEPS subsumed in the purchase price of the cigarettes CEMSA purchased from Sam's Club was slightly more than half the amount that CEMSA claimed by way of rebates. On a proper calculation of the IEPS, and after accounting for financial costs, there was no profit margin in CEMSA's cigarette export sales. Taking operating expenses into account, the cigarette exports caused a significant loss on each sale.

2. CEMSA's Inadequate Financial Records

513. The Claimant's auditor, C.P. Jamie Zaga Hadid (Zaga), has testified that CEMSA's financial records for 1997 were incomplete and suggests that this may be the fault of the SAT audit team. It is clear from the audit report that the audit team, after being denied entry to

CEMSA's premises for 48 hours²⁸⁹, found CEMSA's records to be inadequate and incomplete in many respects. Mr. Feldman was given a list of 134 records that the audit team considered to be missing. He failed to produce these records, stating that he would instead produce them in his NAFTA claim against Mexico²⁹⁰. The missing records have not been produced in this proceeding.

514. Although he does not say so in his statement, it can be assumed that the inadequacy of CEMSA's financial records partly explains the negative opinion Mr. Zaga expressed on the 1997 accounts, signed one month after the SAT audit team attended at CEMSA's premises to copy documents²⁹¹.

515. Various aspects of CEMSA's inadequate record keeping were found to be *irregularidades* (fiscal violations) in the 1998 audit. Although the Claimant downplays these problems, the requirement to maintain consecutively numbered sales invoices, for example, is an express requirement of the Fiscal Regulations which, if breached, can result in sanctions.

516. CEMSA's failure to maintain proper accounting records—which the Respondent attributes to an attempt to conceal the true nature of CEMSA's relationship with the Poblano-Gamez-Guemes network—also presents a problem for the Claimant in establishing a value for CEMSA or its cigarette export business. The Claimant did not refer to CEMSA's financial statements (ordinarily the underpinning of any business valuation), preferring instead to construct a projected cash flow based on purported sales figures aimed at establishing that the "cigarette export business" was highly profitable, rewarding CEMSA with a gross profit margin of 71% on its cost of sales.

3. CEMSA's Gross Over-Estimate of IEPS Paid on Cigarettes

517. As demonstrated previously in this Counter-memorial, the Claimant's method of calculating IEPS rebates on CEMSA's cigarette exports was wrong in both 1996 and 1997, resulting in a massive overpayment of IEPS rebates. The Claimant's valuation expert assumes the validity of these payments and the methodology for calculating them in concluding that CEMSA's cigarette export business was profitable. It was not. As the Respondent has demonstrated, and as SHCP determined in the 1998 audit, CEMSA's claims for IEPS rebates were almost double the amount of IEPS the cigarette producers remitted to the Treasury on the goods that CEMSA acquired from Sam's Club.

²⁸⁹ Due to Mr. Feldman's absence the first day and due to his refusal to permit the auditors to enter the premises the second day. CM 1197-1201.

²⁹⁰ CM 05807.

²⁹¹ CEMSA's Audited Financial Statement for 1996, issued on 19 August 1998. [CM 03537]

4. Effect of the 1998 Amendment to the IEPS Law

518. The Claimant contends that valuation of CEMSA's cigarette export business should not take account of the 1 January 1998 amendment to the IEPS law because Article 1110(2) provides for compensation based on "fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier".

519. By selecting 1 December 1997 as the date of expropriation "for convenience", the Claimant seeks to avoid the obvious difficulty that the amendment to the law was determined not to be an expropriation. The Claimant thus purports to rely on an alleged "action taken by the Mexican executive on or about December 1, 1997 to drive CEMSA out of the cigarette business" and SHCP's decision to deny IEPS rebates for cigarettes exported in the months of October and November 1997 and "a small amount exported in December".

