

LIST OF AUTHORITIES

Authority No.	Description
CA-12	<i>Canfor Corp. et al. v. United States of America</i> , UNCITRAL, Order of the Consolidation Tribunal (7 Sep. 2005)
CA-13	<i>Marvin Roy Feldman Karpa v. United Mexican States</i> , ICSID Case No. ARB(AF)/99/1, Award (16 Dec. 2002)
CA-14	<i>Lantzy v. Centex Homes</i> , 73 P.3d 517 (Cal. 2003), as modified (Aug. 27, 2003)

Legal Authority CA-12

In the matter of:
The North American Free Trade Agreement (NAFTA)
and
A Request for Consolidation by the United States of America of the Claims in:

CANFOR CORPORATION
V.
UNITED STATES OF AMERICA

AND

TEMBEC *ET AL*
V.
UNITED STATES OF AMERICA

AND

TERMINAL FOREST PRODUCTS LTD.
V.
UNITED STATES OF AMERICA

ORDER OF THE CONSOLIDATION TRIBUNAL

Before the Arbitral Tribunal established under Article 1126 of the NAFTA and comprised
of:

Professor Armand L.C. de Mestral, Arbitrator
Davis R. Robinson, Esq., Arbitrator
Professor Albert Jan van den Berg, Presiding Arbitrator

Secretary of the Tribunal: Mr. Gonzalo Flores, ICSID

Washington, D.C., 7 September 2005

**Representing the United States
of America:**

Mr. Mark A. Clodfelter
*Assistant Legal Adviser
Office of the Legal Adviser*
Ms. Andrea J. Menaker
Chief, NAFTA Arbitration Division
Mr. Mark S. McNeill
*Office of International Claims
and Investment Disputes*
UNITED STATES DEPARTMENT OF STATE
Washington, DC 20520
United States of America

**Representing Canfor Corporation
and**

Terminal Forests Products, Ltd.:

Mr. P. John Landry
DAVIS & COMPANY LLP
2800-666 Burrard Street
Vancouver, British Columbia
Canada V6C 2Z7
and

Mr. Keith E. W. Mitchell
HARRIS & COMPANY
1400 – 550 Burrard Street
Vancouver, British Columbia
Canada V6C 2B5

**Representing Tembec Inc.,
Tembec Investements Inc.,
and**

Tembec Industries, Inc.:

Mr. Elliot J. Feldman
Mr. Mark A. Cymrot
Mr. Michael S. Snarr
Mr. Ronald J. Baumgarten
BAKER & HOSTETLER LLP
Washington Square, Suite 1100
1050 Connecticut Avenue, N.W.
Washington, D.C. 20036-5304
United States of America

Table of Contents

I.	INTRODUCTION	4
II.	PROCEDURE	4
III.	FACTS	8
	A. Proceedings in Canfor	8
	B. Proceedings in Tembec	9
	C. Proceedings in Terminal	10
IV.	SUMMARY OF THE PARTIES’ POSITIONS	11
	A. Position of the United States	11
	B. Position of Canfor	13
	C. Position of Tembec	14
	D. Position of Terminal	18
V.	CONSIDERATIONS OF THE CONSOLIDATION TRIBUNAL	20
	A. Article 1126 of the NAFTA	21
	(a) <i>Legislative history</i>	22
	(b) <i>Rationale</i>	27
	(c) <i>Consensual nature</i>	29
	(d) <i>Alleged structural problems inherent in Article 1126</i>	31
	(e) <i>Discretionary power</i>	34
	(f) <i>Burden of proof</i>	35
	(g) <i>The term “jurisdiction”</i>	38
	(h) <i>The terms “all or part of the claims” and “one or more of the claims”</i>	40
	(i) <i>The term “a question of law or fact in common”</i>	42
	(j) <i>Anticipated questions</i>	45
	(k) <i>The term “in the interests of fair and efficient resolution of the claims”</i>	46
	(l) <i>Seriatim consolidation</i>	56
	(m) <i>Where consolidated proceedings are to begin</i>	57
	(n) <i>The position of the Article 1120 Tribunals</i>	59
	B. Conduct of the Present Proceedings	60
	C. Alleged Laches and Estoppel against the United States	62
	D. Commonality	65
	(a) <i>Jurisdiction</i>	66
	(b) <i>Liability</i>	70
	(c) <i>Damages</i>	77
	E. Fair and Efficient Resolution of the Claims	77
	F. Conclusion	81
VI.	DECISION OF THE CONSOLIDATION TRIBUNAL	84

I. INTRODUCTION

1. Presently before the Consolidation Tribunal is a request by the Government of the United States of America (“United States”) to consolidate, pursuant to Article 1126(2) of the North American Free Trade Agreement (“NAFTA”), the claims submitted to three arbitrations under Article 1120 of the NAFTA: *Canfor Corporation v. United States of America*, *Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc. v. The United States of America*, and *Terminal Forest Products Ltd. v. The United States of America*. The claims in all three proceedings were submitted to arbitration under the UNCITRAL Arbitration Rules.
2. The Consolidation Tribunal grants the request of the United States for the reasons set forth below and in the manner set forth in Section VI of this Order.

II. PROCEDURE

3. The claims filed against the United States by Canfor Corporation (“Canfor”), Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc. (collectively referred to as “Tembec”), and Terminal Forest Products Ltd. (“Terminal”),¹ all Canadian producers of softwood lumber, concern a number of countervailing duty and antidumping measures adopted by the United States relating to Canadian softwood lumber products.
4. By letter dated 7 March 2005, the United States requested that the Secretary-General of the International Centre for the Settlement of Investment Disputes (“ICSID”) establish a tribunal in accordance with Article 1126(5) of the NAFTA.² Pursuant to Article 1126(5), the Secretary-General appointed Mr. Davis R. Robinson, Esq., a United States national residing in the United States, Professor

¹ In this Order collectively referred to as “Claimants.”

² Available at <http://www.state.gov/documents/organization/43492.pdf>.

Armand de Mestral, a Canadian national residing in Canada, as arbitrators, and Professor Albert Jan van den Berg, a Dutch national residing in Belgium, as presiding arbitrator. This Consolidation Tribunal was established on 6 May 2005.

5. On 9 May 2005, the United States applied to the Consolidation Tribunal for a stay of the *Canfor* and *Tembec* proceedings pursuant to Article 1126(9) of the NAFTA.³ Canfor, Tembec and Terminal objected to the request by letters dated 9, 10 and 12 May 2005. On 19 May 2005, after due consideration, the Consolidation Tribunal ordered, pursuant to Article 1126(9), a stay of proceedings in the *Canfor* and *Tembec* arbitrations, pending the Consolidation Tribunal's decision on the United States' request to consolidate.⁴ The Tribunal confirmed its stay order on 1 June 2005. It adopted an expedited schedule concerning the question of request for consolidation.
6. The United States' submission in support of its request for consolidation, dated 3 June 2005, was received by ICSID on 4 June 2005 and by the Consolidation Tribunal on 5 June 2005. In that submission, the United States particularized its request:

For the foregoing reasons, the United States respectfully requests that this Tribunal assume jurisdiction over, and hear and determine together, the entirety of the claims submitted by Canfor Corp., Tembec Inc. *et al.* and Terminal Forests Products Ltd. The United States further requests that, pursuant to Article

³ Article 1126(9) provides: "On application of a disputing party, a Tribunal established under this Article, pending its decision under paragraph 2, may order that the proceedings of a Tribunal established under Article 1120 be stayed, unless the latter Tribunal has already adjourned its proceedings."

⁴ Unlike Article 1126(2), which requires an Article 1126 Tribunal to hear the parties prior to deciding on a request under Article 1126(2), Article 1126(9) does not contain a requirement for hearing the parties. Nonetheless, when considering the United States' request for a stay, the Consolidation Tribunal has had due regard to the observations expressed by all parties on the request for a stay. The request required an expeditious ruling in view of the hearing that was scheduled in the *Tembec* arbitration (i.e., 2 - 3 June 2005).

40 of the UNCITRAL Arbitration Rules, claimants be required to bear all costs of the arbitration, including costs and expenses of counsel.

7. Submissions in opposition to the United States' request by Canfor, Tembec and Terminal were received by ICSID on 10 June 2005, and transmitted to the Consolidation Tribunal on 11 June 2005.
8. On 20 May 2005, Tembec instituted challenge proceedings against Mr. Davis R. Robinson. By a decision dated 15 June 2005, the Secretary-General of ICSID rejected the challenge.
9. The disputing parties through their counsel presented oral arguments and responded to the Tribunal's inquiries at a hearing held at the seat of ICSID in Washington, D.C., the place of the arbitration as agreed by the parties, on 16 June 2005.⁵
10. On 27 June 2005, Tembec submitted a motion requesting that:

[T]he Tribunal make a preliminary decision on whether the United States' request for consolidation should be dismissed for lack of jurisdiction pursuant to Rule 21(3) of the UNCITRAL Arbitration Rules,⁶ or in the alternative because of the ethical problems arising from Article 1126 of NAFTA in this particular proceeding that the motion for consolidation be denied for lack of jurisdiction before this Tribunal.

⁵ The transcript of the hearing is referred to in this Order as "Tr." The (uncorrected) transcript is available at <http://www.state.gov/documents/organization/48508.pdf>

⁶ Article 21(3) of the UNCITRAL Arbitration Rules provides: "A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence or, with respect to a counter-claim, in the reply to the counter-claim."

11. Tembec further requested that:

[T]he Tribunal stay briefing on the merits of the United States' request for consolidation (currently scheduled for July 22 and August 8 [*sic*], 2005⁷) pending resolution of this motion.

12. As requested by the Consolidation Tribunal, Canfor, Terminal and the United States submitted observations on Tembec's motion on 12 July 2005.

13. By letter dated 14 July 2005, the Consolidation Tribunal ruled:

Having considered Tembec's motion and the observations by Canfor, Terminal and the United States as well as the expediency required by Article 1126 of NAFTA, the Tribunal denies Tembec's motion to make a preliminary decision and will consider and rule on the matters raised by Tembec in the Order on the merits of the United States' request for consolidation (*cf.* Rule 21(4) of the UNCITRAL Arbitration Rules⁸). Accordingly, the Tribunal also denies Tembec's request for a stay of the briefing on the merits of the United States' request for consolidation.⁹

14. Post-hearing briefs were simultaneously submitted by agreement of the parties on 22 July 2005. In those briefs, the parties answered a number of questions put to them by the Consolidation Tribunal at the hearing.

⁷ The date was 12 August 2005 pursuant to the agreement of the parties reached at the hearing of 16 June 2005.

⁸ Article 21(4) of the UNCITRAL Arbitration Rules provides: "In general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question. However, the arbitral tribunal may proceed with the arbitration and rule on such a plea in their final award."

⁹ The arguments raised by Tembec in its Motion to Dismiss are addressed at various places in this Order.

15. On 28 and 29 July 2005, the Governments of Canada and Mexico advised the Consolidation Tribunal that they will not file a NAFTA Article 1128 Submission.¹⁰
16. Reply post-hearing briefs were simultaneously submitted by agreement of the parties on 12 August 2005.
17. The Consolidation Tribunal deliberated in Washington, D.C., on various occasions.

III. FACTS

A. Proceedings in Canfor

18. After filing a Notice of Intent on 5 November 2001, Canfor, a forest-products company incorporated in British Columbia, Canada, filed on 9 July 2002, a Notice of Arbitration under Chapter 11 of the NAFTA and the UNCITRAL Arbitration Rules against the United States. The Notice of Arbitration also served as a Statement of Claim. Canfor alleges that the United States adopted in May 2002 certain countervailing duty and antidumping measures on Canadian imports of softwood lumber to the United States, in breach of the NAFTA Articles 1102 (National Treatment), 1103 (Most-Favored-Nation Treatment), 1105 (Minimum Standard of Treatment), and 1110 (Expropriation). Canfor also claims damages for losses caused by the allegedly illegal Byrd Amendment, enacted into United States law in 2000, which provides that duties assessed pursuant to countervailing duty or antidumping orders shall be distributed annually to affected U.S. domestic

¹⁰ Article 1128 (Participation by a [State] Party) provides: “On written notice to the disputing parties, a Party may make submissions to a Tribunal on a question of interpretation of this Agreement.”

producers. Canfor seeks damages of not less than US\$250 million and an award of costs.

19. The *Canfor* Tribunal was constituted on 22 July 2003, consisting of Professor Emmanuel Gaillard, as presiding arbitrator, and Professor Joseph H. H. Weiler and Mr. Conrad Harper, Esq., as arbitrators. The first organizational hearing was held on 16 October 2003. Two weeks prior to the organizational hearing, the United States submitted an objection to the Tribunal's jurisdiction and sought bifurcation of the proceedings to address its objection. Canfor opposed the United States' request for bifurcation, seeking to have any jurisdictional objection addressed with the merits. After briefing the issue of, *inter alia*, bifurcation, the *Canfor* Tribunal ordered on 23 January 2004 the bifurcation with respect to the jurisdictional objection. The parties briefed the jurisdictional issue and a hearing was held in Washington, D.C., on 7-9 December 2004.
20. While the *Canfor* Tribunal was deliberating the jurisdictional issue, arbitrator Harper resigned from the Tribunal on 2 March 2005, citing an alleged conflict of interest. Shortly thereafter, on 7 March 2005, the United States filed the request for consolidation. As mentioned, the United States then made an application for a stay of the *Canfor* proceedings pursuant to NAFTA Article 1126(9) on 11 May 2005, which the Consolidation Tribunal granted on 19 May 2005, pending its decision under NAFTA Article 1126(2).

B. Proceedings in Tembec

21. After filing a Notice of Intent on 3 May 2002, Tembec, consisting of three forest products corporations organized under the laws of Canada, filed on 3 December 2004 a Notice of Arbitration against the United States under Chapter 11 of the NAFTA and UNCITRAL Arbitration Rules, alleging damages from measures also challenged in *Canfor*. Tembec seeks damages of at least US\$200 million and an award of costs. The Notice of Arbitration also served as a Statement of Claim.

22. The *Tembec* Tribunal was constituted on 4 August 2004, consisting of Judge Florentino Feliciano as presiding arbitrator, and Professors James Crawford and Kenneth W. Dam as arbitrators. An organizational meeting by telephone was held on 30 November 2004. A jurisdictional challenge was raised by the United States in the *Tembec* proceeding as well (i.e., on 4 February 2005). The *Tembec* Tribunal scheduled a hearing on the jurisdictional issue for 2 - 3 June 2005.
23. After the parties had filed their initial submissions on jurisdiction, but before filing their reply and rejoinder, the United States filed the request to consolidate on 7 March 2005. The United States informed the *Tembec* Tribunal of its request to consolidate and applied to that tribunal for a stay of proceedings. The *Tembec* Tribunal held the request for a stay in abeyance, and the parties completed briefing the jurisdictional issues. As mentioned, the United States then made an application to the Consolidation Tribunal on 11 May 2005 for a stay of the *Tembec* proceedings pursuant to NAFTA Article 1126(9). The Consolidation Tribunal granted the United States' request on 19 May 2005, pending its decision under NAFTA Article 1126(2).

C. Proceedings in Terminal

24. Having filed a Notice of Intent on 12 June 2003, Terminal, a forest products corporation organized under the laws of British Columbia, Canada, filed on 31 March 2004 a Notice of Arbitration under Chapter 11 of the NAFTA and the UNCITRAL Arbitration Rules against the United States on measures also challenged in the *Canfor* and *Tembec* arbitrations. Terminal seeks damages of at least US\$90 million. Since filing its Notice of Arbitration, Terminal has not taken further steps to prosecute its claim. Terminal's Notice of Arbitration does not serve as a

Statement of Claim, considering that Terminal stated in its Notice that it “will more fully articulate its basis for the claim in its Statement of Claim when filed.”¹¹

IV. SUMMARY OF THE PARTIES’ POSITIONS

A. Position of the United States

25. In its request for consolidation of 7 March 2005 and its submission of 3 June 2005, the United States contends that common issues of law and fact call for consolidation.
26. With respect to the issues of law, the United States points out that it objects to the jurisdiction of all three claims on the basis that NAFTA Article 1901(3) expressly bars the submission of claims regarding antidumping and countervailing duty law to arbitration under Chapter 11 of the NAFTA. The United States also objects to jurisdiction on the basis that the claims do not “relate to” Claimants or their U.S.-based investments as required by NAFTA Article 1101(1). Finally the United States contends that jurisdiction is lacking over Tembec’s and Canfor’s claims because those Claimants filed claims before NAFTA Chapter 19 bi-national panels with respect to the same measures at issue here, in violation of the NAFTA Article 1121(1).
27. Furthermore, according to the United States, all three Claimants allege that the same measures breach the same provisions of the NAFTA, namely, Articles 1102 (National Treatment), 1103 (Most-Favored-Nation Treatment), 1105 (Minimum Standard of Treatment), and 1110 (Expropriation), and assert the same factual bases for those alleged breaches. The United States anticipates that, if the cases reach the merits, it would raise many of the same legal defenses to the claims of all three Claimants.

¹¹ Terminal’s Notice of Arbitration ¶ 19.

28. With respect to the issues of fact, the United States asserts that Claimants are all Canadian softwood lumber producers that export softwood lumber to the U.S. market. The United States contends that Claimants base their claims on the same U.S. government measures, including (i) the U.S. Department of Commerce's ("Commerce") August 2001 preliminary countervailing duty determination; (ii) Commerce's August 2001 preliminary critical circumstances determination; (iii) Commerce's October 2001 preliminary antidumping determination; (iv) Commerce's March 2002 final countervailing duty determination; (v) Commerce's March 2002 final antidumping determination; (vi) the International Trade Commission's ("ITC") May 2002 final material injury determination; and (vii) the Continued Dumping and Subsidy Offset Act of 2000 (the "Byrd Amendment"), enacted by the U.S. Congress in October 2000.
29. The United States further contends that considerations of fairness and efficiency favor consolidation because consolidation conserves resources, will result in an expeditious resolution of the claims, and is the only way to eliminate the risk and unfairness of inconsistent results.
30. In its post-hearing brief of 22 July 2005, the United States responded to the questions of the Consolidation Tribunal raised at the hearing ("United States PHB"). Those responses will be considered in the analysis of the Tribunal below.
31. In its reply post-hearing brief of 12 August 2005, the United States responds to a number of arguments by Claimants in their post-hearing briefs ("United States R-PHB"). The United States contends that consolidation for purposes of jurisdiction should be granted; consolidation on the merits is warranted; the United States' application is not time-barred; and Claimants' attempt to vitiate Article 1126(2) should be rejected.

B. Position of Canfor

32. Canfor objects to the United States' request for consolidation.
33. In its submission of 10 June 2005, Canfor contends that the United States has failed to satisfy Article 1126(3) of the NAFTA. It further asserts that the United States has failed to establish the existence of common questions of fact or law. It also contends that it is not necessary for the fair and efficient resolution of the claims for consolidation to occur because: the cases raise different issues; the softwood lumber industry is intensely competitive; consolidation proceedings will be unworkable; the United States' conduct in bringing an application for consolidation at a late date justifies denying the application; Canfor should not be required to reargue the jurisdictional objection; cost considerations warrant denying the consolidation application; consolidation will result in delay; the parties ought to be able to choose their own arbitrators; and there is no risk of inconsistent decisions.
34. In its post-hearing brief of 22 July 2005, Canfor contends with respect to common questions of law or fact that: the United States has not satisfied the test set out in Article 1126; NAFTA requires commonality, not similarity; the United States misstates the test of commonality; and the United States has not established commonality.
35. With respect to the fair and efficient resolution of the claims, Canfor asserts that: the United States is not entitled to seek consolidation simply because risks it anticipated, but was prepared to accept, have materialized; the United States brings this application for tactical reasons; the withdrawal of arbitrator Harper does not have the effect that the United States contends; consolidation in these circumstances is not fair and efficient; the United States acknowledges the efficiency of allowing the Canfor proceedings to continue; the United States has not raised an Article 1121 objection against Canfor, and has already deferred its

“conditional” Article 1101 objection to the merits; the Consolidation Tribunal should not consolidate either jurisdiction or the merits; the risk of disclosure of confidential information argues against consolidation; and reducing the risk of inconsistent decisions is not the Tribunal’s overriding goal.

36. In its post-hearing brief of 22 July 2005 (which is the same as Terminal’s post-hearing brief, except where expressly noted), Canfor responded to the questions of the Consolidation Tribunal raised at the hearing (“Canfor & Terminal PHB”). Those responses will be considered in the analysis of the Tribunal below.
37. In its reply post-hearing brief of 12 August 2005 (which was also filed on behalf of Terminal), Canfor responded to a number of the answers given by the United States to the Tribunal questions in its post-hearing brief (Canfor & Terminal R-PHB”). Those responses will also be considered in the analysis of the Tribunal below.

C. Position of Tembec

38. Tembec also objects to the United States’ request to consolidate.
39. In its submission of 10 June 2005, Tembec contends that the Consolidation Tribunal should deny the request for consolidation as untimely and prejudicial under the UNCITRAL Arbitration Rules and principles of international law because: the request is untimely under Article 21(3) of the UNCITRAL Arbitration Rules; jurisdiction should be settled by the Article 1120 Tribunals before this Consolidation Tribunal considers whether to consolidate on the merits; and the doctrines of laches and estoppel are applicable.
40. Tembec also contends that the United States’ objections to jurisdiction and the claims on the merits lack commonality to justify consolidation.

41. Tembec further asserts that consolidation is not in the interests of fair or efficient resolution of the claims because: the United States' request for consolidation imposed more delay on the resolution of Tembec's claims; the United States should not be given another "bite at the apple" on jurisdiction; the Claimants are prejudiced by the request for consolidation; the parties' autonomy to present their claims would be compromised by consolidation; consolidation proceedings would be inefficient during arguments, discovery, and procedural issues unique to the Claimants; consolidation would not be efficient even were commonality found among claims for liability; and Tembec should not bear through consolidation the burdens of the United States' frustration with Canfor and Terminal.
42. Finally, Tembec contends that the alleged risk of inconsistent results is no basis for consolidation because: the risk of inconsistent decisions is immaterial to the question of consolidation; consolidation will not obviate the risk of inconsistent decisions; all of the parties already have assumed the "risk" of inconsistent decisions; and the *CME/Lauder v. The Czech Republic* cases and accompanying literature cited by the United States are irrelevant where there is no affiliation among the Claimants.
43. In its post-hearing brief of 22 July 2005 ("Tembec PHB"), Tembec contends that the request for consolidation is untimely, in accordance with the ordinary meaning of Article 1126(2) and (8) of the NAFTA, Article 21 of the UNCITRAL Arbitration Rules, and principles of international law relating to the doctrines of laches and estoppel. In that context, Tembec asserts that the United States continues to withhold information with respect to *Corn Products International, Inc. v. United Mexican States*, and *Archer Daniels Midland Company and Tate & Lyle*

Ingredients Americas, Inc. v. United Mexican States, Order of the Consolidation Tribunal (20 May 2005, hereafter the “*Corn Products case*”).¹²

44. Tembec also contends that the Consolidation Tribunal has no authority to consolidate the jurisdictional questions presented to the Article 1120 Tribunals.
45. Tembec further asserts that the purpose and rationale of Article 1120 do not allow consolidation in this case because: the text of the NAFTA provides the test for consolidation; the purpose and rationale of Article 1126 are derived primarily from the text of the NAFTA; consolidation of phases of the cases is impossible where the parties are direct competitors; consolidation was not meant to give “two bites at the apple;” and this case contrasts with examples where consolidation would be appropriate under Article 1126.
46. Tembec then argues that there are insufficient common questions of law or fact to warrant consolidation because: common questions of law or fact must be material to the disposition of an award to warrant consolidation; the United States has not met its burden of showing that the questions material to disposition of an award are in common; and the material questions of law and fact in these cases are distinct.
47. Tembec also asserts that consolidation of these cases is not in the interests of fairness or efficiency because: the fairness and efficiency of Article 1126 consolidation must be compared to the Article 1120 proceedings; the direct business competition between Tembec and Canfor makes it unfair and inefficient to consolidate the claims (arguing that: Tembec could not present its claims were it required to disclose confidential business information before its competitors;

¹² Available at http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Consolidacion/acuerdos/050520_Orden_de_Tribunal_de_Acumulacion.pdf.

procedures to guarantee non-disclosure of proprietary business information could not be instituted and enforced with fairness or efficiency; and the competitive nature of the Claimants creates other procedural problems and inefficiencies, including the incentive for the Claimants to undermine each others' claims that is not present in separate proceedings, and questions of Claimants' procedural rights with respect to each others' claims); and Tembec has incurred, and may continue to incur, additional unnecessary expenses.

48. Finally, Tembec contends that the Consolidation Tribunal should exercise its discretion not to consolidate these cases because the United States has approached the consolidation issue unfairly as a means of advancing a negotiated settlement in the softwood lumber dispute.
49. In its post-hearing brief of 22 July 2005, Tembec also responded to the questions of the Consolidation Tribunal raised at the hearing. Those responses will be considered in the analysis of the Tribunal below.
50. In its reply post-hearing brief of 12 August 2005 ("Tembec R-PHB"), Tembec submits that the Tribunal may not consolidate the cases to decide the jurisdiction of the Claimants' claims because: the jurisdictional objections of the United States are not claims; the United States waived consolidation under Article 21(3) of the UNCITRAL Arbitration Rules; the jurisdictional objections are not common amongst Claimants; estoppel is part of the "governing law" under Article 1131 of the NAFTA and bars consolidation here; and fairness and efficiency require that the Article 1120 Tribunals finish their decisions on jurisdiction. Tembec also submits that the United States has not established commonality, arguing: the burden rests with the United States; common laws or facts are not common questions of law or fact; and the dispositive questions of law and fact are not common. Tembec further submits that consolidation would be unfair and inefficient, not merely inconvenient, because: submission of confidential

information will be unavoidable in the merits and damages phases; fairness requires protection of confidential information, but protection in a consolidated proceeding here would make adjudication unfair and inefficient; confidentiality concerns may make consolidation rare, but not “obsolete;” these and any subsequent consolidation proceedings before this Tribunal are unfair because the United States has a party-appointed arbitrator while the Claimants do not; and, by the United States’ own absolute fairness/efficiency standard, these cases should not be consolidated. Tembec also contends that the cost estimates by the United States are inaccurate and unreliable. It then contends that the United States has not met the high standard for consolidation because: the NAFTA Parties drafted other high threshold procedural standards; and no claims have ever been consolidated, even when in dispute was a single measure of a single government. Tembec also argues that none of the United States’ arguments regarding the “risk” of inconsistent decisions supports consolidation. Finally, Tembec submits that NAFTA Article 1126 does not grant the Tribunal broad discretion to consolidate without consent of the disputing parties.

D. Position of Terminal

51. Terminal opposes the application of the United States for consolidation of the proceedings for the reasons set forth by Canfor.
52. In addition to the arguments advanced by Canfor, Terminal argues that the fact that it has common counsel with Canfor weighs against consolidation. Canfor and Terminal agreed to common counsel on the condition that counsel not share confidential information, including confidential business information, about either Canfor or Terminal with the other company. As long as the claims are separate, Terminal contends that there is no need for separate counsel because there is little likelihood of any conflict arising from the mere fact that the two parties have the same counsel. However, if the proceedings were consolidated, then separate

counsel may need to be retained to represent Terminal's interests, which differ from Canfor's interests.

53. Terminal reiterates Claimants' concern with consolidating proceedings among Claimants who are competitors and who will have to disclose confidential information during the proceedings. Terminal is concerned that it will not be able to obtain a fair hearing under the circumstances.
54. With respect to the United States' contention that Terminal has merely filed a Notice of Arbitration but failed to prosecute its claims, Terminal points out that the United States has not filed any objections to Terminal's conduct in the arbitration or requested that it take any action. Likewise, since there have been no filings in this proceeding other than the Notice of Arbitration, including an objection to jurisdiction on behalf of the United States, Terminal objects to the United States' contention that commonality of the jurisdictional issue exists with respect to all three Claimants.
55. Further, Terminal argues that the United States has failed to establish the existence of common questions of fact or law, particularly because Terminal is focused almost entirely upon the high-value Western Red Cedar market. According to Terminal, the characteristics of that market are fundamentally different from the SPF (Spruce, Pine, Fir) market, on which Canfor and Tembec focus. Terminal explains that it is not in the commodity market and that many of the issues and much of the conduct of the United States as it relates to Terminal are significantly different from the issues and conduct relating to the other commodity producers of softwood lumber.
56. Finally, Terminal contends that consolidation will, if so determined, result in delay. Terminal will need to determine whether it needs separate counsel, will have to retain counsel, brief counsel on the case, and prepare a statement of claim.

Then Terminal may have to brief any jurisdictional issue that the United States may advance.

57. In its post-hearing brief (which is the same as Canfor's post-hearing brief, except where expressly noted), Terminal responded to the questions of the Consolidation Tribunal raised at the hearing ("Canfor & Terminal PHB"). Those responses will be considered in the analysis of the Tribunal below.
58. In its reply post-hearing brief of 12 August 2005 (which was also filed on behalf of Canfor), Terminal responded to a number of the answers given by the United States in its post-hearing brief to the Tribunal questions ("Canfor & Terminal R-PHB"). Those responses will also be considered in the analysis of the Tribunal below.

V. CONSIDERATIONS OF THE CONSOLIDATION TRIBUNAL

59. As required by Article 1131(1) of the NAFTA, the Tribunal shall apply "this Agreement [the NAFTA] and the applicable rules of international law." Accordingly, the Tribunal will also apply the rules of interpreting treaties as set forth in Articles 31 and 32 of the Vienna Convention on the Law of Treaties of 1969.¹³ While the 1969 Vienna Convention is not in force among the three

¹³ Article 31 – General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

(footnote cont'd)

NAFTA State Parties (the United States has never ratified it), Articles 31 and 32 are regarded as reflective of established customary international law.

60. In the analysis below, the Tribunal has not only considered the positions of the parties as summarized in the preceding Section but also their numerous detailed arguments in support of those positions as well as the arguments made at the hearing. To the extent that these arguments are not referred to expressly, they must be deemed to be subsumed in the analysis.

A. Article 1126 of the NAFTA

61. The question before this Tribunal is whether the NAFTA Chapter 11 claims,¹⁴ submitted by Canfor, Tembec and Terminal to arbitrations under Article 1120 of the NAFTA, should be consolidated in whole or in part. Where the claims of several parties to separate Article 1120 arbitrations have “a question of law or fact in common,” the Tribunal may, “in the interests of fair and efficient resolution of

3. There shall be taken into account, together with the context:

- (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
- (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
- (c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32 – Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.

¹⁴ See Sub-section V.A(h) (page 40) *infra*, discussing the meaning of “claims” in Article 1126(2).

the claims,” issue an order pursuant to Article 1126(2) of the NAFTA, which provides:

Where a Tribunal established under this Article is satisfied that claims have been submitted to arbitration under Article 1120 that have a question of law or fact in common, the Tribunal may, in the interests of fair and efficient resolution of the claims, and after hearing the disputing parties, by order

(a) assume jurisdiction over, and hear and determine together, all or part of the claims; or

(b) assume jurisdiction over, and hear and determine one or more of the claims, the determination of which it believes would assist in the resolution of the others.

62. The provisions of Article 1126 of the NAFTA pose a number of questions, which require analysis in order to determine the request of the United States.

(a) Legislative history

63. As of the first draft (December 1991) of what has become Chapter 11 of the NAFTA, investor-State arbitration was contemplated.¹⁵
64. After some ten published drafts, the draft dated 4 June 1992 (called “Virginia Composite”) contained a proposal made by Canada that is relevant for the present Article 1126. The proposal was bracketed, which meant that it had not yet been accepted by Mexico and the United States.

¹⁵ Draft of December 1991, Article XX07. The legislative history (“rolling texts” only) is published on the websites of the State Parties to NAFTA:

Government of Canada, International Trade, NAFTA Chapter 11 website:

<http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-en.asp>

Government of Mexico, Secretary of Economy, NAFTA website:

http://www.economia-snci.gob.mx/sic_php/l523al.php?s=18&p=1&l=1

(footnote cont’d)

65. Article XX07.9 of the draft of 4 June 1992 provided that a State Party only was permitted to request the Secretary of the International Chamber of Commerce (“ICC”) to establish a panel of three arbitrators (all to be appointed by the Secretary). The State Party had to do so, within 90 days after an investor had given its notice of intent to arbitrate, “if it considers that the dispute, or the dispute and other investment disputes in which it is a disputing Party, raises important issues of public policy or that the dispute and other investment disputes in which it is a disputing Party should be consolidated.”¹⁶ The claimants and their governments were allowed to participate in the proceedings. The moving State Party was allowed “to refer to the arbitration panel such issues as it considers appropriate.” The mission of the panel appeared to be mandatory: “[T]he panel shall determine and dispose of those issues.” It was further provided: “The determination and disposition of the arbitral panel, or the settlement by the [State] Parties on the issue or issues before it, is binding on the parties to the proceedings before the panel and on any arbitral panel or tribunal established pursuant to paragraph 4, 8 or 10 to which the same issue or issues is or have [*sic*] been referred for arbitration.”
66. Although not entirely clear, the draft of 4 June 1992 seems to provide for two types of proceedings. First, another tribunal (to be appointed by the Secretary of the ICC) could be required by a State Party to act as a tribunal in which two or more investment disputes were heard and determined in a consolidated fashion. Second, another tribunal could be required by a State Party to determine issues irrespective of whether there were one or more arbitrations pending on those

US Department of State, International Claims and Investment Disputes website:
<http://www.state.gov/s/l/index.cfm?id=3439>.

¹⁶ Draft of 4 June 1992, Article XX07.7(b).

issues. The determination of those issues would be binding on the other tribunal or tribunals.

67. The Canadian proposal remained in the subsequent drafts until two drafts of 4 August 1992 (called “Watergate Daily Update”). The first draft mentioned beneath the caption “Article 2119: Dispute Settlement”: “[SEE SUBGROUP TEXT],” which text is not publicly available but seems to be inserted in a second draft of the same date. The second draft contained a Section headed: “Settlement of Disputes between a Party and an Investor of Another Party,” under which were set forth Articles 2119 – 2123. Most of them were not bracketed, which indicates that the State Parties had reached agreement in principle on those provisions. The non-bracketed Article 2129, captioned “Consolidation,” differed in various respects from the (Canadian) draft of 4 June 1992. Both a respondent State and an investor could request the constitution of another tribunal. That tribunal was to be established by the Secretary-General of ICSID (rather than the Secretary of the ICC). There was no longer a period of time specified for making the request. The tribunal was no longer mandatorily required to determine and dispose of the issues brought before it. Rather, “[w]here it appears to the arbitration tribunal that arbitrations that have been initiated under Article 2125 that have questions of law or fact in common, the tribunal may, in the interests of fair and efficient resolution of the disputes, . . . , order” It could issue an order to (a) “hear and determine together, all or part of the investment disputes,” or (b) “hear and determine, one or more of the investment disputes the determination of which it believes would assist in the resolution of the others.”¹⁷ Article 2129 provided that an arbitral tribunal shall not have jurisdiction to decide an investment dispute, or a part of an

¹⁷ Second draft of 4 August 1992, Article 2129(4).

investment dispute, over which the tribunal established under that article had assumed jurisdiction.¹⁸

68. It is common knowledge that, on 12 August 1992, Canada, Mexico and the United States announced the completion of the negotiations of the NAFTA, it being understood that “further legal drafting and review are required to implement the understandings reached by the negotiators.”¹⁹ Thus, on 12 August 1992, the three States reached agreement in principle on the substance of the NAFTA, subject to a “scrubbing” of the text by their lawyers, ensuring, *inter alia*, consistency of the texts of the many chapters negotiated by various teams.²⁰
69. The draft of the “consolidation” provisions remained the same until 4 September 1992. The first draft of that day (called “Lawyers’ Revision,” and time stamped 1:30) was still the same, but the second draft (also called “Lawyers’ Revision,” and time stamped 6:00) contained various amendments (now Article 1125). One of those amendments replaced the term “investment disputes” by the word “claims.” Thus, the terminology was no longer “all or part of the investment disputes” or “one or more of the investment disputes the determination of which it believes would assist in the resolution of the others,” but had rather become “all or

¹⁸ Second draft of 4 August 1992, Article 2129(5).

¹⁹ President George H.W. Bush, Statement released by the White House, Office of the Press Secretary, Washington, D.C., 12 August 1992.

²⁰ US Trade Representative Ambassador Carla Hills made a NAFTA presentation on 13 August 1992 before the US Chamber of Commerce in Washington. As reported by the Federal News Service, she said in response to a question: “We got out very detailed summaries yesterday, and we will continue to add data to those summaries. What we’re doing now is scrubbing the text and drafting the text to capture the agreement . . . what we don’t want to do is to get out a text and then have the lawyers say that there is language inconsistent with another part of the agreement . . .” President Bush is also quoted as staying: “[the text] had to be ‘scrubbed’ by lawyers into proper legal language . . .,” Journal of Commerce, 19 August 1992 p. 5A (“Citizens Group wants copy of NAFTA text”).

part of the claims” or “one or more of the claims, the determination of which it believes would assist in the resolution of the others.”²¹

70. A subsequent revision of the provisions occurred in a draft of 2 October 1992 (in which Article 1125 was renumbered Article 1126). The draft of 4 September 1992 had mentioned in a footnote that paragraph 8 “does not address as what would be the status of an Article 1120 Tribunal pending decision on whether to consolidate by a Consolidation Tribunal, and does not address the effect of an order under paragraph 2(b).” The draft of 2 October 1992 dealt with that question by providing that, on the application of a disputing party,²² an Article 1126 Tribunal may by order stay the proceedings of the Article 1120 Tribunal pending its decision on consolidation.²³
71. After the revision in the draft of 2 October 1992, no further amendments were made and Article 1126 in that draft became the final text.
72. There is very little contemporaneous commentary by the drafters of Article 1126 of the NAFTA. Mr. Daniel Price (one of the US lawyers involved in the negotiations) noted: “The chapter does not resolve all the questions that may occur during consolidation. Many issues will need to be worked out by the tribunal in consultation with the disputing parties.”²⁴ Mr. Price does not identify those questions but, as it appears from the analysis below, there are some that require interpretation by this Consolidation Tribunal and, if consolidation is ordered,

²¹ Draft of 4 September 1992 (6:00), Article 1125(2) and (8).

²² The drafts are “case-sensitive”: a “disputing Party” with a capitalized “P” means a State Party against which a claim is made, and a “disputing party” with a lower “p” means a State Party or a disputing investor. See draft of 4 September 1992 (6:00), Article 1138 (Definitions). That distinction has remained in the final text (Article 1139).

²³ Draft of 2 October 1992, Article 1126(9).