520. In fact:

- a) there was no "action taken by the Mexican executive ... to drive CEMSA out of the cigarette exporting business" before 1 December 1997 or at any time;
- b) SHCP resolved to deny CEMSA's rebate claims for October, November and December 1997 on 7 November 1997, 5 December 1997 and 9 January 1998, respectively, but these resolutions were not issued until 4 April 1998, after the Feldman-Gómez Gordillo meetings of February and March 1998;
- c) on 12 December 1997 CEMSA issued a formal inquiry regarding its entitlement to IEPS rebates which SHCP answered on 24 February 1998, stating, *inter alia*, that CEMSA was not entitled to rebates without possessing invoices with the IEPS separately stated;
- d) the Claimant was fully aware, not later than 28 November 1997, of the Respondent's intention to amend the law (which is not an expropriation), as evidenced by his letter to Jose Luis Martinez, *Contralor Interno de la SHCP*, copied to President Zedillo, complaining that Proc. Gómez Gordillo and Mario Gabriel Budebo were guilty of "abuse of power" in connection with the pending amendment to Article 11 of the IEPS law. This was followed by full page advertisements published in *Reforma* on 1 December and 15 December asking President Zedillo to reconsider the pending amendment; and
- e) prior to the decision of the competent authorities that the 1998 amendment is not an expropriation, the Claimant openly contended—in his "What is CEMSA's Tantamount to Expropriation Case?" web page and his Notice of Intent to Submit a Claim to Arbitration—that the amendment to the law was the measure that was "tantamount to expropriation of CEMSA".

B. Submissions

1. Subject and Date of Valuation

521. The Claimant's valuation expert has proffered an opinion on the discounted cash flow value of CEMSA's "cigarette export business" as at 1 December 1997 and of CEMSA's estimated loss of revenue arising from the Claimant's allegation that SHCP unlawfully prevented CEMSA from obtaining IEPS rebates on cigarette exports between 1 January 1994 (when the NAFTA entered into force) and May 1996 (when CEMSA started exporting cigarettes "in earnest")²⁹².

522. The Claimant's valuation expert does not proffer an opinion on the "fair market value" of CEMSA's cigarette export-IEPS rebate business of 1996-97, or the cigarette export-IEPS rebate business that CEMSA was allegedly precluded from pursuing in 1994-95.

523. The Respondent has submitted in legal argument that, leaving the *res judicata* and ripeness issues aside, CEMSA's so-called cigarette export business is not an "investment of an investor of another Party", nor was CEMSA's alleged entitlement to IEPS rebates on cigarettes exported between October and December 1997 an "investment" within the meaning of Article 1139 of the NAFTA.

524. CEMSA was the Claimant's only "investment" within the meaning of Article 1139. The Respondent submits that any claim of expropriation must be limited to assessing whether CEMSA was directly or indirectly expropriated by a measure taken by the Respondent which the Claimant is entitled to submit to arbitration, having first complied with Article 2103(6). The Claimant does not contend that CEMSA was expropriated. Indeed, it is clear that CEMSA continued to carry on its traditional lines of business (importing milk and exporting various goods other than cigarettes) after 31 December 1997.

525. The date of valuation chosen by the Claimant's valuation expert — 1 December 1997 — reflects the Claimant's attempt to circumvent the competent authorities' determination that the amendment to the IEPS law effected one month later is not an expropriation.

526. The Respondent's valuation expert was instructed to assess the value of CEMSA's cigarette export-IEPS rebate business between 30 September 1997 and 31 December 1997 on the basis of the Claimant's contention that SHCP's denial of rebates for cigarettes exported in October, and November (plus "a small amount in December") was "tantamount to expropriation" of CEMSA's cigarette export business. In any event, FGA has opined that the value of CEMSA's cigarette export-IEPS rebate business did not change between 30 September 1997 and 31 December 1997. It had no value at any material time.

527. The Respondent instructed FGA to assess the value of CEMSA's so-called cigarette export business in order to answer the valuation evidence submitted by the Claimant. This is not

²⁹² Memorial at paragraph 238.

to be taken as an admission or any form of acknowledgement that CEMSA's cigarette export-IEPS rebate business is an "investment" within the meaning of Article 1139, or that there could be any finding of liability.

2. Review of the Respondent's Valuation Evidence

528. Fausto Garcia has been a professional investment consultant in Mexico since obtaining his Master's Degree in Business Administration (MBA) at Stanford University in 1969. Prior to establishing FGA, he was employed by a venture capital fund where he became responsible for the fund's operations in Mexico, Latin America and the Caribbean. As the Director General and Founding Partner of FGA, he has provided consulting services in mergers and acquisitions, venture capital financing and debt restructuring since 1981. A more complete description of FGA's experience and expertise is contained in an appendix to the FGA report.

529. FGA was instructed to (i) determine the value of CEMSA's "cigarette export business" between 30 September 1997 and 31 December 1997 and (ii) evaluate the opinion rendered by Mr. Cervera on behalf of the Claimant.

530. FGA performed a complete analysis of CEMSA audited financial statements and financial records pertaining to its cigarette exports and rebates in 1996-1997 in order to ascertain the proper cash flow (operating cash flow minus non-operating cash flow) of the CEMSA's cigarette export business.

531. FGA determined that, using the correct calculation for IEPS rebates, CEMSA's gross profit margin on cigarette sales averaged only 2.2%, before taking financing costs or operating expenses into account. There was a negative profit margin of -7.3% after accounting for financing costs. FGA could not calculate the actual cash flow of CEMSA's cigarette export business because the margin of loss would only increase upon accounting for operating costs and other appropriate considerations.

532. FGA accordingly determined that the value of CEMSA's cigarette exporting business was nil, as from 30 September 1997 to 31 December 1997, noting that it no value at any time during 1996-1997.

C. Review of the Claimant's Valuation Evidence

533. The Claimant's valuation expert, Ernesto Cervera Gomez, is an economist whose predominant expertise and experience relates to economic analysis of government initiatives and programs. He does not profess experience or expertise in accounting, mergers and acquisitions or business valuation.

534. Mr. Cervera's report makes no reference to CEMSA's audited financial statements. Rather, following a largely immaterial review of Mexico's cigarette industry and CEMSA's alleged growing importance as an exporter of cigarettes, Mr. Cervera purports to assess—on the basis of "documents and information provided by the Claimant"—(i) the "present adjusted value of non-paid IEPS" for exports in October to December 1997; (ii) "damages for lost profits during

the period January 1, 1994—May 30, 1996”; and (iii) the “value of CEMSA’s cigarette-export business as of December 1, 1997.

535. Section V of the FGA report analyses Mr. Cervera’s opinion.

536. FGA observes that Cervera was plainly wrong in concluding that CEMSA would have enjoyed a 62.4% profit margin (71% less financing costs) on its lost cigarette exports between 1994 and 1996, noting that he wrongly relied on CEMSA’s 85% of cost methodology for calculating IEPS rebates.

537. FGA further observes that the methodology employed by Cervera to justify his calculations is incorrect because it is not appropriate to compare financial ratios of manufacturing companies with those of trading companies. The weighted average of the gross profit margin among established trading companies in Mexico in 1997 was 22.4% compared to the figure of 72.4% stated by Cervera for Mexico’s cigarette manufacturers. (It also bears noting that CIGATAM’s net profit margin in 1996-1997 was in the range of 13% to 17%)²⁹³.

538. Finally, FGA notes that it is inappropriate to assess the value of any business on a cash flow basis without including working capital requirements, operational costs, taxes, and investment in fixed assets. In other words, “gross profit margin” is completely different than “cash flow”.

539. Using the approach employed by Cervera, but using the correct methodology for calculating the IEPS FGA determined that:

- a) CEMSA would owe SHCP over 12.6 million dollars for excessive IEPS rebates claimed in 1996-1997;
- b) if CEMSA had exported cigarettes from January 1994 to May 1996, it would have lost 5.5 million U.S. dollars under Cervera’s “conservative scenario”, 6.9 million U.S. dollars under the “intermediate scenario” and 8.8 million U.S. dollars under the “optimistic scenario”;
- c) the value of CEMSA’s cigarette export business at 1 December 1997 would be nil.

D. Response to the Claimant’s Submissions on Damages

540. The Claimant engages in obfuscation in describing the measure of compensation that an arbitral tribunal may award for a breach of Section A of Chapter Eleven of the NAFTA. He continues a practice that began with the filing of his Notice of Arbitration (immediately after the competent authorities determined that the 1998 amendment is not an expropriation), making vague and unsupportable claims of “unlawful discrimination” and “denial of justice”.

²⁹³ Witness statement of Noe Salazar Martinez [CM 06070], at paragraph 5.

541. By operation of Article 2103(6) the Claimant is confined to two possible claims of expropriation—the alleged refusal to implement the 1993 *amparo* judgment, and the denial of CEMSA’s IEPS rebates claims for cigarettes exported in October and November 1997. As Article 1105 does not apply to taxation measures, the only other claim open to the Claim—as permitted by the Tribunal’s Interim Decision on jurisdiction issues—is the claim pursuant to Article 1102 for alleged denial of national treatment.