²⁴ Daniel M. Price, *An Overview of the NAFTA Chapter: Substantive Rules and Investor-State Dispute Settlement*, 27 INT’L LAWYER 727, 734 (1993).

consultation with the parties. Mr. Jonathan Fried (one of the Canadian lawyers involved in the negotiations) noted: “Special and novel procedures provide an effective means for the ‘consolidation’ of cases [footnote omitted], to avoid procedural harassment [footnote omitted] . . .”²⁵

(b) *Rationale*

73. The just quoted observation by Mr. Fried concerning avoidance of procedural harassment appears to be the main rationale of the provisions set forth in Article 1126 of the NAFTA. The initial proposal by Canada provided that a State Party only could make a request under what has become Article 1126. The initial, main concern seemed to have been that a State Party would be faced with a multitude of claims by investors arising out of the same event or related to the same measure by that State. In such a situation, procedural economy may be served by consolidating multiple proceedings. The latter concern is also reflected in the text of Article 1126(2) which refers to “*efficient* resolution of the claims” (emphasis added). Mr. Henri Alvarez observes: “it may be assumed that this consolidation provision is intended to relieve a State Party from the hardship of having to defend multiple claims arising from the same measure . . .”²⁶
74. In the subsequent drafts, the right of a State Party to request the establishment of a separate tribunal was extended to disputing investors as well. Moreover, the mission of the tribunal was no longer mandatory, but instead became discretionary. These changes indicate that the drafters wished to balance the procedural rights of State Parties and disputing investors.

²⁵ Jonathan T. Fried, *Two Paradigms for the Rule of International Trade Law*, 20 CAN-U.S. L.J. 39, 49 (1994).

²⁶ Henri C. Alvarez, *Arbitration under the North American Free Trade Agreement*, 16 ARB’N INT’L 393, 414 (2000).

75. However, the enlargement of parties that may make a request under Article 1126, and of the powers of an Article 1126 Tribunal, does not take away its intended purpose and object, as have become clear from the referenced legislative history, which are procedural economy in the light of the position of State Parties in particular. That objective includes considerations of saving costs and time for a State Party, while simultaneously taking into account and balancing the interests of the disputing investors.
76. The term “procedural economy” is used here advisedly in the sense of an effective administration of justice. The Tribunal has purposely rejected the term “judicial economy,” given the various meanings that the term carries in both national and international law. It can be said that, in certain national laws, judicial economy involves deciding a claim on the narrowest possible ground, or not deciding issues that need not be addressed once a dispute has been resolved on a different ground. This meaning has on occasion been used in the international arena. However, “judicial economy” has also been used differently in international cases.²⁷ In any event, in this instance, the Consolidation Tribunal means to refer in particular to the goal of alleviating the resources of the State Parties in defending against multiple claims, as opposed to conserving the resources of the Article 1120 Tribunals empanelled to hear the individual disputes.
77. Finally, with respect to the rationale of Article 1126, it is to be noted that consolidation is well known in many domestic court procedures, including in

²⁷ See, e.g., International Court of Justice’s Decision to Render an Opinion in Response to the Request under General Assembly Resolution 49/75K, *Legality of the Threat or Use of Nuclear Weapons*, Dissenting Opinion of Judge Oda, Part Two, ¶ 53 (referring to “judicial economy” in the sense of using the ICJ’s judicial resources to provide solutions to inter-State disputes of a contentious nature instead of rendering advisory opinions on legal questions of a general nature as to whether a specific action would or would not be in conformity with the application of treaty law or of customary law). The WTO has applied the term “judicial economy” differently. See ¶ 182 *infra*.

Canada, Mexico and the United States.²⁸ It is a procedural device combining two or more proceedings into one proceeding.

(c) *Consensual nature*

78. Claimants contest consolidation on the grounds that it would be against the consensual nature of arbitration (or the principle of party autonomy). However, the dispute settlement mechanism contained in Section B of Chapter 11 of the NAFTA is the result of an international treaty negotiated by three States. They provided for dispute settlement between them and investors by means of arbitration governed by international law. In doing so, the State Parties to the treaty are entitled as sovereigns to set certain conditions.²⁹ In the case of the NAFTA, the States wished to ensure procedural economy in the case of multiple claims arising out of the same event or related to the same measure. As it is pointed out by Mr. Henri Alvarez:

²⁸ Canada: *Federal Rules of Court*, Rule 105; *Code de procédure civile du Québec* L.R.Q. c. C-25, Article 270; Ontario *Courts of Justice Act* R.S.O. 1990 c. C-43 as am'd Section 107; Ontario *Rules of Civil Procedure* Rule 6. Mexico: *Código de Procedimientos Civiles* Article 72; *Ley de Amparo* Article 57. United States: *Federal Rules of Civil Procedure* (“FRCP”) Rule 42. A review of these texts shows that the language of Article 1126(2) of the NAFTA bears some similarities with Rule 42(a) of the US FRCP, which provides: “Consolidation. When actions involving a common question of law or fact are pending before the court, it may order a joint hearing or trial of any or all the matters in issue in the actions; it may order all the actions consolidated, and it may make such orders concerning proceedings therein as may tend to avoid unnecessary costs or delay.” Article 1126(2) of the NAFTA also shows some similarities with Rule 23 of the US FRCP, which deals with the subject of “class actions.” A “class action” allows for a member of a class, under specified circumstances, to “sue or be sued as representative” of all in the class. One of the specified conditions of Rule 23 appears in Rule 23(B)(3) which refers to whether there are “questions of law or fact common to the members of the class” as well as to whether the institution of a class action would benefit “the fair and efficient adjudication of the controversy.”

²⁹ Those conditions, however, should always be subject to the fundamental requirements of due process. *See also* Article 1115: “. . . this Section establishes a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the [State] Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal.”

Although mandatory consolidation is not widely accepted in private commercial arbitration, it makes good sense in the case of Chapter 11 of NAFTA, which is not the usual private, consensual context of international commercial arbitration. Rather, Chapter 11 creates a broad range of claims which may be brought by an equally broad range of claimants who have mandatory access to a binding arbitration process without the requirement of an arbitration agreement in the conventional sense nor even the need for a contract between the disputing parties. In view of this, some compromise of the principles of private arbitration may be justified.³⁰

79. Claimants' argument that, if consolidation is ordered, their claims will be adjudicated by a tribunal to which they have not consented, can, therefore, not be accepted either. The possibility of an order under Article 1126(2) forms part and parcel of Section B of Chapter 11 of the NAFTA. If a disputing investor opts for arbitration under Section B, it can only do so if "the investor consents to arbitration *in accordance with the procedures set forth in this Agreement*" (emphasis added; Article 1121). By consenting to arbitration within the confines of Article 1121, the disputing investor accordingly also consents to Article 1126, with the potential consequence that its claims will be adjudicated by a tribunal that is composed of persons different from those who formed part of the original Article 1120 Tribunal. This result is also explicitly stated in the exception formulated in Article 1123 of the NAFTA:

*Except in respect of a Tribunal established under Article 1126, and unless the disputing parties otherwise agree, the Tribunal shall comprise three arbitrators, one arbitrator appointed by each of the disputing parties and the third, who shall be the presiding arbitrator, appointed by agreement of the disputing parties. (emphasis added)*³¹

³⁰ See n. 26 *supra* at 414.

³¹ Reference may also be made to the possibility of consolidation under Article 1117(3):

(footnote cont'd)

80. It may be added that the aforementioned consent includes the agreement that, if the arbitration is consolidated under Article 1126, that arbitration is to be conducted in accordance with the UNCITRAL Arbitration Rules “*except as modified by this Section [B of Chapter 11 of the NAFTA]*” (emphasis added; Article 1126(1)). That circumstance is also the case when the disputing investors initially opted for arbitration under the Additional Facility Rules of ICSID pursuant to Article 1120(1)(b).³² In the present case, however, all Claimants have opted for arbitration on the basis of the UNCITRAL Arbitration Rules in respect of the Article 1120 proceedings.

(d) Alleged structural problems inherent in Article 1126

81. In the context of the question concerning the consensual nature of Article 1126 as analyzed in the preceding Sub-section, certain arguments raised by Tembec, in particular in its Motion to Dismiss of 27 June 2005, need also to be considered. Tembec asserts that unique problems inherent in the procedural structure of Article 1126 counsel against the Consolidation Tribunal proceeding as constituted. It argues: (i) that Article 1126 places members of the Tribunal in the position of deciding a question in which they have a financial interest, including the contention that Article 1126 presents “unique” conflicts for arbitrators and that the

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

It is further to be pointed out that an arbitral tribunal established under Section B of Chapter 11 of the NAFTA may be bound by an interpretation by the Free Trade Commission of a provision of the NAFTA. *See* Articles 1131(2) and 1132 as well as Chapter 20 of the NAFTA.

³² The same would have applied to arbitration under the ICSID Convention of 1965 (*see* Article 1120(1)(a)), but only the United States is party to that Convention and not Canada and Mexico.

parties in the *Corn Products* case recognized the ethical problems of Article 1126; and (ii) that consolidation under Article 1126 eliminates Tembec's right to select even one arbitrator to review the merits of the case.³³ The Consolidation Tribunal rejects these arguments for the following reasons.

82. With respect to the alleged incentive for members of an Article 1126 Tribunal, that situation is not uncommon in arbitration. Indeed, any arbitral tribunal that is faced with an objection to its jurisdiction would have the purported conflict. If this contention were correct, either no arbitral tribunal could decide on an objection to jurisdiction or every arbitral tribunal should always decide to decline jurisdiction. Yet, modern arbitration treaties, laws and rules require an arbitral tribunal to decide on any objection to jurisdiction.³⁴ In that respect, there is no difference between an Article 1120 Tribunal and an Article 1126 Tribunal.³⁵ For the reasons set forth above, Article 1126 Tribunals also derive their jurisdiction and legitimacy through consent of the parties.³⁶

³³ Tembec's Motion to Dismiss at 12-20.

³⁴ A general principle in international arbitration, referred to as "*compétence de la compétence*," provides that an arbitral tribunal has the power to determine its own jurisdiction over claims. *E.g.*, ICSID Convention of 1965, Article 41(1); UNCITRAL Model Law on International Commercial Arbitration of 1985, Article 16 (providing for the competence of an arbitral tribunal to rule on its jurisdiction); and UNCITRAL Arbitration Rules of 1976, Article 21 (providing that an arbitral tribunal shall have the power to rule on objections that it has no jurisdiction).

³⁵ Technically, an Article 1126 Tribunal does not decide on jurisdiction but rather gives a decision of an administrative nature. *See* Sub-section V.A(g) (page 38) *infra*.

³⁶ Tembec's reliance on Section 1.3 of the IBA Guidelines on Conflicts of Interest in International Arbitration of 2004 is not correct. Under the caption "Non-Waivable Red List," the Guidelines include the instance where: "The arbitrator has a significant financial interest in one of the parties or the outcome of the case." A situation appearing on the Non-Waivable Red List means that a prospective arbitrator must always decline an appointment. However, the "financial interest in . . . the outcome of the case" does not apply to the arbitrator's remuneration as arbitrator, but applies to situations such as sharing in the amount awarded on the merits.

83. It is conjecture to state that: “Presumably arbitrators will be more likely than courts to find jurisdiction, since arbitrators get paid if they hear a dispute.”³⁷ There are reported cases in which an arbitral tribunal has declined jurisdiction.³⁸
84. The perceived ethical conflict would apply to many professionals. To take two examples: a lawyer is to advise his or her client to bring a legal action; or a surgeon is to advise his or her patient about heart surgery. The lawyer is to advise his or her client about the strengths and weaknesses of the case and the chances of success; the surgeon is to advise the patient about the condition of the heart and the chances of success of the surgery. That is what the deontology of these professionals requires them to do. This situation basically is not any different for an arbitrator. He or she is to analyze the claims, and the factual and legal arguments in support thereof, and to make a determination in a professional, impartial and independent manner.
85. As to the agreement concluded in conjunction with the *Corn Products* case, parties are free under the NAFTA to determine by advance agreement the method of constituting an arbitral tribunal, which power also applies in connection with an Article 1126 Tribunal. See Article 1123 quoted at ¶ 79 above. But here, the parties did not so agree.

³⁷ William W. Park, *Bridging the Gap in Forum Selection: Harmonizing Arbitration and Court Selection*, 8 TRANSNAT’L L. & CONTEMP. PROBS. 19, 50, (1999), quoted by Tembec, *id.* at 16.

³⁸ See, e.g., *Waste Management, Inc. v. the United Mexican States*, Case No. ARB(AF)/98/2, Award on Jurisdiction of 2 June 2000, available at http://www.worldbank.org/icsid/cases/waste_award.pdf; *Joy Mining Machinery Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction of 6 August 2004, available at <http://www.worldbank.org/icsid/cases/joy-mining-award.pdf>; *Consortium Groupement L.E.S.I. - DIPENTA v. Algeria*, ICSID Case No. ARB/03/8, Award of 10 January 2005, available at <http://www.worldbank.org/icsid/cases/lesi-sentence-fr.pdf>; *Lucchetti S.A. and Lucchetti Peru, S.A. v. Republic of Peru*, ICSID Case No. ARB/03/4, Award of 7 February 2005, available at <http://www.worldbank.org/icsid/cases/lucchetti-award.pdf>; *Hussein Nuaman Soufraki v. United Arab Emirates*, ICSID Case No.

(footnote cont’d)

86. Tembec seems to contend that the provisions relating to the constitution of an Article 1126 Tribunal are defective and in all cases should necessitate an agreement among the parties on the constitution of the Tribunal. However, no such agreement is required by the text of Article 1126. In the absence of a special advance agreement, members of an Article 1126 Tribunal are appointed by a neutral person, i.e., the Secretary-General of ICSID, a method to which all parties have consented as a result of Articles 1121 and 1123 of the NAFTA. If a party believes that an arbitrator lacks impartiality or independence, that party can challenge such an arbitrator under the applicable arbitration rules.³⁹ To accept the proposed interpretation of Article 1126 would be contrary to the principle of effectiveness, which, under the terms of the 1969 Vienna Convention, requires that meaning be given to the words of a treaty.
87. Furthermore, as it becomes evident from the present Order, while the text of Article 1126 in some instances demands interpretation, that does not mean that its provisions are defective or that they cannot be applied without a further agreement of the parties.

(e) Discretionary power

88. An Article 1126 Tribunal has discretionary power to make an order under Article 1126(2) of the NAFTA, subject to the requirements set forth below. The text of Article 1126(2) of the NAFTA uses the expression “*may . . . order*” (emphasis added). The discretionary power is also confirmed by the legislative history which

ARB/02/7, Award of 7 July 2004, available at <http://www.investmentclaims.com/decisions/Soufraki-UAE-Award-7Jul2004.pdf>.

³⁹ Tembec did challenge one of the members of the present Tribunal, which challenge was rejected. See ¶ 8 *supra*.

shows a difference between the first (Canadian) draft that provided for mandatory determination,⁴⁰ and the subsequent drafts that abandoned that requirement.

89. The power to make an order under Article 1126(2) is circumscribed by the express conditions (i) that “claims have been submitted to arbitration under Article 1120,” (ii) that these claims have “a question of law or fact in common,” (iii) that the order is “in the interests of fair and efficient resolution of the claims,” and (iv) that the disputing parties have been heard. This power is further circumscribed by what an Article 1126 Tribunal may order pursuant to sub-paragraphs (a) and (b) of Article 1126(2) of the NAFTA. A number of those conditions will be examined in the Sub-sections that follow.
90. The Consolidation Tribunal disagrees with the argument that: “The text of NAFTA Article 1126 intentionally sets a high bar to consolidation” and that “such a high bar would make consolidation a rarity . . .”⁴¹ A “high bar” or “high threshold procedural standards” are neither expressed nor implied in the text of Article 1126.
91. It may be added that the discretionary power of an Article 1126 Tribunal to make an order under Article 1126(2) is also to be used to reign-in any frivolous requests for consolidation.

(f) Burden of proof

92. Claimants argue that the party requesting an order under Article 1126(2) of the NAFTA has the burden of proof that a question of law or fact is in common and that the order is in the interests of fair and efficient resolution of the claims. The

⁴⁰ See ¶ 64 *supra*.

⁴¹ Tembec R-PHB at 35.

United States denies that such a burden of proof is imposed on an applicant under Article 1126.

93. The rules concerning burden of proof in international law are well established.⁴² However, those rules have a limited relevance in the context of an application for an order under Article 1126(2).
94. Paragraph 3 of Article 1126 requires that a disputing party that seeks an order under paragraph 2 shall specify in the request: (a) the name of the disputing Party or disputing investors against which the order is sought; (b) the nature of the order sought; and (c) the grounds on which the order is sought. Paragraph 3 does not impose a specific burden of proof on the party seeking an order under Article 1126(2) other than furnishing elements for setting into motion the proceedings for a possible consolidation under Article 1126(2).
95. According to the English text of Article 1126(2), the Tribunal must be “satisfied that claims have been submitted to arbitration under Article 1120 that have a question of law or fact in common.” The equally authentic French text is slightly different: “*Un tribunal établi aux termes du présent article qui est convaincu que les plaintes soumises à l’arbitrage en vertu de l’article 1120 portent sur un même point de droit ou de fait.*” The also equally authentic Spanish text leaves out the Spanish counterpart for the word “satisfied” or “*convaincu*” altogether: “*Cuando un tribunal establecido conforme a este artículo determine que las reclamaciones*

⁴² See, generally, Mojtaba Kazazi, BURDEN OF PROOF AND RELATED ISSUES. A STUDY OF EVIDENCE BEFORE INTERNATIONAL TRIBUNALS (1996). See also *Asian Agricultural Products Ltd. (AAPL) (Hong Kong) v. The Republic of Sri Lanka*, Final award of 27 June 1990 in ICSID Case No. ARB/87/3, at ¶ 56, available at <http://www.investmentclaims.com/decisions/AsianAgricultural-SriLanka-FinalAward-27Jun1990.pdf>, reprinted in XVII YB Comm. Arb’n (1992) 106 at 122-124. *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, adopted 23 May 1997, WT/DS33/AB/R and Corr. 1, p. 14, available at http://www.wto.org/english/tratop_e/dispu_e/ab_reports_e.htm, quoted approvingly in *Marvin Feldman v. Mexico* (NAFTA), ARB(AF)/99/1, 16 December 2002, available at <http://www.investmentclaims.com/decisions/Feldman-Mexico-Award-16Dec2002-Eng.pdf>.

sometidas a arbitraje de acuerdo con al Artículo 1120 plantean cuestiones en común de hecho o de derecho.” A combined reading of these texts, pursuant to Article 33(4) of the Vienna Convention on the Law of Treaties of 1969,⁴³ indicates that an Article 1126 Tribunal has discretionary power in determining whether there is a question of law or fact in common. Correspondingly, in addition to fulfilling the requirements of Article 1126(3), quoted above, a party seeking an order under Article 1126(2) has to show to the satisfaction of the Tribunal that there is a question of law or fact in common in the Article 1120 arbitrations in respect of which that party seeks consolidation. It is to that extent only that a party seeking an order under Article 1126(2) has a burden of proof.

96. On the other hand, the condition that the order be “in the interests of fair and efficient resolution of the claims” pertains to the need for argument of the parties on this issue. The appreciation of that condition, which is prospective in nature, is again within the discretion of an Article 1126 Tribunal, having to take into account the positions of all parties.

⁴³ Article 33 – Interpretation of treaties authenticated in two or more languages

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.

2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.

3. The terms of the treaty are presumed to have the same meaning in each authentic text.

4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

(g) *The term “jurisdiction”*

97. Article 1126(2) provides that the Tribunal may issue an order to “assume jurisdiction over” all or part of the claims, or one or more of the claims, that have been submitted to arbitration under Article 1120. Article 1126(8) provides in turn: “A Tribunal established under Article 1120 shall not have jurisdiction to decide a claim, or a part of a claim, over which a Tribunal established under this Article has assumed jurisdiction.” The meaning of the term “jurisdiction”⁴⁴ in those provisions is examined below in the context of various arguments made with respect to that term.
98. It is argued that this wording in Article 1126 means that an Article 1126 Tribunal cannot decide on objections to jurisdiction and, in the alternative, that, if a party requests consolidation, it waives the right to object to jurisdiction.⁴⁵ The Consolidation Tribunal disagrees with those arguments for the following reasons.
99. If a party commences arbitration, an arbitral tribunal has jurisdiction to hear and to determine the dispute submitted to it. It is when a party timely raises a plea as to the jurisdiction of a tribunal that the tribunal is called upon to decide on its own jurisdiction. Until the tribunal has ruled on the plea as to jurisdiction, its jurisdiction remains in force and effect. Thus, Article 21(1) of the UNCITRAL Arbitration Rules provides: “The arbitral tribunal shall have the power to rule on objections that it has no jurisdiction” Article 21(4) provides: “In general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question. However, the arbitral tribunal may proceed with the arbitration and rule on such plea in their final award.”

⁴⁴ See ¶ 100 *infra* for a discussion of the term “assume.”

⁴⁵ Tembec Submission of 10 June 2005 at 25-26; Motion to Dismiss at 4-12; PHB at 3-7; R-PHB at 5 *et seq.*

100. In the case of an order for consolidation under Article 1126(2), the term “assume jurisdiction” in Article 1126(2) and (8) means nothing else than that the Article 1126 Tribunal takes over the proceedings, in the capacity of an arbitral tribunal, to hear and to determine the disputes from the respective Article 1120 Tribunals. That action is of a procedurally administrative nature, in which two or more arbitral tribunals are replaced by one arbitral tribunal with respect to the same disputes.⁴⁶
101. The assumption of jurisdiction in such a context does not have any relevance for the question of whether the jurisdiction of the Article 1120 Tribunals or of the Article 1126 Tribunal is justified. That question has to be addressed in the context of Article 21 of the UNCITRAL Rules, either by the Article 1120 Tribunal or, if the proceedings of the Article 1120 Tribunal have not reached the stage of a ruling on a plea as to jurisdiction, by the Article 1126 Tribunal. A request under Article 1126, therefore, cannot be considered a waiver of the right to object to the jurisdiction of an arbitral tribunal, whether it be the Article 1120 one or the Article 1126 one, to hear and to determine a dispute.⁴⁷
102. For the same reasons, the Consolidation Tribunal rejects the argument that having submitted its statement of defense in *Canfor* and *Tembec* without raising any objection to the Article 1120 Tribunals’ jurisdiction based on Article 1126, the United States’ plea that jurisdiction over the Claimants’ claims properly lies with

⁴⁶ See Tr. at 174-75 (United States arguing that consolidation under Article 1126 results in a “transfer” of jurisdiction but does not act as a ground for objecting to jurisdiction); Tr. at 225 (Tembec pointing out the apparent inconsistency of the United States arguing that the Consolidation Tribunal should assume jurisdiction under Article 1126, but that such a transfer of jurisdiction overcomes the requirements of Article 21(3), providing: “A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence or, with respect to a counter-claim, in the reply to the counter-claim.”). See also ¶ 103 *supra*.

⁴⁷ A different question is whether the United States’ request is barred by the doctrines of laches and estoppel, see Section V.C (page 62) *infra*.

the Article 1126 Tribunal is untimely under the UNCITRAL Arbitration Rules. The invocation by a disputing party of Article 1126 is not, by the ordinary meaning of its terms, a jurisdictional objection to an Article 1120 Tribunal. The issue of whether to consolidate is, as such, separate and apart from the issue of jurisdiction.

103. A different question is whether a party can no longer raise a plea as to the jurisdiction in the Article 1126 proceedings if it has not timely raised such a plea in the Article 1120 arbitration. According to Article 21(3) of the UNCITRAL Arbitration Rules, the plea should have been raised not later than in the statement of defense. Although Article 1126 of the NAFTA (and the UNCITRAL Rules for that matter) are silent on this different question, the Consolidation Tribunal is of the opinion that this question must in principle be answered in the affirmative. Thus, if a party has failed to raise the plea as to jurisdiction in the Article 1120 arbitration at the latest in the statement of defense (assuming that the Article 1120 arbitration has reached that stage), a party is in principle barred from raising the plea in the consolidation proceedings.⁴⁸

(h) The terms “all or part of the claims” and “one or more of the claims”

104. Sub-paragraphs (a) and (b) of Article 1126(2) provide for the assumption of jurisdiction by an Article 1126 Tribunal of “all or part of the claims,” or “one or more claims, the determination of which it believes will assist in the resolution of the others.”
105. The Consolidation Tribunal notes that the request of the United States in the present case is one pursuant to sub-paragraph (a) of Article 1126(2) since it seeks

⁴⁸ The bar is what the text of Article 21(3) of the UNCITRAL Arbitration Rules of 1976 provides. *Cf.* UNCITRAL Model Law on International Commercial Arbitration of 1985, which adds in the corresponding Article 16(2) *in fine*: “The arbitral tribunal may . . . admit a later plea if it considers the delay justified.”

the consolidation of the entirety of all three Article 1120 arbitrations together, in respect of which the United States submits that they have questions of law and fact in common.

106. In order to place the United States' request in context, the question concerning the difference between sub-paragraphs (a) and (b) of Article 1126(2) needs to be addressed. That difference is indicated by the expression "hear and determine together" in sub-paragraph (a), while sub-paragraph (b) uses the expression "hear and determine" without the qualifier "together." The qualifier shows that sub-paragraph (a) contemplates claims in two or more Article 1120 arbitrations to be heard and determined in whole or in part in a single proceeding. In contrast, under sub-paragraph (b), claims in one or more of the Article 1120 arbitrations, but not in all, may be singled out by an Article 1126 Tribunal from the total of the Article 1120 arbitrations that have a question of law or fact in common so that a decision on the claims in the Article 1120 arbitration(s) that has (have) been singled out by the Article 1126 Tribunal would assist the other Article 1120 Tribunal(s) in the resolution of the claims before them.
107. A question is whether the term "claims" in Article 1126(2) also includes jurisdictional (and/or admissibility) objections raised against the bringing of one or more claims.⁴⁹ It must indeed be deemed to be so. Article 1126 refers to "claims . . . that have a question of law or fact in common." As will be explained below, that phrase connotes a factual or legal issue that requires a finding to dispose of a claim.⁵⁰ If a jurisdictional objection is raised against a claim, the claim can be disposed of only if the jurisdictional objection is also disposed of. The legislative history reviewed above does not indicate that, in the successive drafts, the

⁴⁹ Tembec R-PHB at 5-7.

⁵⁰ See Sub-section V.A(i) (page 42) *infra*.

negotiators intended to narrow the scope of an Article 1126 Tribunal's competence. Moreover, if it were otherwise, Article 1126 would lose its object and purpose of procedural economy because an Article 1126 proceeding could then take place only after each of the Article 1120 Tribunals has ruled on jurisdictional objections.

108. In conclusion, an Article 1126 Tribunal can order many forms of consolidation under, in particular, sub-paragraph (a) of Article 1126(2). For example, an Article 1126 Tribunal can order the consolidation of all issues relating to liability, leaving damages to the Article 1120 Tribunals. An Article 1126 Tribunal may also order consolidation of a National Treatment claim under Article 1102 and/or a Most-Favored-Nation Treatment claim under Article 1103 and/or a Minimum Standard of Treatment claim under Article 1105, and leave an Expropriation claim under Article 1110 to the Article 1120 Tribunals.⁵¹ Further, an Article 1126 Tribunal may consolidate issues relating to objections to jurisdiction (and/or admissibility) alone, and, to the extent that it rejects those objections, leave the remainder of the dispute to the Article 1120 Tribunals.⁵²

(i) *The term “a question of law or fact in common”*

109. The notion of “question” in the term “a question of law or fact in common” as appearing in Article 1126(2) means a factual or legal issue that requires a finding to dispose of a claim. That meaning follows from the wording and structure of Article 1126(2). It refers to “claims [that] have been submitted to arbitration under Article 1120” and then to those claims “hav[ing] a question of law or fact in common.”

⁵¹ Such a consolidation seems less likely since claims under Articles 1102, 1103, 1105 and 1110 of the NAFTA are regularly in the alternative on the basis of the same facts and it would not be in the interests of fair and efficient resolution of the claims to do so.

110. An issue to which the invocation of a provision of Section A of Chapter 11 of the NAFTA gives rise,⁵³ should, therefore, be in common in the Article 1120 arbitrations. The mere invocation of the same provision of the NAFTA is not sufficient.
111. Furthermore, a fact may be in common in the Article 1120 arbitrations, but here again there should also be an issue concerning that fact that is in common.
112. However, the distinction is not as black or white as the previous paragraphs may suggest since there is often an interaction between legal and factual issues. Thus, it may be that, in all Article 1120 arbitrations, the fact that a State has adopted a certain measure is not disputed, and hence there would not be a factual issue, but it may also be that the issue in those arbitrations is whether that measure constitutes a violation of a provision of the NAFTA.
113. Another question is whether one or several questions of law or fact are necessary to justify an order under Article 1126(2). The English and equally authentic French texts of Article 1126(2) are phrased in the singular.⁵⁴ In contrast, the

⁵² See Sub-section V.A(1) (page 56) *infra* (discussing *seriatim* consolidation).

⁵³ Which may also include an alleged breach under Articles 1503(2) and 1502(3)(a) of the NAFTA. See Articles 1116(1) and 1117(1). Article 1503(2) (State Enterprises) provides: "Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under Chapters Eleven (Investment) and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges." Article 1502(3)(a) (Monopolies and State Enterprises) provides: "Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately owned monopoly that it designates and any government monopoly that it maintains or designates: (a) acts in a manner that is not inconsistent with the Party's obligations under this Agreement wherever such a monopoly exercises any regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charges."

⁵⁴ French text: "*un même point de droit ou de fait.*"

equally authentic Spanish text is phrased in the plural.⁵⁵ Pursuant to Article 33(4) of the Vienna Convention on the Law of Treaties of 1969, a meaning has to be adopted which best reconciles the texts, having regard to the object and purpose of the treaty.⁵⁶ The object and purpose of the relevant part of the NAFTA are mainly related to procedural economy. Within that perspective, the presence of one common question of either law or fact in two or more Article 1120 arbitrations will serve that object and purpose under given circumstances.

114. As is rightly pointed out by the United States,⁵⁷ the question need not be purely a quantitative one, but a qualitative one as well. The determination that one question of law or fact is in common, requires a further determination that resolution of that question is in the interests of fair and efficient resolution of the claims. Thus, at least one question of law or fact in common may present itself, but resolution of that question by an Article 1126 Tribunal may not serve the fair and efficient resolution of the claims advanced before the Article 1120 Tribunals. Whether that is so depends entirely on the circumstances of the cases and cannot be answered in the abstract.
115. The Consolidation Tribunal notes that the qualitative aspect mentioned in the preceding paragraph is basically not much different from what Tembec argues: “the common questions of law or fact must be material to the disposition of an award. A ‘material’ common question is one which is ‘[i]mportant’ to or ‘having influence or effect’ on the ultimate outcome of a case.”⁵⁸ However, the Tribunal prefers not to use in this context qualifiers such as “material” and “important” –

⁵⁵ Spanish text: “*cuestiones en común de hecho o de derecho.*”

⁵⁶ See n. 43 *supra*.

⁵⁷ United States PHB at 7-8.

⁵⁸ Tembec PHB at 29, quoting *Black’s Law Dictionary* at 674 (abridged 6th ed. 1991); see also Tembec R-PHB at 17-19.

which are not expressed in the language of Article 1126 – as they could be interpreted to unduly curtail the explicit discretionary power given to an Article 1126 Tribunal when determining whether to issue an order under paragraph 2 of that Article.

(j) Anticipated questions

116. Another query is whether “a question of law or fact in common” should already have been presented to the Article 1120 Tribunals, or whether the alleged anticipation that such a question will arise, comes within the purview of Article 1126(2). The Consolidation Tribunal needs to address that question because the United States contends:

Finally, although the United States is not in a position at this time to comprehensively articulate its defences to the merits of claimants’ claims, given the similarities and factual allegations and claims of breach, the United States anticipates that should these cases proceed to the merits, it would raise many, if not all, of the same legal defenses to all three claims.⁵⁹

117. Canfor and Terminal assert that anticipation for the purposes of consolidation is insufficient and that the Consolidation Tribunal must only be satisfied on the basis of evidence or pleadings, not mere anticipation or expectation.⁶⁰
118. The Consolidation Tribunal agrees with Canfor and Terminal that a “mere anticipation or expectation” is insufficient for satisfying the condition of Article 1126(2) that there exist “a question of law or fact in common.” However, where an issue has been raised in one or more Article 1120 proceedings that a party shows that it is with a degree of certainty to raise in other Article 1120

⁵⁹ Tr. at 32:13-20; United States’ Submission of 3 June 2005 at 12 and n. 28.

⁶⁰ Canfor & Terminal PHB ¶¶ 11-12.

proceedings that are the subject of the request for consolidation, an Article 1126 Tribunal may legitimately take such anticipated issue into account. That result should particularly apply where the stages of the proceedings are not fully aligned.

119. The consideration of an anticipated issue in the aforementioned manner may serve the purpose of procedural economy and the expediency with which Article 1126(2) requests must be addressed. If it were otherwise, an Article 1126(2) request would suffer delay until the Article 1120 arbitrations were substantially pleaded.
120. Usually, such an anticipated issue is to be taken into account if there are one or more common issues that have already in fact been raised in the Article 1120 arbitrations. The anticipated issue will then serve as an additional factor in the determination whether an order under Article 1126(2) is merited within the discretionary power of the Article 1126 Tribunal.

(k) The term “in the interests of fair and efficient resolution of the claims”

121. The United States contends that the term “in the interests of fair and efficient resolution of the claims” sets forth an absolute, and not a relative, standard. It argues that Article 1126(2) does not provide that consolidation is available only when it is the most fair and efficient means of resolving the claims, or that consolidation must be more fair and efficient than proceeding separately before Article 1120 Tribunals. Rather, according to the United States, under the plain terms of Article 1126, a Tribunal’s role is to determine, at the time that the request is made, whether an order under paragraph 2 would be fair and efficient. In that respect, the status of the ongoing Article 1120 proceedings is relevant. The United

States asserts that the three elements of fairness and efficiency under Article 1126 are: (i) time; (ii) costs; and (iii) the avoidance of conflicting decisions.⁶¹

122. Canfor and Terminal take the position that fairness and efficiency must be considered relative to the positions of the individual disputing parties in their respective Article 1120 proceedings, and that the words “fairness and efficiency” cannot be interpreted in the abstract. According to Canfor and Terminal, the considerations which must be weighed by an Article 1126 Tribunal in evaluating the fairness and efficiency of the proceedings include factors such as: costs to all parties; length of hearings; procedural complexity; the parties’ wishes; the parties’ conduct or representation to each other; the impact on party autonomy; the importance and complexity of confidentiality; the timing of the consolidation application; and the progress that has been made in the parties’ Article 1120 arbitrations. Canfor and Terminal add that the fact that there are a small number of claims is another factor to be taken into account in refusing consolidation.⁶²
123. Tembec argues that the term “in the interests of fair and efficient resolution of the claims” is to be interpreted not in isolation but in comparison to the existing Article 1120 arbitrations. Although Tembec does not list separately specific factors to be taken into account, it appears to rely on factors such as: costs; abusive and disruptive litigation techniques; no impairment of the ability to present one’s case; party autonomy (including parties’ preferences on the issue of consolidation); procedural inefficiency; delay; and confidentiality.⁶³
124. The Consolidation Tribunal notes that the text of Article 1126(2) neither expresses nor implies that a comparison must be made between the Article 1120 arbitrations

⁶¹ United States PHB at 5-6.

⁶² Canfor & Terminal PHB ¶¶ 68-70.

⁶³ Tembec PHB at 37-56.

and an Article 1126 arbitration when applying the term “in the interests of fair and efficient resolution of the claims.” The Tribunal is of the view that efficiency in the sense of procedural economy is the operative goal of consolidation under Article 1126. That is basically an objective, fact-driven standard which an Article 1126 Tribunal can apply as it deems appropriate under the circumstances. Determining what is efficient under Article 1126(2) is not an accounting exercise of drawing up a matrix of comparative advantages and disadvantages and applying relative weighing factors. It suffices that the Article 1126 Tribunal is convinced that efficiency in the resolution of the claims will, under the circumstances before it, be served by a consolidation.

125. In making that determination, an Article 1126 Tribunal is also to consider what is “fair.” That requirement indicates that the interests of all parties involved should be balanced in determining what is the procedural economy in the given situation. For example, a balance needs to be struck between a hearing that is longer for one party but at the same time shorter for another. It may also happen that what is procedurally less efficient for one party is procedurally more efficient for another. In that respect, the procedural economy that will redound to the benefit of a disputing State Party is another relevant factor, for the reasons explained earlier.⁶⁴ The necessary balancing further includes the consideration that all parties shall continue to receive the fundamental right of due process as it is set forth in Article 15(1) of the UNCITRAL Arbitration Rules (“ . . . the parties are treated with equality and each party is given a full opportunity of presenting his case”).
126. While the standard of efficiency is an objective one, a guiding test is a comparison with the situation as it exists, and would continue to exist, if no consolidation were ordered. Factors to take into account in making such a comparison are: (i) time;

⁶⁴ See Sub-section V.A(b) (page 27) *supra*.

(ii) costs; and (iii) avoidance of conflicting decisions. These factors correspond textually with the factors listed by the United States but factor (i) in particular comprises more than what the United States has argued. Factor (i), time, includes consideration of the status of the Article 1120 arbitrations for which a party seeks consolidation and of the delay, if any, that might result in the resolution of the claims. In that connection, the differences in stages in the Article 1120 proceedings may constitute a relevant aspect. Factor (ii), costs, involves an assessment of the costs to all parties involved. Factor (iii), avoidance of conflicting decisions, requires a consideration of whether conflicting decisions on common questions of law or fact, that are before the 1120 Tribunals, can arise.

127. While factor (ii) does not call for additional comment, factors (i) and (iii) merit further observations.
128. With respect to factor (i), the Consolidation Tribunal notes that a request under Article 1126(2) is not subject to a specific time limit. An initial draft provided for a time limit,⁶⁵ but that provision was abandoned in subsequent drafts. However, the principle of procedural economy includes the general proposition that the more advanced the separate proceedings are, the less likely it is that consolidation will be ordered.
129. It is likely that, if consolidated, the proceedings may take more time than required for individual Article 1120 arbitrations. Thus, an Article 1120 arbitration may be more efficient for an individual disputing investor in terms of time than an Article 1126 arbitration. In contrast, an Article 1126 proceeding may be more efficient for a respondent State Party. These competing positions require an Article 1126 Tribunal to balance the interests of all parties when considering the issuance of an order under Article 1126(2), rather than to deny an Article 1126 application for the

⁶⁵ See ¶¶ 65 and 67 *supra*.

sole reason that the proceedings would be more time consuming for individual disputing investors.