“Restitution Damages”

542. Chapter Eleven does not provide for “restitution damages”. The Claimant misconstrues the clear language of Article 1135:

Article 1135: Final Award

1. Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only:

- (a) monetary damages and any applicable interest;
- (b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.

A tribunal may also award costs in accordance with the applicable arbitration rules.

543. Article 1135 says only that a tribunal may order restitution of property, provided that the disputing Party may pay monetary compensation instead. Thus, in the case of expropriation of property, a tribunal could direct that the property be returned to the disputing investor, or that the disputing Party pay monetary compensation which, in the case of expropriation, would be the fair market value of the property as prescribed by Article 1110(2).

“Expropriation”

544. “Restitution damages” are not the stated measure of compensation for expropriation under Article 1110. Although it may amount to the same thing in a given case, Article 1110 (2) prescribes payment of compensation equal to fair market value, taking into account going concern value, asset value, declared tax value of tangible property and other valuation criteria, as appropriate.

“Discrimination”

545. Compensation for a breach of Article 1102 is not “identical” to compensation for breach of Article 1110. In the former case, an investor may seek compensation for “loss or damage by

reason of, or arising out of” the breach²⁹⁴ whereas in the case of expropriation, the measure of compensation is prescribed as the “fair market value” of the expropriated investment.

Claim for “Payment of IEPS Rebates for October-November 1997”

546. The Claimant acknowledges that the claim for IEPS rebates allegedly owing for cigarettes exported by CEMSA in October and November 1997 is “a claim for a tax refund”. He has not attempted to explain how the NAFTA authorizes such a claim. The Respondent has addressed the question of whether a tax refund could be an “investment” in legal argument.

547. CEMSA challenged the denial of these rebate applications in the Fiscal Court and lost. He appealed by way of *amparo* and lost again. As the Respondent has submitted in legal argument, this is a juridical fact (one which the Claimant has sought to obscure) that is binding on this Tribunal.

548. If CEMSA could establish that it had a legal right to payment of the October and November rebate claims and that this Tribunal can award compensation for denial of that right under Chapter Eleven (which the Respondent submits it cannot), the Claimant would be restricted to claiming the amount of IEPS actually remitted by the producers on the subject goods. That amount would be the result of applying the 85% rate to the *precio al detallista* established for the goods in question at the material time.

Claim for “Lost Profits January 1, 1994-May 1996”

549. The Claimant contends that its claim for loss of profits from the date the NAFTA entered into force to the date that CEMSA “began exporting cigarettes in earnest” in 1996 arises from withholding of IEPS rebates from CEMSA “in breach of Mexican and international law beginning in January 1993”. The Tribunal has already ruled that in principle it does not have jurisdiction to consider breaches of domestic law or general international law. The Claimant says only that claim arises from “Respondent’s measures from January 1, 1994 ... through May 1996 ...” without specifying how such measures amount to a breach of Section A.

550. The Respondent has submitted in legal argument that SHCP’s alleged failure to implement the 1993 *amparo* judgment (which was fully implemented) was not an expropriation of CEMSA’s cigarette export business in January 1994 or thereafter. The Claimant’s proper remedy in 1994 and 1995 was to commence exporting cigarettes and challenge any denial of CEMSA’s rebate claims in the Fiscal Court, as he did in 1998. He cannot now claim a tax rebate from a NAFTA tribunal as if it were the Fiscal Court of Mexico.

551. The Respondent further submits:

- a) the valuation urged by the Claimant is not based on the fair market value of CEMSA or its intended cigarette export business at the material time.

²⁹⁴ NAFTA Articles 1116 and 1117.

- b) the amount of lost profits calculated by Cervera is based on the Claimant's 1997 methodology for calculating the IEPS—multiplying CEMSA's acquisition cost by 0.85—but FGA has demonstrated the CEMSA would have suffered a loss in 1994-1995 (as well as in 1996-1997) if the correct methodology is used;
- c) the damages assessed by Cervera are calculated as if they were tax rebates actually owing—adjusted for inflation and interest as prescribed by the Fiscal Code, plus multas (penalties) that only SHCP is entitled to impose on unpaid taxes;
- d) the Claimant cannot in any event claim damages for any breach of the NAFTA occurring before 30 April 1996, being three years prior to the date that he submitted his claim to Arbitration.