130. With respect to factor (iii), the parties have debated at length whether the avoidance of inconsistent decisions is one of the goals of Article 1126 of the NAFTA. The United States argued in favor of that proposition. Claimants, and in particular Tembec,⁶⁶ contend that concerns of consistency are immaterial to the question of consolidation.
131. It is true that arbitral awards, including in the context of the NAFTA, do not constitute binding precedent. It is also true that to the extent that they constitute persuasive precedent, certain cases are distinguishable on the facts. But that circumstance leaves unaltered the fact that an effective administration of justice, which is demanded by efficient proceedings as referred to in Article 1126(2), requires the *avoidance* of conflicting results. Such avoidance will occur if claims are wholly or partially consolidated. If a total consolidation under sub-paragraph (a) of Article 1126(2) occurs, no conflicting decisions can arise. But if a partial consolidation under that provision occurs, no conflicting decisions can arise either since a decision by an Article 1126 Tribunal must be deemed to be binding on the Article 1120 Tribunals to the extent of the questions chosen for determination in the partial consolidation.⁶⁷
132. It may be added that experience has shown that inconsistent results do occur as was unfortunately demonstrated by the conflicting outcomes in the cases of *CME/Lauder v. The Czech Republic*.⁶⁸ These cases are the more regrettable

⁶⁶ Tembec Submission of 10 June 2005 at 52-56; R-PHB at 39-41.

⁶⁷ See ¶ 157 *infra*.

⁶⁸ *CME Czech Republic B.V. v. Czech Republic* (UNCITRAL, The Netherlands-Czech Republic BIT), Partial Award of 13 September 2001, available at <http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13Sept2001.pdf>, and Final Award, 14 March 2003, available

(footnote cont'd)

because, for all practical purposes, the parties and the claims were the same (even though the bilateral investment treaties in those cases were partly between different State Parties).

133. The desirability of avoiding conflicting results is not limited to cases where the parties are the same. Cases with different parties may present the same legal issues arising out of the same event or related to the same measure. Conflicting results then may take place if the findings with respect to those issues differ in two or more cases.
134. Other factors mentioned by the parties are less or not relevant for the purposes of applying the term “in the interest of fair and efficient resolution of the claims.”
135. As analyzed before,⁶⁹ party autonomy (to which Claimants also refer as the consensual nature of the process or as the parties’ wishes) is not relevant for considering a consolidation request under Article 1126.
136. The number of claims that are involved is not relevant either. Canfor asserts that the fact that there are only a small number of claims is a factor to be taken into consideration in refusing consolidation.⁷⁰ It appears that the drafters of Article 1126 mainly had situations in mind where numerous claims would be brought against a State Party arising out of the same event or related to the same measure. However, the text of Article 1126 does not impose such a quantitative requirement nor does it imply it. According to the text of Article 1126(2), consolidation can occur when there are but two Article 1120 arbitrations.

at <http://www.investmentclaims.com/decisions/CME-Czech-FinalAward-14Mar2003.pdf>; *Lauder v. Czech Republic* (UNCITRAL, United States-Czech Republic BIT), Final Award of 3 September 2001, available at <http://www.investmentclaims.com/decisions/Lauder-Czech-FinalAward-3Sept2001.pdf>

⁶⁹ See Sub-section V.A(c) (page 29) *supra*.

137. The alleged presence of abusive and disruptive litigation techniques, such as making a request for alleged tactical reasons or for the alleged purpose of forum shopping,⁷¹ are equally irrelevant, unless a party can show that the party requesting consolidation is guilty of an abuse of right under international law (a matter that is neither alleged nor proven in the present proceedings).⁷²
138. Finally, concerns over confidentiality are, in the view of the Consolidation Tribunal, not relevant when considering a request for consolidation, save for exceptional cases where consolidation would defeat efficiency of process or would infringe the principle of due process enunciated in Article 1115 of the NAFTA. The Tribunal is aware that confidentiality vis-à-vis competitors was the main ground on which consolidation was denied in the *Corn Products* case, for reasons that the Tribunal in that case saw fit under the given circumstances.
139. The general trend in investor-State arbitration is transparency of process, a trend to which the Consolidation Tribunal subscribes. Within the perspective of that trend, the issue of confidentiality must be approached with caution.
140. The Consolidation Tribunal further notes that the States Party to the NAFTA have specifically addressed concerns over confidentiality in the *Notes of Interpretation of Certain Chapter 11 Provisions*, issued by the NAFTA Free Trade Commission on 31 July 2001.⁷³ The relevant provisions are:

⁷⁰ Canfor & Terminal PHB ¶ 69.

⁷¹ These allegations are made by Tembec in particular in the present case: PHB at 57-60; R-PHB at 14-16.

⁷² See Bin Cheng, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS (1987) 121-36.

⁷³ Available at <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>.

A. Access to documents

1. Nothing in the NAFTA imposes a general duty of confidentiality on the disputing parties to a Chapter Eleven arbitration, and, subject to the application of Article 1137(4),⁷⁴ nothing in the NAFTA precludes the Parties from providing public access to documents submitted to, or issued by, a Chapter Eleven tribunal.

2. In the application of the foregoing:

(a) In accordance with Article 1120(2),⁷⁵ the NAFTA Parties agree that nothing in the relevant arbitral rules imposes a general duty of confidentiality or precludes the Parties from providing public access to documents submitted to, or issued by, Chapter Eleven tribunals, apart from the limited specific exceptions set forth expressly in those rules.

(b) Each Party agrees to make available to the public in a timely manner all documents submitted to, or issued by, a Chapter Eleven tribunal, subject to redaction of:

(i) confidential business information;

⁷⁴ Article 1137(4) of the NAFTA provides: “Annex 1137.4 applies to the Parties specified in that Annex with respect to publication of an award.” Annex 1137.4 (Publication of an Award) provides:

Canada

Where Canada is the disputing Party, either Canada or a disputing investor that is a party to the arbitration may make an award public.

Mexico

Where Mexico is the disputing Party, the applicable arbitration rules apply to the publication of an award.

United States

Where the United States is the disputing Party, either the United States or a disputing investor that is a party to the arbitration may make an award public.

⁷⁵ Article 1120(2) of the NAFTA provides: “The applicable arbitration rules shall govern the arbitration except to the extent modified by this Section.”

(ii) information which is privileged or otherwise protected from disclosure under the Party's domestic law; and

(iii) information which the Party must withhold pursuant to the relevant arbitral rules, as applied.

(c) The Parties reaffirm that disputing parties may disclose to other persons in connection with the arbitral proceedings such unredacted documents as they consider necessary for the preparation of their cases, but they shall ensure that those persons protect the confidential information in such documents.

(d) The Parties further reaffirm that the Governments of Canada, the United Mexican States and the United States of America may share with officials of their respective federal, state or provincial governments all relevant documents in the course of dispute settlement under Chapter Eleven of NAFTA, including confidential information.

3. The Parties confirm that nothing in this interpretation shall be construed to require any Party to furnish or allow access to information that it may withhold in accordance with Articles 2102 or 2105.⁷⁶

141. Furthermore, in general, the fact that parties to proceedings are competitors is not unique to consolidation proceedings. One sees that situation in arbitrations between a single claimant and a single respondent, including Article 1120 arbitrations. It has never been seriously suggested that arbitration cannot proceed

⁷⁶ Article 2102 (National Security) is to the effect that nothing in the NAFTA shall be construed: to require any State Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; to prevent any State Party from taking any actions that it considers necessary for the protection of its essential security interests; or to prevent any State Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security. Article 2105 (Disclosure of Information) provides that nothing in the NAFTA shall be construed to require a State Party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the State Party's law protecting personal privacy or the financial affairs and accounts of individual customers of financial institutions.

in those cases for the mere reason that the parties are competitors and that disclosure of confidential information is purportedly bound to occur.

142. Article 1111(2) of the NAFTA carries the distinct implication that the drafters of the NAFTA considered that confidential business information can be protected from prejudicial disclosure, at least as far as a State Party is concerned:

Notwithstanding Articles 1102 or 1103, a Party may require an investor of another Party, or its investment in its territory, to provide routine information concerning that investment solely for informational or statistical purposes. *The Party shall protect such business information that is confidential from any disclosure that would prejudice the competitive position of the investor or the investment.* Nothing in this paragraph shall be construed to prevent a Party from otherwise obtaining or disclosing information in connection with the equitable and good faith application of its law. (emphasis added)

143. There are sufficient measures available to arbitral tribunals to ensure confidential treatment of information (including: protective orders; imposition of confidentiality undertakings; partially separate hearings *in camera*; classifying submissions, documents and testimony; appointment of a confidentiality advisor; redaction of award for public access), while ensuring that each party is afforded a full opportunity of presenting its case. In many international arbitrations, parties negotiate and execute an appropriate confidentiality agreement among themselves.
144. The matter of enforceability of confidentiality obligations is not unique to Article 1126 arbitrations either; it may also arise under Article 1120 arbitrations.
145. The fact that confidentiality issues may increase if the Article 1120 arbitrations are consolidated is inherent in the consolidation process, but that factor is not in and of itself a reason not to consolidate.
146. The fact that confidentiality measures may make the proceedings more complex is not a reason not to conduct consolidated proceedings either. Tribunals operating

at a level of the NAFTA and of other multilateral or bilateral investment treaties should be, and are as a rule, capable of dealing with procedurally complex cases with difficult confidentiality issues without an appreciable decline in efficiency or without any impairment of due process.

147. The exceptional cases where confidentiality would defeat efficiency of process or would infringe the principle of due process enunciated in Article 1115 of the NAFTA, if proceedings were consolidated, are not likely often to occur. Such a situation may be present in the event that clearly identified and significant confidentiality issues are bound to arise in the proceedings, if consolidated; that these issues outweigh all three factors (time, cost and avoidance of conflicting results); and that these issues are such that, if the proceedings are consolidated, they are manifestly counterproductive to an effective administration of justice.

(l) *Seriatim consolidation*

148. A question that was raised at the 16 June 2005 hearing was whether an Article 1126 Tribunal may order consolidation in a *seriatim* fashion. For example, there is an issue as to whether it would be permissible for an Article 1126 Tribunal to consolidate issues relating to objections to jurisdiction (and/or admissibility) and to retain the power to order consolidation of other aspects of the Article 1120 arbitrations after the Article 1126 Tribunal has rendered its ruling on the jurisdictional objections.
149. The United States submits that consolidation in a *seriatim* fashion is possible under Article 1126 of the NAFTA. It argues that “[n]othing in the text of Article 1126 suggests that the Tribunal’s powers are limited to making a single decision on consolidation” and that the State Parties left the text of Article 1126

“nonspecific so as to grant consolidation tribunals flexibility to fashion a proceeding to fit the circumstances.”⁷⁷

150. Canfor and Terminal disagree. They argue that the “Consolidation Tribunal’s only powers are those set out in Article 1126(2). Those powers do not include the right to reserve judgment on whether to subsequently assume jurisdiction over further aspects of the proceedings at a later date.” Moreover, Canfor and Terminal argue that such treatment is not what the United States is asking the Tribunal to do in any event.⁷⁸
151. The Consolidation Tribunal is of the view that the text of Article 1126 does not leave room for reserving judgment concerning consolidation at some moment in the future. The text of Article 1126 demands a decision on a consolidation request “after hearing the disputing parties.” That indicates that one proceeding, and one order, concerning a consolidation request are contemplated.⁷⁹ Moreover, once an Article 1126 Tribunal has issued an order on consolidation, its mandate transforms from deciding whether or not to consolidate into one of hearing and determining claims.

(m) Where consolidated proceedings are to begin

152. The United States submits that if the relevant Article 1120 claims were consolidated, this Tribunal would start anew procedurally.⁸⁰ Canfor and Terminal take the position that consolidated proceedings must pick up at the stage at which

⁷⁷ United States PHB at 8-9.

⁷⁸ Canfor & Terminal PHB ¶¶ 76-78 and R-PHB ¶ 7. Tembec does not address the question in its PHB; *see also* Tembec’s argument at ¶ 181 *infra*.

⁷⁹ Another question is whether, subsequent to the disposition of a consolidation order, a disputing party may again request consolidation. As it is not an issue before the Tribunal, the Tribunal will not consider that question in the present Order.

⁸⁰ United States PHB at 26-27.

those proceedings left off. Canfor argues that, if a jurisdictional award had been issued in *Canfor*, and the proceedings were subsequently consolidated, Canfor could not be compelled to revisit jurisdiction, although a different claimant, who has not had the opportunity to address jurisdiction, could not be deprived of its right to raise that issue. Similarly, Canfor and Terminal argue, Terminal cannot be deprived of its right to articulate a claim in a statement of claim.⁸¹ Tembec contends that, were the Tribunal to consolidate jurisdictional questions, those questions would have to be taken from the Article 1120 Tribunals at the *status quo ante*.⁸²

153. The Consolidation Tribunal is of the opinion that it has discretionary power to determine where consolidated proceedings are to begin. The possible exception is the untimely raising of an objection to jurisdiction, as is explained at ¶ 103 above. If an Article 1126 Tribunal assumes jurisdiction, it is in a position that is not much different from the situation in which one or more arbitrators in a case are replaced. In that respect, Article 14 of the UNCITRAL Arbitration Rules offers guidance: “If under articles 11 to 13 the sole or presiding arbitrator is replaced, any hearings held previously shall be repeated; if any other arbitrator is replaced, such prior hearings may be repeated at the discretion of the arbitral tribunal.” Once consolidated by order, this Tribunal has, under this rationale, the discretion to determine the conduct and sequence of the consolidated proceedings, but will naturally exercise that discretion in consultation with the parties.
154. The Consolidation Tribunal need not address the question whether a decision by an Article 1120 Tribunal on its jurisdiction, or a partial award on liability by such

⁸¹ Canfor & Terminal PHB ¶ 116.

⁸² Tembec PHB at 25-26. In addition, Tembec argues, were the Tribunal simply to “start over” substantially, it could not begin with the pending jurisdictional objections, for it has no authority to address them. The Consolidation Tribunal disagrees with that argument, for the reasons stated in Sub-section V.A(g) (page 38) *supra*.

a Tribunal, would be binding in the consolidation proceedings since in none of the three Article 1120 arbitrations in question has such a decision or award been issued. Hence, there is no question of a “*de facto* appeal process” by the United States as is argued by Canfor and Terminal.⁸³ In any event, it would seem that this question is theoretical because, if an Article 1120 Tribunal has rendered a decision on liability, there may no longer be a question of law or fact in common with another Tribunal insofar as liability is concerned.

(n) *The position of the Article 1120 Tribunals*

155. As mentioned, Article 1126(8) of the NAFTA provides: “A Tribunal established under Article 1120 shall not have jurisdiction to decide a claim, or a part of a claim, over which a Tribunal established under this Article has assumed jurisdiction.”
156. If an Article 1126 Tribunal orders consolidation in full, the Article 1120 Tribunals cease to function because of the dictates of Article 1126(8).
157. If an Article 1126 Tribunal orders consolidation in part, then the relevant Article 1120 Tribunals no longer have jurisdiction over the part over which the Article 1126 Tribunal has assumed jurisdiction. The decision that the Article 1126 Tribunal gives with respect to the part over which it has assumed jurisdiction must be deemed to be binding on the Article 1120 Tribunals that are subject to the consolidation. It is not only a logical inference, but it also follows from the text of Article 1136(1): “An award made by a Tribunal shall have no binding force *except between the disputing parties and in respect of the particular case.*” (emphasis

⁸³ Canfor & Terminal R-PHB ¶ 30.

added).⁸⁴ It follows that if, for example, an Article 1126 Tribunal has decided liability as part of the claims, the decision is binding on the Article 1120 Tribunals deciding on damages.

158. Partial consolidation further raises the question whether, and if so, to what extent, the Article 1120 Tribunals should adjourn the proceedings before them, pending resolution by the Consolidation Tribunal. Article 1126 does not expressly deal with that question. It does, in Article 1126(9), address explicitly the matter of a stay pending the decision of the Consolidation Tribunal on the consolidation. As it is not an issue before the Consolidation Tribunal and in light of its decision on the consolidation request in the present case, the Tribunal will refrain from deciding on the above question relating to partial consolidation.

B. Conduct of the Present Proceedings

159. Canfor objects to the United States' request for consolidation, arguing that the United States has not satisfied the requirement under NAFTA Article 1126(3) for the presentation of particularized submissions. Canfor further objects to the United States' reliance on materials that are allegedly not accessible to Canfor, such as the pleadings in the *Corn Products* case, the only other NAFTA case considering the question of consolidation.⁸⁵
160. Canfor's objections lack merit. The consolidation request of the United States of 7 March 2005 contained the information required by Article 1126(3), which stipulates that a disputing party "shall specify in the request: . . . (c) the grounds on which the order is sought." Those grounds were specified in the request of 7 March 2005. The United States particularized the grounds in its submission of 3

⁸⁴ The term "Tribunal" means "an arbitration tribunal established under Article 1120 or 1126" (Article 1139).

⁸⁵ Canfor Submission of 10 June 2005 ¶¶ 5, 8, 11, 37-40.

June 2005, to which Canfor and the other Claimants responded in their submissions of 10 June 2005.

161. As to the materials in the *Corn Products* case,⁸⁶ these materials were available on the website of the Government of Mexico soon after submission of the consolidation request by the United States.⁸⁷ The Order of the Consolidation Tribunal in that case of 20 May 2005 was also soon thereafter published on the website of the Government of Mexico. A simple search, with an adequate search engine on the Internet, would have revealed the existence of these published materials. Moreover, it appears that Claimants wished to have access to these materials in order to show that Article 1126 of the NAFTA requires an agreement of the parties once an order under Article 1126(2) is sought. As is explained earlier, such an agreement is not required.⁸⁸
162. Here, all parties have had a full opportunity to present their case on the issue of consolidation. Like in the *Corn Products* case, this Consolidation Tribunal is of the opinion that a request under Article 1126(2) of the NAFTA should be disposed of within the shortest possible time in order to minimize delay in the Article 1120 arbitrations if the request is denied and also in the Article 1126 arbitration if the request is granted. Thus, Claimants have had a full opportunity to present their case in their submissions of 10 June 2005, at the hearing held on 16 June 2005, in the post-hearing briefs of 12 July 2005 and in the reply post-hearing briefs of 12 August 2005. The sequence and length of the briefing schedule after the hearing

⁸⁶ Tembec also alleges that the United States withholds information regarding the *Corn Products* case, see PHB at 8.

⁸⁷ Available at http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Corn/Corn.htm.

⁸⁸ See ¶ 85 *supra*. The same applies to Claimants' request for materials in the *Cases Regarding the Border Closure Due to BSE Concerns*, available at <http://www.state.gov/s/l/c14683.htm>.

were the result of an agreement reached among all the parties to the present proceedings.

C. Alleged Laches and Estoppel against the United States

163. Tembec asserts that the United States' request for consolidation should be barred by the doctrines of laches and estoppel.⁸⁹ According to Tembec, the United States had notice of both Canfor's and Tembec's claims but delayed in requesting consolidation while Claimants heavily invested in the prosecution of their claims before the Article 1120 Tribunals. Canfor and Terminal do not rely upon these doctrines, arguing that it is unnecessary to pursue them because allegations of delay or misrepresentations made by a party fall within the terms fairness and efficiency.⁹⁰ While the Tribunal does not disagree with Canfor and Terminal, it deems it more appropriate to deal with the issue of laches and estoppel separately.
164. The Consolidation Tribunal notes that the general principle underlying the Anglo-American doctrine of laches has been invoked before international tribunals, and that a number of international legal scholars have argued for its existence in international law.⁹¹ However, the Tribunal questions the application of the doctrine in the context of the present request for consolidation.
165. Laches is an equitable defense asserted to bar the adjudication of stale claims. The doctrine is premised on the theory that a claim that is plagued with undue delay prejudices a defendant because evidence is no longer available to defend against

⁸⁹ See Tembec Submission of 10 June 2005 at 28–32; Tembec PHB at 8-15; Tembec R-PHB at 12-14.

⁹⁰ Canfor & Terminal PHB at 25-26.

⁹¹ See Ashraf Ray Ibrahim, *The Doctrine of Laches in International Law*, 83 VA. L. REV. 647 (April 1997) (surveying history of *laches* in international law); US RESTATEMENT 3rd #902 Comment c. (“*Lapse of time*: No general rule of international law limits the time within which a claim may be made. However, international tribunals have barred claims because of a delay in presentation to the respondent state if the delay was due to the negligence of the claimant state.”).

the claim.⁹² Although *Tembec* defines *laches* as prohibiting a party's "exercise of a right that has been delayed,"⁹³ the authorities cited by *Tembec* all refer to the application of the principle in the context of claims, and refer to cases in which tribunals have applied the doctrine to claims. The Tribunal is not convinced that under international law this doctrine is appropriately invoked by a claimant to bar a procedural request for consolidation of claims. The Tribunal notes that, in some legal systems, *laches* may bar requests for consolidation, as, for example, under New York law.⁹⁴ However, the forms of equity known to Anglo-American common law do not form part of the corpus of public international law. While there is a borrowing of principles derived from domestic legal systems in public international law, this takes the form of general principles of law that do not necessarily replicate the rules of domestic law from which they derive their common origin.⁹⁵

166. Even if it were appropriate to apply the doctrine of *laches* under principles of international law in this context, the Tribunal concludes that *laches* would not bar the United States' present request. The timeline under scrutiny is not so lengthy as to render the request for consolidation stale. *Tembec* argues that the United States delayed making its request for 12 to 18 months. A notion akin to *laches* has been applied by international tribunals primarily in cases where the delay involves decades (20 to 80 years), not months.⁹⁶ In any event, in the context of a request for consolidation, the *Tembec* Tribunal had not even held a hearing on the

⁹² Ibrahim, n. 91 *supra*, at 676 – 83.

⁹³ *Tembec* Submission of 10 June 2005 at 28.

⁹⁴ See David D. Siegel, *NEW YORK PRACTICE*, 3d Edition §128 (1999) ("Laches, determined on a *sui generis* basis, can be an enemy.").

⁹⁵ See Bin Cheng, *GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS* (1987) 377.

⁹⁶ See Ibrahim, n. 91 *supra*.

jurisdictional challenge when the United States filed its Article 1126 request. Consequently, the Tribunal cannot conclude that the *Tembec* arbitration had proceeded to the point of rendering a request for consolidation stale. Further, the United States has provided a reasonable justification for the course of events – the sudden resignation of an arbitrator and the resulting sudden procedural alignment of the Article 1120 cases. The Tribunal notes that the United States acted promptly by filing the Article 1126 request within a week after the resignation. Finally, the contention that the United States has filed its request for tactical or strategic reasons is of no relevance to the application of the doctrine of laches and confuses this doctrine with other forms of equitable relief.

167. Tembec also asserts that the United States' delay in requesting consolidation should be barred on the theory of estoppel. Tembec argues that the United States misrepresented its intention not to seek consolidation, and that, in reliance on the United States' assurances, Tembec proceeded in the Article 1120 Tribunal.
168. The Tribunal accepts that, as amply demonstrated by the parties in their post-hearing briefs, estoppel is a recognized general principle of law that has been applied by many international tribunals.⁹⁷ Of the essence to the principle of estoppel is detrimental reliance by one party on statements of another party, so that reversal of the position previously taken by the second party would cause serious injustice to the first party.⁹⁸
169. In the Tribunal's view, Tembec has attached undue weight to the United States' indications that it did not intend at a given time to seek consolidation by

⁹⁷ See *Tembec PHB* at 8-15; *United States PHB* 22 July 2005 at 9-11; e.g., *Pope & Talbot, Inc. v. Canada*, (NAFTA–UNCITRAL) Interim Award of 26 June 2000, at 39-41, available at <http://www.investmentclaims.com/decisions/Pope-Canada-InterimAward-26June2000.pdf>.

⁹⁸ See D.W. Bowett, *Estoppel Before International Tribunals and Its Relation to Acquiescence*, 33 *Brit. Y.B. Int'l L.* (1957) 176 at 183-84.

classifying them as misrepresentations warranting equitable relief. In light of the various exchanges between the Claimants and the United States, it is not possible to say that the United States wholly abandoned its rights under Article 1126, or led the Claimants reasonably to rely to their detriment that the United States would never invoke such rights.⁹⁹ During the first 18 months of defending against Tembec's claims, the United States may very well have intended not to seek consolidation. However, there is no denying that the *Canfor* and *Tembec* cases were filed 18 months apart, but proceeded at different paces with Tembec's claim catching up to Canfor's by March 2005 when one of the *Canfor* arbitrators recused himself. As mentioned, the United States at that point wasted no time in deciding to exercise its right to request consolidation. The Tribunal does not view such decision as having been made in bad faith. Therefore, the Tribunal declines to bar the consolidation request by operation of the doctrine of estoppel.

D. Commonality

170. Having regard to the analysis of Article 1126 in Section A above, and in particular in Sub-section A(i) (page 42), the Consolidation Tribunal concludes that the United States has shown to the satisfaction of the Tribunal that the claims submitted to arbitration under Article 1120 in these cases have questions of law and fact in common within the meaning of the text of Article 1126(2), considering the following.
171. To aid the Tribunal in making its commonality determination, the Tribunal requested that the parties submit charts, setting forth the purported questions of

⁹⁹ For example, as Tembec pointed out in its PHB at 13, in response to Tembec's request to the United States as to whether it would seek consolidation, the United States informed Tembec and Canfor that the United States might revisit its intention with regard to consolidation were another Chapter 11 claim filed in the *Softwood Lumber* proceedings.

law and fact in common among the relevant Article 1120 arbitrations, in conjunction with their post-hearing briefs.

172. The Tribunal notes that the chart submitted by the United States was helpful.
173. The Tribunal further notes that Tembec submitted a chart to prove that the questions of law material to the determination of Tembec's claims were not material to the resolution of either Canfor's claims or Terminal's claims, as well as a chart demonstrating the particular factual differences between the softwood lumber industry in eastern and western Canada. However, the test for the Tribunal is whether there exist common questions of law or fact among the claims asserted by the Claimants, not whether the legal and factual theories can be exported from one arbitration to another in order to determine liability in the latter dispute.
174. The chart submitted by Canfor and Terminal identifies a host of common legal questions among the parties' claims. The fact that the Tribunal will evaluate evidence particular to each Claimant in assessing some of the claims or parts thereof, as described by Canfor and Terminal, does not negate the commonality among the underlying legal issues.

(a) Jurisdiction

175. The United States objects to the jurisdiction of the Chapter 11 Tribunals over the claims asserted by the Claimants. The United States bases its jurisdictional objections over the *Canfor* claims on two grounds, and over the *Tembec* claims, on the same two grounds, plus a third ground.
176. Although the *Terminal* proceedings have not reached this phase, the United States confirms in its request for consolidation that it will object to jurisdiction over the

claims asserted by Terminal on the same grounds.¹⁰⁰ Having also regard to the position taken by the United States in the *Canfor* and *Tembec* proceedings, there is indeed a degree of certainty that the United States will raise the same objection to jurisdiction in the *Terminal* proceedings.¹⁰¹ The Tribunal accepts that also with respect to the defenses that the United States anticipates to make against liability and damages contentions in connection with Terminal's claims.

177. In April 2002, the Canadian Government and other parties, including Tembec and Canfor, filed requests for panel proceedings under Chapter 19 of the NAFTA to review Commerce's final affirmative antidumping and countervailing duty determinations.
178. The United States first objects to the jurisdiction of the three Article 1120 Tribunals in these cases because it contends that NAFTA provides for specialized bi-national panels constituted under Chapter 19 to have exclusive jurisdiction over claims that seek to impose obligations on a State Party with respect to its antidumping and countervailing duty laws. Thus, according to the United States, it has rejected investor-State arbitration of Canfor, Tembec and Terminal's claims because of the express terms of the NAFTA. The United States argues that the Chapter 11 proceedings would impose obligations on the United States outside the Chapter 19 proceedings against the express terms of Article 1901(3),¹⁰² and that Chapter 19 has provided for an exclusive forum for resolution of claims relating to the United States' antidumping and countervailing duty laws.¹⁰³ Both Canfor and

¹⁰⁰ United States' Request of 7 March 2005 at 3.

¹⁰¹ See ¶¶ 116-118 *supra*.

¹⁰² Article 1901(3) provides: "Except for Article 2203 (Entry into Force), no provision of any other Chapter of the Agreement shall be construed as imposing obligations on a Party with respect to the Party's antidumping law or countervailing duty law."

¹⁰³ In its R-PHB at 12, Tembec contends that "Article 1901(3) objections are not the same between Tembec and Canfor" and that "The United States indeed presented the issues differently,

(footnote cont'd)

Tembec oppose those arguments of the United States in the Article 1120 proceedings.

179. The United States next argues that the three Article 1120 Tribunals do not have jurisdiction over these claims because the Claimants have not sufficiently alleged that they are “investors” with “investments” in the United States, as defined in, and required by, NAFTA Article 1101(1). With respect to Canfor’s claims, the United States agrees that this is not an issue that should be addressed as a preliminary question, rather that it is intertwined with Canfor’s evidence on the merits and should be considered along with the merits of the claims. The United States does not so qualify its argument with respect to Tembec.
180. The commonality between the issues raised by the first two objections to jurisdiction (or, depending on the characterization, admissibility) supports a decision to consolidate. That is not altered by the fact that the United States asserts an additional ground for objecting to the jurisdiction of the *Tembec* Tribunal. The United States points out that NAFTA Article 1121 requires that any party must submit a waiver promising not to initiate or continue any other proceedings with respect to a breach of Section A of Chapter 11 of the NAFTA. The United States recognizes that Tembec provided the requisite waivers, but the United States contends that Tembec is not honoring those waivers by pursuit of its claims in the Chapter 19 proceedings. The existence of this additional ground is not such as to override the commonality of the other above mentioned two issues relating to jurisdiction that exist among the three cases.
181. The Tribunal declines to decide the issue on the basis of “judicial economy” as advocated by Tembec. Tembec argues: “The Tribunal should decide only those

and briefing was not the same.” A different presentation of the issues or a different briefing does not take away a commonality of the issues relating to Article 1901(3).

matters that are essential to be decided in accordance with the doctrine of judicial economy. [footnote omitted] It need not decide matters that may be mooted by the Tribunal's decisions on other issues. [footnote omitted]"¹⁰⁴ Tembec argues that the Consolidation Tribunal should lift the stay of the Article 1120 proceedings and let the Article 1120 Tribunals complete their decisions on the jurisdictional objections of the United States.

182. In support of its argument, Tembec refers to the doctrine of judicial economy as developed by the WTO. At the WTO, however, the doctrine of judicial economy means that panels are not required to address all the legal claims that the complainant makes if the challenged measure violates different WTO provisions in either the same or various covered agreements. If the panel has already found that the challenged measure is inconsistent with a particular provision of a covered agreement, it is generally not necessary to proceed to examine whether the same measure is also inconsistent with other provisions that the complainant invokes. Panels have the discretion to decline to rule on these further claims, but they must do so explicitly.¹⁰⁵
183. The doctrine of judicial economy in the sense as used by the WTO may be applied by an Article 1120 Tribunal or by an Article 1126 Tribunal when considering claims. An Article 1126 Tribunal cannot apply the doctrine in that sense when determining whether to issue an order under Article 1126(2). An Article 1126 Tribunal has not to decide whether it will hear and determine certain claims and not others. Rather, it has to determine whether it assumes jurisdiction over all or part of the claims or over one or more of the claims the determination of which it believes would assist in the resolution of the others. In that respect, the

¹⁰⁴ Tembec Submission of 10 June 2005 at 27-28; *see also* R-PHB at 6-7.

¹⁰⁵ *See* http://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c10s4p1_e.htm.

Consolidation Tribunal does not apply the doctrine of “judicial economy” but rather that of procedural economy in the sense of an effective administration of justice.¹⁰⁶ Moreover, a consolidation in a *seriatim* fashion is not possible under Article 1126.¹⁰⁷

184. Tembec’s argument based on Article 21(3) of the UNCITRAL Arbitration Rules was addressed earlier in this Order.¹⁰⁸

(b) *Liability*

185. With respect to a determination of the United States’ liability on the merits of the claims should Claimants prevail on the issue of jurisdiction, consolidation is warranted by the common questions of law and fact present in most of the claims. A review of the claims reveals that not only did the Claimants plead their allegations of the United States’ unlawful determinations as against the softwood lumber industry as a whole, but that few of the claims are specific to any of the Claimants or their business or call for company-specific information.
186. All of the claims relate to certain determinations that the United States made after receiving a petition from the members of the United States lumber manufacturing industry with regard to the Canadian softwood lumber producers. All of the Claimants allege that the petition was deficient and, thus, the investigation unlawfully initiated.
187. The Claimants all allege that the United States, in making its determinations: did not provide the Canadian softwood lumber producers the best level of treatment that it provides to analogous producers based in the United States operating in the

¹⁰⁶ See ¶ 76 *supra*.

¹⁰⁷ See Sub-section V.A(1) (page 56) *supra*.

¹⁰⁸ See Sub-section V.A(g) (page 38) *supra*.

same industry and under the same circumstances (Article 1102); did not accord to Canadian investors and their investments treatment no less favorable than that which is available to any other foreign investor or its investment under a similar treaty (Article 1103); and did not accord to investments of Canadian investors treatment in accordance with international law (Article 1105). As a result, it is alleged that the United States engaged in expropriation of the property of the Canadian softwood lumber producers' investments in the United States (Article 1110).

188. (i) *Subsidy Determinations.* All of the Claimants allege that Commerce's preliminary and final determinations that there was a subsidy in Canada favoring softwood lumber producers were unlawful determinations. The United States allegedly evaluated the provincial stumpage program in Canada and determined that it constituted a subsidy. All three Claimants attack the methods employed by the United States in making its determination, including the use of cross-border benchmarks, and all three allege that Commerce made its determination under political pressure and to achieve a certain political result.
189. In stating its claim, Canfor provides detailed allegations as to the method that Commerce employed to determine the existence of a subsidy. A review of Commerce's determination involves consideration of whether the stumpage program constituted a financial contribution to producers in the softwood lumber industry; whether the stumpage program was specific to an enterprise or industry; and whether it provided a benefit to those within the industry. None of these factors, in the judgment of the Tribunal, involves a claimant-specific evaluation that would render consolidation of this issue a problem.
190. Tembec, on the other hand, supports its claim with detailed allegations of the political influence and pressure exerted on Commerce to make a particular determination that favored the United States lumber industry and hurt the

Canadian industry. While also questioning the methods employed by Commerce, Tembec focuses on why Commerce was motivated to make the determination that it did.

191. Terminal's submission generally includes the same allegations as those put forward by Canfor and Tembec.
192. Tembec argues that the different allegations asserted by Canfor and Tembec in support of their claims regarding Commerce's subsidy determination constitute different questions of fact and law prohibiting consolidation. The Consolidation Tribunal disagrees. NAFTA Article 1126(2) requires that there be common questions of law and fact at issue, which there clearly are, not that the legal strategy, the evidence in support of the claims or the presentation of counsel be similar. If ever there was a fluid, changing creature, it would be the legal strategy of counsel. At this point in the proceedings, counsel can only speculate as to what its strategy and that of the other Claimants' counsel will be. This uncertainty does not constitute a basis to prohibit or to require consolidation.
193. (ii) *Duty Determination.* Having determined that a subsidy exists, the United States then imposed a duty on Canadian softwood lumber producers' exports to the United States. Canfor and Tembec allege that the United States ignored their requests for a company-specific duty and imposed a countrywide rate that caused further harm to Claimants. Tembec alleges that a company-specific rate would have been lower than the countrywide rate it is paying. Canfor alleges that had Commerce accepted its application for a company-specific rate, it would have paid less than the countrywide rate. The Consolidation Tribunal considers that there is commonality with respect to the questions of the United States' rejection of Claimants' requests for a company-specific duty and of the legitimacy of imposing a countrywide rate for all of the Claimants.

194. (iii) *Critical Circumstances Determination.* All three Claimants allege that the United States made a determination that “critical circumstances” existed with respect to the alleged Canadian softwood lumber subsidies and dumping activities. If critical circumstances are determined to be present, then under United States countervailing and antidumping duty law, retroactive duties may be applied to softwood lumber imports that occurred up to 90 days prior to the determination. To make such a determination, Commerce was required to find that a relevant and applicable export subsidy actually existed, and that there were massive imports over a relatively short period of time.
195. Canfor and Terminal dispute that the export subsidy that Commerce identified in its analysis, a subsidy program employed by the Province of Quebec for its producers, was an export subsidy. All three Claimants dispute the method employed by Commerce to calculate the amount of exports of softwood lumber that it deemed qualified as “massive exports” over a “relatively short time.” Tembec additionally pleads specific allegations that Commerce coordinated with other branches of the United States government to bring about this predetermined result favorable to United States industry.
196. None of Claimants’ allegations on this issue requires a claimant-specific determination. All three Claimants object to the critical circumstances determination as unlawful and identify at least one common way in which the determination was unlawfully made. Additionally, Canfor relies upon the effect of the critical circumstances determination on the softwood industry as a whole to establish damages, arguing that the United States’ determination created “a potential retroactive liability for Canadian exporters including Canfor exceeding \$300 million,” but such an additional allegation is insufficient to deny consolidation in light of the commonality of the other issues.

197. *(iv) Antidumping Determinations.* Claimants all contend that the United States made preliminary and final determinations that Canadian softwood lumber producers were dumping softwood lumber in the United States market in an unlawful manner. All Claimants attack the methodologies employed by Commerce to determine that dumping existed and the manner in which Commerce calculated company-specific weighted average dumping margins, including use of unfair price comparisons and of the technique called “zeroing.”
198. Tembec additionally alleges that certain United States Senators pressured Commerce to make findings on the dumping issue that were favorable to United States’ industry, and that Commerce failed to take into account the Softwood Lumber Agreement in making its antidumping determination. While these allegations are particular to Tembec on this particular issue, Canfor and Terminal have put forth general allegations of political influence in stating their claims, and have identified Commerce’s failure to take the Softwood Lumber Agreement into account in making its subsidy determination and critical circumstances determination, respectively.
199. While Claimants all object to the methodologies employed by Commerce to calculate the dumping margin, the determination is company-specific, requiring an analysis of company-specific cost and sales data. This is an area where Canfor, and the other Claimants, will have to produce individual, potentially confidential information. The analysis of the Tribunal will be partly company-specific. However, given the number of common objections relating to the dumping determination, such a company-specific analysis does not pose a barrier to consolidation, also because of the protections that the Tribunal will craft in consultation with the parties.
200. *(v) The ITC Determinations.* The ITC made preliminary and final determinations relating to whether there was a reasonable indication that the

domestic industry producing the competing product had been materially injured or threatened with material injury by reason of unfairly traded imports of the subject merchandise. In both its preliminary and final determinations, the ITC concluded that, with the expiration of the Softwood Lumber Agreement between the United States and Canada, Canadian softwood lumber exports to the United States would surge, constituting a threat of material injury.

201. While all Claimants refer to the ITC's determinations, Tembec argues that the determination improperly was not based on any facts, and that the ITC was improperly influenced by United States political considerations in making its determinations. Tembec also alleges that the ITC determination was reached in an arbitrary, capricious and unfair manner.
202. *(vi) Expropriation.* All Claimants allege that as a result of the United States' determinations, preliminary and final, with respect to countervailing and antidumping duties and critical circumstances, the United States expropriated the United States' investments of Claimants in violation of the NAFTA Article 1110 and denied the Claimants due process. Tembec and Canfor also allege that in making its determinations, Commerce held *ex parte* meetings with the petitioning members of the United States' lumber manufacturing industry, without disclosing details of such meetings or putting meeting memoranda on the record. Determining the United States' liability under this Article will require an analysis of whether the United States provided full, fair and effective compensation to investors, and whether investors have been compensated if the government action substantially interfered with the use or enjoyment of the investment. This appears to be a claimant-specific analysis which, however, would not bar consolidation having regard to the many other common questions.
203. *(vii) Byrd Amendment.* The Byrd Amendment, passed in 2000, provides that duties assessed pursuant to countervailing duty or antidumping orders shall be

distributed annually to affected United States' domestic producers. Claimants all allege that the Byrd Amendment, in its adoption by the United States, and the United States' application or intended application of the amendment to softwood lumber countervailing and antidumping duties, violates NAFTA. This claim is not specific to any Claimant and, given the potential problems with inconsistent findings regarding the Byrd Amendment, supports consolidation of the claims.

204. *(viii) Tembec's Claim Relating to Class/Kind Determination.* Based on certain facts unique to Tembec, Tembec has one additional claim that it argues prohibits a finding of commonality supporting consolidation. Tembec's business relates in part to Eastern White Pine and Finger-Jointed Flangestock. These types of lumber are unique to Tembec in this case. Tembec alleges that it asked the ITC to perform separate analyses of these products with respect to its material injury determination, but that the ITC refused to do so. Tembec also alleges that it asked Commerce to treat these products as separate classes or kinds of merchandise in its countervailing duty and antidumping determinations because of their distinct characteristics. According to Tembec, a separate class or kind finding would have required Commerce to terminate its investigation as to Eastern White Pine and Finger-Jointed Flangestock because the petitioners made no allegations and provided no evidence as to this type of wood in their petition. Tembec alleges that, instead, Commerce lumped these wood types together with all types of softwood lumber in its evaluation of the petitions, and ended up limiting supply, creating market uncertainty and forcing Tembec to close its investments in the United States and Canada for these types of wood.
205. While this is a claim not common among Claimants, it is only one issue that is uncommon out of many that are common. The presence of this one claim does not destroy the commonality of the issues arising out of the other claims among the Claimants so as to prohibit consolidation within the meaning of Article 1126(2).

(c) *Damages*

206. Tembec and the United States agree, and Canfor does not expressly oppose, that the same Tribunal that considers liability with respect to the claims should also consider damages.¹⁰⁹ Since the Consolidation Tribunal determines that all claims will be consolidated, there is no need to examine the commonality of issues relating to damages. In any event, after determining the liability phase of consolidated proceedings, if any, the Consolidation Tribunal agrees that a determination of damages by this Tribunal will further the interests of efficiency.

E. Fair and Efficient Resolution of the Claims

207. Having regard to the analysis of Article 1126 in Section A above, and in particular in Sub-section A(k) (page 46), the Consolidation Tribunal concludes that consolidation of all claims submitted to the three relevant Article 1120 arbitrations is in the interests of the fair and efficient resolution of those claims, considering the following.
208. It may be recalled that the three factors to be considered in relation to the term “in the interests of fair and efficient resolution of the claims” are: (i) time; (ii) costs; and (iii) avoidance of conflicting decisions.¹¹⁰
209. With respect to factor (i), in none of the relevant Article 1120 proceedings has the arbitral tribunal issued a decision on jurisdictional objections, let alone on liability or damages.

¹⁰⁹ Tr. at 51:5-8 (United States arguing that “it is efficient for the same Tribunal to handle both the liability and damages phases, should these cases advance that far.”); Tr. at 137:6-16 (Tembec stating, “First, generally, liability and damages need to be addressed separately, but they must be addressed in each instance by the same Tribunal.”). Tembec took a different position in its Submission of 10 June 2005 at 47-48 where it stated: “Damages could be addressed only in separate tribunals.”

¹¹⁰ See ¶ 126 *supra*.

210. The fact that the United States could have made the request earlier is a risk that the United States took since, as mentioned before, the principle of procedural economy includes in general the proposition that the more advanced the separate proceedings are, the less likely it is that consolidation will be ordered.¹¹¹ However, that risk to the United States did not materialize as none of the Article 1120 proceedings has advanced to such a stage that consolidation would no longer serve procedural economy.¹¹²
211. If consolidated, Canfor will have some delay, but it would also face delay in the Article 1120 proceeding in getting a new arbitrator up to speed. Tembec will equally face some delay, but would still have to argue the jurisdictional issue and have to wait for a decision on that issue from the Article 1120 Tribunal. Terminal will actually have to prosecute its claim, but will not thereby suffer from delay.
212. Terminal asserts that delay will occur on account of the fact that it is represented by the same counsel as counsel for Canfor, and that, if consolidated, Terminal will have to retain separate counsel who will require to familiarize himself or herself with the case.¹¹³ Counsel for Canfor and Terminal was unable to give a convincing explanation at the 16 June 2005 hearing as to why no conflict had arisen when Canfor and Terminal were represented by the same counsel in separate Article 1120 arbitrations while at the same time a conflict would arise if the arbitrations were consolidated.¹¹⁴ In any event, it is a problem (if it is one) for Canfor and Terminal of their own making, which cannot form part of the

¹¹¹ See ¶ 128 *supra*..

¹¹² A different question is whether the United States' request under Article 1126(2) is barred by the doctrines of laches and estoppel. The Consolidation Tribunal has concluded that it is not. See Section V.C (page 62) *supra*.

¹¹³ Terminal Submission of 10 June 2005 at ¶¶ 3-5.

¹¹⁴ Tr. at 206:10 – 212:8.

consideration of whether consolidation would be in the interests of the fair and efficient resolution of the claims.¹¹⁵

213. Canfor contends that it should not be required to reargue jurisdiction.¹¹⁶ Yet, such an eventuality may become a consequence of consolidation.¹¹⁷ In the present case, if not consolidated, Canfor may have been required to reargue jurisdiction in light of the resignation of one of the arbitrators after the hearing on jurisdiction in *Canfor* and in light of the provisions of Article 14 of the UNCITRAL Arbitration Rules.¹¹⁸
214. More in general, the Consolidation Tribunal has concerned itself with ensuring that there not be an unfair delay in the Claimants' proceedings.
215. With respect to factor (ii), the Consolidation Tribunal has considered the cost estimates submitted by each of the parties. While appreciating that cost estimates of the pursuit of any litigation are notoriously difficult to make, the Tribunal concludes that consolidated proceedings will be less expensive than three separate

¹¹⁵ Tembec is not entirely correct when it argues that this Tribunal “has no authority to force a claimant to submit a statement of claim.” Tembec R-PHB at 42. The Article 1126 proceedings are conducted on the basis of the UNCITRAL Arbitration Rules. See Article 1126(1). According to Article 18(1) of the UNCITRAL Rules: “Unless the statement of claim was contained in the notice of arbitration, within a period of time to be determined by the arbitral tribunal, the claimant shall communicate his statement of claim in writing to the respondent and to each of the arbitrators” Article 28(1) of the UNCITRAL Rules further provides: “If, within the period of time fixed by the arbitral tribunal, the claimant has failed to communicate his claim without showing sufficient cause for such failure, the arbitral tribunal shall issue an order for the termination of the arbitral proceedings” In this connection it may be pointed out that a filing of a statement of claim is not a condition precedent to raising a plea that an arbitral tribunal does not have jurisdiction. Article 21(3) of the UNCITRAL Rules provides: “A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence” An objection to jurisdiction, therefore, can be filed prior to a statement of claim.

¹¹⁶ Canfor Submission of 10 June 2005 at ¶¶ 77-78.

¹¹⁷ See ¶¶ 103 and 153 *supra*.

¹¹⁸ Article 14 of the UNCITRAL Rules provides: “If under articles 11 to 13 the sole or presiding arbitrator is replaced, any hearings held previously shall be repeated; if any other arbitrator is replaced, such prior hearings may be repeated at the discretion of the arbitral tribunal.”

arbitrations for the United States¹¹⁹ and that, for each of the Claimants, costs will increase but not excessively.

216. It is not correct, as Canfor argues, that “the money spent on the Canfor Tribunal is simply thrown away”¹²⁰ since a fair amount of the work product submitted in the *Canfor* proceedings to date can be used again in the consolidation proceedings.
217. With respect to factor (iii), in light of the numerous common questions of law and fact in the three Article 1120 arbitrations, there is a risk that, if not consolidated, their Tribunal decisions will be inconsistent.
218. It may be recalled that, in the view of the Consolidation Tribunal, confidentiality is not a factor to be taken into account when considering “the interests of fair and efficient resolution of the claims,” save for exceptional cases where consolidation would defeat efficiency of process or would infringe the principle of due process enunciated in Article 1115 of the NAFTA. Claimants’ arguments on this subject lack, in the view of the Tribunal, relevance for the reasons stated earlier in this Order.¹²¹ The arguments of the Claimants have not convinced the Consolidation Tribunal that an exceptional case will arise if the proceedings are consolidated.¹²²
219. Nor are the due process rights of the Claimants curtailed due to confidentiality issues (assuming that they would arise to any appreciable extent) if the proceedings are consolidated. In particular, Claimants are mistaken when they argue that the United States will have an advantage by having confidential information: the United States will also have that information if the proceedings

¹¹⁹ In which the mathematical error of the calculation by the United States as identified by Tembec in its R-PHB at 34 is taken into account.

¹²⁰ Canfor Submission of 10 June 2005 at ¶ 82.

¹²¹ See ¶¶ 138-146 *supra*.

¹²² See ¶ 147 *supra*.

are not consolidated. Furthermore, the Tribunal will craft the necessary measures to assure fairness and efficiency in the protection of proprietary information.

220. Considering these factors, the Consolidation Tribunal concludes that, on balance and in fairness, procedural economy counsels in favor of the Consolidation Tribunal assuming jurisdiction over all the claims in the three Article 1120 arbitrations as contemplated by Article 1126(2)(a).

F. Conclusion

221. The Consolidation Tribunal concludes that all four conditions of Article 1126(2) of the NAFTA are met in the present proceedings. First, it is common ground that the claims in question have been submitted to arbitration under Article 1120. Second, the Tribunal has found that many questions of law and fact are common in the three Article 1120 arbitrations. Third, the Tribunal has also found that the interests of fair and efficient resolution of the claims merit the assumption of jurisdiction over all of the claims. And fourth, the parties to the present proceedings have been heard.
222. The result in the present case differs from the one in the *Corn Products* case. There are several reasons for the different outcome, which include the following. First, the Order on Consolidation in *Corn Products* is silent about what Article 1126(2) requires for satisfying the term “a question of law or fact in common.” The Tribunal there wrote, without any further inquiry expressed in the Order, in ¶ 6: “The Consolidation Tribunal accepts that the claims submitted to arbitration do have certain questions of law or fact in common for purposes of Article 1126(2),” and at ¶ 15: “The Tribunal is persuaded that notwithstanding certain common questions of law and fact, the numerous distinct issues of state responsibility and

quantum further confirm the need of separate proceedings.”¹²³ Second, as a general proposition, the present Tribunal disagrees with the statements found in ¶ 9 of the *Corn Products* Order: “Two tribunals can handle two separate cases more fairly and efficiently than one tribunal where the two claimants are direct and major competitors, and the claims raise issues of competitive and commercial sensitivity,” and in ¶ 10: “However, confidential information among competitors is much more easily protected in separate proceedings, which in turn also permit a far more efficient arbitration process under such circumstances.”¹²⁴ Third, in ¶ 14, the *Corn Products* Tribunal notes: “Yet, as CPI pointed out in its written submission, Mexico did not indicate, apart from jurisdiction, common defenses it intends to raise to the claims.” While the present case involves also common questions of law and fact relating to jurisdiction, the same applies to liability as well, in respect of which the United States has raised, and intends to raise, common questions of law and fact.¹²⁵ Moreover, in the judgment of the present Tribunal, anticipated questions may also be taken into account if there is a degree of certainty that they will be raised.¹²⁶ Fourth, while acknowledging the risk of inconsistent awards, in ¶ 16 of the *Corn Products* Order, it is stated that: “This Tribunal does not have before it a large number of identically or very similarly situated claimants. . . . The tax could, for example, constitute an expropriation as to one claimant, but not another.” This fact pattern does not apply to the present case. Lastly, in ¶ 19, the *Corn Products* Order emphasizes that the cases there “are not close to procedural alignment,” which is not applicable in the present case either.

¹²³ See Sub-section V.A(i) (page 42) and Section V.D (page 65) *supra*.

¹²⁴ See ¶¶ 138-147 and 219-220 *supra*.

¹²⁵ See Section V.D (page 65) *supra*.

¹²⁶ See Sub-section V.A(j) (page 45) and ¶ 176 *supra*.

223. The consequence of the decision of the present Consolidated Tribunal is that the Article 1120 Tribunals cease to function.¹²⁷
224. The next step in the proceedings will be for the Tribunal to consult with the parties about the conduct and sequence of the proceedings, having regard to the observations made in Sub-section A(m) above (page 57).
225. The Tribunal reserves the decision on the award of costs of the present proceedings as referred to in Articles 38-40 of the UNCITRAL Arbitration Rules to a subsequent order, decision or arbitral award, having regard to the fact that none of the parties has made submissions on costs. Reservation of the decision on costs is also appropriate in light of the alternative relief sought by Canfor and Terminal in their reply post-hearing brief to the effect that, if consolidation is ordered, “the United States should be ordered to pay Canfor and Terminal’s costs that have been thrown away by virtue of the United States having been dilatory in bringing this consolidation application,”¹²⁸ to which relief the United States has not had an opportunity to respond because of the timing of the relief sought.

¹²⁷ See Sub-section V.A(n) (page 59) *supra*.

¹²⁸ Canfor & Terminal R-PHB ¶ 32.

VI. DECISION OF THE CONSOLIDATION TRIBUNAL

226. For the foregoing reasons, the Consolidation Tribunal by order:

- (1) ASSUMES JURISDICTION over all claims in the Article 1120 arbitrations *Canfor Corporation v. United States of America, Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc. v. The United States of America*, and *Terminal Forest Products Ltd. v. The United States of America*, within the meaning of Article 1126(2)(a) of the NAFTA;
- (2) DENIES Tembec's Motion to Dismiss of 27 June 2005; and
- (3) RESERVES the decision on the costs of the present proceedings to a subsequent order, decision or arbitral award.

Made in Washington, D.C., 7 September 2005,

THE CONSOLIDATION TRIBUNAL:

Professor Armand L.C. de Mestral
Arbitrator

Davis R. Robinson, Esq.
Arbitrator

Professor Albert Jan van den Berg
Presiding Arbitrator

Legal Authority CA-13

Date of dispatch to the parties: December 16, 2002

International Centre for
Settlement of Investment Disputes

MARVIN FELDMAN

v.

MEXICO
CASE No. ARB(AF)/99/1

AWARD

President : Prof. Konstantinos D. KERAMEUS
Members of the Tribunal : Mr. Jorge COVARRUBIAS BRAVO
Prof. David A. GANTZ
Secretary of the Tribunal : Mr. Alejandro A. ESCOBAR
and Ms. Gabriela ALVAREZ AVILA

In Case No. ARB(AF)/99/1,
between Mr. Marvin Roy Feldman Karpa,
represented by
Mr. Mark B. Feldman, Ms. Mona M. Murphy, Mr. Douglas R.M. King
of Feldman Law Offices, P.C. (formely Feith & Zell, P.C.), and
Mr. Nathan Lewin and Ms. Stephanie Martz of the Law Firm of Miller, Cassidy,
Larroca & Lewin, L.L.P.

and
The United Mexican States,
represented by Lic. Hugo Perezcano Díaz, Consultor Jurídico Subsecretaría de
Negociaciones Comerciales Internacionales
Ministry of Economy

THE TRIBUNAL,
Composed as above,
Makes the following Award

TABLE OF CONTENTS

A	Introduction and Summary of the Dispute	1
B	Representation.....	1
C	The Arbitral Agreement.....	1
D	Facts and Allegations.....	2
E	The Proceedings	8
F	Jurisdiction	13
F.1	Standing.....	14
F.2	Time Limitation	15
F.3	Admissibility of an Additional Claim under NAFTA Article 1102.....	15
F.4	Relevance of Claims Pre-Dating NAFTA’s Entry into Force	15
G	Additional Jurisdictional Issues	15
G.1	Estoppel with regard to the Period of Limitation and the Basis of the Claim	15
G.2	Exhaustion of Local Remedies	21
G.3	Analysis.....	23
G.4	Other Jurisdictional Constraints.....	26
H	Merits	30
H.1	Expropriation: Overview of the Positions of the Disputing Parties	30
H.2	Applicable Law: NAFTA Article 1110 and International Law	33
H.3	Respondent’s Actions as an Expropriation Under Article 1110.....	39
H.3.1	Many Business Problems Are Not Expropriations	41
H.3.2	Gray Market Exports and International Law	42
H.3.3	Continuing Requirements of Article 4(III) of IEPS Law.....	44
H.3.4	Public Purpose	54
H.3.5	Non-Discrimination.....	55
H.3.6	Due Process/Fair and Equitable Treatment/Denial of Justice	56
H.3.7	The Claimant in Control of CEMSA	58
H.3.8	Other NAFTA Decisions	59
I	National Treatment (NAFTA Article 1102).....	63
I.1	Views of the Disputing Parties	64
I.2	Analysis by the Tribunal	67

I.2.1	In Like Circumstances.....	69
I.2.2	Existence of Discrimination.....	71
I.2.3	Discrimination as a Result of Nationality	75
I.2.4	Most Favored Investor Requirement?	77
J	Damages	79
K	Costs and Fees.....	86
L.	Decision	88

A INTRODUCTION AND SUMMARY OF THE DISPUTE

1. This case concerns a dispute regarding the application of certain tax laws by the United Mexican States (hereinafter “Mexico” or “the Respondent”) to the export of tobacco products by Corporación de Exportaciones Mexicanas, S.A. de C.V. (“CEMSA”), a company organized under the laws of Mexico and owned and controlled by Mr. Marvin Roy Feldman Karpa (hereinafter “Mr. Feldman” or “the Claimant”), a citizen of the United States of America (“United States”). The Claimant, who is suing as the sole investor on behalf of CEMSA, alleges that Mexico’s refusal to rebate excise taxes applied to cigarettes exported by CEMSA and Mexico’s continuing refusal to recognize CEMSA’s right to a rebate of such taxes regarding prospective cigarette exports constitute a breach of Mexico’s obligations under the Chapter Eleven, Section A of the North American Free Trade Agreement (hereinafter “NAFTA”). In particular, Mr. Feldman alleges violations of NAFTA Articles 1102 (National Treatment), 1105 (Minimum Level of Treatment), and 1110 (Expropriation and Indemnification).¹ Mexico denies these allegations.

B REPRESENTATION

2. The Claimant is represented in these proceedings by Mr. Mark B. Feldman of Feldman Law Offices, P.C. (formerly Feith & Zell, P.C.) The Respondent is represented by Lic. Hugo Perezcano Díaz, Consultor Jurídico, Subsecretaría de Negociaciones Comerciales Internacionales, Secretaría de Economía, Government of Mexico.

C THE ARBITRAL AGREEMENT

¹ See the Notice of Intent to Submit a Claim, submitted under NAFTA Article 1119, p. 2. The Notice of Intent also mentioned NAFTA Article 1106, on performance requirements, but the obligations of this provision were not invoked in the Notice of Claim.

3. The dispute is subject to arbitration under the North American Free Trade Agreement, concluded between the Government of the United States of America, the Government of Canada and the Government of the United Mexican States, and which entered into force on January 1, 1994.

4. NAFTA Article 1117 entitles an investor to bring a claim against a NAFTA State Party on behalf of an enterprise of another NAFTA Party which the investor owns or controls. NAFTA Article 1139 provides that an “enterprise of a Party means an enterprise constituted or organized under the law of a [NAFTA] Party.”

5. NAFTA Article 1120 provides that arbitral proceedings may be instituted under the Additional Facility Rules of the International Centre for Settlement of Investment Disputes (“ICSID”), as modified by the provisions of Chapter Eleven, Section B of the NAFTA, provided that either the disputing Party whose measure is alleged to be a breach referred to in Article 1117 (in this case, Mexico) or the Party of the investor (in this case, the United States), but not both, is a party to the ICSID Convention.² The ICSID Additional Facility Rules, rather than the ICSID Convention, are applicable in this case since only the United States, as the Party of the investor, but not the United Mexican States, as the Respondent in this case, is a Contracting State to the ICSID Convention. Under NAFTA Article 1122(1), in conjunction with NAFTA Articles 1116, 1117 and 1120, Mexico expresses its consent to the submission to arbitration of claims of investors who are nationals of another State Party to the NAFTA either under the ICSID Convention, under the Additional Facility Rules, or under the UNCITRAL Arbitration Rules.

D FACTS AND ALLEGATIONS

6. Much of the complexity of this case results from the parties’ disagreements with regard to the facts. The reasons for this are several. First, in some instances, records are not available because they have been destroyed, as records are routinely destroyed at the Mexican Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*, hereinafter

² Convention on the Settlement of Investment Disputes between States and Nationals of Other States, opened for signature March 18, 1965, entered into force October 14, 1966.

“SHCP”) after five years (counter-memorial, para. 144). Secondly, there are disagreements to particular facts which the Tribunal cannot rectify on the basis of the material presented, either because the information does not exist or because the Respondent has been unwilling or unable to produce it. As a result, in some instances, the “evidence” presented by both sides results in an assertion of facts rather than proof of facts. This section summarizes what the Tribunal believes to be the key facts and assertions, noting when the "facts" are from a particular party's point of view. They are discussed in more detail in the relevant sections of this award.

7. The case concerns the tax rebates which may be available when cigarettes are exported. Mexico imposes a tax on production and sale of cigarettes in the domestic market under the Impuesto Especial Sobre Producción y Servicios ("IESP") law, a special or excise tax on products and services. In some circumstances, however, a zero tax rate has been applied to cigarettes that are exported. According to the Respondent, the IEPS Law "has basically remained the same since its origins [in 1981], although the underlying methodology of the tax has changed several times" (counter-memorial, para. 85). Review of the various versions of the IEPS law between 1990 and 1999 confirms this conclusion.

8. Under the 1991 IEPS law, certain activities generated liability for the tax, including, *inter alia*, selling domestically, importing and exporting the goods listed in Article 2, section I of the Law. The IEPS law also included the 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 (Article 2). However, the IEPS rate on exports of cigarettes from 1990 through 1997 was 0%. 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. In most instances, when cigarettes were purchased in Mexico at a price that included the tax, and subsequently exported, the tax amounts initially paid could be rebated.

9. The Claimant's firm, CEMSA, first began exporting cigarettes in 1990. According to the Respondent, the record shows that SHCP paid the IEPS rebates to the claimant for 1990-1991 in full (including amounts properly owing to inflation and interest) and declined

only to pay the demanded "financial costs" for which there was no provision under the Fiscal Code (counter-memorial, para. 142(b)). While the Claimant contended that CEMSA had by 1991 established a cigarette export business, the Respondent alleges that CEMSA's request for IEPS rebates in November 1990-1991 related solely to exports of beer and alcoholic beverages (counter-memorial, para. 142(a)).

10. According to the Claimant, an authorized producer of cigarettes in Mexico, Carlos Slim "protested [regarding Claimant's exports] and the government took administrative steps and passed legislation to cut off rebates to CEMSA in 1991" (memorial, p. 2). This assertion is contested by the Respondent. The 1991 legislation was apparently designed to provide IEPS rebates to exports undertaken by producers of cigarettes (such as Cigatam, a firm allegedly controlled by Carlos Slim), but to deny rebates for exports by resellers of cigarettes, such as CEMSA (memorial, p. 2, counter-memorial, para. 93). The amendments to Article 2, Section III in 1991, specified 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 (counter-memorial, para. 93). The Claimant, as a reseller, became ineligible for rebates.

11. The Claimant initiated an *Amparo* action before the Mexican courts in February, 1991, challenging the constitutional validity of Article 2, Section III, in that it limited the 0% tax rate to producers and bottlers. The *Amparo* alleged that these measures infringed upon the constitutional principle of "equity of taxpayers" by excluding all other exporters from the possibility of obtaining the 0% rate (counter-memorial, para. 102). In April, 1991, the Fifth District Judge in Administrative Matters dismissed CEMSA's *Amparo*, in part, but granted it, in part, citing that SHCP had no authority to issue the implementing fiscal regulations for 1991, which CEMSA was challenging. The decision was appealed by both sides in May, 1991. In July, CEMSA also filed a criminal complaint against the SHCP officials responsible for enactment of the 1991 amendment to Article 2 section III of the IEPS Law, for abuse of authority and conspiracy (counter-memorial, para. 107).

12. Pending final resolution of the *Amparo*, the Mexican Congress amended the IEPS law, effective January 1, 1992, to allow IEPS rebates to all cigarette exporters, and CEMSA was able to export cigarettes with rebates most of that year. Effectively, this new law reverted to the system in force in 1990, making all final exports eligible for application of the 0% rate (counter-memorial, para. 93). As far as the Tribunal is able to determine, the 1992 legislation remained unchanged in all aspects relevant to this case through 1997.

13. According to the Claimant, after the IEPS law was amended in 1992, the Claimant began to export cigarettes. Claimant claims to have received rebates thereafter (counter-memorial, paras. 144, 146); this assertion is neither confirmed nor denied by the Respondent, because the records have been destroyed after five years in accordance with normal SHCP policies (counter-memorial, para. 144).

14. In January, 1993, according to the Claimant, the Respondent shut down CEMSA's cigarette export business for a second time, (memorial, p. 3) because the Claimant could not meet other requirements of the IEPS law (counter-memorial, paras. 151-152). The reasons for the Claimant's inability to produce invoices are rather complicated.

15. The IEPS requires cigarette producers to pay the 85% tax, which is then passed on to purchasers in their purchase price (Article 8 of IEPS). The taxable base is the sales price to the retailer, and further tax is not paid on subsequent sales (Article 4, Section 8 of IEPS). To be eligible for the tax rebate, the IEPS tax on the cigarettes must be stated "separately and expressly on their invoices" (memorial, p. 3; counter-memorial, paras. 89, 91). This is required by Article 4 of the IEPS Law, which applies to all taxes covered by the IEPS, not just taxes on cigarettes. Only producers, and not resellers, have access to the itemized invoice. CEMSA purchased the cigarettes from volume retailers such as Wal-Mart or Sam's club (rather than the producers), at a price that included the IEPS tax, but was not itemized separately on the invoice. CEMSA thus was never able to obtain invoices separating the tax.

16. In August, 1993, the Supreme Court of Justice ruled in favor of CEMSA, finding unanimously that "measures allowing IEPS rebates only to producers and their distributors

violated constitutional principles of tax equity and non-discrimination" (memorial, p. 2; see also counter-memorial, para. 108). The court did not discuss or rule explicitly on any other relevant issues, such as whether the Claimant was entitled to rebates notwithstanding the Claimant's inability to produce invoices stating the tax amounts separately.

17. During the period 1993-1995, the Respondent recognized that CEMSA was a taxpayer entitled to the 0% tax rate on cigarette exports, but continued to demand that the Claimant meet the invoice requirements of Article 4 of the IEPS law, even though it was impossible for CEMSA to meet those requirements.

18. CEMSA claims that Mexican tax officials gave the Claimant "assurances" in 1995-1996 that rebates would be paid (memorial, p. 2) and alleges that negotiation of an oral "agreement" took place in 1995, confirmed and finally implemented in 1996, which would permit CEMSA to resume exporting cigarettes in large quantities in June 1996. As discussed in detail in Section F5, the Respondent vigorously denies the existence of any such agreement, and asserts that it was complying with the 1993 Supreme Court *Amparo* decision by affording Claimant access to the 0% tax rate for exports. Neither party was able to produce conclusive evidence of the existence or non-existence of such an agreement or understanding.

19. Regardless of the possible existence or non-existence of an agreement, the Claimant states that he was paid rebates from June 1996 to September 1997, a total of sixteen months (memorial, pp. 2, 3). CEMSA claims that during these sixteen months, "Hacienda officials knew that CEMSA was receiving IEPS rebates on cigarette exports without having obtained invoices separating the tax" (memorial, p. 4). The Respondent counters by observing that it is standard practice for SHCP to pay requests for rebates promptly as they are submitted, given that they have the authority to audit IEPS tax returns to determine if the requirements of the law have been complied with. According to the Claimant, "by late 1997, CEMSA accounted for almost 15% of Mexico's cigarette exports" (memorial, p. 4).

20. However, this situation did not last. The Respondent finally terminated rebates to CEMSA on or before December 1, 1997. According to the Claimant, this was done without

prior warning (memorial, pp. 2, 4), and the Respondent refused to pay rebates of US \$2.35 million owed to CEMSA on exports made in October and November 1997 (memorial, p. 4) .

21. Since December 1, 1997, the IEPS law has been amended to bar rebates to cigarette resellers such as CEMSA, limiting such rebates to the “first sale” in Mexico. Articles 11 and 19 of the IEPS were amended so as to provide that tax rebates are not allowed on sales subsequent to those made to the retailer. The amendments also imposed an obligation on exporters of certain goods, including cigarettes, of registering in the Sectorial Exporters Registry in order to be entitled to apply for the 0% IEPS rate on exports. Subsequently, under the 1998 amendment, CEMSA was also refused registration as an authorized exporter of cigarettes and alcoholic beverages (memorial, p. 4, see also reply, para. 5). Absent such registration, Mexican Customs authorities will not issue the “pedimento” (export documentation) that is required to export goods from Mexico. The Respondent contends that this refusal was a result of an on-going audit of CEMSA’s earlier claims for IEPS tax reimbursements.

22. On July 14, 1998, SHCP began an audit of CEMSA and demanded that CEMSA repay the approximately US\$25 million for IEPS rebates SHCP asserts the Claimant received during the twenty one-month period of January 1996 to September 1997, with interest and penalties. To avoid forfeiture and criminal sanctions for non-payment, CEMSA challenged the “assessment” in the Mexican courts. This assessment proceeding in the Mexican courts remains pending. A separate proceeding, which has been concluded, challenged the Respondent’s denial of IEPS rebates for the period October-November 1997.

23. The Claimant is not the only reseller/exporter of cigarettes in Mexico. The Claimant and the Respondent agree that at least two other firms, Mercados I and Mercados II, owned by named Mexican nationals (the “Poblano Group”) are resellers of cigarettes in "like circumstances" with CEMSA (counter-memorial, paras. 460-470, 48). The Claimant asserts that these Mexican firms have been permitted to obtain rebates for taxes on exported cigarettes during periods when such rebates have been denied to the Claimant, notwithstanding the inability of these firms to produce the necessary invoices stating the tax amounts separately. The Respondent concedes that at least five companies have been registered as cigarette exporters, but

has been unable or unwilling to provide any detailed information on the status of those firms or their access to IEPS tax rebates. The Respondent, however, alleges that the Claimant and the “Poblano Group” belong effectively to the same business entity and, therefore, are not eligible to be compared to each other for national treatment purposes.

E THE PROCEEDINGS

24. The present arbitration was initiated on April 30, 1999, when the Claimant, pursuant to NAFTA Article 1120, submitted a Notice of Arbitration and request for approval of access to the Additional Facility to the Secretary-General of ICSID. The Claimant asserted that Mexico’s actions in this case were “tantamount to nationalization or expropriation and constitute[d] a denial of justice in violation of the rules and principles of international law and NAFTA Articles 1110 and 1105(1).”³ The Claimant requested the following relief:

- (a) a declaration that Mexico has breached its obligations to Marvin Feldman by expropriating his investments without providing prompt, adequate and effective compensation, and by failing to accord to CEMSA fair and equitable treatment and full protection and security;⁴
- (b) an order directing Mexico to pay Marvin Feldman damages in respect of the loss CEMSA has suffered through Mexico’s conduct described above of US\$50 million, or approximately \$475 million Mexican pesos, along with interest on the award to be computed at the applicable rate of interest; and
- (c) any other legal or equitable relief deemed just and warranted.

The Acting Secretary-General of ICSID approved access to the Additional Facility on May 27, 1999 and issued a Certificate of Registration of the Notice of Arbitration on the same day.

³ The Claimant’s Notice of Arbitration, p. 5 (submitted on April 30, 1999).

⁴ The Claimant subsequently submitted an additional request for a declaration that Mexico had breached its obligations to afford CEMSA national treatment under NAFTA Article 1102.

25. An arbitral tribunal was constituted in accordance with NAFTA Articles 1123 and Article 6 of the ICSID Arbitration (Additional Facility) Rules (hereinafter “the Arbitration Rules”). The Claimant appointed Professor David A. Gantz (a national of the United States) and Mexico appointed Mr. Jorge Covarrubias Bravo (a national of Mexico), as arbitrators. Following a request made by the Claimant under NAFTA Article 1124, and after extensive consultation with the parties, the Secretary-General of ICSID appointed Professor Konstantinos D. Kerameus (a national of Greece) as President of the Tribunal. On July 30, 1999, in accordance with NAFTA Article 1125, the Claimant agreed in writing to the appointment of all the arbitrators. On January 18, 2000, in accordance with Article 14 of the Arbitration Rules, ICSID informed the parties that all the arbitrators had accepted their appointment and that the Tribunal was therefore deemed to be constituted, and the proceeding to have begun, on that date. Mr. Alejandro A. Escobar, Senior Counsel, ICSID, was assigned to serve as the secretary of the Tribunal. All subsequent written communications between the parties were to be made through the ICSID Secretariat.

26. The first session of the Tribunal was held, with the parties’ agreement, in Washington, D.C. on March 10, 2000. Among the matters agreed on at the first session, it was determined that the languages of the proceeding would be English and Spanish. In accordance with NAFTA Article 1130 and Articles 20 and 21 of the Arbitration Rules, the Tribunal then issued Procedural Order No. 1, determining that the place of arbitration would be Ottawa, Province of Ontario, Canada, without prejudice to the Arbitral Tribunal meeting at any other place, with or without the parties, as may be convenient. The parties accepted this determination.

27. On February 15, 2000, the Claimant had submitted a request for provisional measures for the preservation of his rights, to which the Respondent replied on March 6, 2000. Proposals and observations on the scheduling of the proceedings were also exchanged. Following further discussion on these matters at the first session of the Tribunal, on May 3, 2000 the Tribunal issued Procedural Order No. 2, declining, under NAFTA Article 1134, to grant the Claimant’s request for provisional measures. In Procedural Order No. 2, the Tribunal also determined a schedule for the request, disclosure and production of documents, and for the filing

of a memorial and counter-memorial, reserving any instructions that the parties file a reply and a rejoinder.

28. In the context of the parties' requests for documentation, the Claimant submitted communications of May 23, June 20, and July 11, 2000, to which the Respondent replied by a communication of July 11, 2000. Finding that the foregoing communications raised "jurisdictional issues that both parties wish[ed] the Tribunal to consider and rule upon before the exchange of written pleadings on the merits," the Tribunal, on July 18, 2000, issued Procedural Order No. 3 directing the parties to exchange written pleadings on preliminary jurisdictional matters and suspending the schedule set forth in the second procedural order. Under this order, the Claimant was requested to file a memorial on jurisdictional issues, the Respondent was then to file a counter-memorial, and the parties were then simultaneously to file further observations on such jurisdictional issues.

29. On July 18, 2000, the Claimant requested the revision of Procedural Order No. 3 asking for the jurisdictional issue to be joined to the merits, for the briefing schedule on other issues to be adjusted, and for a direction that discovery proceed pending such disposition. On July 20, 2000, the Respondent replied opposing the Claimant's request for revision of Procedural Order No. 3.

30. Referring to the correspondence from both the Claimant and the Respondent subsequent to the issuance of Procedural Order No. 3, the Tribunal on August 3, 2000 issued Procedural Order No. 4 reaffirming the directions given in Procedural Order No. 3 and fixing a revised schedule for the briefing of preliminary jurisdictional issues.

31. By respective communications of August 15, 2000, Canada and the United States requested that the Tribunal permit each of them to make submissions pursuant to NAFTA Article 1128 on the jurisdictional issues raised in the case within 14 days of the date of the last filing by a party on such issues. By letter of August 18, 2000, the Respondent referred to those communications from Canada and the United States, and requested an additional time period for commenting on their submissions made under NAFTA Article 1128 as well as on the Claimant's

additional observations on jurisdiction. By letter of August 21, 2000, the Claimant opposed such modification of the briefing schedule sought by the Respondent, and on the same day submitted his memorial on jurisdictional issues as directed by the Tribunal.

32. By letter of the Secretary of August 24, 2000, the Tribunal determined it unnecessary to modify the briefing schedule set forth in Procedural Order No. 4, under which “the parties have been afforded an opportunity of a simultaneous second round of written pleadings on preliminary issues in order to address, by way of further explanation, arguments already made.” Also on August 24, 2000, the Tribunal invited Canada and the United States to file any NAFTA Article 1128 submissions on preliminary issues by October 6, 2000.

33. On August 29, 2000, the Respondent requested that the Tribunal order the production of documents by the Claimant concerning the preliminary issues briefed by the parties. On September 1, 2000, the Tribunal directed both parties to promptly comply with any requests for the production of documents which they regard to be in good faith, and after exhaustion of all best efforts, to be admissible, relevant and otherwise inaccessible to the party requesting them.

34. On September 8 and 11, 2000, respectively, the Respondent filed English and Spanish versions of its counter-memorial on preliminary issues. On September 13, 2000, following a request by the Claimant, the Respondent filed an English translation of the Appendixes of its counter-memorial.

35. On September 22, 2000, the parties simultaneously filed their additional observations on the preliminary jurisdictional issues in English and, in Spanish on September 27 and 28, 2000, respectively. On October 6, 2000, Canada and the United States of America filed their respective submissions under NAFTA Article 1128.