Claim for the "Value of the Cigarette Export Business as of December 1, 1997"

552. The Claimant contends that SHCP's denial of IEPS rebates on CEMSA's cigarette exports in October and November 1997 coupled with "refusing to allow CEMSA IEPS rebates on future exports" amounted to a constructive taking of CEMSA's cigarette export business. Again, the Claimant avoids identifying the measure he says was operative and amounted to a breach of Section A.

553. The Claimant's selection of 1 December 1997 as the date of expropriation "for convenience" is intended to establish a date that the Claimant can say predates his knowledge of the Respondent's intention to amend the IEPS law. It bears no connection to the only other alleged expropriation properly before the Tribunal. All that had occurred by 1 December 1997 was SHCP's resolution to deny CEMSA's application for IEPS rebates on cigarettes exported in October 1997 (submitted to SHCP on 3 November 1997) which SCHP did not issue to CEMSA until 4 April 1998. The Claimant must be taken to have known of the Respondent's intention to amend the IEPS law by 28 November 1997 when he complained in writing to SHCP and President Zedillo that two SHCP officials were guilty of "abuse of power" in connection with the pending amendment²⁹⁵.

554. Although the Respondent submits that the Tribunal can and should take account of SCHP's intention to amend the law as of 1 January 1998, it matters little to the assessment of the fair market value of CEMSA's cigarette export business because CEMSA could not profitably export cigarettes if it claimed IEPS rebates in the correct amount.

555. This has been established conclusively by the Respondent in the testimony of four witnesses—Fausto Garcia and Associates, Noe Salazar Martinez, Raphael Obregon Castellano and Rolando Garcia Ramos, and in the findings of the 1998 audit.

²⁹⁵

CM 04631.

556. As explained by FGA, using the correct method of calculating the IEPS, CEMSA's gross profit margins of 2.2% are insufficient to generate any profit once CEMSA's financing costs are taken into account. Rather, it results in a loss of -7.3%. If operating costs and change in working capital are deducted to establish a proper cash flow figure, the loss is even greater.

557. This analysis applies equally to any claim the Claimant may advance for an alleged violation of Article 1102. If permitted to claim IEPS rebates on cigarette exports after 1 January 1998, as Mr. Feldman believes Mercados I and Mercados II may have been allowed to do, CEMSA could not have done so profitably.

E. Concluding Remarks on Damages

558. The question of what, if any, fair market value could be attributed to CEMSA or its so-called cigarette export business also deserves consideration in light of the actual nature of the Claimant's business activities.

559. As FGA explains in its concluding comments, the classic definition of "fair market value" requires consideration of what a willing buyer, informed of the relevant facts, would pay a willing seller for the asset in question.

560. CEMSA was not a normal trading company. It did not have exclusive or preferred rights to distribute the products it exports. It did not have a sales force or network of sales agents or significant business assets. Rather, it was (and apparently still is) a one man company with one or two employees that traded on opportunities, taking advantage of the differential between the price of various goods that CEMSA could acquire in Mexico and the prevailing price of similar goods in various export markets. In the case of cigarettes, it is apparent that CEMSA engaged in "gray marketing". It is possible that CEMSA directly supplied cigarettes to persons engaged in trade in contraband.

561. As FGA explains, the purchaser's "due diligence" investigation would include scrutiny of CEMSA's financial records and its customer base. To put itself in the position of the "willing buyer informed of the relevant facts", the Tribunal must assume that at least the following facts would have become known:

- a) CEMSA's financial records were incomplete and did not comply with generally accepted accounting practice or the requirements of the Fiscal Code;
- b) CEMSA had a substantial contingent tax liability as a result of over-claiming IEPS rebates in 1996-1997 that were almost double what it was entitled to claim;
- c) CEMSA could not export cigarettes profitably if it claimed IEPS rebates in the proper amount;
- d) about half of CEMSA's sales went to three related entities in Central America, of which at least two did not exist in the countries where they purported to import cigarettes purchased from CEMSA;

- e) the other half of CEMSA's sales went to a group of related entities in the United States, all tied to CEMSA's ostensible competitors in the cigarette export business, notwithstanding that Mexican cigarettes cannot be sold in the United States.