36. The Claimant, by letter of October 6, 2000, opposed what it alleged were two new motions made by the Respondent in its additional observations as submitted on September 22, 2000 regarding the production of documents and the matter of confidentiality with regard to

public statements made by the parties in the case. On October 20, 2000, the Respondent submitted its observations on the submissions of Canada and the United States, the Claimant's communication of October 6, 2000 and the Claimant's additional observations of September 22, 2000. The Respondent further requested a hearing on the preliminary issues briefed by the parties. The Claimant submitted a letter on October 24, 2000 in which it opposed a hearing on preliminary issues. The Tribunal decided not to hold a hearing on these matters.

37. On December 6, 2000, the Tribunal issued its Interim Decision on Preliminary Jurisdictional Issues (the "Interim Decision"), ruling on certain jurisdictional questions and joining others to the merits of the case, as described further below. Also on December 6, 2000, the Tribunal issued its Procedural Order No. 5, declining to grant the requests of the Respondent regarding the production of documents and the confidentiality of matters related to the proceedings. The Tribunal set forth a new schedule for the exchange of documents and pleadings on the merits.

38. On December 22, 2000, the Claimant requested the Secretariat to distribute certain documents he had filed with the Secretariat in response to a request by the Respondent. On December 29, 2000, in accordance with Procedural Order No. 5, the parties filed their submissions on the presentation of witnesses and the production of documents. On January 5, 2001 the Tribunal issued further directions regarding the production of documents.

39. Pursuant to the Tribunal's directions of January 5, 2001, the Claimant filed, on January 10, 2001, a letter indicating the reasons for which he opposed the production of certain documents and informed which documents have already been produced to the Respondent. Similarly on January 11, 2001, the Respondent indicated the reasons for which it opposed the production of certain documents requested by the Claimant and commented on the Claimant's communication of December 29, 2000.

40. The Claimant, by letter of January 16, 2001, commented on the Respondent's previous correspondence regarding the production of documents. On February 5, 2001, the Tribunal issued further directions regarding the production of documents.

41. The Claimant's memorial and the Respondent's counter-memorial on the merits were filed respectively on March 30 and May 24, 2001. The Claimant filed his reply to the counter-memorial on the merits on June 11, 2001. The Tribunal, on June 19, 2001, issued its Procedural Order No. 6 concerning the marshalling of evidence at the hearing on the merits. The Respondent's rejoinder was filed on June 25, 2001.

42. On June 28, 2001, Canada made a NAFTA Article 1128 submission on issues concerning the merits. The United States made no such submission.

43. From July 9 to July 13, 2001, the Tribunal held its hearing on the merits in Washington, D.C., at which both parties appeared and presented witnesses. Witnesses called by the Claimant for cross-examination were Rafael Obregón-Castellanos and Fernando Heftye-Etienne; witnesses called for cross-examination by the Respondent were Oscar Roberto Enríquez Enríquez, Marvin Feldman Karpa and Jaime Zaga Hadid. Full verbatim transcripts in English were made of the hearing and distributed to the parties.

44. On April 17, 2002, the Tribunal asked the parties and the NAFTA Parties to submit their views on how the Tribunal should treat parallel proceedings and on the issue of relief. The Claimant filed his submission on May 28, 2002 and the Respondent its submission on May 29, 2002. The NAFTA Parties made no submission in this respect.

45. The Deputy Secretary-General, by letter of August 5, 2002, informed the Tribunal that Mr. Alejandro A. Escobar, to the Secretariat's regret, left ICSID for private legal practice and indicated that Ms. Gabriela Alvarez Avila, Counsel, ICSID, was replacing him as Secretary of the Tribunal.

F JURISDICTION

46. In its Procedural Order No. 4, the Tribunal identified the five preliminary jurisdictional questions on which the parties were to submit their written pleadings:

- a. Whether the Claimant, being a citizen of the United States of America, and a registered permanent resident in Mexico, had standing to sue under Chapter Eleven of NAFTA?
- b. Whether the Respondent was entitled to raise any defense on the basis of the time limitation set forth in NAFTA Article 1117(2), and in particular whether such time limitation affected the Tribunal's consideration of facts relevant to the claim or claims, and whether the Respondent was estopped from relying on such time limitation?
- c. Whether the Claimant had properly submitted a point of claim in this arbitration proceeding concerning an alleged violation of NAFTA Article 1102?
- d. Whether the Claimant was allowed to submit additional claims, if any, or amend its claim, on the basis of an alleged violation of NAFTA Article 1102?
- e. Whether measures alleged to be taken by the Respondent in the period between late 1992 and January 1, 1994, when NAFTA came into force, and which are alleged to be in violation of NAFTA, general international law, or domestic Mexican law, were relevant for the support of the claim or claims?

47. The Tribunal, in its Interim Decision of December 6, 2000, decided most of the jurisdiction issues, which will be summarized below under the headings of standing, time limitation, admissibility of an additional claim under NAFTA Article 1102, and relevance of claims pre-dating NAFTA's entry into force. Discussion of additional jurisdiction issues, not addressed in the Interim Decision, will follow, including issues of estoppel with regard to the period of limitation and the basis of the claim and exhaustion of local remedies.

F.1 Standing

48. On the issue of the Claimant's standing, the Tribunal ruled in its Interim Decision of December 6, 2000 (paras. 24-38), that the Claimant, being a citizen of the United States and of the United States only, and despite his permanent residence (*inmigrado* status) in Mexico, has standing to sue in the present arbitration under NAFTA Chapter 11. The Tribunal accordingly dismissed the Respondent's preliminary defense pertaining to the Claimant's lack of standing because of his permanent residence in Mexico, and found that it was not necessary to address the Claimant's allegation that Respondent's defense about the Claimant's standing is not timely.

F.2 Time Limitation

49. Regarding the issue of time limitation under NAFTA Article 1117(2) for submitting claims to arbitration, the Tribunal found in its Interim Decision (paras. 39-47) that the cut-off date of such three-year limitation period is April 30, 1996 rather than February 16, 1995. Two additional questions concerning such time limitation were joined to the consideration of the merits of the case and are discussed further below (paras. 53-65).

F.3 Admissibility of an Additional Claim under NAFTA Article 1102

50. As to whether the Claimant has submitted or is allowed to submit additional claims, or amend his claims, on the basis of an alleged violation of NAFTA Article 1102 concerning denial of national treatment, the Tribunal found in its Interim Decision (paras. 50-59) that the point of claim concerning an alleged violation of NAFTA Article 1102 was properly before the Tribunal because it had been in substance included in the notice of intent to submit the claim to arbitration (i.e., “the notice of arbitration” referred to in the Interim Decision), and had been presented in a timely fashion. In addition, to the extent that such point of claim was subsequently presented as ancillary claim, the Tribunal accepts such incidental or additional claim to be within its jurisdiction.

F.4 Relevance of Claims Pre-Dating NAFTA’s Entry into Force

51. On the issue whether measures alleged to be taken by the Respondent in the period between late 1992 and January 1, 1994, when NAFTA came into force, and which are alleged to be in violation of NAFTA, general international law, or domestic Mexican law, are relevant for the support of the claim or claims, the Tribunal found in its Interim Decision (paras. 60-63) that only measures alleged to be taken by the Respondent after January 1, 1994, when NAFTA came into force, and which are alleged to be in violation of NAFTA, are relevant for the support of the claim or claims under consideration.

52. The Tribunal hereby confirms each of the findings on jurisdictional questions, and the reasons on which they are based, set forth in its Interim Decision of December 6, 2000, which is attached to this Award and forms an integral part hereof.

G ADDITIONAL JURISDICTIONAL ISSUES

G.1 Estoppel with regard to the Period of Limitation and the Basis of the Claim

53. In its Interim Decision of December 6, 2000, the Arbitral Tribunal, joined the following questions to the examination of the merits (Interim Decision para. 49):

- (a) whether the Parties on or about June 1, 1995 reached an agreement concerning CEMSA's right to export cigarettes and to receive tax rebates on such exports, and whether deviation from this agreement was formally confirmed in February 1998, thus bringing about a suspension of the limitation period for some 32.5 months, i.e. from June 1, 1995 to mid-February 1998; and
- (b) whether the Respondent is equitably estopped from invoking any limitation period because it gave the Claimant assurances that exports would be permitted and rebates paid to CEMSA (*ibid.*, para. 48).

During the examination of the merits, the Claimant enlarged his invocation of estoppel, in order for it to cover not merely the defense of limitation but the very basis of the damages claim itself (see Claimant's memorial, Introduction and Summary, p. 8, and paras. 179-186).

54. The first, and more technical, issue of a possible suspension of the limitation period for about 32.5 months has been addressed by the Claimant in his memorial (paras. 62-68, 184, 187) and partly in his reply (para. 65), and by the Respondent partly in its counter-memorial (paras. 18-20, 57, 401-427) and partly in its rejoinder (paras. 106-143).

55. In essence, the Claimant alleges several meetings with middle- and high- ranking SHCP officials in 1995 concerning the resumption of cigarette exports by CEMSA with rebates of the IEPS. During these meetings, Claimant alleges that oral assurances were given by the Mexican tax administration to the Claimant. The Claimant understands such assurances as amounting to an agreement. He concludes by asserting that a suspension or "tolling" of the period of limitation is "appropriate in a case such as this one where a lawsuit was discouraged by the actions of a defendant. Although the clearest example is where a defendant has expressly agreed not to raise a defence based upon a statute of limitations, other representations, promises, or actions will suffice to estop a party from invoking a statute of limitations" (memorial, para. 187; footnotes omitted).

56. The Respondent denies that any oral agreement was reached. 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 (counter-memorial, paras. 19-20).

57. The scope of this issue seems to be more limited than it appears at first sight. In fact, the Claimant asks for a suspension of the period of limitation for about 32.5 months. If accepted, such suspension would effectively extend backwards the cut-off date of the three-year limitation period under NAFTA Article 1117(2) from April 30, 1996 to mid-August 1993. Since, however, the Tribunal's jurisdiction *ratione temporis* starts only from January 1, 1994, when NAFTA came into force (see *supra*, para. 51, and in more detail, the Interim Decision of December 6, 2000, para. 62), the same date would necessarily be the *terminus post quem* for limitation purposes if a suspension, as requested, were to be admitted.

58. In substance, in view of the Tribunal, such suspension or "tolling" of the period of limitation is unwarranted. NAFTA Article 1117(2) does not provide for any suspension of the three-year period of limitation. Even under general principles of law to be applied by international tribunals, it should be noted that in several national legal systems such suspension is provided only in the final part of the limitation period (*e.g.* in the last six months) and only either in cases of act of God or if the debtor maliciously prevented the right holder from instituting a suit (see *e.g.* German Civil Code para. 203; Greek Civil Code Article 255). In this case no such unavoidable events have been pleaded. Basically, the Claimant maintains that a lawsuit was "discouraged" by the Respondent's actions (memorial, para. 187), among other things because the Claimant took the revocation of an audit as a confirmation of alleged previous agreements (*ibid.*, para. 68). However, "discouraging" a lawsuit does not amount to preventing it. The decision whether, and when, to bring a lawsuit lies with the prospective plaintiff, who also bears the respective benefits and risks. Among the various factors to be taken into consideration is the running of the period of limitation and its interruption as well. Nothing in the file shows that the Claimant, appropriately represented by counsel, was prevented from taking into consideration all relevant factors. Therefore, the Tribunal confirms April 30, 1996 as the cut-off date of the three-year limitation period under NAFTA Article 1117(2).

59. We turn now to the more general issue of the Respondent's estoppel from invoking any limitation period because it gave the Claimant assurances that exports would be permitted and rebates paid to CEMSA, as well as from denying the very basis of the damages

claim itself (see *supra*, para. 53). According to the Claimant, the IEPS law in force from January 1, 1992 through December 31, 1997 recognized that all cigarette exporters were entitled to rebates of the IEPS tax included in the purchase price of cigarettes. The Respondent is estopped from asserting a contrary view in this arbitration, because Mexican officials confirmed that interpretation to the Claimant over the years both in writing and verbally (memorial, para. 170 b). The formal requirement of the IEPS law that a taxpayer seeking a rebate obtain a vendor's invoice stating the IEPS tax separately and expressly is not applicable to CEMSA as a matter of Mexican or international law because that requirement could not be complied with by CEMSA for reasons beyond its control (*ibid.*, para. 170 c). SHCP was fully aware of CEMSA's export activities and, without requiring invoices stating the IEPS tax separately and expressly, agreed to grant rebates, which they did until the policy was changed in November 1997 (memorial, para. 175). SHCP officials made express commitments to the Claimant that SHCP would rebate IEPS taxes to CEMSA, and that CEMSA was entitled to calculate the tax itself without having invoices from its vendors stating the IEPS tax separately and expressly. The Claimant and CEMSA relied on such commitments and representations to their detriment when CEMSA purchased cigarettes including an 85% IEPS tax. The Respondent is, therefore, estopped from (1) denying CEMSA's application for rebates in October-November 1997, and (2) claiming repayment for rebates on exports in 1996-1997 (memorial, paras. 184, 185).

60. In addition, the Claimant asserts, within the same issue of estoppel, that a statement regarding how a law is applied is a statement of fact. In any event, the distinction is not relevant under international law. Estoppel can be availed of to deny both statements as well as their legal consequences. Domestic tax law rules do not have the function or the authority of establishing or refuting the estoppel principle. The doctrine of estoppel, based on the fundamental legal interest in predictability, reliance and consistency, is particularly important in the context of NAFTA, a regime designed to protect and promote trade and investment among the parties (reply, paras. 59-63).

61. The Respondent, on the other hand, denies that any oral agreement to waive the invoice requirement was ever reached. Even if existent, such agreement would have been legally irrelevant under Mexican law. Under the tax systems of all three NAFTA countries, taxpayers

are precluded from raising an estoppel preventing the enforcement of tax laws, as they are written, through the methods followed by the Claimant (counter-memorial, para. 20). More generally, estoppel may have effect only in relation to statements of fact, not to statements on the meaning of a law. Presently, the alleged estoppel results not from statements of fact but rather from statements, if any, as to the meaning of the IEPS law, an alleged agreement as to the calculation of IEPS and so on (counter-memorial, paras. 401-407). The Respondent alleges that the approach taken to the issue of estoppel by the three NAFTA countries is relevant to a consideration of estoppel under international law. In Mexico, only a written resolution by SHCP to resolve a real and concrete issue of tax law is binding. In Canada, a government official cannot create an estoppel in relation to the interpretation of legislation. In the United States, an erroneous interpretation of the law by tax authorities does not estop them from asserting an appropriate tax (counter-memorial, paras. 411-427). There can be no agreement whereby CEMSA could overstate the amount of IEPS claimed so that it receives more money than paid by the original taxpayers. Indeed, the Claimant has grossly miscalculated the IEPS tax paid (counter-memorial, paras. 428-433).

62. In addition, according to the Respondent, the cases cited by the Claimant in support of estoppel involve state boundary disputes and even there it is not clear whether the International Court of Justice really applied the doctrine of estoppel. An attempt to borrow underdeveloped and peripheral principles from such an area of international law and apply them to another should be made with caution. The same legal effect that attaches to the conduct of States in boundary disputes, which they are presumed to have considered with the utmost seriousness, cannot apply in cases where a large state bureaucracy deals with an individual taxpayer (rejoinder, paras. 108-111, 127). Finally, preclusion of estoppel under the domestic law of the NAFTA countries is important because it disproves the Claimant's allegations (1) that there was reliance on his part, (2) that there is an international law of estoppel directly applicable to SHCP, as it would be extraordinary to conclude that the NAFTA Parties had imposed on their tax authorities an obligation contrary to their domestic laws, and (3) that such an estoppel is part of customary international law (*ibid.*, paras. 38-143).

63. In view of conflicting arguments by the Parties (*supra*, paras. 59-62), the Arbitral Tribunal stresses that, like many other legal systems, NAFTA Articles 1117(2) and 1116(2) introduce a clear and rigid limitation defense which, as such, is not subject to any suspension (see *supra*, para. 58), prolongation or other qualification. Thus the NAFTA legal system limits the availability of arbitration within the clear-cut period of three years, and does so in full knowledge of the fact that a State, *i.e.*, one of the three Member Countries, will be the Respondent, interested in presenting a limitation defense. The quality of one Party as a State as well as all specificities and constraints necessarily connected to any state activity neither exclude nor qualify resort to the defense of limitation. Of course, an acknowledgment of the claim under dispute by the organ competent to that effect and in the form prescribed by law would probably interrupt the running of the period of limitation. But any other state behavior short of such formal and authorized recognition would only under exceptional circumstances be able to either bring about interruption of the running of limitation or estop the Respondent State from presenting a regular limitation defense. Such exceptional circumstances include a long, uniform, consistent and effective behavior of the competent State organs which would recognize the existence, and possibly also the amount, of the claim. No such circumstances were presented to the Tribunal in this case. It is true that some assurances on CEMSA's entitlement to IEPS tax rebates were given to Claimant and CEMSA at various times by various middle-and high-ranking SHCP officials, and with varying content. But such assurances never amounted to either an authorized and formal acknowledgment of the claim by the Respondent or to a uniform, consistent and effective behavior of Respondent. Therefore, the Tribunal does not deem that the Respondent is estopped from invoking the three-year limitation period under NAFTA Article 1117(2).

64. Analogous, although not identical, considerations prevail with regard to the next issue, to wit whether the Respondent is, on account of the same assurances and promises, estopped from denying the very basis of the damages claim itself (see *supra*, paras. 53 *in fine*, 59). Here again the criterion is a long, uniform, consistent and effective behavior of the competent State organs (see *supra*, para. 63). The Tribunal recognizes again that some assurances on CEMSA's entitlement to IEPS tax rebates were given to Claimant and CEMSA at various times, probably over a longer period, by various middle- and high-ranking SHCP

officials, and with varying content. However, the Tribunal misses the uniform, consistent and effective character of such behavior as well as its connection with the competent State organs at all times. In this respect, the Tribunal also takes into consideration that in any state governed by the rule of law there is no way to impose, to reduce, to claim, to recuperate, or to transfer any tax burdens by agreements with some tax officials not provided by the law. Such agreements would necessarily have a *quasi* private character and could neither bind the State nor be enforced against it.

65. Accordingly, the Tribunal does not find that the Respondent is equitably or otherwise estopped from denying the very basis of the damages claim itself. Notwithstanding this finding, the Tribunal will consider such behavior of several SHCP officials while examining the bases of “creeping” or otherwise relevant form of expropriation, or effective denial of national treatment, under NAFTA Articles 1110 and 1102. Indeed, it is possible that behavior of some State organs such as the ones under consideration here may have led the Claimant to initiate, or to expand, his investment and, thus, may have contributed to the occurrence or the amount of his damage, if any. This may be particularly relevant with respect to more or less technical or “procedural” aspects of Mexican legislation on taxation, such as the requirement of separately and expressly stating the IEPS tax in invoices issued to CEMSA.

G.2 Exhaustion of Local Remedies

66. Both Parties have addressed the relationship between domestic litigation in Mexico and this international arbitration as well as the related doctrine of exhaustion of local remedies (memorial, paras. 214-219; counter-memorial, paras. 365-378; reply, paras. 34-52; rejoinder, paras. 41-51).

67. In essence, the Claimant alleges that NAFTA Chapter 11, and particularly its Section B, was designed to provide investors of the NAFTA Parties with impartial international dispute resolution. A prospective claimant must make an election. If he wants to pursue a damage claim under NAFTA, he has to waive his rights to pursue damages in the local courts. Thus, Mexico traded its traditional position on the exclusive jurisdiction of its courts in exchange for the enormous benefits to be drawn from NAFTA (see opening statement by Mr. Feldman on July 9, 2001, transcript, vol. 1, pp. 52-53). Accordingly, this Arbitral Tribunal may well examine both Mexican domestic laws and the conduct of Mexican tax authorities to determine whether they meet minimum standards of international law, including due process of law, fair

and equitable treatment, and full protection and security, as incorporated by NAFTA Articles 1110(1)(c) and 1131(1) (*ibid.*, pp. 54-55). Therefore, an international tribunal reviewing state action under international law may reach a different result than a domestic tribunal reviewing the same conduct under domestic law. The potential difference of results is due to the difference of standards. This could readily happen in a case where the domestic statutory framework was designed to discriminate against the claimant (see closing statement by Mr. Feldman on July 13, 2001, transcript, vol. 5, p. 182).

68. In addition, the Claimant maintains that both the investor and the investment have waived their right to claim damages in the Mexican courts, as required by NAFTA Article 1121 (reply, para. 34). Whatever proceedings may be pending now in Mexico, they do not constrain the Arbitral Tribunal since (1) under Mexican procedure, the Claimant was required to challenge SHCP's actions in order to avoid seizure of property and, likely, imprisonment; and (2) after this Tribunal was constituted, the Claimant filed papers seeking to terminate all domestic litigation (reply, para. 39). In sum, the Claimant neither has any effective legal remedy under Mexican law nor can be required to introduce every year a new *Amparo* procedure in order to meet all annual minor amendments to the IEPS law, no matter how marginal and irrelevant these legislative amendments may be.

69. The Respondent basically denies that the Claimant has any right to receive IEPS rebates as a matter of Mexican law. Subject to constitutional questions, the particular issue of the requirement of separate and express invoices has been resolved in two separate proceedings before the Mexican courts, which have sole jurisdiction over issues of Mexican law, and is likely to be addressed again in one of the proceedings for an extended period of time. Neither is there any international legal right to IEPS rebates nor is this Arbitral Tribunal authorized to substitute its views of domestic law for those of the local courts (rejoinder, paras. 29-33). According to the Respondent, the Claimant is having his day in court in Mexico, and in any event, as those proceedings involve issues of Mexican law they are not relevant to this proceeding. Those proceedings would be relevant only if the Claimant were in a position to challenge the Mexican court actions as constituting a denial of justice under international law, which the Claimant has not done. Consequently, it would be incorrect to state that there were an absence of an effective

legal remedy just because the Claimant lost in one of the proceedings; at the time of the Respondent's submission, the Claimant appears to be prevailing in the second action, but it is not final. If that were true, every disappointed litigant who otherwise met the standing requirements of NAFTA Chapter Eleven, Section B, would bring a claim under international law (rejoinder, paras. 40, 41). The Respondent concludes therefore that, with the exception of the claim for an alleged denial of national treatment, all of the claims advanced in this proceeding would require the Arbitral Tribunal to apply domestic law in the place of the proper judicial body (counter-memorial, para. 40).

70. In addition, the Respondent maintains that, in any event, any CEMSA's claimed right to IEPS rebates would depend on issuing invoices separately and expressly stating the tax. This particular condition, which was never complied with by the Claimant, is now *sub judice* on appeal in the Mexican courts (counter-memorial, paras. 11, 360-364). Accordingly, the international responsibility of a State cannot be engaged unless and until the measure in issue has been tested at the local level and has become final by pronouncement of the highest competent authority (counter-memorial, para. 371). The exhaustion of local remedies rule is applicable under NAFTA as in general under international law. Nor does any relevant waiver exist here, since the waiver required by NAFTA Article 1121 is limited to damages only (transcript, vol. 2, pp. 79, 81) and, in any event, the Claimant neither discontinued proceedings in the domestic courts nor did he refrain from initiating others with respect to measures allegedly in breach of NAFTA Chapter Eleven, Section A (rejoinder, paras. 47-51).

G.3 Analysis

71. The decision on the issue of exhaustion of local remedies as a condition for claim admissibility primarily depends on the wording and construction of the relevant NAFTA provisions. Indeed, it is generally understood that the local remedies rule may be derogated from, qualified, or varied by virtue of any binding treaty (*Case Concerning Elettronica Sicula, S.p.A., United States of America v. Italy*, 1989, I.C.J. Reports 4, para. 50). Such qualification took place here under NAFTA Articles 1121 and Annex 1120.1.

72. Article 1121(2)(b) and (3) in its relevant parts provides as follows:

2. A disputing investor may submit a claim under Article 1117 [Claim by an Investor of a Party on Behalf of an Enterprise] to arbitration only if both the investor and the enterprise:

.....

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

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

73. It appears that this Article, rather than confirming or repeating the classical rule of exhaustion of local remedies, envisages a situation where domestic proceedings with respect to the same alleged breach referred to in Article 1117 are either available or even pending in a court or tribunal operating under the law of any Party. In such case, Article 1121(2)(b) requires, for a recourse to arbitration to be open, that the disputing investor waive his right to initiate or continue the other domestic proceedings. Therefore, in contrast to the local remedies rule, Article 1121(2)(b) gives preference to international arbitration rather than domestic judicial proceedings, provided that a waiver with regard to the latter is declared by the disputing investor. This preference refers, however, to a claim for damages only, explicitly leaving available to a claimant “proceedings for injunctive, declaratory or other extraordinary relief” before the national courts. Thus, Article 1121(2)(b) and (3) substitutes itself as a qualified and special rule on the relationship between domestic and international judicial proceedings, and a departure from the general rule of customary international law on the exhaustion of local remedies. The thrust of such substitution seems to consist in making recourse to NAFTA arbitration easier and speedier, as opposed to the general pattern of opening up international arbitration to private parties as against third states.

74. In particular with respect to Mexico as Respondent, Annex 1120.1 of NAFTA restricts resort to arbitration. According to this provision in its relevant parts,

“With respect to the submission of a claim to arbitration:

.....

(b) where an enterprise of Mexico that is a juridical person that an investor of another Party owns or controls directly or indirectly alleges in proceedings before a Mexican court or administrative tribunal that Mexico has breached an obligation under

(i) Section A

.....,

the investor may not allege the breach in an arbitration under this Section”.

75. Annex 1120.1 of NAFTA gives, thus, a statutory preference to domestic proceedings in Mexico vis-à-vis a possible international arbitration under NAFTA Chapter 11, Section A, by obviously preventing the disputing investor from instituting, then waiving domestic proceedings and, only thereafter resorting to arbitration, as provided under Article 1121(2)(b) (see *supra*, paras. 72, 73). This prohibition applies, however, only if the Claimant “alleges in proceedings before a Mexican court or administrative tribunal that Mexico has breached an obligation under ... Section A”. In any event, since the Respondent expressly confirms that “the Claimant has also not sought to submit an alleged breach of the NAFTA to the Mexican courts, so there is no conflict with Annex 1120.1” (rejoinder, para. 48), the Tribunal does not see any obstacle to the present arbitration connected to Annex 1120.1 of NAFTA.

76. As far as the waiver requirement under Article 1121(2)(b) and (3) is concerned, the Arbitral Tribunal is satisfied that the appropriate waivers were attached by both the Claimant and CEMSA as Exhibits B and C to the Notice of Arbitration of April 30, 1999 and also delivered to the Respondent, as indicated in the Notice of Arbitration (p. 3 under B(1)(a)), noting that the Respondent has not challenged the delivery or the sufficiency of the waivers (rejoinder, para. 46).

77. Under Article 1121(2)(b), the waivers are required for, and limited to, claims for damages only. Indeed, the Notice of Arbitration presents as requests four related claims for damages (p. 11 under D); they do not apply to “proceedings for injunctive, declaratory or other extraordinary relief.” A later request by the Claimant with regard to the illegality or invalidity of a tax assessment by the Respondent for about US\$25 million asks for declaratory relief only and, therefore, does not require a waiver under Article 1121(2)(b) (see *supra*, paras. 72, 73). It has to be examined below, however, whether this request, while relieved from the requirement of waiver, stands properly before the Tribunal in terms of its scope of authority (see *infra*, para. 88).

78. The Respondent observes that the Claimant, in spite of the waiver, did not in fact withdraw from several related domestic proceedings in Mexico; nor does the Respondent suggest that it was incumbent upon the Claimant to withdraw (see rejoinder, paras. 47, 48). The Arbitral Tribunal, however, does not find the point to be pertinent. Mexican courts are hailed by the Respondent as the appropriate forum for determining the Claimant's rights under the IEPS law (see, *e.g.*, counter-memorial, paras. 367, 368; rejoinder, paras. 48-51). In the first instance, we agree. However, questions as to whether Mexican law as determined by administrative authorities or Mexican courts is consistent with the requirements of NAFTA and international law are to be determined in this arbitral proceeding, and we are not barred from making that determination by the fact that not all of the issues have yet been resolved by Mexican courts. Otherwise, any arbitral tribunal could be prevented from making a decision simply by delaying local court proceedings. Nor is an action determined to be legal under Mexican law by Mexican courts necessarily legal under NAFTA or international law. At the same time, an action deemed to be illegal or unconstitutional under Mexican law may not rise to the level of a violation of international law.

G.4 Other Jurisdictional Constraints

79. As noted earlier, several jurisdictional issues in this arbitration have been resolved by the Tribunal's "Interim Decision on Preliminary Jurisdictional Issues" rendered on December 6, 2000. However, this decision was limited to "the specific preliminary issues set forth in [the Tribunal's] Procedural Order No. 4 and at paragraph 11" of the Interim Decision itself. Other jurisdictional issues were not precluded, to the extent they have arisen in the course of this arbitral proceeding.

80. Such an additional jurisdictional issue, which arose later, pertains to the authority of this Tribunal to grant declaratory relief with respect to the validity or legality of the 1998 audit and the corresponding tax assessment by SHCP vis-à-vis CEMSA.

81. It appears to be common ground between the Parties (memorial, paras. 121-126; counter-memorial, paras. 240-268) that in July 1998 SHCP launched an audit, or a verification

visit by an audit team (*visitadores*), with regard to CEMSA's 1996-1997 exports. The audit was conducted with the presence of the police and with the use of several photocopying machines brought by the visiting team for that purpose. Several months later, on March 1, 1999, SHCP issued its determination by which it concluded the audit through a tax assessment against CEMSA in the amount of \$250,551,635 Mexican pesos for wrongfully obtained tax rebates in 1996-1997, plus interest, fines, and actualization on account of inflation. The Claimant (memorial, para. 123) alleges that this amount is equal to about US\$25 million, including a claim of recovery of some US\$9.1 million in IEPS rebates paid in 1996 and 1997.

82. Thereafter, in March 1999, CEMSA challenged the audit of the April 1996 - September 1997 IEPS rebates and the ensuing tax assessment before the first-instance Fiscal Tribunal of the Federation. The Claimant argued that there was a fatal inconsistency between his right to the 0% tax rate under Article 2 of the IEPS and the invoice requirements under Article 4 of the same law. The Fiscal Tribunal's decision held in favor of CEMSA on some points and in favor of SHCP on others. Apparently the decision held that SHCP could not require invoices with the IEPS expressly transferred and stated separately since it was a requirement with which it was impossible to comply in the case of cigarette exports (see counter-memorial, paras. 261, 571-574). On the other hand, the decision denied any tax rebates on processed tobacco exports to "low tax jurisdictions", notably Honduras, in accordance with Article 2 of the IEPS law. As a result, however, the tax assessment by SHCP was quashed.

83. Both parties opposed this decision (*supra*, paras. 68-69). The Claimant also filed an *Amparo* proceeding before the Circuit Court; SHCP availed itself of a "recourse of revision" before the same court. The circuit courts held that the requirements of Articles 2 and 4 were not contradictory. Further appeals ensued. In the most recent (March 29, 2002) determination in this litigation, a Mexican court of appeals has apparently held that the Claimant did have a constitutional right under the IEPS law in force in 1996-1997 notwithstanding his inability to produce invoices showing the tax amounts separately, on the ground that the invoice "formality" discriminates among different taxpayers (producers and exporters) who carry on the same activity. The decision also appears to hold unconstitutional the provision of the IEPS law that precludes receipt of tax refunds for exports to low tax jurisdictions (*see* Claimant's May 8

submission, 2002, paras. 7-8.). However, both Parties agree that this most recent decision is not final so that the proceeding remains *sub judice* before the competent federal courts (Claimant's May 8, 2002 submission, para. 17; Respondent May 8, 2002 submission, para. 18; memorial, para. 124; counter-memorial, para. 268).

84. What, then, is the relevance of these Mexican court decisions for this Tribunal? The Tribunal is not inclined to give them significant weight, in part because neither of the Parties has suggested that they are controlling, although the Mexican courts' discussion of legal issues provides necessary background to the Tribunal's understanding of these issues as required for a proper application of NAFTA and international law. First, of course, the 1998 assessment proceeding is not final. While the most recent decision favors the Claimant, the Respondent may prevail at the next step. Second, the 1998 decision, related to the negative response to a request presented to the tax authority (this decision differs from the Claimant's position specifically with regard to the exigency of separately stating the IEPS amounts in the invoices) which is final, essentially reinforces the Respondent's position, creating a conflict which this Tribunal cannot and should not try to resolve. Third, and probably most important, Mexican courts are applying Mexican law, while this Tribunal must apply the provisions of NAFTA and international law, which do not necessarily provide the same results as under Mexican law. Finally, as noted earlier, the Claimant has not challenged any of the Mexican court decisions, even those unfavorable to the Claimant, as breaching the international law standard for denial of justice, and it is premature to consider any question of possible non-compliance of a Mexican court decision by the Respondent, since the issue of compliance has not yet arisen.

85. The purely declaratory character of the relief sought by the Claimant, to wit to declare the Respondent's 1999 tax assessment as invalid, is not necessarily inconsistent with NAFTA Chapter 11, Section B, in particular Articles 1116(1) and 1117(1), which appear to limit relief to claim for "loss or damage by reason of, or arising out, that breach". It may also not be generally inconsistent with the exception of taxation measures in view of NAFTA Article 2103(6). Particular attention should be drawn, however, to the question whether such declaratory relief is admissible in the circumstances of this case.

86. The Claimant qualifies the requested declaration as “an incidental or additional claim respecting the audit and tax assessment ... The issues and the evidence are the same as those in the original claim, and the Tribunal will necessarily decide the new claim when it decides the first” (reply, para. 31). The Claimant concludes on this point by asserting a denial of justice if the Tribunal should award damages to the Claimant and the Respondent could seek to set off against those damages any audit liability assessed by the Mexican tax authorities, given that the issues at stake are the same with the ones litigated before the Tribunal (reply, paras. 32-33).

87. The Respondent answers by denying this Tribunal’s 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” because

- (a) NAFTA Chapter Eleven, Section B, vests the Tribunal only with jurisdiction to award monetary compensation;
- (b) the Claimant has not submitted to arbitration a claim in respect of the 1998 audit; and
- (c) the requested declaration would usurp the jurisdiction of the Mexican courts and would not be enforceable in any event (counter-memorial, para. 575).

Further, according to the Respondent, the Tribunal has no jurisdiction to entertain the claim that a contingent award be issued in the amount of any tax assessment levied against the Claimant as a result of the 1998 audit, for the additional reason that such claim would not yet be ripe (*ibid.*, paras. 576, 577).

88. In view of conflicting arguments by the Parties (*supra*, paras. 86-87), the Arbitral Tribunal stresses that, according to NAFTA Article 1136(1), an award made by a Tribunal shall have binding force between the disputing Parties and in respect of the particular case. This rule also implies that a NAFTA State Party must comply with a final arbitral award in its entirety as well. *In casu*, CEMSA’s entitlement to tax rebates in the critical period necessarily constitutes an important segment of the present arbitration. Any decision by this Arbitral Tribunal thereon

is bound to have, under the terms of NAFTA Article 1136(1), a direct bearing upon any domestic litigation (pending or final) on the entitlement to tax rebates. Therefore the validity or legality of the 1999 tax assessment with respect to the tax rebates obtained in the years 1996 and 1997 hardly constitutes an independent or unrelated count in this arbitration. Rather, the validity or recovery of these tax rebates functionally have an impact on, and belong to, the Tribunal's evaluation whether a "creeping" or any other relevant (under NAFTA Articles 1110 and 2103(6)) form of expropriation has taken place. In addition, it appears to the Arbitral Tribunal that the Claimant as well understands this declaratory relief in the context of expropriation under NAFTA Article 1110 since his request seeks an arbitral finding that such tax assessment by the Respondent "constitutes a measure tantamount to expropriation under, and in breach of, NAFTA Article 1110" (memorial, submission A(4), p. 130). Similarly, the validity or recovery of these tax rebates may be relevant to determining whether Respondent has violated Article 1102, to the extent the Tribunal determines that Claimant has been treated less favourably with regard to the tax rebates than domestic investors in like circumstances, as discussed in Section I, *infra*. Therefore, since the Claimant submits this allegation of invalidity within the framework of NAFTA Articles 1102 and 1110, the invalidity issue will be dealt with within the appropriate framework but does not warrant an autonomous answer in the operative part of this Award.

H MERITS

H.1 Expropriation: Overview of the Positions of the Disputing Parties

89. In this proceeding, the Claimant's key contention is that the various actions of Mexican authorities, particularly SHCP, in denying the IEPS rebates on cigarette exports to CEMSA, resulted in an indirect or "creeping" expropriation of the Claimant's investment and were tantamount to expropriation under Article 1110. They were also arbitrary, confiscatory and discriminatory, a violation of the Claimant's right to due process (see memorial, Introduction and Summary, p. 6; first Swan's affidavit, paras. 30-34). The Claimant asserts that the "measures" he has complained about may also be characterized as a "denial of justice" (one aspect of denial of due process) under article 1110 (memorial, paras. 189-203). Nor does the Claimant believe that the Mexican government policy of limiting cigarette exports is justified by public policy

concerns, particularly in light of the stated purpose of the IEPS law in 1980, which was to encourage Mexican exports (memorial, para. 189, quoting Statement of Purpose of IEPS Law for 1981, Diario Oficial, Dec. 30, 1980).

90. In particular, the Claimant asserts that the 1993 Supreme Court *Amparo* decision required Mexican officials not only to provide CEMSA with the 0% excise tax rate on exports, but also to permit CEMSA to obtain rebates of the tax amounts included in the price CEMSA paid its suppliers, Walmart and Sam's Club. According to the Claimant, the decision makes no sense if it holds Article 2 of the IEPS Law -- permitting only manufacturers, not resellers, to obtain the 0% tax rate for exported cigarettes -- unconstitutional, but continues to permit SHCP to deny the rebates to firms that are not IEPS taxpayers and do not have invoices showing the tax amounts stated separately, as Article 4(III) of the IEPS law specifies. In seeking the rebates, the Claimant asserts that he reasonably relied on a series of letters from SHCP officials, oral assurances from those officials, and their actions in granting the rebates during some periods (1992 and April 1996 to September 1997). Rebates were granted although the officials were fully aware at all relevant times that the Claimant lacked invoices that stated the tax amounts separately, and would rely on their actions. Some of the same officials had denied those rebates during earlier periods. In fact, according to the Claimant, there was effectively an oral agreement or understanding with SHCP officials, concluded through a series of meetings and exchanges of letters in 1994 and 1995, to the effect that the 1993 *Amparo* decision provided the Claimant the right to receive rebates, rather than simply the right to a 0% IEPS tax on cigarette exports (memorial, paras. 68-69). This understanding, according to the Claimant, resulted from the impossibility of the Claimant's obtaining the invoices, the influences of the U.S. Embassy and the entry into force of NAFTA (memorial, Introduction and Summary, pp. 3-4).