562. The Respondent submits that the Tribunal should also find that a potential purchaser would be imputed with knowledge that CEMSA's exports to the United States were possibly returned to Mexico illicitly.

563. FGA makes another interesting observation—that the potential buyer would be concerned that there are no barriers to entry by competitors. This underscores an important point—if CEMSA's cigarette exports were lawful, and its customers were genuine importers, and its claims for IEPS rebates were validly made—other trading companies would soon engage in the same practice. The only other traders that did so were members of the Poblano-Gómez-Guemes group, CEMSA's co-venturers in the activities at issue.

564. In light of the above, it would be wrong to ascribe any value to CEMSA's cigarette export business, let alone the figure of 14.8 million dollars claimed by Mr. Feldman, or to conclude that CEMSA's cigarette business would have had any value at anytime—before or after 1996-1997—when the Claimant contends he could have been exporting cigarettes if only CEMSA has been permitted to obtain IEPS rebates.

VI. PUBLIC POLICY

565. The claim has not been advanced in a forthright manner.

566. The obvious inference to be drawn by the trucking of cigarettes that cannot be sold in the United States from the Houston and Dallas international airports to a notoriously leaky border crossing is that the cigarettes re-entered Mexico. A search of the *Secretaria de Economia's* import data base and a comparison of U.S. export statistics shows that exports of cigarettes to Mexico reported in the U.S. data base are some 10 times greater than the Mexican import statistics. Moreover, the data-base records *no* imports of cigarettes through El Paso – Ciudad Juarez for 1996-97 while the U.S. statistics record some 8 million U.S. dollars worth of exports from El Paso to Mexico²⁹⁶.

567. A recent article published in the *Washington Post*, shows that cigarette smuggling is a major problem for both U.S. and Mexican customs authorities. Jorge E. Paserat, the new Customs Administrator for Ciudad Juarez appointed by President Vicente Fox Quezada to clean up this border crossing, has confirmed that the smuggling of cigarettes into Mexico is a major problem²⁹⁷.

568. Canada has also encountered major problems as a result of attempts to erode its high cigarette taxes. Indeed, Canada has gone so far as to commence a lawsuit against certain tobacco companies under the U.S. Racketeering Influenced and Corrupt Organizations Act (the "RICO" Act). The United States has also encountered attempts to evade Federal and state cigarette taxes.

569. CEMSA's participation in the Central American sales to two fictitious companies and the circumstantial evidence of "round trip" shipments of cigarettes to the U.S. appear to the Respondent to be an abuse of the IEPS taxation scheme.

570. It is respectfully submitted that it would be contrary to public policy to award any damages to this Claimant.

²⁹⁶ Witness statement of Rolando Garcia [CM 06021] at Tables 8 and 9.

²⁹⁷ CM 05768.

VII. FINAL SUBMISSIONS

A. The Claimant's Request for Injunctive Relief and Contingent Damages

571. The relief requested by the Claimant in respect of SHCP's pending tax assessment of CEMSA is based on erroneous statements of fact and is in any event beyond the jurisdiction of this Tribunal.

572. As matters presently stand:

- a) the Fiscal Court has agreed with CEMSA that it may obtain IEPS rebates without having purchase invoices which separately state the IEPS;
- b) the Fiscal Court has agreed with SHCP that CEMSA may not claim IEPS rebates on its exports to Honduras;
- c) the Fiscal Court has remanded the matter to SHCP with directions to calculate CEMSA's entitlement to IEPS rebates on all exports, except those to Honduras, by calculating the actual amount of IEPS contributed by the producers of the goods that CEMSA exported;
- d) the question of whether CEMSA is entitled to obtain IEPS rebates without having purchase invoices that separately state the IEPS is *sub judice* in SHCP's appeal of the Fiscal Court ruling;
- e) the question of whether CEMSA may obtain IEPS rebates on its exports to Honduras is *sub judice* in CEMSA's *amparo* against the Fiscal Court ruling; and
- f) CEMSA did not challenge the remand directions of the Fiscal Court for SHCP to calculate CEMSA's entitlement to IEPS rebates on the basis of the amount of IEPS actually contributed by the producers.

573. Accordingly, it is possible that SHCP will be entitled to deny all of CEMSA rebate claims on the basis that it did not obtain purchase invoices separately stating the IEPS as required by Article 4, III of the IEPS law. It is also possible, although highly unlikely, that the Claimant will be entitled to claim IEPS rebates on all of its exports, including its exports to Honduras.