91. It is the Claimant's view, however, that the Mexican government did not comply with the *Amparo* decision, despite the oral agreement to afford the Claimant the rebates. Rather, Mexican government officials sought return of the rebates that had been granted between April 1996 and September 1997, and ultimately denied the Claimant's rebates for October and November 1997, effectively preventing the Claimant from exporting cigarettes. The application of the IEPS law by Mexican authorities (particularly strict application of Article 4(III)) requiring

invoices with the separate statement of tax amounts, even though it was impossible for CEMSA to obtain them, had the intended result. SHCP's actions effectively drove CEMSA out of the cigarette export business, in violation of Article 1110. According to the Claimant, these facts precisely fit the traditional definition of indirect or creeping expropriation: Mexico's intent was to put the Claimant out of the cigarette export business through manipulation or interpretation of IEPS legal requirements, and by denying the IEPS rebates over a period of time. The Claimant concludes that the fact that tax laws are applied in such a way as to accomplish the expropriation does not convert an expropriation into valid regulation.

92. The Respondent disagrees on a variety of grounds. First, SHCP's actions -- demanding invoices with the IEPS tax amounts stated separately as a condition of the IEPS rebates -- were required by the IEPS law. That requirement in the Respondent's view is fully consistent with the 1993 Mexican *Amparo* Supreme Court case, which applied to both cigarette and alcoholic beverage exports, and decided *only* that resellers such as the Claimant, as well as producers, were entitled to the 0% IEPS tax rate on their exports (counter-memorial, paras. 1-2). SHCP was prepared to apply the 0% tax rate and to grant the rebates, but if and only if the Claimant complied with the other requirements of the IEPS law, including those relating to invoices. According to the Respondent, the question of the requirement that the person seeking the rebates be a taxpayer and, particularly, of invoices stating the tax amounts separately was never before the Mexican Supreme Court and was not decided by it (counter-memorial, para. 23). Moreover, there was never any intent on the part of SHCP officials to waive the requirements of Article 4 of the IEPS law. Rebates are initially granted in a virtually automatic process, with SHCP reserving the right under the law to audit recipients to determine whether they were entitled to the rebates and whether the amounts sought were correct.

93. According to the Respondent, there is no basis for finding an "agreement" between the Claimant and SHCP that the Claimant was entitled to rebates under the *Amparo* decision. There was no such agreement beyond the obvious understanding of SHCP officials, communicated to the Claimant both orally and in writing, that they would comply with the *Amparo* decision. That decision goes no further than to require that the Claimant be afforded the 0% tax rate. SHCP officials did not, and could not have, abrogated the other requirements of the

IEPS law, including but not limited to providing invoices with tax amounts separately stated, in accordance with Article 2 (counter-memorial, paras. 168, 172).

94. Also, the Mexican circuit court has determined, *inter alia*, in the “nullification” proceeding initiated by the Claimant in 1998, that IEPS legal provisions requiring invoices stating the tax amounts separately as a condition of obtaining rebates are not inconsistent with principles of tax equity. In the Respondent’s view, this is a determination under Mexican law that is not properly before the Tribunal (rejoinder, para. 16). While the arguments are in general detailed and complex, the Respondent believes that this litigation proves that Mexican administrative authorities acted consistently with Mexican law and court decisions (even though the case only applies by its actual terms to applications for rebates submitted in November and December 1997). Thus, there is no denial of justice under Mexican law, or other violation of international law that could be considered the basis for a violation of Article 1110.

95. The Respondent also questions whether the Claimant can demonstrate the ownership of an “investment” that was allegedly expropriated in Mexico by Mexican authorities; in the absence of an investment, the Claimant has no standing to bring an action under Chapter 11. In particular, to the extent the Claimant is seeking payment of rebate amounts for October and November 1997, this is a debt obligation that is specifically excluded from the definition of investment under NAFTA Article 1139. Nowhere is there an “investment” of which the Respondent seized ownership and control (counter-memorial, para. 302 ff.).

H.2 Applicable Law: NAFTA Article 1110 and International Law

96. A threshold question is whether there is an “investment” that is covered by NAFTA. The term “investment” is defined in Article 1139, in exceedingly broad terms. It covers almost every type of financial interest, direct or indirect, except certain claims to money. The first listed item under “investment” is “an enterprise.” There is no disagreement among the parties that Corporación de Exportaciones Mexicanas, S.A. (CEMSA) is a corporate entity organized under the laws of Mexico, essentially wholly owned by the American citizen investor, Marvin Roy Feldman Karpa (first Feldman statement, para. 1). Among the dictionary definitions of “enterprise” are “a unit of economic organization or activity; *esp.* a business organization”

(Webster's New Collegiate Dictionary, 1977 ed.). As such, the Tribunal determines that CEMSA comes within the term "enterprise" and is thus an "investment" under NAFTA. This conclusion is consistent with that reached by other NAFTA Chapter 11 tribunals. For example, the tribunal in *S.D. Myers v. Canada* concluded that a Canadian corporation organized for the purpose of facilitating hazardous waste exports to the United States, an affiliate of S.D. Myers in the United States owned by the same shareholders as S.D. Myers, satisfied the NAFTA requirements for an "investment." (*S.D. Myers v. Government of Canada* , Partial Award, November 13, 2000, paras. 230-231, <http://www.state.gov/documents/organization/3992.pdf>.)

97. Expropriation under Chapter 11 is governed by NAFTA Article 1110, although NAFTA lacks a precise definition of expropriation. That provision reads in pertinent part as follows:

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 6.5

The key issue, in general and in the instant case, is whether the Respondent's actions constitute an expropriation.

98. The Article 1110 language is of such generality as to be difficult to apply in specific cases. In the Tribunal's view, the essential determination is whether the actions of the Mexican government constitute an expropriation or nationalization, or are valid governmental activity. If there is no expropriatory action, factors a-d are of limited relevance, except to the extent that they have helped to differentiate between governmental acts that are expropriation

5 Emphasis added. Paras. 2-6 provide for compensation "equivalent to the fair market value of the expropriated investment immediately before the expropriation took place;" that compensation be paid without delay and be fully realizable; include interest in a hard currency; and be freely transferable. *Id.* Article 1110(1) (2-6).

and those that are not, or are parallel to violations of NAFTA Articles 1102 and 1105. If there is a finding of expropriation, compensation is required, *even if* the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).

99. The view that the conditions (other than the requirement for compensation) are not of major importance in determining expropriation is confirmed by the Restatement of the Law of Foreign Relations of the United States, a source relied on by many American and Canadian lawyers that has been discussed in the memorials of both the Claimant and the Respondent in this proceeding.⁶ For example, according to the Restatement, the public purpose requirement “has not figured prominently in international claims practice, perhaps because the concept of public purpose is broad and not subject to effective reexamination by other states.” (AMERICAN LAW INSTITUTE, Restatement of the Law Third, the Foreign Relations of the United States, USA, American Law Institute Publishers, Vol. 1, 1987, (hereinafter Restatement), Section 712, Comment g.). Similarly, the Restatement suggests that if proper compensation is paid for an expropriation, the fact that the taking was not for a public purpose and was discriminatory, “might not in fact be successfully challenged.” A comment observes, perhaps somewhat inconsistently, that “economic injuries [falling under section 712(3)] are generally unlawful because they are discriminatory or are otherwise arbitrary.” (*Id.*, Sec. 712, Comment i.) This last clause suggests that if the government actions (legislative, administrative or judicial) are discriminatory or arbitrary (or perhaps unfair or inequitable), as arguably is the case here, they are more likely to be viewed as expropriatory, imparting a degree of circularity to the “expropriation versus regulation” dichotomy.

100. Most significantly with regard to this case, Article 1110 deals not only with direct takings, but indirect expropriation and measures “tantamount to expropriation,” which potentially encompass a variety of government regulatory activity that may significantly interfere with an investor’s property rights. The Tribunal deems the scope of both expressions to be

⁶ Memorial, paras. 151 ff.; counter-memorial, paras. 335 ff. (with some qualifications). It is important to note that the language used by the Restatement, section 712, differs significantly from that used in NAFTA, even though the concepts are similar.

functionally equivalent. Recognizing direct expropriation is relatively easy: governmental authorities take over a mine or factory, depriving the investor of all meaningful benefits of ownership and control. However, it is much less clear when governmental action that interferes with broadly-defined property rights -- an “investment” under NAFTA, Article 1139 -- crosses the line from valid regulation to a compensable taking, and it is fair to say that no one has come up with a fully satisfactory means of drawing this line.

101. By their very nature, tax measures, even if they are designed to and have the effect of an expropriation, will be indirect, with an effect that may be tantamount to expropriation. If the measures are implemented over a period of time, they could also be characterized as “creeping,” which the Tribunal also believes is not distinct in nature from, and is subsumed by, the terms “indirect” expropriation or “tantamount to expropriation” in Article 1110(1). The Claimant has alleged “creeping expropriation.” The Respondent has objected that the Claimant has in effect added a new element to the case which, among other things, should have been submitted to the Competent Authorities under Article 2103(6) for a determination as to whether it should be excluded from consideration as an expropriation. The Restatement defines “creeping expropriation” in part as a state seeking “to achieve the same result [as an outright taking] by taxation and regulatory measures designed to make continued operation of a project uneconomical so that it is abandoned” (Restatement, Section 712, Reporter’s Note 7). Since the Tribunal believes that creeping expropriation, as defined in the Restatement, noted above, is a form of indirect expropriation, and may accordingly constitute measures “tantamount to expropriation”, the Tribunal includes consideration of creeping expropriation along with its consideration of these closely related terms. ⁷

⁷ The Tribunal notes that the *S.D. Myers* tribunal (citing *Pope & Talbot*) effectively concluded that the words “tantamount to expropriation” were designed to embrace the concept of “creeping” expropriation rather than to “expand the internationally accepted scope of the term expropriation.” See *S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, para. 286, <http://www.state.gov/documents/organization/3992.pdf> .

102. Ultimately, decisions as to when regulatory action becomes compensable under article 1110 and similar provisions in other agreements appear to be made based on the facts of specific cases. This Tribunal must necessarily take the same approach.

103. The Tribunal notes that the ways in which governmental authorities may force a company out of business, or significantly reduce the economic benefits of its business, are many. In the past, confiscatory taxation, denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes, among others, have been considered to be expropriatory actions. At the same time, governments must be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this (see *infra* para. 105).

104. Drawing the line between expropriation and regulation has proved difficult both in the pre-NAFTA context and for the handful of NAFTA Chapter 11 tribunals that have considered the issue. Here again, despite the less specific language and the lack of references to “tantamount to expropriation,” the Restatement is somewhat helpful, particularly the comments, in understanding customary international law in this area. Section 712 reads in pertinent part as follows:

“A state is responsible under international law for injury resulting from:

- (1) a taking by the state of the property of a national of another state that
 - (a) is not for a public purpose, or
 - (b) is discriminatory, or
 - (c) is not accompanied by provision for just compensation.”

While the language itself differs considerably from Article 1110, many of the essential substantive elements are the same, particularly the concept of a taking and the conditions.

105. The “comments” to the Restatement are designed to assist in determining, *inter alia*, how to distinguish between an indirect expropriation and valid government regulation:

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 alien’s property or its removal from the state’s territory... *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....* (Restatement, Section 712, comment g, emphasis supplied.)

106. It is notable that the Restatement comment specifically includes “taxation” as a possible expropriatory action and establishes state responsibility, *inter alia*, for unreasonable interference with an alien’s property. At the same time, non-discriminatory, bona fide *general* taxation does not establish liability. The Reporter’s Notes to the Restatement further suggest that “whether an action by the state constitutes a taking and requires compensation under international law, or is a police power regulation or tax that does not give rise to an obligation to compensate even though a foreign national suffers loss as a consequence” must be determined in light of all the circumstances (Restatement, Section 712, Reporter’s Note 5).

107. Along with the Restatement, this Tribunal has also sought guidance in the decisions of several earlier NAFTA Chapter 11 Tribunals that have interpreted Article 1110. The Tribunal realizes that under NAFTA Article 1136(1), “An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case,” and that each determination under Article 1110 is necessarily fact-specific. However, in view of the fact that both of the parties in this proceeding have extensively cited and relied upon some of the earlier decisions, the Tribunal believes it appropriate to discuss briefly relevant aspects of earlier decisions, particularly *Azinian v. United Mexican States* and *Metalclad v. United Mexican States*. Nevertheless, there has been only one prior finding of a taking under Article 1110, in *Metalclad*, and the principal rationale for that decision was substantially overruled by the reviewing court, the Supreme Court of British Columbia. In the other decisions to date which

have considered allegations of a violation of Article 1110 and attempted to articulate criteria for the determination (*S.D. Myers v. Canada* and *Pope & Talbot v. Canada*) the tribunals for various reasons have failed to find violations of Article 1110.

H.3 Respondent's Actions as an Expropriation Under Article 1110.

108. The Tribunal has struggled at considerable length, in light of the facts and legal arguments presented, the language of Article 1110 and other relevant NAFTA provisions, principles of customary international law and prior NAFTA tribunal decisions, to determine whether the actions of the Respondent relating to the Claimant constituted indirect or “creeping” expropriation, or actions tantamount to expropriation. (There is in this case no allegation of a direct expropriation or taking under Article 1110.) The conclusion that they do not is explained below.

109. The facts presented here might, depending on their interpretation, appear to support a finding of an indirect or creeping expropriation. The Claimant, through the Respondent's actions, is no longer able to engage in his business of purchasing Mexican cigarettes and exporting them, and has thus been deprived completely and permanently of any potential economic benefits from that particular activity.⁸ Between 1991, when the Claimant brought his *Amparo* action, and December 1997, when SHCP definitively refused to provide CEMSA with tax rebates on exported cigarettes, SHCP followed an inconsistent and non-transparent course of action. In some instances, SHCP authorized and paid the rebates (for 1992 exports, for example), in others, for significant periods of time (1994 -1995), it denied them. At various times SHCP officials provided written documentation to the Claimant that might have led some persons—reasonably or otherwise-- to believe that SHCP had agreed with the Claimant's position that the 1993 *Amparo* decision required that the Claimant be afforded the rebates (see, *e.g.*, letters of March 12, 1992, May 10, 1994 and March 16, 1997). SHCP has

⁸As discussed in the “Damages” section of this Award (paras. 189-207), there is a serious question as to whether the Claimant's business would have been economically viable even had SHCP consistently granted the rebates in the proper amount, given the very low gross profit, based on the gross profit of less than US\$0.10 between CEMSA's net-of-tax cost of the cigarettes and the selling prices realized from CEMSA's customers.

sought through a tax audit a refund of rebates paid to the Claimant in 1996 and 1997, increased by an inflation factor, interest and possible penalties. Also, under Article 2103(6) of NAFTA, the State Parties expressly confirm that tax regulatory activity may be expropriatory under Article 1110, albeit with significant limitations.⁹

110. No one can seriously question that in some circumstances government regulatory activity can be a violation of Article 1110. For example, in *Pope & Talbot*, Canada argued that “mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required.”¹⁰ That tribunal rejected this approach:

Regulations can indeed be characterized in a way that would constitute creeping expropriation... Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation. (*Id.*, para. 99.)

However, the *Pope & Talbot* tribunal failed to find a violation of Article 1110 in that case. This Tribunal finds the legal arguments against a finding of expropriation more persuasive, for reasons described in detail below, and reaches the same conclusion on facts very different from those in *Pope & Talbot*.

111. This Tribunal’s rationale for declining to find a violation of Article 1110 can be summarized as follows: (1) As *Azinian* suggests, not every business problem experienced by a foreign investor is an expropriation under Article 1110; (2) NAFTA and principles of customary

⁹ First, NAFTA Article 2103 generally excludes tax measures from coverage under NAFTA: “Except as set out in this Article, nothing in this Agreement shall apply to tax measures.” However, this exclusion is not absolute. Article 2103(3)(b) makes Article 1102 applicable to tax measures, and Article 2103(6) makes Article 1110 applicable under certain conditions. Article 1105 is not mentioned among the exceptions to the exclusion; therefore, it does not apply to tax measures, other than in a situation in which an expropriation under Article 1110 has been found, and there is an analysis as to whether the expropriatory action met the requirements of due process and Article 1105 as provided in Article 1110(1)(c).

¹⁰ *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, paras. 87-88, <http://www.state.gov/documents/organization/3989.pdf>. Canada also asserted that “tantamount” simply means “equivalent,” and that this language was not intended to expand Article 1110’s coverage beyond creeping expropriation to cover regulatory action. *Id.* para. 89.

international law do not *require* a state to permit “gray market” exports of cigarettes; (3) at no relevant time has the IEPS law, as written, afforded Mexican cigarette resellers such as CEMSA a “right” to export cigarettes (due primarily to technical/legal requirements for invoices stating tax amounts separately and to their status as non-taxpayers); and (4) the Claimant’s “investment,” the exporting business known as CEMSA, as far as this Tribunal can determine, remains under the complete control of the Claimant, in business with the apparent right to engage in the exportation of alcoholic beverages, photographic supplies, contact lenses, powdered milk and other Mexican products--any product that it can purchase upon receipt of invoices stating the tax amounts-- and to receive rebates of any applicable taxes under the IEPS law. While none of these factors alone is necessarily conclusive, in the Tribunal’s view taken together they tip the expropriation / regulation balance away from a finding of expropriation.

H.3.1 Many Business Problems Are Not Expropriations

112. First, the Tribunal is aware that not every business problem experienced by a foreign investor is an indirect or creeping expropriation under Article 1110, or a denial of due process or fair and equitable treatment under Article 1110(1)(c). As the *Azinian* tribunal observed, “It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities... It may be safely assumed that many Mexican parties can be found who had business dealings with governmental entities which were not to their satisfaction...” (*Robert Azinian and Others v. The United Mexican States*, Award, November 1, 1999, para. 83, 14 ICSID Review. FILJ 2, 1999.) To paraphrase *Azinian*, not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110. Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue.

113. Here, it is undeniable that the Claimant has experienced great difficulties in dealing with SHCP officials, and in some respects has been treated in a less than reasonable manner, but that treatment under the circumstances of this case does not rise to the level of a

violation of international law under Article 1110. Unfortunately, tax authorities in most countries do not always act in a consistent and predictable way. The IEPS law on its face (although not necessarily as applied) is undeniably a measure of general taxation of the kind envisaged by Restatement Comment g (see *supra*, paras. 105, 106). As in most tax regimes, the tax laws are used as instruments of public policy as well as fiscal policy, and certain taxpayers are inevitably favored, with others less favored or even disadvantaged.

114. Moreover, the Claimant could have availed himself early on of the procedures available under Mexican law to obtain a formal, binding ruling on the invoice issue from SHCP, but apparently chose not to do so (see prepared testimony of Fernando Heftye, paras. 7-9). Despite the legal uncertainties of the issues upon which the success of his business depended, the Claimant asked for clarification of the legal issues under Article 4 of the IEPS law only when effectively forced to do so, in April 1998 after SHCP denied the Claimant's request for tax rebates for the October 1997 – January 1998 exports, and in March 1999 when as a result of a tax audit SHCP demanded return of rebates, plus interest, inflation adjustment and penalties, for rebates earlier received in 1996 and 1997¹¹. It is unclear why he refrained from seeking clarification, but he did so at his peril, particularly given that he was dealing with tax laws and tax authorities, which are subject to extensive formalities in Mexico and in most other countries of the world.

H.3.2 Gray Market Exports and International Law

115. Second, NAFTA and principles of customary international law do not, in the view of the Tribunal, *require* a state to permit cigarette exports by unauthorized resellers (gray market exports). A prohibition to this effect may rely on objective reasons. Such reasons include

¹¹ Also, although the Tribunal is aware, as indicated earlier, that the 1999 Fiscal Court proceedings challenging SHCP's efforts to recoup tax rebates from the Claimant are not final, the most recent decision has upheld the Claimant's position that the requirements of the IEPS law for invoices stating the tax amounts separately and precluding rebates for exports to low tax jurisdictions, are unconstitutional under Mexican law. The significance of this court decision is somewhat offset by the fact that in a separate, 1998 proceeding challenging denials of tax rebates from October 1997 through January 1998, which is final, another Mexican court determining essentially the same issues found in favor of SHCP (see Amparo decision of August 24, 2000).

discouragement of smuggling (of cigarettes purportedly exported back into Mexico), which may deprive a government of substantial amounts of tax revenue, maintenance of high cigarette taxes to discourage smoking (as in Canada) and, as a Mexican government official has suggested, assisting producers in complying with trademark licensing obligations under private agreements (see statement of Ismael Gomez Gordillo, App. 6045-6054). It is undeniable, as both parties in this proceeding have recognized, that smuggling of cigarettes is a serious problem not only for Mexico but for many other nations.¹²

116. The conclusion that neither NAFTA nor rules of customary international law require a state to permit gray market cigarette exports is to some extent reinforced by the determination of the U.S. Competent Authority that Mexico's action in enacting legislation effective January 1, 1998, which restricted the availability of rebates of excise taxes to those who purchase cigarettes in the "first sale" within Mexico (i.e., the sale from the producer to the producer's customer, but not any subsequent resales) was not an expropriation under Article 1110 of NAFTA. (Letter of Feb. 17, 1999 from Assistant U.S. Treasury Secretary Donald C. Lubick to Mexican Under Secretary of Revenue Tomas Ruiz.) The effect of this 1998 IEPS amendment had exactly the same objective as the 1991 IEPS amendment that denied resellers the availability of the zero tax rate for their exports. (This was the 1991 IEPS amendment that was held unconstitutional in the *Amparo* decision by the Mexican Supreme Court in 1993.) The U.S. Competent Authority letter attempts to de-link the 1998 measure to the earlier measures by stating that "No inference should be drawn concerning my views or the views of the United States government regarding whether the first two measures described above [the alleged refusal of Mexico to implement the *Amparo* decision and its refusal to provide the IEPS rebates] is an expropriation under Article 1110 of the NAFTA," but the comparison is inescapable. At minimum, it suggests that tax law and policy changes are intended to be given relatively broad

¹² See, e.g., Annex 6 of the Claimant's reply memorial, providing copies of recent newspaper reports regarding the smuggling of U.S. cigarettes to Canada and several European countries; indications that cigarette producers in Mexico have reduced cigarette prices by 25% in order to compete more effectively with smuggled cigarettes (transcript, July 12, 2001, p. 148); and documentation provided by the Respondent suggesting that some cigarettes exported from Mexico to the United States are being re-imported into Mexico from El Paso.

leeway under NAFTA, even if their effect is to make it impractical for certain business activities to continue.

H.3.3 Continuing Requirements of Article 4(III) of IEPS Law

117. Third, in the present case, a *per se* government ban on reseller exports of cigarettes (or other products) from Mexico was *not* in force during the entire 1990-1997 period. The Respondent's efforts to impose such a ban legislatively in 1990 were held unconstitutional by the Supreme Court in a 1993 *Amparo* decision. In a narrow interpretation of that decision – that it required both producers and resellers be offered the zero percent tax rate for exports, but no more – it was legally possible for the Claimant to export cigarettes at the 0% rate if the Claimant could meet the other requirements of the IEPS law.¹³ However, the Claimant was effectively prevented from benefiting from the 0% rate, and therefore from exporting cigarettes, unless he could also obtain a rebate of the taxes reflected (but not separately stated) in the price that the Claimant paid to large retailers – Walmart and Sam's – for his cigarettes. This problem resulted from the fact that Mexican cigarette producers – particularly Cigatam, the Mexican licensee of the Marlboro brand – refused to sell to him because they wanted to maintain an export monopoly (according to first Feldman statement, para. 14) or perhaps for other reasons, a refusal which was apparently within their right under Mexican law. In economic terms, it would have been impossible for the Claimant to pay the price of the cigarettes in Mexico, including the 85% excise tax required under the IEPS law, and then sell the cigarettes in any foreign country. (Once the foreign nation added its own excise taxes upon importation, the Mexican cigarettes with both tax amounts included would have been priced far out of the market.)

118. In his efforts to obtain the rebates, the Claimant was stymied by a long-standing requirement of the IEPS law, the requirement in Article 4(III) that when seeking rebates he, as non-taxpayer, present invoices showing that the IEPS tax had been separately transferred to the

¹³ Technically, the *Amparo* appears to apply only to the IEPS law challenged, i.e. the 1990 version. However, Article 2(III) of the law was further amended in 1992 to provide the 0% tax rate to reseller/exporters as well as producer/exporters, so long as the destination nation was not a low tax (tax haven) jurisdiction.

taxpayer (see *supra* para.15). However, even assuming that the Claimant is a “taxpayer” under this provision given the peculiarities of the tax calculation for cigarettes – and there is some doubt as to this conclusion – he could not obtain the required invoices at any relevant time. The Claimant could not obtain the information from the retailers who supplied his cigarettes (since they did not know the tax amounts themselves), and the producers of the cigarettes were unwilling to provide the information.¹⁴ Thus, it appears to the Tribunal that the Claimant never really possessed a “right” to obtain tax rebates upon exportation of cigarettes, but only a right to the 0% tax rate. This is important, because as far as the Tribunal can determine, the only significant asset of the investment, the enterprise known as CEMSA, is its alleged right to receive IEPS tax rebates upon exportation of cigarettes, and to profit from that business.¹⁵ We also note that the Claimant concedes that “discrimination between cigarette producers and resellers is [not] necessarily a violation of international law.” (See Claimant’s May 8, 2002 submission, para. 9.) The Claimant relies, rather, on the alleged refusal of Mexican authorities to comply with the 1993 *Amparo* decision and the alleged subsequent agreement between the Claimant and SHCP officials that the Claimant would be permitted the rebates despite the absence of invoices stating the tax amounts separately.

119. The key contentious issue here is whether the denial of IEPS rebates for failure to meet with the invoice requirement constituted expropriation of the Claimant’s investment (a right to export cigarettes) under Article 1110. A related issue is the denial of tax rebates for

¹⁴ Although the tax base for the IEPS cigarette tax was the retail sale price, under the IEPS law the party responsible for paying the tax was the producer or its controlled distributor, not the retailer, presumably to assure that the full amount of the taxes would be paid in a distribution system where many of the retailers were small kiosk operators who apparently were not trusted to remit the proper tax amounts to SHCP, or to maintain records adequate to assure SHCP that the full taxes were being paid. See IEPS Law, Article 11 (1991).

¹⁵ The record is largely devoid of any statement of CEMSA’s physical assets. The Claimant asserts that the initial capitalization of CEMSA upon its formation in 1998 was a total of \$ 510,000 Mexican pesos, but there is no indication as to what percentage of this was paid in capital. Feldman declaration of March 28, 2001, para. 1. Moreover, the Claimant’s claim for compensation is based almost entirely on a calculation of lost profits and its value as a going business [concern], plus a demand for the rebates anticipated but not paid for October - November 1997. See memorial, para. 231.

exports allegedly made to a low tax jurisdiction (Honduras), also purportedly barred under the IEPS law (see *supra* para.8). However, in determining whether the Claimant was deprived of a “fundamental right of ownership” (the term used by the *Pope & Talbot* tribunal) by Mexican government actions in the critical 1996-1997 period, it is important to observe that the invoice requirements of the IEPS law were not new, and had not been changed by Mexican officials (except to the extent or non-extent of enforcement) to the detriment of the Claimant. At *all* times between January 1, 1987, including April 1990, when CEMSA was first registered as an export company, and January 1, 1998, when the new IEPS law definitively denied rebates except for the “first sale” in Mexico, Article 4(III) of the IEPS law as written (even if not always as applied) effectively required resellers such as CEMSA to obtain invoices stating the tax amounts separately. Even if the 1999 Mexican Fiscal Court proceeding ultimately results in a decision that the denial of the rebates for 1996-1997 is unconstitutional under Mexican law, this is not a situation in which the Claimant can reasonably argue that post investment changes in the law destroyed the Claimant’s investment, since the IEPS law at all relevant times contained the invoice requirements. Of course, Mexico had first sought to ban such exports in 1990 by denying the 0% tax rate to resellers, but that effort was defeated by the Supreme Court. Thus, in retrospect, the Claimant’s most intractable problem with regard to cigarette exports was *not* the 0% tax rate, but the technical requirements of the IEPS law with regard to invoices and, much later, the denial of tax rebates for exports to low tax jurisdictions, also clearly stated in the IEPS law during all relevant periods.

120. The Claimant argues that the 1993 *Amparo* Supreme Court decision resolved not only the 0% tax rate, but the invoice and taxpayer limitations in the IEPS law as well, and contends that SHCP improperly limited the scope of that decision to the 0% tax rate. There is language in the opinion that condemns discrimination between producers and other sellers generally, which is not limited to the 0% tax rate. Also, there is some inherent logic behind the Claimant’s position; if the Claimant were correct, this would be a strong argument for finding a creeping expropriation or denial of justice. If the *Amparo* decision resolves only the 0% tax rate, but the Claimant cannot satisfy the other requirements of the IEPS law, including Article 4 regarding invoices, there is no possibility of CEMSA’s benefiting from that decision with regard

to cigarette exports, as the company is still prevented from carrying on its cigarette export business.

121. The problem for the Claimant is that a careful reading of the *Amparo* Supreme Court decision reveals no mention of Article 4; the discussion is confined solely to the availability of the 0% tax rate under Article 2 of IEPS law to resellers as well as producers, and to a general assessment of the unconstitutionality of discrimination. For various reasons, Article 4 was not raised by the Claimant and was not discussed by the Supreme Court, even though the issue of the 0% tax rate was specifically raised with regard to both alcoholic beverages and cigarettes.¹⁶ There is no indication in the opinion that the Supreme Court intended to abrogate or modify this critical provision of the IEPS law, since it apparently did not even consider the issue, and the Tribunal has no way of guessing what the result would have been had the Article 4 issue been squarely presented to the Supreme Court. In this respect, even the Claimant admits that the court in the *Amparo* case did not review the mechanics of IEPS (reply, para. 43). Rather, as noted above, no Mexican court directly addressed these issues until the Claimant brought the April 1998 and March 1999 challenges.

122. Moreover, the *Amparo* judgment limited to Article 2 (and a parallel *Amparo* decision sought by another company, Lynx) were successful in protecting the Claimant's (and Lynx's) rights to export alcoholic beverages, since both the Claimant and Lynx could obtain the necessary invoices from their suppliers due to their ability to purchase alcoholic beverages directly from the Mexican manufacturers and function as eligible taxpayers, and the different IEPS tax structure applicable to alcoholic beverages.¹⁷ Thus, the decision had considerable

¹⁶ Several possible reasons emerged during the hearing. It was suggested that Article 4 of the IEPS law could only have been challenged within 15 days of the enactment of the provision, which occurred in 1984 or 1985, well before CEMSA was incorporated, or because at the time the Article 4 requirements had not been applied to the Claimant (transcript, July 12, 2001, pp. 127-135, testimony of Oscar Enriquez Enriquez).

¹⁷ The IEPS applied to alcoholic beverages appears to function in a manner similar to normal value added taxes, with each succeeding seller being treated as a taxpayer. The special rules using the retail price as the tax base but making the producer or distributor the person
(Continued ...)

practical benefit for the Claimant at the time even without addressing or resolving the Article 4 question which the Claimant had not raised in the proceeding. In this Tribunal's view, that court decision did not resolve the Claimant's problems with obtaining tax rebates on cigarette exports because the Claimant failed to challenge Article 4 of the IEPS law.

123. The documentation and testimony regarding what transpired subsequently between the Claimant and the Respondent concerning the IEPS requirements is unfortunately ambiguous and often conflicting, making it difficult for this Tribunal to determine exactly what occurred. For example, a letter was provided to the Claimant by SHCP on March 12, 1992, in response to a written request from the Claimant – before the *Amparo* decision but after the 1992 changes in the IEPS law. It is unclear whether the request was treated by SHCP as a formal ruling under Article 34 of the Fiscal Code; SHCP officials subsequently have asserted that the letter was general and did not relate to a specific situation, and thus was not treated as a formal, binding ruling under Article 34. (See witness statement of Jose Riquer, May 17, 2001, para. 7). That letter refers to Article 2 of the IEPS law and Articles 22, 34 and 42 of the Fiscal Code, but does not mention Article 4 of the IEPS law.¹⁸ However, this letter may have been issued at a time when the invoices stating the taxes separately were not yet at issue, as the Claimant's statement of facts suggests (see memorial, para. 14-18, discussing the problem in the context of denial of IEPS rebates to re-sellers).

responsible for paying the taxes for cigarettes apparently apply only to tobacco products, gasoline and diesel fuel. See IEPS law, Article 11 (1992 and other years).

18 It states in operative part that “you are hereby confirmed your opinion in the sense that you are entitled to request the return of the balance in your favor resulting from the crediting of the special tax on production and services paid on the acquisition of alcoholic beverages and processed tobacco exported as from January 1st, 1992, provided such exports are made to countries with an Income Tax rate applicable to legal entities exceeding 30%.” (Letter from Jose Antonio Riquer Ramos to CEMSA, March 12, 1992, App. 0062-0069.) SHCP reserved the rights of surveillance and verification. It is also unfortunate that neither the Claimant nor the Respondent were able to produce a copy of the February 6, 1992, letter to which SHCP's letter was a response, so it is impossible for the Tribunal to know whether this response was in the context of a letter raising the Article 4 invoice issue, or, equally likely, raising only the 0% tax rate issue which was then before the Supreme Court.

124. Other than this 1992 letter and an even more ambiguous May 10, 1994, letter confirming the obligation of tobacco and alcoholic beverage *sellers* to show the transfer of the tax amount separately on the invoice, there are no other written communications that could reasonably be treated as formal rulings, and none at all that specifically address the Article 4 requirement. SHCP officials state that they have been unwilling to provide written rulings to the Claimant on the issues raised by the Claimant informally, and that only a written ruling pursuant to Article 34 of the Fiscal Code would be binding. (See testimony of Fernando Heftye Etienne, paras. 8-11.) Officials explain this on the not unreasonable ground that the Claimant did not follow proper administrative procedures under Article 34 of the Fiscal Code in requesting such determinations. Insofar as the Tribunal has been able to determine, at no time before 1998 did the Claimant present the Article 4 issue to a Mexican court, or seek a formal, binding administrative ruling from SHCP.

125. The Claimant also contends that, in accordance with the Claimant's interpretation of the *Amparo* decision, SHCP effectively concluded an oral agreement with the Claimant to permit the rebates, and then refused to carry out the agreement. Such a failure, if proven, could be evidence of a denial of due process or fair and equitable treatment, and support a conclusion that the IEPS law was intentionally being administered in a manner designed to destroy CEMSA's export operations. There is considerable evidence in the record of some sort of an informal agreement or understanding between the Claimant and SHCP in 1995, based on a number of meetings and correspondence. The Claimant suggests that the agreement was to provide rebates without the invoices, with the understanding that SHCP would then not have to seek the invoices from Carlos Slim/Cigatam as may be required of SHCP by Mexican law (first Feldman Statement, paras. 40-42). Perhaps the best evidence for some sort of understanding is the fact that a high profile taxpayer such as the Claimant was granted the rebates for a sixteen month period in 1996-1997, even though SHCP officials were well aware that it was impossible for the Claimant to obtain invoices with the IEPS tax amounts separately stated. On the other hand, given SHCP's authority to audit rebates after the event, and the fact that it is a large organization with various offices accepting IEPS and other tax rebate applications in significant

numbers, it is possible that the Claimant's applications did in fact receive routine treatment/approval.

126. Unfortunately for the Claimant, however, even if there was some sort of oral understanding, there is little persuasive evidence as to its scope, i.e., whether it was limited to assuring the availability of the 0% tax rate as required by the 1993 *Amparo* Supreme Court decision, or whether it also authorized the Claimant to obtain rebates notwithstanding the lack of invoices stating the tax amounts separately, or even authorized the Claimant to obtain rebate amounts in excess of those otherwise permitted. Not only has no written document from SHCP been made available to the Tribunal, but apparently neither the Claimant nor his counsel prepared any contemporaneous memoranda reflecting such an agreement, despite the many meetings with SHCP officials.

127. SHCP flatly denies the existence of an oral agreement (testimony of Fernando Heftye Etienne, para. 3). While SHCP contends it has not violated the *Amparo* decision requiring the 0% tax rate (counter-memorial, paras.112-113), it also takes position that the decision applied only to the 1990 law, not to subsequent versions of the IEPS law, and in any event that the law at all relevant times required the Claimant to possess invoices stating the tax amounts separately, since SHCP had no authority to exempt the Claimant from the requirements of Article 4(III) of the IEPS law (*Id.*, paras. 6, 12). Thus, even if the Claimant has met his burden of proof with regard to the existence of an oral agreement or understanding, he has not met that burden with regard to demonstrating the precise subject matter of such an undertaking. SHCP's inconsistent actions (or inactions) belie any clear understanding between the Claimant and SHCP, beyond compliance with the application of the 0% tax rate to CEMSA's exports.

128. As noted above, a finding of expropriation here depends in significant part on whether under the circumstances the Article 4 invoice requirements are inconsistent with the Claimant's rights under NAFTA Article 1110. On the basis of the evidence presented to the Tribunal, the Tribunal is not persuaded that they are. The Article 4 invoice requirements have been part of the IEPS law at least since 1987, that is, for at least three years *before* CEMSA was first registered as an export company in 1991. Since the operation of its export business

depended substantially on the terms of the IEPS law, the Claimant was or should have been aware at all relevant times that the separate invoice requirement existed, as there has been no *de jure* change in it at any time relevant to this dispute. Equally important, the Tribunal is reluctant to find an expropriation based largely on the failure of Mexican government officials to comply with an agreement in which those officials allegedly waived an explicit requirement of a tax law, even though there is some evidence, albeit contested by the Respondent, that the requirement was *de facto* ignored at some times both for the Claimant and for other cigarette resellers, including but not limited to members of the [so-called] Poblano group.¹⁹ This, however, is not in the view of the Tribunal evidence of expropriatory action and will be dealt with below in the section on national treatment.

129. If the IEPS law, Article 4, obligation to possess invoices stating the tax amounts separately was simply a technical requirement of the IEPS law, the result here might be considered formalistic and unreasonable. As noted earlier (para. 114, note 11), it is under challenge as unconstitutional discrimination between taxpayers in Mexico, according to the still pending 1999 Fiscal Court proceedings. However, the Tribunal does not consider the invoicing requirements to be a mere formality or patently unreasonable, to be waived easily by officials based on their discretion. The obvious and legitimate purpose of the requirement that the IEPS tax amounts be stated separately on invoices to be submitted to SHCP authorities on demand as the basis of a tax rebate is to make it possible for the tax authorities to determine in a straightforward manner whether the tax amounts on exported products for which a rebate is sought are accurate and not overstated. This is clearly a rational tax policy and a reasonable legal requirement.

¹⁹ As discussed more fully in the section of this award on discrimination, evidence in the record suggests that there are 5-10 or more firms registered under Mexican law as cigarette exporters. (Obregon-Castellanos testimony, transcript, July 9, 2001, p. 141). It may well be that the requirements of Article 4 have been waived from time to time for them as well given the practical impossibility for resellers to export without the tax rebates, although the Mexican government has unfortunately been unwilling or unable to enlighten the Tribunal on this fact.

130. The Claimant himself is an excellent example of why this requirement is necessary to protect the revenue. Without invoices, it was of course impossible for the Claimant to know the precise amount of the IEPS taxes included in the selling price of the cigarettes he purchased from Walmart or Sam's Club, for his exports in 1996 and 1997. However, a very close approximation of the IEPS tax amounts could have been made by the Claimant for these years, just as it was in 1992 (see Zaga-Hadid affidavit, annex A) based on the IEPS tax rate for cigarettes applicable in 1996 and 1997 (85%), by dividing the selling price (inclusive of tax) by 1.85 to determine the price net of taxes, and then subtracting that amount from the selling price to determine the tax amounts. For example, if as the Claimant alleges, he paid US\$7.40 per carton for cigarettes, and the tax rate specified in the IEPS law was 85%, the tax included in the US\$7.40 price was approximately US\$3.40.20

131. The Claimant apparently used this formula in 1992, and received the rebates. He used a somewhat different formula in 1996, which over-stated the rebate amounts.²¹ Then, in 1997, he used a completely different formula, which had the effect of grossly overstating the tax amounts, US\$6.55 instead of US\$3.40 per carton, an overstatement of 93%.²² The Claimant asserts that this methodology was explicitly approved by Director of Major Taxpayers Jose Riquer Ramos (Feldman affidavit, Mar. 28, 2001, para. 70). Mr. Riquer has denied this (Riquer statement, May 17, 2001, paras. 19-25). In the final analysis, the Tribunal does not find the Claimant's testimony on this issue to be credible. It is inconceivable to the Tribunal that even if SHCP officials were prepared to forego the invoice requirement informally during some periods,

20 Using the formula $7.40 = 1.85 X$, where X is the price net of tax, $X = 7.40/1.85 = 4.00$. (See Feldman affidavit, Mar. 28, 2001, para. 6.) The remaining amount is the tax, $US\$7.40 - US\$4.00 = US\$3.40$. See IEPS law, Article 2(1)(H).

21 Although the methodology used in 1996 is relatively obscure (see Zaga-Hadid affidavit, annex A, exh. 3 of memorial), the result of the methodology used was to increase the portion of the purchase price treated as IEPS taxes subject to rebates from 45.95% to 55.95% of the purchase price.

22 He arrived at this figure by simply multiplying the price of US\$7.40 by 85%, in other words, treating 85% of the purchase price as tax amounts subject to government rebate upon exportation. (Zaga-Hadid affidavit, annex 3; first Feldman statement, para. 70.) This increased the tax amounts, in an unwarranted way, from 45.95% to 85% of the gross sales price.

as appears to be the case, they would have given the Claimant or any other taxpayer carte blanche to over-estimate the amount of the rebates, in flagrant violation of the IEPS law.²³

132. The Claimant also argues that notwithstanding the Respondent's (and this Tribunal's) interpretation of the scope of the 1993 *Amparo* decision, SHCP's actions between 1993 and 1997, particularly certain oral and written communications, were so arbitrary as to constitute expropriatory action. The Tribunal, as noted earlier (para. 125), has some sympathy with the Claimant's position here. The various written and oral communications from SHCP to the Claimant are at best ambiguous and misleading, perhaps intentionally so in some instances, as were SHCP's actions in permitting rebates during some periods and denying them in others. However, a reasonable person, given the complex and exacting nature of tax laws and regulations, and the ambiguity of statements by and correspondence with SHCP officials, should have sought expert tax counsel if it was not already available to him. Had this occurred, the Tribunal doubts that any competent tax attorney would have confirmed the Claimant's right to rebates in the absence of proper invoices showing the tax amounts separately, given the text of Article 4 of the IEPS law and the lack of apparent legal authority on part of SHCP officials to waive this requirement.

133. While the transparency in some of the actions of SHCP may be questioned, it is doubtful that lack of transparency alone rises to the level of violation of NAFTA and international law, particularly given the complexities not only of Mexican but most other tax laws. The British Columbia Supreme Court held in its review of the *Metalclad* decision that Section A of Chapter 11, which establishes the obligations of host governments to foreign investors, nowhere mentions an obligation of transparency to such investors, and that a denial of transparency alone thus does not constitute a violation of Chapter 11 (*United Mexican States v.*

²³ There was considerable discussion in the testimony of the parties regarding whether one of the Poblano Group companies, Lynx, had received excess IEPS rebates for 1991 as a result of Lynx's *Amparo* suit. (See third statement of Enrique Diaz Guzman, paras. 7-8, App. 6455-6456; declaration of Oscar Enriquez Enriquez, Jun. 8, 1991, paras. 3 bis - 14 bis.) However, the Tribunal believes that the Claimant failed to demonstrate that the amounts received on behalf of Lynx were excessive, once interest and an inflation factor for the five year period between accrual and payment are factored in.

Metalclad, Supreme Court of British Columbia, Reasons for Judgment of the Honorable Mr. Justice Tysoe, May 2, 2001, paras. 70-74, <http://www.naftalaw.org.>; transparency is a general NAFTA obligation of the NAFTA Parties under Chapter 18). While this Tribunal is not required to reach the same result as the British Columbia Supreme Court, it finds this aspect of their decision instructive.

134. Under the circumstances, therefore, the Claimant would have been wise to seek a formal administrative ruling on the applicability of Article 4 of the IEPS, and court review if the ruling were adverse, far before he was forced to do so in 1998, but for whatever reason he chose not to do so. Formal administrative procedures and the courts, according to the record, were at all times available to him, and have not been challenged here as being inconsistent with Mexico's international law obligations. Moreover, in Mexico, as in the United States and most other countries, oral or informal opinions are not binding on the tax authorities (see Article 34 of Fiscal Code, counter-memorial, paras. 18-20). Regardless of the results of the ruling process the Claimant would have been better off. If he had received a favorable ruling on Article 4, it would have been much easier for him to defend his rights under Mexican law and before this Tribunal. If he had lost, he could have at least avoided the uncertainties of his alleged right to rebates during much of the 1992-1997 period, and could have brought a NAFTA claim under Chapter 11 much earlier.

H.3.4 Public Purpose

135. As noted earlier, in the absence of a finding of expropriation and in view of the Restatement comments the Tribunal is reluctant to give excessive weight to the public purpose, non-discrimination and due process criteria in Article 1110(1). However, in this instance even if they are considered significant the Tribunal believes that they do not contradict an otherwise negative finding. The Claimant suggests, accurately in the view of this Tribunal, that Mexican government policy is designed to prevent cigarette resellers including CEMSA from exporting cigarettes from Mexico to other countries. He attributes this to political pressures from Carlos Slim, a major owner of Mexico's largest cigarette producer, Cigatam. He alleges that this policy is in conflict with normal Mexican policies that promote exports, and cites such policies as

evidence that the restrictions do not have a valid public purpose (see memorial, paras. 31, 188, 189).

136. However, the Tribunal has already indicated its view that there are rational public purposes for this policy. These include, *inter alia*, discouraging “grey” market exports and seeking to control illegal re-exportation of Mexican cigarettes into Mexico. There is ample evidence on the record to suggest that cigarette smuggling is a significant problem for Mexico, even if that evidence does not effectively link the Claimant with the illegal imports.²⁴ It may be that Mexican authorities feel they have greater control over cigarette producers who export (or that such producers are constrained by licensing agreements, such as the one that presumably exists between Philip Morris of the United States and Cigatam, the Marlboro producer, in Mexico), than they do over independent resellers. Also, as noted above, there are valid public policy reasons for requiring invoices that separately state the IEPS tax amounts as a condition of receiving the refunds, i.e., to prevent inaccurate or excessive claims for rebates.²⁵

H.3.5 Non-Discrimination

137. The Chapter 11 scheme establishes a right to national treatment for investors (and damages for breach thereof) that is distinct from the right to damages from acts of expropriation.²⁶ In this respect, the Tribunal notes that the *S.D. Myers* tribunal, having weighed

²⁴ Respondent made an extensive effort in its briefs and during the hearing to document a series of export transactions by the Claimant, and to link those exports with re-entry of the cigarettes into Mexico. While Respondent was unable to demonstrate that the Claimant was aware of any such illegal practices, or that any of the cigarettes the Claimant exported were re-entered into Mexico, Respondent did demonstrate evidence of a serious problem. Counter-memorial, pp. 104-116, and transcript, July 12, 2001, pp. 148 ff.

²⁵ See *supra*, paras. 130, 131, and Respondent’s exhibits for cross-examination of the Claimant, Vol. II, tab 6.

²⁶ Moreover, under international law, there is considerable doubt whether the discrimination provision of Article 1110 covers discrimination other than that between nationals and foreign investors, i.e., it is not applicable to discrimination among different classes of investors, such as between producers and resellers of tobacco products, at least unless all producers are nationals and all resellers are aliens. Thus, under the Restatement, the relevant comment states that “a program of taking that singles out aliens generally, or aliens of a
(Continued ...)

the allegations of expropriation and finding no violation of Article 1110, nevertheless found Canada in violation of its obligations under Article 1102 and Article 1105 (*S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 256, 268, <http://www.state.gov/documents/organization/3992.pdf>), violations that also constituted discrimination under Article 1110(1)(b) and denial of fair and equitable treatment under Article 1110(1)(c). This issue is examined below: see the section I on Article 1102.

H.3.6 Due Process/Fair and Equitable Treatment/Denial of Justice

138. Regarding the possible claim of a denial of due process or a denial of justice, the Tribunal notes that the Claimant actually alleges a denial of justice primarily with regard to SHCP's failure – the failure of the Executive Branch – to implement the 1993 *Amparo* decision (memorial, p. 8). The Claimant only suggests in passing that the nullification decision of the circuit court may rely on a provision of the 1998 IEPS law to deny rebates that the Claimant sought for 1997 (reply, p. 16). In April 1998, the Claimant was effectively forced to seek “injunctive, declaratory or other extraordinary relief” before the Mexican Fiscal Court, as permitted under Article 1121. In that first case, CEMSA sought a declaratory judgment confirming CEMSA's right to receive tax rebates. This was necessary because of a determination of the tax authorities that CEMSA was not entitled to the rebates for exports made in October-November 1997, since CEMSA could not present invoices that complied with the Article 4 requirement that the IEPS tax amounts be stated separately, and was not a taxpayer entitled to claim IEPS rebates under Article 11 (the latter applied only to the situation under the amended IEPS law effective January 1, 1998). In that action the Mexican courts ultimately decided, *inter alia*, that CEMSA was subject to the invoice requirements of Article 4 (proceeding related to the negative response to a request presented to the tax authority referred above in

particular nationality, or particular aliens, would violate international law.” The comment does not refer to discrimination between national producers and resellers (whether national or foreign) operating under somewhat different circumstances, particularly under the tax laws. Also, there is an implication in the NAFTA Parties' interpretation of Article 1105 of July 31, 2001, that a breach of one substantive provision of Section A should not in itself be considered a breach of a separate provision (NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, July 31, 2001, consulted on the web site of the Department of Foreign Affairs and International Trade of the Government of Canada. See NAFTA Articles 1131(2) and 2001).

paragraph 84). The Tribunal notes that this decision is in obvious conflict with the Claimant's interpretation of the 1993 *Amparo* decision as guaranteeing the Claimant's right to obtain IEPS rebates notwithstanding the Article 4 invoice requirement. In a separate action challenging SHCP's decision to audit CEMSA and ultimately to demand return of the rebate amounts paid to CEMSA between April 1996 and September 1997, discussed *supra* at paras. 82-83, the issue of whether the invoice requirements under Article 4 of the IEPS law are legal under Mexican law and the Mexican constitution remains pending.

139. Assuming that Article 1110 must be interpreted in accordance with international law, as Article 1131(1) states, not just any denial of due process or of fair and equitable treatment (the latter through the cross-reference in Article 1110(1)(c) to Article 1105) constitutes a violation of international law. In this instance, the allegations of denial of due process or denial of justice are weakened by several factors. Here, as in *Azinian*, the Claimant does not effectively contend that there was a denial of justice by Mexican courts, either with regard to the Supreme Court's *Amparo* decision or the various lower courts' subsequent determinations in the nullification and assessment cases. Rather, in the instant case the Claimant's assertions of denial of justice relate to actions of SHCP rather than the courts. (See Claimant's May 8, 2002 submission, para. 9, stating that "the Claimant maintains that Respondent's insistence on such discrimination [between producers and exporters] in disregard of both the Supreme Court decision and the agreement Mexican officials made with the Claimant in 1995-96 constitutes discrimination and denial of justice under international law.") *Azinian* states that "A governmental authority surely cannot be faulted for acting in a manner validated by its own courts *unless the courts themselves are disavowed at the international level.*" *Azinian* further suggests that there must be a showing that the court decision itself is a violation of NAFTA, or that the relevant courts have not accepted the suit, or there is "a clear and malicious misapplication of the law" (*Robert Azinian and Others v. The United Mexican States*, Award, November 1, 1999, paras. 97, 102, 103, 14 ICSID Review. FILJ 2, 1999.).

140. This is a standard that the nullity and assessment decisions almost certainly do not meet.²⁷ Given as noted earlier that Mexican courts and administrative procedures at all relevant times have been open to the Claimant, the Claimant's victory in the 1993 *Amparo* decision, and the availability of court review in the nullity and assessment decisions filed by the Claimant in 1998, there appears to have been no denial of due process or denial of justice there as would rise to the level of a violation of international law. As the Respondent concedes, this Tribunal could find a NAFTA violation even if Mexican courts uphold Mexican law (counter-memorial, para. 364); this Tribunal is not bound by a decision of a local court if that decision violates international law. Also, as discussed in Section G2, NAFTA does not require a claimant to exhaust local court remedies before submitting a claim to arbitration. The Claimant is limited only by the requirements of Article 1121(2)(b).

141. While there may be an argument for a violation of Article 1105 under the facts of this case (a denial of fair and equitable treatment), this Tribunal has no jurisdiction to decide that issue directly. As noted earlier, Article 1105 is not available in tax cases, but may be relevant in the cross-reference of Article 1110(1)(c). The Tribunal does not need to decide whether this cross-reference makes a full Article 1105 consideration appropriate in a tax matter. Even assuming, *arguendo*, that the Respondents' actions in the aggregate do constitute a denial of fair and equitable treatment that reaches the relatively egregious level of a violation of international law, this alone does not establish the existence of an illegal expropriation under Article 1110. As *S.D. Myers* indicates, it may be appropriate for a NAFTA tribunal to find a violation of Article 1105 and at the same time decline to find a violation of Article 1110(1)(c).

H.3.7 The Claimant in Control of CEMSA

142. Although the Tribunal does not consider this a controlling argument, the regulatory action has not deprived the Claimant of control of his company, CEMSA, interfered

²⁷ Moreover, the Mexican courts have been deciding issues of national law which it is inappropriate for the Tribunal to review, except and unless those determinations (or of Mexican administrative agencies such as SHCP) are themselves denials of justice or otherwise in violation of NAFTA or international law.

directly in the internal operations of CEMSA or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of business activity, such as exporting alcoholic beverages or photographic supplies, as in the past, or other products for which he can obtain from Mexico the invoices required under Article 4. Of course, he was effectively precluded from exporting cigarettes, certainly by the IEPS law amendments, that went into force in 1998 making the IEPS rebates available only to producers, and in the Tribunal's view by the invoice requirements of Article 4(III), which were stated requirements of Mexican law at least since 1987, and did not change at any relevant time subsequently. However, this does not amount to Claimant's deprivation of control of his company.

H.3.8 Other NAFTA Decisions

143. The Tribunal's conclusion that the actions by the Mexican government against the Claimant – even though in some instances inconsistent, and arbitrary – should not be treated as expropriatory, is in the Tribunal's view consistent with earlier NAFTA Chapter 11 decisions that have sought to interpret Article 1110, including not only *Metalclad*, *Azinian* and *S.D. Myers*, discussed above, but also *Pope & Talbot*.

144. *Metalclad v. United Mexican States* is the only NAFTA decision to date in which a violation of Article 1110 has been found. Metalclad was granted a federal government permit for a hazardous waste disposal facility in January 1993, and began construction shortly thereafter. However, despite early support, opposition arose from the state and municipal governments, apparently because of the usual "NIMBY" (not in my back yard) concerns. Work on the new facility, which included a clean up of the residues left by the previous operators, was completed in March 1995, but opposition from local interests intensified, despite efforts of Metalclad and the federal government to satisfy them.²⁸

²⁸ See *Metalclad Corporation v. United Mexican States*, Award, August 30, 2000, paras. 1, 32, 38, 40, 45-46, 16 ICSID Review. FILJ 1, 2001. Metalclad and Mexican federal environmental authorities entered into an agreement in which Metalclad agreed, *inter alia*, to make certain modifications in the site, take specified conservation steps, recognize the participation of a Technical Scientific Committee and a Citizen Supervision Committee, employ
(Continued ...)

145. Ultimately, the municipality denied Metalclad's construction permit, in a process which was closed to Metalclad, and the governor of San Luis Potosi issued an "Ecological Decree" declaring the area of the landfill to be a "Natural Area for the protection of rare cactus" (see *Metalclad Corporation v. United Mexican States*, Award, August 30, 2000, paras. 50, 54, 57, 59-60, 16 ICSID Review. FILJ 1, 2001). Based on these actions, the *Metalclad* Tribunal opined that Article 1110,

includes not only open, deliberate and acknowledged takings of property... but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of the property even if not necessarily to the obvious benefit of the host state. (*Id.*, para. 103.)

146. The tribunal, in reaching its finding of indirect expropriation, not only cited "reasonably-to-be-expected economic benefit," but found it important that Metalclad had relied on the representations of the Mexican federal government of its exclusive authority to issue permits for hazardous waste disposal facilities. It also faulted the lack of transparency in the Mexican legal system for siting of hazardous waste facilities. Separately, without much discussion, the Tribunal found that the state government's decree fixing Metalclad's site as an "ecological preserve" effectively barring the landfill operation permanently, was a "further ground for a finding of expropriation." 29

147. The *Metalclad* Tribunal's finding of an expropriation based on transparency and, implicitly, on reliance by the Claimant, was effectively vacated by the British Columbia

local manual labor, and make regular contributions toward the social welfare of the municipality, including limited free medical advice. *Id.*, para. 48.

29 This is rather strangely characterized as an act "tantamount to expropriation," although it probably was more accurately described as a direct expropriation. *Id.* paras. 109-111. Ultimately, the tribunal awarded Metalclad compensation of US\$16,685,000 for the loss of its investment in Mexico (more than US\$90 million in damages was sought) based on violations of NAFTA Articles 1105 (fair and equitable treatment) and 1110 (expropriation). See *Metalclad, Id.*, paras. 76-92, 103-105, 123-125, 128, 131.

Supreme Court (British Columbia was the “seat” of the arbitration), responding to a challenge by the Government of Mexico. However, the tribunal’s determination that the Mexican state’s decision to make Metalclad’s site into an ecological preserve was expropriatory was confirmed by the British Columbia Court. (*United Mexican States v. Metalclad*, Supreme Court of British Columbia, Reasons for Judgment of the Honorable Mr. Justice Tysoe, May 2, 2001, para. 84, <http://www.naftalaw.org>.)

148. The facts, and the reasonableness of the Claimant’s reliance in *Metalclad*, are thus quite different from the instant case. The assurances received by the investor from the Mexican government in *Metalclad* were definitive, unambiguous and repeated, in stating that the federal government had the authority to authorize construction and operation of hazardous waste landfills, and that Metalclad had obtained all necessary federal and other permits for the facility. (See *ibid.*, paras. 28-41.) Nor is there any indication that the assurances received by Metalclad, despite some ambiguities, were inconsistent with Mexican law on its face. Finally, Metalclad was deprived of all beneficial use of its property, which was incorporated into an “ecological preserve.”

149. In contrast, in the present case, the Mexican government essentially opposed the Claimant’s business activities at every step of the way, notwithstanding a few periods when the rebates were granted. Also, in the present case the assurances allegedly relied on by the Claimant (which assurances are disputed by Mexico) were at best ambiguous and largely informal (since the Claimant never sought a formal written tax ruling on the Article 4 issue, or litigated the issue until 1998). They were also in direct conflict with Article 4(III) of Mexico’s IEPS law requiring the possession of invoices stating the taxes separately as a condition of receiving tax rebates.³⁰

³⁰ Here, as in *Metalclad*, there was without doubt a lack of transparency with regard to some actions by Mexican government officials. Yet, if the British Columbia Supreme Court is correct that lack of transparency is not in itself a violation of Chapter 11 of NAFTA, the fact that SHCP communications and other actions after the 1993 *Amparo* decision were inconsistent and ambiguous, and difficult for the Claimant to assess, are insufficient to justify a finding of expropriation under Article 1110.

150. *S.D. Myers v. Canada* involved a government action barring exports (hazardous waste). There, the tribunal noted that expropriation normally constitutes a taking of “property” with a view toward transfer of ownership,³¹ a situation that did not occur in that case or in this one. No expropriation was found in *S.D. Myers*, although the Tribunal did find violations of Articles 1102, 1105 and 1106 (see paras. 123, 256, 280, 284).

151. Somewhat different issues arise in comparison with *Pope & Talbot* which again focused on the alleged denial of a right to export, in this instance, softwood lumber.³² The *Pope & Talbot* Tribunal had opined (in what would be considered *dicta* in the US legal system) that regulatory measures could constitute expropriation under Article 1110, and found that the lumber export control regime came within Article 1110. However, it also noted that the investor was able to continue to export and to earn profit on those exports, and declined to find a violation of Article 1110, based on this consideration and on the ground that the investor “remains in control of the Investment, it directs the day-to-day operations of the Investment, and no officers or employees of the Investment have been detained.... Canada does not...take any other actions outing the Investor from full ownership and control of his investment.” The Tribunal suggested further that in determining “whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been ‘taken’ from its owner.” (*ibid.*, paras. 100, 102.)

³¹ *S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, para. 280, <http://www.state.gov/documents/organization/3992.pdf>.

³² The Claimant had argued that the Canadian lumber export control regime had “deprived the Investment of its ordinary ability to alienate its product to its traditional and natural market,” and that by reducing the claimant’s quota of lumber that could be exported to the United States without paying a fee, Canada violated Article 1110. *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, para. 81, <http://www.state.gov/documents/organization/3989.pdf>.

152. Given that the Claimant here has lost the effective ability to export cigarettes, and any profits derived therefrom³³, application of the *Pope & Talbot* standard might suggest the possibility of an expropriation. However, as with *S.D. Myers*, it may be questioned as to whether the Claimant ever possessed a “right” to export that has been “taken” by the Mexican government. Also, here, as in *Pope & Talbot*, the regulatory action (enforcement of long-standing provisions of Mexican law) has not deprived the Claimant of control of the investment, CEMSA, interfered directly in the internal operations of CEMSA or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of export trading, such as exporting alcoholic beverages, photographic supplies, or other products for which he can obtain from Mexico the invoices required under Article 4, although he is effectively precluded from exporting cigarettes. Thus, this Tribunal believes there has been no “taking” under this standard articulated in *Pope & Talbot*, in the present case.

153. On the factual basis set out in the record, and this analysis, the Tribunal holds that the actions of Mexico with regard to the Claimant’s investment do not constitute an expropriation under Article 1110 of NAFTA.

I NATIONAL TREATMENT (NAFTA ARTICLE 1102)

154. In the present case, there are only a handful of relevant investors, one foreign (the Claimant) and one domestic (the Poblano-Guemes Group), each engaged in the business of purchasing Mexican cigarettes and marketing those cigarettes abroad. These investors cannot purchase the cigarettes from Mexican cigarette producers because the producers (and their wholly owned distributors) refuse to sell to them. Therefore, the Claimant or the Poblano Group firms must purchase their cigarettes from volume retailers, Walmart and Sam’s Club. Since Walmart and Sam’s Club are retailers and not IEPS taxpayers, they do not have available to them the precise amounts of the IEPS taxes included in the price paid first by the retailers in the transaction with the producers or distributors, and then by the Claimant and other reseller/exporters. Accordingly, neither the Claimant nor the Poblano Group companies can

³³ For a discussion of the profitability of the Claimant’s cigarette exporting business (or lack thereof), see Section J, *infra*.

comply with the requirement of the IEPS law, Article 4(III), which makes it a condition of obtaining tax rebates upon export that the applicant be a taxpayer who possesses invoices showing the tax amount stated separately.

I.1 Views of the Disputing Parties

155. The essence of the Claimant's denial of national treatment argument is that Mexico discriminated against CEMSA in the 1998-2000 period. During that period, SHCP permitted at least three resellers of cigarettes (Mercados Regionales and Mercados Extranjeros – respectively Mercados I and Mercados II: the Poblano Group, and MEXCOBASA, ownership unknown) and possibly some others, to export cigarettes and to receive rebates, notwithstanding the fact that like the Claimant, they purchased their goods from retailers, are not formally taxpayers and thus could not have invoices stating the IEPS tax amounts separately (memorial, paras. 128-135, 225). The Claimant also objects to similar discriminatory treatment in the 1996 - 1997 period. The Claimant reports that the Respondent admits paying NP\$ 91,000,000 to three cigarette exporter/trading companies after September 1996, a period when the Claimant was either denied rebates or an effort was made by SHCP to recoup rebate amounts originally granted (memorial, para. 134).

156. In addition, the Claimant's firm, CEMSA, was denied registration as an export trading company, while no similar denial occurred with regard to the members of the Poblano Group. There is no persuasive evidence that SHCP has made any parallel effort to recoup the rebates paid to the members of the Poblano Group during the relevant periods. Thus, according to the Claimant, CEMSA and the members of the Poblano group have been treated differently, and "there is a NAFTA violation under the ordinary meaning of the words used in Article 1102" (reply, para. 12).

157. The Claimant also argues that discrimination under Article 1102 is actionable whether it is *de jure* or *de facto*. In this case, even though the IEPS law is non-discriminatory on its face, it has been applied in a discriminatory manner. Nor is there any need to demonstrate that the reason for the discrimination is a result of the Claimant's nationality, if in fact the

Claimant is being treated less favorably than a domestic investor in like circumstances (memorial, paras. 224-226).

158. The Respondent counters that the known domestic investors in the business of reselling/exporting cigarettes, the “Poblano-Gamez-Guemes network companies” were in fact related to CEMSA rather than competitors (counter-memorial, paras. 487-500). The Respondent asserts that the evidence shows that there were not really distinct entities, CEMSA and the Poblano Group. Rather, CEMSA and the Poblano Group companies were effectively part of the same corporate group, even if there was no common ownership of shares. They sold goods to each other; Poblano group members loaned money under favorable terms to CEMSA; and they engaged in a range of financial and business dealings which were not arms-length in nature. As a legal matter there cannot be discrimination under Article 1102 unless there exists a foreign investor and an unrelated domestic investor who are treated differently. If the foreign investor and the domestic firms in like circumstances are really one and the same, there can be no discrimination as between Mexican and foreign investors.

159. The Respondent also argues that there is no *de jure* discrimination in the IEPS law, in the sense that the law by its terms treats all re-sellers in the same manner. Also, because of the manner in which the law operates Mexican authorities do not know until after the fact who is seeking rebates on cigarettes and therefore, there can be no *de facto* discrimination (counter-memorial, paras. 501-504). It was SHCP’s policy to deny IEPS rebates to all cigarette reseller/exporters who lacked the requisite invoices, regardless of nationality (counter-memorial, para. 505). The Respondent has demonstrated that all resellers are being audited and will be assessed if there is evidence that they did not have the proper invoices (Díaz Guzman first and second statements, rejoinder, para. 184).

160. According to the Respondent, notwithstanding the fact that CEMSA is arguing *de facto* discrimination, because CEMSA cannot show *de jure* discrimination, it would be highly inappropriate for the Tribunal to find a violation of national treatment based on the failure of SHCP to provide a benefit which they had no authority under Mexican law to provide. Under Article 4(III) of the IEPS law, SHCP has no authority to provide IEPS rebates to persons

claiming such rebates unless those claimants have invoices showing the tax amounts stated separately. Thus, a SHCP official would be acting *ultra vires* if he agreed that CEMSA could apply for and receive IEPS rebates without regard to the amounts or whether the correct formula for calculating the rebates was used by CEMSA. Moreover, the fact that the overstatement of the rebate amounts by CEMSA was discovered only after an audit reinforces the reasonableness of Mexican legislation (Article 4 of the IEPS law) which requires a taxpayer to have invoices with the correct tax amounts stated therein as a condition of receiving the rebates.

161. Thus, according to the Respondent, there is simply no indication of discrimination between foreign investors and domestic investors in this instance. Evidence on the record indicates that the Poblano group, like CEMSA, even if unrelated, is also being audited with regard to irregularities in tax payments. SHCP conducts hundreds or thousands of audits each year and the fact that it audits one company (which happens to be foreign) sooner than it audits a company in like circumstances (which happens to be domestic) is not in itself evidence of discrimination. Administrative agencies must receive some latitude in carrying out their duties, as the tribunals in *Pope & Talbot v. Canada* and *S.D. Myers v. Canada* have stated.

162. According to Mexico, denial of CEMSA's registration as an export trading company – a separate but related issue – was not a denial of national treatment, because in this instance CEMSA and the Poblano Group were not in like circumstances. CEMSA was at the time under audit and SHCP had discovered discrepancies in the amounts of the IEPS rebates sought for 1996 and 1997. The Poblano Group was not at that time under audit. Thus, it was reasonable for SHCP to deny export registration to CEMSA until the irregularities discovered in the audit had been resolved.

163. Assuming, *arguendo*, that there is different treatment, Mexico argues that it is not sufficient under Article 1102 just to show different treatment for there to be a violation of Article 1102. Rather, any discrimination shown between the Claimant and domestically owned cigarette seller/exporters must be shown to be a result of the fact that the Claimant is a foreign national. (rejoinder, para. 174; see transcript, July 10, 2002, pp. 107-109.)

164. Neither Canada nor the United States has exercised its right under Article 1128 to express views on the proper interpretation of Article 1102 in its Article 1128 submission, and the Tribunal for that reason is left to consider only the views of the Claimant and Mexico.³⁴

I.2 Analysis by the Tribunal

165. The national treatment/non-discrimination provision is a fundamental obligation of Chapter 11.35 The concept is not new with NAFTA. Analogous language in Article III of the GATT has applied as between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods. Article 1602 of the United States - Canada Free Trade Agreement, with regard to investment, applied between those two NAFTA Parties from 1989-1993. NAFTA's Article 1102(2) provides that

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

(Article 1102(1) is the same except that it refers to “investors” rather than to “investments of investors;” under Article 1102(3), the obligation applies to state/provincial governments as well, but this is not relevant here.)

166. Despite its deceptively simple language, the interpretative hurdles for Article 1102 are several. They include (a) which domestic investors, if any, are in “like circumstances” with the foreign investor; (b) whether there has been discrimination against foreign investors, either *de jure* or *de facto*; (c) the extent to which differential treatment must be demonstrated to

³⁴ Mexico has provided excerpts from United States submissions in other cases, which imply that there must be a showing that the reason for differential treatment is nationality. See, e.g., U.S. Submission of April 7, 2000, in *Pope & Talbot*, <http://www.state.gov/documents/organization/4097.pdf>. However, such statements were made in the context of cases with different fact situations and, possibly, legal and policy considerations. Under those circumstances, this Tribunal chooses not to consider them.

³⁵ See Daniel M. Price & P. Brian Christy, *An Overview of the NAFTA Investment Chapter*, in *The North American Free Trade Agreement: A New Frontier in International Trade and Investment in the Americas* 165, 174 (Judith H. Bello, Allan F. Holmer & Joseph J. Norton, eds., 1994).

be *a result of* the foreign investor's nationality; and (d) whether a foreign investor must receive the most favorable treatment given to *any* domestic investor or to just some of them.³⁶

167. Analysis of these issues in the present case is complicated by the fact that only a limited amount of relevant factual information has been presented to the Tribunal, particularly with regard to the various domestic companies which may be in the business of reselling and exporting cigarettes from Mexico, and the treatment by SHCP of those resellers other than the Claimant. Neither party suggests that there are any foreign owned reseller/exporters other than the Claimant. One of the Respondent's witnesses indicated under questioning that there might be 5-10 or more other firms registered in Mexico for exporting cigarettes. There is agreement between the parties that there is at least one Mexican owned reseller/exporter, the so-called "Poblano Group," consisting of Mercados Regionales and Mercados Extranjeros ("Mercados I" and "Mercados II") and possibly other entities. A third company, MEXCOBASA, was mentioned by the Claimant but the ownership is not indicated in the record (first Feldman statement, para. 94). A Mexican official, Enrique Díaz Guzman, has confirmed that at least three trading companies (i.e., not producers) received IEPS rebates for cigarette exports at various times between September 1996 and May 2000, in the total amount of approximately NP\$ 91,000,000 (first Diaz Guzman statement, App. 0506, 0515). Many of those rebates were authorized and paid after January 1, 1998, when amendments to the IEPS law effectively made the 0% tax rate and IEPS rebates on cigarette exports legally unavailable to *anyone* other than producers (by limiting the payment of the tax rebates to the first sale) (1998 IEPS law, Article 11).

168. There is disagreement as to how these trading companies (presumably the Poblano Group companies) were treated in comparison to the Claimant, that is, whether the

³⁶ The issue of whether the size of the "universe" of foreign investors, and of domestic investors, matters has been an issue in other NAFTA Chapter 11 cases, including *S.D. Myers* (see *S.D. Myers v. Government of Canada*, Partial Award, November 13, 2000, paras. 93, 112, 256, <http://www.state.gov/documents/organization/3992.pdf>) and particularly in *Pope & Talbot* (see *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, paras. 11, 24, 36, 38, <http://www.state.gov/documents/organization/3989.pdf>). However, the Respondent here has not raised that issue, and the Tribunal accordingly does not address it (see *infra* paras. 185, 186).

Poblano Group was provided IEPS tax rebates denied during some periods to the Claimant, notwithstanding the same lack of invoices stating the tax amounts separately, as required by Article 4 and, after January 1, 1998, notwithstanding the bar to rebates except on the first sale. There is also a lack of detailed information as to whether SHCP has made effective efforts to recoup the rebates provided to the Poblano Group for the 1996-1997 period, as it has with respect to the Claimant, or for IEPS payments made in 1998 to 2000. On the grounds that there is an ongoing audit of Caesar Poblano, the principal owner of the Poblano Group companies, SHCP has declined to provide any detailed information on the treatment of the Poblano Group and how that treatment compares to treatment by SHCP of the Claimant. One of SHCP's witnesses, Mr. Diaz Guzman, did, however, state that only one of the three trading companies he identified was in the process of audit (as of March 2001), so presumably there are two others which have not been audited, despite being in like circumstances with the Claimant.

169. Also, given that this is a case of likely *de facto* discrimination, it does not matter for purposes of Article 1102 whether in fact Mexican law authorizes SHCP to provide IEPS rebates to persons who are not formally IEPS taxpayers and do not have invoices setting out the tax amounts separately, as has been required by the IEPS law consistently since at least 1987 and perhaps earlier. The question, rather, is whether rebates have *in fact* been provided for domestically owned cigarette exporters while denied to a foreign re-seller, CEMSA. Mexico is of course entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner, as between foreign investors and domestic investors. Thus, if the IEPS Article 4 invoice requirement is ignored or waived for domestic cigarette reseller/exporters, but not for foreign owned cigarette reseller/exporters, that *de facto* difference in treatment is sufficient to establish a denial of national treatment under Article 1102.

I.2.1 In Like Circumstances

170. In the investment context, the concept of discrimination has been defined to imply *unreasonable* distinctions between foreign and domestic investors in like circumstances (Restatement, Sec. 712, Comment f). As discussed in the Article 1110 section (*supra*, paras. 115, 129), there are at least some rational bases for treating producers and re-sellers differently, *e.g.*, better control over tax revenues, discourage smuggling, protect intellectual property rights,

and prohibit gray market sales, even if some of these may be anti-competitive.³⁷ Thus, as discussed in the expropriation section, the Tribunal does not believe that such producer - reseller discrimination is a violation of international law.

171. In this instance, the disputing parties agree that CEMSA is in “like circumstances” with Mexican owned resellers of cigarettes for export, including the two members of the Poblano Group, Mercados Regionales and Mercados Extranjeros (see memorial, para. 222; counter-memorial, para. 486), although Mexico of course denies that there has been any discrimination largely on the ground that CEMSA and the Poblano Group are effectively the same entity. In the Tribunal’s view, the “universe” of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the business of reselling/exporting cigarettes. Other Mexican firms that may also export cigarettes, such as Mexican cigarette producers, are not in like circumstances. While the Claimant’s *Amparo* decision held discrimination between producers and resellers of alcohol and tobacco products (at least as to the availability of the 0% tax rate for exported goods) to be unconstitutional, such discrimination is effectively reinstated by the 1998 IEPS law that limits IEPS tax rebates to the first sale, excluding any subsequent purchaser/exporter from the benefit, and has effectively been upheld in the other litigation brought by the Claimant in 1998, also discussed earlier. The Tribunal also notes that Article 1102 says nothing regarding discrimination among different classes of a Party’s own investors.

172. Accordingly, the Tribunal holds that the companies which are in like circumstances, domestic and foreign, are the trading companies, those in the business of purchasing Mexican cigarettes for export, which for purposes of this case are CEMSA and the corporate members of the Poblano Group.

³⁷ With minor exceptions, NAFTA does not regulate the creation and maintenance of monopolies. “Nothing in this Agreement shall be construed to prevent a Party from designating a monopoly.” Article 1502(1). Thus, affording cigarette producers a monopoly on exports would not appear to be an article 1102 violation, as long as all non-producers, both domestic and foreign, are treated in the same manner.

I.2.2 Existence of Discrimination

173. The limited facts made available to the Tribunal demonstrate on balance to a majority of the Tribunal that CEMSA has been treated in a less favorable manner than domestically owned reseller/exporters of cigarettes, a *de facto* discrimination by SHCP, which is inconsistent with Mexico's obligations under Article 1102. The only confirmed cigarette exporters on the limited record before the tribunal are CEMSA, owned by U.S. citizen Marvin Roy Feldman Karpa, and the Mexican corporate members of the Poblano Group, Mercados I and Mercados II. According to the available evidence, CEMSA was denied the rebates for October-November 1997 and subsequently; SHCP also demanded that CEMSA repay rebate amounts initially allowed from June 1996 through September 1997. Thus, CEMSA was denied IEPS rebates during periods when members of the Poblano Group were receiving them (see *supra* para. 167, memorial, p. 3).