574. These juridical facts will not be known until the domestic legal proceedings are finally concluded. However, in any possible scenario, SHCP will calculate CEMSA's entitlement to IEPS rebates by applying the 85% tax rate to the *precio al detallista* —as the IEPS law provides and as the Fiscal Court has directed.

575. This Tribunal has no jurisdiction to entertain the Claimant's request for "a declaration that Respondent is not entitled to recover rebates paid to CEMSA in respect of cigarette exports in 1996-1997" for the following reasons:

- a) Section B of Chapter Eleven vests the Tribunal only with jurisdiction to award monetary compensation for loss or damage arising from a breach of Section A. There is no provision for declaratory relief, except Article 1134 which allows for interim measures of protection and cannot be used to enjoin the measure alleged to be a breach of Section A;
- b) the Claimant has not submitted a claim to arbitration in respect of the 1998 audit, SCHP's assessment of CEMSA, or the subsequent court proceedings that CEMSA initiated and remain extant. These matters are therefore outside the scope of the submission to arbitration; and
- c) the requested declaration would usurp the jurisdiction of the Mexican courts and would not be enforceable in any event.

576. This Tribunal also has no jurisdiction to entertain the Claimant's request for "a contingent award of damages in the amount of any tax assessment by Respondent against CEMSA..." for the reasons stated above and for the additional reason that any claim the Claimant might choose to submit to arbitration in the future in connection with the assessment arising from the 1998 audit or the ongoing court proceedings is not yet ripe.

577. Put another way, the Tribunal is being asked to presume that administrative and judicial actions that have not yet occurred (and may never occur) will amount to violations of Section A of Chapter Eleven that will cause loss or damage for which the Claimant is entitled to seek compensation under Section B. To state the proposition is to refute it.

B. Relief Requested

578. The Respondent requests that the claim be dismissed on the ground that no breach of Section A of NAFTA Chapter Eleven has been proven.

579. In the unlikely event that the Tribunal were to find any breach, the Respondent requests that no damages be awarded on the ground that no damages have been proven.

C. Claim for Costs

580. The Respondent rejects as unfounded the Claimant's allegations and the motives he imputes to the Respondent in connection with its conduct in this arbitral proceeding. A review of the administrative record will confirm that the Respondent has sought only to see the proceedings conducted fairly and appropriately, according to the governing Arbitration Rules and recognized international arbitration practice.

581. The submission now made by the Claimant is regrettably consistent with a litany of caustic accusations that have characterized this proceeding for more than a year. The Respondent intends to say nothing further on the subject unless invited to do so by the Tribunal.

582. The Respondent requests the Tribunal to make an award of costs in its favor, including the costs of the arbitration, counsel's fees and disbursements, expert witness fees and the Respondent's expenses for travel, reproducing documents and related matters.

583. The Respondent submits that the presentation of this NAFTA claim is part of a pattern of practice that began in 1993 when Marvin Feldman first accused SHCP officials of "criminal" conduct and participation in a conspiracy with Carlos Slim to illegally manipulate the IEPS law to the Claimant's prejudice.

584. Allegations of this kind have been made repeatedly in paid advertisements in the Wall Street Journal and leading Mexican newspapers, in letters to the President of Mexico and Secretaries of State, and in documents posted on the Internet. The Tribunal can only conclude that these actions were calculated to threaten or embarrass the individuals concerned.

585. The Claimant's NAFTA claim relies on similar accusations which remain unsupported by credible evidence. Indeed, they are contradicted by events and written records that have been known to the Claimant throughout.

586. The Claimant's NAFTA claim has been characterized by obfuscation and shifting theories in an apparent attempt to avoid the limits placed on the Tribunal's jurisdiction by NAFTA Article 2103. The Claimant has also attempted to conceal the true nature of his cigarette exporting business, fearing the implications of his revealing relationship with the Poblano-Gómez-Guemes group and the fact that he has deceived Mexico's taxation authorities by claiming excessive tax rebates. Finally, he has presented a claim for damages that is grossly exaggerated by any reasonable standard.

587. The Respondent accordingly submits that it should be entitled to complete indemnity for its legal costs and associated expenses.

All of which is respectfully submitted

[signed in the original]

Hugo Perezcano Diaz

Consultor Juridico