174. Even if Mexico is auditing Mr. Poblano, the process was begun long after the audit of CEMSA, and according to the files provided to the Tribunal concerning this audit, there is no documentation that the audit continued after approximately March 2000, or that it even involved IEPS rebates (transcript, July 11, 2001, p. 2). CEMSA's rebates (before and after audits) have already been denied, and several years later no such action has been taken with regard to the Poblano Group. Arguably, the fact that CEMSA has been audited well before any other domestic reseller/exporters is in itself evidence of discrimination, even if SHCP is legally authorized to audit all taxpayers. If Mexican authorities are auditing or intend to audit other taxpayers who are in like circumstances with CEMSA, the Government of Mexico, as the only party with access to such information, has not been particularly forthcoming in presenting the necessary evidence. The two files presented to the Tribunal during the hearing (designated nos. 328 and 333) are incomplete, indicating no final or even continuing audit action (transcript, July 11, 2001, p. 2). The only clear knowledge that Mr. Poblano is subject to some sort of audit was supplied by the Claimant (first Feldman affidavit, para. 92), and counsel for the Claimant asserts that the evidence in the record demonstrates only that Mr. Poblano is subject to a personal audit for 1997 (transcript, July 13, 2001, p. 155). The Mexican Government has declined to provide any specific information as to the number of other possible taxpayers in like circumstances (resellers). The government's witness, Mr. Obregon-Castellanos, admitted that there were more

than five, and likely more than ten firms registered as cigarette exporters (transcript, July 9, 2001, p.141), but was evasive with regard to tobacco exporter numbers even though he testified confidently and explicitly that there were 400 registered exporters of alcoholic beverages (transcript, July 11, 2001, p. 10).

175. The evidence also shows that CEMSA was denied registration as an export trading company, apparently in part because this action was filed, and in part as a result of the ongoing audit of the rebates for exports during 1996 and 1997, even though, as Mr. Diaz Guzman indicated, three other cigarette export trading companies had been granted registration. An unsigned memorandum which reasonably could have been generated only in SHCP indicates that registration was being denied on the basis of the audit of the Claimant's rebate payments. There is no evidence that any domestic reseller/exporter has been denied export privileges in this manner. Moreover, there appears to have been differential treatment between CEMSA and Mr. Poblano with regard to registration issues as well. According to the Claimant's witness, Mr. Carvajal, taxpayer CEMSA filed its application for export registration status on June 30, 1998; information was still being requested in writing seven months later. For taxpayer Mr. Poblano, information was requested by SHCP orally within 14 days of the date of Poblano's application, and any questions were apparently resolved (transcript, July 11, 2001, p. 3).

176. The extent of the evidence of discrimination on the record is admittedly limited. There are only a few documents in the record bearing directly on the existence of differing treatment, particularly the statement of Mr. Diaz Guzman, the "mystery" memorandum from SHCP's files, and the tax registration statement for Mercados Regionales, owned by the Poblano Group. One member of this Tribunal believes that this evidence on the record is insufficient to prove discrimination (see dissent). The majority's view is based first on the conclusion that the burden of proof was shifted from the Claimant to the Respondent, with the Respondent then failing to meet its new burden, and on an assessment of the record as a whole. But it is also based on a very simple two-pronged conclusion, as neither point was ever effectively challenged by the Respondent:

- a. No cigarette reseller-exporter (the Claimant, Poblano Group member or otherwise) could legally have qualified for the IEPS rebates, since none under the facts established in this

case would have been able to obtain the necessary invoices stating the tax amounts separately.

- b. The Claimant was denied the rebates at a time when at least three other companies in like circumstances, i.e. resellers and exporters (see *supra* para. 171) apparently including at least two members of the Poblano Group, were granted them.

177. On the question of burden of proof, the majority finds the following statement of the international law standard helpful, as stated by the Appellate Body of the WTO:

... various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or respondent, is responsible for providing proof thereof. Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defence. *If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.* (Emphasis supplied.)³⁸

Here, the Claimant in our view has established a presumption and a *prima facie* case that the Claimant has been treated in a different and less favorable manner than several Mexican owned cigarette resellers, and the Respondent has failed to introduce any credible evidence into the record to rebut that presumption.

178. In weighing the evidence, including the record of the five day hearing, the majority is also affected by the Respondent's approach to the issue of discrimination. If the Respondent had had available to it evidence showing that the Poblano Group companies had not been treated in a more favorable fashion than CEMSA with regard to receiving IEPS rebates, it

³⁸ *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, Adopted 23 May 1997, WT/DS33/AB/R, p. 14. Accordingly, *Asian Agricultural Products Limited v. Republic of Sri Lanka*, *ICSID Reports*, pp. 246, 272, 1990. (“In case a party adduces some evidence which *prima facie* supports his allegation, the burden of proof shifts to his opponent.”).

has never been explained why it was not introduced. Instead, the Respondent spent a substantial amount of its time during the hearing and in its memorials seeking (unsuccessfully in the Tribunal's view) to demonstrate that CEMSA and the Poblano Group were related companies (as there could be no discrimination, presumably within a single company group)³⁹. Yet, if the Poblano Group firms had not received the rebates, that evidence of relationship would have been totally irrelevant. Why would any rational party have taken this approach at the hearing and in the briefs if it had information in its possession that would have shown that the Mexican owned cigarette exporters were being treated in the same manner as the Claimant, that is, denied IEPS rebates for cigarette exports where proper invoices were not available? Thus, it is entirely reasonable for the majority of this Tribunal to make an inference based on the Respondent's failure to present evidence on the discrimination issue. It is also notable that despite the lengthy presentation of evidence by the Respondent seeking (unsuccessfully in the Tribunal's view) to link the Claimant with an alleged smuggling operation *operated by or on behalf of Mr. Poblano*, export registration was nevertheless granted for Mr. Poblano's companies. This occurred at approximately the same time as registration was being denied for CEMSA, apparently because of the pending CEMSA audit. Again, the differing treatment of CEMSA and the Poblano Group is obvious.

179. There is also evidence in the record to suggest that Lynx, an earlier Poblano Group company, was treated somewhat more favorably by Mexico, as the Federal Fiscal Tribunal decided in February 1996 that Lynx was entitled to IEPS rebates on cigarette exports,

³⁹ Counter-memorial, para. 488; see, *e.g.*, transcript, July 10, 2001, pp. 110-113. It is undeniable that CEMSA and the Poblano Group maintained a business relationship; CEMSA, *inter alia*, was a seller of cigarettes to several of the Poblano Group companies from time to time, and had borrowed working capital from Mr. Poblano (memorial, paras. 101-102). However, there is no evidence of any common stock ownership, common membership on corporate boards of directors or any of the normal indices of common ownership and control. Moreover, SHCP has treated the two as completely separate taxpayers, audited CEMSA early on, while more than three years later no final action has been taken against the Poblano Group. Clearly, there is no evidence that the Mexican government considered CEMSA and the Poblano Group companies to be a common enterprise prior to this proceeding. Accordingly, this Tribunal would not be inclined to treat them as such so as to defeat the Claimant's assertion of discrimination.

despite the likely absence of invoices stating the tax amounts separately (*e.g.* memorial, para. 36; App. 1047-1070). As a result of this decision and Lynx' *Amparo* victory (which applied specifically only to alcoholic beverage exports), SHCP also paid rebates to Lynx for IEPS taxes applicable to cigarette exports in 1992, along with substantial additional amounts for interest and inflation.⁴⁰ This was a period during which CEMSA faced uncertainty over the availability of rebates for cigarette exports, despite the fact that limited exports were made in 1992 by CEMSA. However, by 1996, when SHCP recognized Lynx' right to the rebates, SHCP had denied rebates to CEMSA for test shipments for several years.

180. All of this confirms a further weakness in the Respondent's argument that there can be no *de facto* discrimination under circumstances where rebates are essentially granted initially on the basis of a ministerial decision, with the detailed analysis coming later in the event of questions or an audit. Given the Claimant's notoriety at SHCP over the years, the newspaper articles and threats of litigation against SHCP officials, the audit that was initiated and then abruptly terminated in 1995, the multiple meetings with SHCP officials, etc., it is difficult for the Tribunal to believe that the Claimant's requests and actions were not well-known to and carefully monitored by SHCP officials. Those factors certainly created the necessary conditions for discrimination.

I.2.3 Discrimination as a Result of Nationality

181. It is clear that the concept of national treatment as embodied in NAFTA and similar agreements is designed to prevent discrimination on the basis of nationality, or "by reason of nationality." (U.S. Statement of Administrative Action, Article 1102.) However, it is not self-evident, as the Respondent argues, that any departure from national treatment must be

⁴⁰ See Zaga-Hadid testimony, transcript, July 13, 2001, p. 142, tables introduced into evidence during the hearing. Allegations that Lynx had been intentionally paid excessive rebates by SHCP were denied (third witness statement of Diaz-Guzman, App. 06455-06456) and further disputed at the hearing by both parties. The evidence on this issue before the Tribunal is conflicting, and the Tribunal is not convinced that the amounts paid, including interest paid and the inflation adjustment for the 1993-1996 period, were in fact excessive.

explicitly shown to be a result of the investor's nationality. There is no such language in Article 1102. Rather, Article 1102 by its terms suggests that it is sufficient to show less favorable treatment for the foreign investor than for domestic investors in like circumstances. In this instance, the evidence on the record demonstrates that there is only one U.S. citizen/investor, the Claimant, that alleges a violation of national treatment under NAFTA Article 1102 (transcript, July 13, 2001, p. 178), and at least one domestic investor (Mr. Poblano) who has been treated more favorably. For practical as well as legal reasons, the Tribunal is prepared to assume that the differential treatment is a result of the Claimant's nationality, at least in the absence of any evidence to the contrary.

182. However, in this case there is evidence of a nexus between the discrimination and the Claimant's status as a foreign investor. In the first place, there does not appear to be any rational justification in the record for SHCP's less favorable *de facto* treatment of CEMSA other than the obvious fact that CEMSA was owned by a very outspoken foreigner, who had, prior to the initiation of the audit, filed a NAFTA Chapter 11 claim against the Government of Mexico. Certainly, the action of filing a request for arbitration under Chapter 11 could *only* have been taken by a person who was a citizen of the United States or Canada (rather than Mexico), i.e., as a result of his (foreign) nationality. While a tax audit in itself is not, of course, evidence of a denial of national treatment, the fact that the audit was initiated shortly after the Notice of Arbitration (first Feldman affidavit, paras. 85-86) and the existence of the unsigned memo at SHCP noting the filing of the Chapter 11 claim in the context of the Claimant's export registration efforts, at minimum raise a very strong suspicion that the events were related, given that no similar audit action was taken against domestic reseller/exporter taxpayers at the time.

183. More generally, requiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. It would be virtually impossible for any claimant to meet the burden of demonstrating that a government's motivation for discrimination is nationality rather than some other reason. Also, as the Respondent argues, if the motives for a government's actions should not be examined, there is effectively no way for the Claimant or this Tribunal to make the subjective determination that the discriminatory action of the government is a result of

the Claimant's nationality, again in the absence of credible evidence from the Respondent of a different motivation. If Article 1102 violations are limited to those where there is explicit (presumably *de jure*) discrimination against foreigners, e.g., through a law that treats foreign investors and domestic investors differently, it would greatly limit the effectiveness of the national treatment concept in protecting foreign investors.

184. This conclusion is consistent with that reached in an earlier Chapter 11 proceeding, *Pope & Talbot v. Government of Canada*. The *Pope & Talbot* tribunal indicated its inclination to presume that discriminatory treatment of foreign investors in like circumstances would be in violation of Article 1102. According to that tribunal such differences between domestic and foreign investors would “presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.” One of that tribunal's concerns was that if there had to be a showing that the discrimination was based on nationality, it would “tend to excuse discrimination that is not facially directed at foreign owned investments” (*Pope & Talbot v. Government of Canada*, Award on the Merits of Phase 2, April 10, 2001, paras. 78, 79, http://www.dfait-maeci.gc.ca/tna-nac/Award_Merits-e.pdf) (The *Pope & Talbot* tribunal, on the facts, ultimately declined to find a violation of national treatment). In the instant case, the treatment between the foreign investor and domestic investors in like circumstances is different on a *de facto* basis, and such discrimination is clearly in conflict with the investment liberalization objective found in Article 1102. This Tribunal sees no reason to disagree with the *Pope & Talbot* tribunal's articulation in this respect.

I.2.4 Most Favored Investor Requirement?

185. NAFTA is on its face unclear as to whether the foreign investor must be treated in the most favorable manner provided for *any* domestic investor, or only with regard to the treatment generally accorded to domestic investors, or even the least favorably treated domestic investor. There is no “most-favored investor” provision in Chapter 11, parallel to the most favored nation provision in Article 1103, that suggests that a foreign investor must be treated no less favorably than the most favorably treated national investor, if there are other national

investors that are treated less favorably, that is, in the same manner as the foreign investor. At the same time, there is no language in Article 1102 that states that the foreign investor must receive treatment equal to that provided to the *most* favorably treated domestic investor, if there are multiple domestic investors receiving differing treatment by the respondent government.

186. It may well be that the size of the domestic investor class here is larger than two – one Mexican government witness stated that there might be 5-10 or more registered to export cigarettes – and it may also be that some of those other investors have been treated in a manner more similar to the Claimant’s treatment than to the more favorable treatment afforded to the Poblano Group. However, in the absence of evidence to this effect presented by Mexico – the only party in a position to provide such information – the Tribunal need not decide whether Article 1102 requires treatment equivalent to the best treatment provided to *any* domestic investors. Presumably, if there was evidence that another domestic investor had been treated in a manner equivalent to the Claimant, in terms of export registration, audit, and granting or withholding of rebates, the Respondent would have provided that evidence to the Tribunal. In this case, the known “universe” of investors is only two, or at the most three, one foreign (the Claimant) and one domestic (the Poblano Group companies), and the Tribunal must make its decision on the evidence before it. Thus, the only relevant domestic investor is the Poblano Group and the comparison must be between the Poblano Group and Claimant.

187. On the basis of this analysis, a majority of the Tribunal concludes that Mexico has violated the Claimant’s rights to non-discrimination under Article 1102 of NAFTA. The Claimant has made a *prima facie* case for differential and less favorable treatment of the Claimant, compared with treatment by SHCP of the Poblano Group. For the Poblano Group and for other likely cigarette reseller/exporters, the Respondent has asserted that audits are or will be conducted in the same manner as for the Claimant, and implied that they will ultimately be treated in the same way as the Claimant. However, the evidence that this has occurred is weak and unpersuasive. The inescapable fact is that the Claimant has been effectively denied IEPS rebates for the April 1996 through November 1997 period, while domestic export trading companies have been given rebates not only for much of that period but through at least May 2000, suggesting that Article 4(III) of the law has been *de facto* waived for some if not all

domestic firms. While the Claimant has also been effectively precluded from exporting cigarettes from 1998 to 2000, there is evidence that the Poblano Group companies have apparently been allowed to do so, notwithstanding Article 11 of the IEPS law. Finally, the Claimant has not been permitted to register as an exporting trading company, while the Poblano Group firms have been granted this registration. All of these results are inconsistent with the Respondent's obligations under Article 1102, and the Respondent has failed to meet its burden of adducing evidence to show otherwise.

188. In reaching the conclusion that the Respondent has breached its obligations to the Claimant under Article 1102, the majority observes that the cigarette exports by the Claimant and other similar situated resellers may be economically unsustainable, if IEPS rebates are unavailable, but there is nothing in the IEPS law during the relevant period (after the 1993 *Amparo* decision and before the 1998 amendments) that legally precludes the exports per se. The majority is also of the view that the factual pattern in this case reveals more than a minor error or two by the Respondent. Rather, it demonstrates a pattern of official action (or inaction) over a number of years, as well as de facto discrimination that is actionable under Article 1102. That being said, there is no disagreement that Chapter 11 jurisdiction over tax matters is carefully circumscribed by Article 2103, or that this Tribunal would be derelict in its duties if it either expanded or reduced that jurisdiction.

J DAMAGES

189. Concerning the quantum of damages to be awarded to the Claimant, the Tribunal observes at the outset that the appropriate measure and amount of damages is only generally and cursorily discussed by the Parties. Still more limited is the amount of evidence presented to the Arbitral Tribunal in this respect.

190. The Claimant assumes that CEMSA's damages for the Respondent's unlawful discrimination under Article 1102 are identical to those claimed for the unlawful expropriation, without either allowing for any divergence in both cases or taking into account the particular

case of only *de facto* discrimination (memorial, para. 233). Regarding the valuation of damages, the Claimant asks for three elements of compensation (memorial, paras. 236-246):

(1) \$64,582,645 Mexican pesos (or US\$6,458,264) for IEPS due in the period of October-December 1997; (2) \$90,350,605 Mexican pesos (or US\$9,035,060) for lost profits in the period of January 1, 1994 - May 1996, calculated on the expected exports applying a profit margin of 62.4% and (3) \$148,886,141 Mexican pesos (or US\$14,888,614), requesting CEMSA's "going concern value" on the basis of the present discounted value of the future cash flow. The sum of the three elements amounts to \$303, 819, 391 Mexican pesos (or US\$30,381,938).

191. In his reply of June 11, 2001, the Claimant asserted that his calculation of IEPS, even if erroneous, was never challenged by the Respondent (reply, paras. 72-75). He adds a claim for lost profits after December 1, 1997, without specifying any amounts (reply, para. 76(3)). He concludes by alleging that, even if CEMSA claimed more IEPS than Cigatam already paid, it would "still be entitled to damages in the order of twenty million dollars" (reply, para. 78).

192. The Respondent, on the other hand, alleges that CEMSA's financial records in the critical period were either inadequate or missing altogether. In addition, it is asserted that CEMSA's cigarette export business was not profitable (counter-memorial, paras. 513-517). Further, the Respondent denies that CEMSA was "a normal trading company" (counter-memorial, para. 560) or had any fair market value at all material times (counter-memorial, paras. 532-539, 564).

193. In its rejoinder, the Respondent objects to the calculation of damages by the Claimant (rejoinder, paras. 202-262). In particular, the Respondent challenges the new claim for lost profits and concludes that the gross profit on each carton sold could be, at best, only five cents (rejoinder, para. 258).

194. The Tribunal, first, observes that under NAFTA Article 1117(1) *in f.* (as well as Article 1116(1) *in f.*) an investor of a Party on behalf of an enterprise may submit to arbitration a claim that the other Party violated, among other provisions, the obligation to accord national

treatment under NAFTA Article 1102 and, therefore, “that the enterprise has incurred loss or damage by reason of, or arising out of, that breach”. NAFTA provides no further guidance as to the proper measure of damages or compensation for situations that do not fall under Article 1110 (expropriation); the only detailed measure of damages specifically provided in Chapter 11 is in Article 1110(2-3), “fair market value,” which necessarily applies only to situations that fall within that Article 1110. It follows that, in case of discrimination that constitutes a breach of Article 1102, what is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach. In the absence of discrimination that also constitutes indirect expropriation or is tantamount to expropriation, a claimant would not be entitled to the full market value of the investment which is granted by NAFTA Article 1110. Thus, if loss or damage is the requirement for the submission of a claim, it arguably follows that the Tribunal may direct compensation in the amount of the loss or damage actually incurred.

195. To date only two other NAFTA tribunals, in *S.D. Myers* and *Pope & Talbot*, have found a compensable violation, of Articles 1102 and 1105 (respectively). The damages phase of *S.D. Myers* has not been completed. However, in outlining its intended approach to damages, that tribunal concluded that in the absence of a special provision, the drafters of the NAFTA intended to leave it open to tribunals to determine a measure of compensation appropriate to the specific circumstances of the case, taking into account the principles of both international law and the provisions of NAFTA. (*S.D. Myers v. Government of Canada* , Partial Award, November 13, 2000, paras. 303-319, <http://www.state.gov/documents/organization/3992.pdf>.)

196. In *Pope & Talbot*, the tribunal found only a relatively minor breach of Article 1105; claims of Article 1102 and Article 1110 violations and additional alleged Article 1105 violations, among others, were rejected. In its opinion of May 31, 2002, that tribunal did not explain its rationale for damages in detail, emphasizing only the rejection of the claimed damages for the cost of management time to deal with the respondent’s breach of Article 1105, and of lost profits for a short period of time during which the firm’s mills were shut down by the respondent, again in breach of Article 1105(the latter were rejected not in principle, but because the tribunal, after considering the claimant’s assertions, determined that there had been no loss of profits). The only damages that were allowed were out-of-pocket expenses relating to the

respondent's violation, incurred by the Claimant in defending itself. (These were items such as legal and accounting, and lobbyist fees.) (*Pope & Talbot v. Government of Canada*, Award in Respect of Damages, May 31, 2002, paras. 81-90, <http://www.naftalaw.org>).

197. It is obvious that in both of these earlier cases, which as here involved non-expropriation violations of Chapter 11, the tribunals exercised considerable discretion in fashioning what they believed to be reasonable approaches to damages consistent with the requirements of NAFTA.

198. On this rationale, the Tribunal focuses on the most recent articulation of damages asked for by the Claimant in his reply (see *supra*, para. 191). For reasons stated earlier, of the three elements of damages sought for by the Claimant, the third one representing CEMSA's "going concern value" is to be dismissed because this item requires a finding of expropriation, which is not the present case (see *supra*, paras. 108-114).⁴¹

199. The second element of damages seeks lost profits in the period of January 1, 1994 - May 1996 and, therefore, is covered by the three-year limitation period under NAFTA Article 1117(2), as explained in paras. 39-47 of the Interim Decision on Preliminary Jurisdictional Issues of December 6, 2000. In that Interim Decision we held that the cut-off date of the three-year limitation period is April 30, 1996. Even if the Claimant asks, under the element under discussion, for lost profits for one month (May 1996) coming immediately after the cut-off date, the claim does not specify its amount with regard to that particular month and, in any case, has not convinced the Tribunal with respect to both existence and extent.

⁴¹ We observe, without deciding, that even if there had been an expropriation, there is inadequate proof in the record to demonstrate that CEMSA had more than negligible going concern value. As noted in footnote 15, there is no statement of CEMSA's physical assets in the record, other than an assertion of an initial capitalization of 510,000 Mexican pesos at the time of formation in 1988, without any indication as to what percentage of this was paid in. The going concern value of an enterprise which earns 90% of its alleged revenues from gray market sales of cigarettes is also suspect. As discussed in para. 201, *infra*, after selling and financing costs, this
(Continued ...)

200. Again, even had there been greater specificity on the part of the Claimant, the Tribunal is not convinced on the basis of the evidence in the record that CEMSA's operations would have been profitable, should CEMSA had received the IEPS rebates during the relevant time in the proper amounts. As discussed earlier, when the IEPS tax rate was 85%, the Claimant erroneously treated 85% of the invoice price as taxes subject to rebate. (In fact, only approximately 45.95% of the invoice price was properly attributable to taxes.) If the gross price to Sam's was US\$7.40, and it is assumed that the IEPS rebate is 85% of the gross price, the net price (less the rebates) would be US\$4.00 ($7.40/1.85$). This produces a gross margin of only US\$0.05 from an export selling price of US\$4.05, which could not possibly cover the Claimant's expenses, including but not limited to the 14% interest on his loans from the Poblano Group (see Feldman affidavit, paras. 6, 72). Even if these approximations are slightly off, there is simply insufficient gross margin to cover normal operating expenses, let alone profit, unless of course, the Claimant can obtain IEPS tax rebates from SHCP, as he did in 1996 and 1997.

201. Assertions that the Claimant, had he been aware of the correct amount of the rebates, would have simply raised his US\$4.05 per carton selling price, are totally unpersuasive from a business or economic point of view. Any reasonable businessman would set his prices based on supply and demand. If the Claimant could have obtained US\$5.00 or US\$6.00 or more per carton, he undoubtedly would have done so, as the Respondent contends (see rejoinder, paras. 216-221). Moreover, the Claimant had no significant customer base. All of his sales in his best year, 1997, were either to members of the Poblano Group, or to an apparently fictitious company, Dilosa, S.A. which may have been allegedly doing business in Honduras, a low tax jurisdiction for which IEPS rebates were not legally available (IEPS Law, 1997, Article 2(III)). In short, the Tribunal is convinced that the Claimant did not have a viable business exporting cigarettes purchased from retailers in Mexico, and could not have made a profit regardless of whether SHCP provided the IEPS rebates, assuming of course that the rebates sought and provided approximated the actual amount of IEPS taxes originally assessed on the cigarettes.

operation could not have been profitable, and a money losing business seldom has significant value as a going concern.

202. There remains only the first element of damages, concerning IEPS rebates due in the period of October - December 1997. According to the Claimant, their amount is \$64,582,645 Mexican pesos (or US\$ 6,458,264). In the record there are customs documents that reasonably reflect the relevant exportations during that period (pp. 3057 to 3199 of volume 8 that is annexed to the memorial).

203. Notwithstanding this assertion, the record demonstrates that during the three months of the relevant period, the Claimant filed only three requests for IEPS rebates for a total amount of \$18,978,361 Mexican pesos as follows:

On November 3, 1997, he requested \$10,134,669 Mexican pesos

On December 1, 1997, he requested \$8,841,061 Mexican pesos

On January 5, 1998, he requested \$2,631 Mexican pesos

To calculate the correct amount of the tax, the value of the exported merchandise should be divided by 1.85. The result, the value of the cigarettes, is subtracted from the gross invoice price, to arrive at the correctly estimated tax amounts. Thus, beginning with the \$18,978,361 Mexican pesos, specified by the Claimant, according to the applications presented November 3, December 1, both of 1997, and January 5, 1998, and assuming that this number results from the erroneous calculation of the tax amounts that was made by the Claimant (applying simply the 85% against the gross invoice price, as discussed earlier (para. 131) and dividing that number by 85 and multiplying it by 100), the gross selling price for the cigarettes on the basis of which CEMSA requested the payment of IEPS is \$22,327,483 Mexican pesos. This amount coincides with the invoices presented by the Claimant, that related to the relevant period.

204. As the gross invoice price is \$22,327,483 Mexican pesos, the tax that corresponds to that amount is \$10,258,573.5 Mexican pesos. This is the result of the following operation:

$$\$22,327,483 / 1.85 = \$12,068,909.73 \text{ Mexican pesos (This is the price of the cigarettes net of the IEPS)}$$

$$\$22,327,483 - \$12,068,909.73 = \$10,258,573.5 \text{ Mexican pesos (This is the approximate correct IEPS amount assuming an 85\% tax rate.)}$$

205. However, the Tribunal believes it appropriate to exclude the IEPS that correspond to an exportation to Honduras made in the relevant period. As Honduras is a tax haven jurisdiction (jurisdicción de baja imposición fiscal), this export was not legally subject to an IEPS rebate under Article 2(III) of the IEPS law. Thus, the total IEPS amount of \$10,258,573.50 Mexican pesos should be reduced by the amount of \$793,946.00 Mexican pesos (the rebate amount for the Honduran sale). Thus, the revised total award is \$9,464, 627.50 Mexican pesos. (This amount of \$793,946.00 Mexican pesos is obtained by dividing the price paid by CEMSA when it acquired the merchandise that it exported to Honduras, by 1.85%. CEMSA bought 27,000 Marlboro Flip Top from Sam's Club, for an amount of \$1,728, 000.00 Mexican pesos, according to invoice 2060 dated September 29, 1997; that same merchandise was exported to Honduras on October 15, 1997 with export declaration 3465-7007533, also dated October 15, 1997, and with the invoice 2068 issued by CEMSA, which refers to 450 boxes or master cases of Marlboro Flip Top; one box or master case of Marlboro Flip Top contains 60 Flip Top packs). The total revised award indicated above of \$9,464,627.50 Mexican pesos is increased by simple interest calculated from the date the rebates should have been paid (see below) to the date of this decision, in accordance with the interest rate paid on Federal Treasury Certificates or bonds issued by the Mexican Government, with a maturity of 28 days (see annex). The total interest so calculated is \$7,496,428.47 Mexican pesos.

The amount of the rebates that should have been paid to Claimant is as follows:

on January 19, 1998, \$4,684,253.45 Mexican pesos;

on February 16, 1998, \$4,778, 951.89 Mexican pesos; and

on March 3, 1998, \$1,422.16 Mexican pesos.

The interest should be calculated according to the law in force for the rebates requested in 1997 (payable 51 days after the request) and for the rebates requested in 1998 (payable 41 days after the request). Thus, as of the date of this decision, the total amount awarded by the tribunal is \$16,961,056 Mexican pesos (principal amount of \$9,464,627.50 plus interest of \$7,496,428.47).

If the Respondent, for any reason, does not immediately pay the amount of compensation herein mentioned, at the time payment is made, the Respondent shall add the interest that continues to

be generated on the original amount of \$9,464,627.50 Mexican pesos, using the same calculation methodology as described above and in the annex of this award.

206. Thus, the correct amount for this (only proved) element of damages, based on the above analysis, is \$9,464,627.50 Mexican pesos, plus simple interest at the rate calculated in conformity with the Mexican Government Federal Treasury Certificates interest rates (CETES) at maturity of 28 days.

207. Concerning the currency of the Award, the Tribunal observes that the Claimant in his Notice of Arbitration of April 30, 1999 asked for an "award of approximately 475 million pesos, which, assuming an exchange rate of \$9.5 Mexican pesos to the U.S. dollar, equals U.S. 50 million dollars" (Notice of Arbitration, p. 11). Thus, it appears that, according to the Claimant, the principal currency of the Award should be the Mexican peso. Such currency also corresponds to the facts of the case since the monetary amount is requested by the Claimant in lieu of IEPS rebates due to him but not paid by the Respondent, such IEPS rebates being necessarily expressed in the Respondent's official currency. Therefore, the Tribunal considers that the Award should also be expressed in Mexican pesos, regardless of whether the Parties in subsequent communications may have referred also to U.S. dollar as a matter of convenience. It must be added that the parity between the Mexican peso and the U.S. dollar does not seem to have significantly changed in the last three years or so. In any event, even more significant changes must have been approximately reflected in the respective rates of interest. For reasons of consistency, then, the Tribunal will apply the Mexican Government bond interest rates to the award of damages expressed in Mexican pesos.

K COSTS AND FEES

208. Regarding the costs of this arbitration, the Tribunal recalls Article 59(1) of the Arbitration (Additional Facility) Rules. Under this provision, "[u]nless the parties otherwise agree, the Tribunal shall decide how and by whom the fees and expenses of the members of the Tribunal, the expenses and charges of the Secretariat and the expenses incurred by the parties in connection with the proceeding shall be borne". In the absence of any agreement by the parties

in this respect, the Tribunal takes into account that both parties have partly won and partly lost, and that the percentage of victory and loss did not have any measurable effect on the amount of costs. Accordingly, the Tribunal decides that each party bear half of the costs of the arbitration (fees and expenses of the members of the Tribunal as well as expenses and charges of the Secretariat), as billed by ICSID. In addition, each party bears its own legal fees and costs in connection with the arbitration.

L. **DECISION**

For these reasons, the Tribunal

209. Finds that the Respondent has not violated the Claimant's rights or acted inconsistently with the Respondent's obligations under NAFTA Article 1110;

210. Finds that the Respondent has acted inconsistently with the Claimant's rights and the Respondent's obligations under NAFTA Article 1102;

211. Orders the Respondent to pay immediately to the Claimant the sum of \$ 9,464,627.50 Mexican pesos as principal, plus interest generated at the time of signature of this award, in the amount of \$7,496,428.47 Mexican pesos, which interest shall accrue until the date the payment is effectively made, pursuant to the last part of paragraph 205 of this award; the interest to be calculated shall be simple interest, for each month of the period of calculation at a rate equivalent to the yield for the month, of the Federal Treasury Certificates, issued by the Mexican Government, with a maturity of 28 days.

212. Denies all other claims for compensation;

213. Orders that each party be responsible for its own legal fees and related costs, and that the costs of the arbitration, as billed by ICSID, be shared equally by the parties.

Made as at Ottawa, Province of Ontario, Canada, in English and Spanish.

Professor Konstantinos D. Kerameus
Date:

Mr. Jorge Covarrubias Bravo
(subject to the attached dissenting opinion)
Date:

Professor David A. Gantz
Date:

Legal Authority CA-14

31 Cal.4th 363
Supreme Court of California

Henry V. LANTZY et al., Plaintiffs and Appellants,
v.

CENTEX HOMES et al.,
Defendants and Respondents.

No. S098660.

|

Aug. 4, 2003.

|

As Modified Aug. 27, 2003.

Synopsis

Background: Subdivision homeowners brought action against developer and related entities for breach of implied warranty, strict liability, and negligence. The Superior Court, Contra Costa County, No. C99–03025, [David Bernard Flinn, J.](#), sustained developer's demurrer without leave to amend. Homeowners appealed. The Court of Appeal reversed.

Holdings: Upon granting developer's petition for review, superseding opinion of the Court of Appeal, the Supreme Court, [Baxter, J.](#), held that:

ten-year limitations period to bring action for latent defect in construction involving real property is not subject to equitable tolling while potential defendant's promises or attempts to repair defect are pending; disapproving [Grange Debris Box & Wrecking Co. v. Superior Court](#), 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515, and [Cascade Gardens Homeowners Assn. v. McKellar & Associates](#), 194 Cal.App.3d 1252, 240 Cal.Rptr. 113;

defendants may be equitably estopped to assert statute of limitations as defense to action concerning latent construction defect;

developer and related entities were not equitably estopped from asserting that homeowners' claims were barred; and

homeowners were not entitled to opportunity to amend first amended complaint to state facts sufficient to set forth equitable estoppel.

Judgment of Court of Appeal reversed.

[Werdegar, J.](#), filed dissenting opinion, in which [Kennard, J.](#), concurred.

Opinion, [107 Cal.Rptr.2d 795](#), superseded.

Attorneys and Law Firms

***[657](#) *[365](#) **[520](#) Duke Gerstel Shearer, [Dawn R. Brennan](#) and [Alan R. Johnston](#), San Diego, for Plaintiffs and Appellants.

Luce, Forward, Hamilton & Scripps, [Charles A. Bird](#), San Diego; Morgan, Miller & Blair, [Kenneth M. Miller](#) and [Kathleen M. DeLaney](#), Walnut Creek, for Defendants and Respondents.

[Fred J. Hiestand](#) for the Civil Justice Association of California as Amicus Curiae on behalf of Defendants and Respondents.

[David S. Jaffe](#); Piper Marbury Rudnick & Wolfe, [Jeffrey A. Rosenfeld](#), Los Angeles, and [Stephen R. Mysliwiec](#) for National ***[658](#) Association of Builders as Amicus Curiae on behalf of Defendants and Respondents.

Dale, Braden & Hinchcliffe, [George D. Dale](#) and [Dianne M. Costales](#) for the California Building Industry Association as Amicus Curiae on behalf of Defendants and Respondents.

Opinion

*[366](#) [BAXTER, J.](#)

Depending on the theory of recovery, a lawsuit alleging a latent defect in the construction of an improvement to real property must be brought within three or four years after the plaintiff discovers the defect, or should have done so. (See Code Civ. Proc., §§ 337, subd. 1, 338, subds. (b), (c); [Regents of University of California v. Hartford Acc. & Indem. Co.](#) (1978) 21 Cal.3d 624, 630, 147 Cal.Rptr. 486, 581 P.2d 197 ([Regents](#)).)¹ However, a 1971 statute established a further general rule that no action for latent construction defects may be commenced more than 10–years after “substantial completion” of the construction project. (§ 337.15; as enacted by Stats.1971, ch. 1569, § 1, p. 3149.)² This “absolute” 10–year limitations period applies regardless of when the defect was discovered. ([Regents, supra](#), at p. 631, 147 Cal.Rptr. 486, 581 P.2d 197.)

Pre-1971 cases held that the discovery-based limitations period for a latent-defect suit alleging breach of an express or implied warranty is “tolled”—that is, halted and suspended in progress—while the defendant's promises or attempts to honor the warranty by repairing the defect are pending. Relying heavily on these earlier authorities, and in suits not confined to warranty theories, two Court of Appeal cases concluded that the alternate 10-year statute of limitations of [section 337.15](#) is also subject to tolling for repairs. (*Grange Debris Box & Wrecking Co. v. Superior Court* (1993) 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515 (*Grange Debris*); *Cascade Gardens Homeowners Assn. v. McKellar & Associates* (1987) 194 Cal.App.3d 1252, 240 Cal.Rptr. 113 (*Cascade Gardens*)).) A more recent Court of Appeal decision disagreed. (*FNB Mortgage Corp. v. Pacific General Group* (1999) 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841 (*FNB Mortgage*)).)

****521** Here the trial court sustained a demurrer without leave to amend and dismissed the action, concluding that the 10-year limitations period could not be extended by a defendant's promises or attempts to repair. The Court of Appeal reversed this judgment. The appellate court held that [section 337.15](#) is subject both to equitable tolling during periods of repair and to equitable estoppel if defendants engaged in conduct that delayed the filing of suit. We granted review to resolve the extent to which the doctrines of equitable ***367** tolling and equitable estoppel should apply to the 10-year statute of limitations set forth in [section 337.15](#).

We agree with *FNB Mortgage, supra*, 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841, that [section 337.15](#)'s 10-year statute of limitations for latent construction defects is not subject to a general rule of equitable *****659** tolling while promises or attempts to repair are pending. A broad tolling-for-repairs rule would contravene the Legislature's clear intent, at the time it adopted [section 337.15](#), to ensure a generous but firm cutoff date for latent-defect suits. Moreover, the extraordinary length of the limitations period set forth in [section 337.15](#) weighs strongly against the need for such a tolling rule as a matter of fair procedure.

Though we thus find no basis for equitable *tolling* during any period in which the defendant's promises or efforts to repair are pending, we do not foreclose application of the distinct doctrine of equitable *estoppel*. A defendant whose conduct induced plaintiffs to refrain from filing suit within the 10-year period might be equitably estopped to assert that the statute of limitations had expired. However, plaintiffs' first

amended complaint alleges no facts sufficient to establish such an estoppel, and we find no basis upon which to allow a further opportunity to amend.

We will therefore reverse the Court of Appeal's judgment. We will also disapprove the *Grange Debris* and *Cascade Gardens* decisions insofar as they conflict with the views expressed in this memorandum.

FACTS

Plaintiffs filed their original complaint on August 5, 1999, and a first amended complaint on December 3, 1999, asserting both individual and class claims. The first amended complaint alleged as follows:

The Eagles Ridge project is a 450-unit development of single-family homes in Antioch. Defendants—Centex Homes and related entities (collectively Centex), American Consolidated Industries, Inc., and numerous Does—variously designed, developed, built, and/or sold the Eagles Ridge homes, or designed, manufactured, sold, and/or installed the windows. The four individual plaintiffs, whose claims typify those of the other class members, are homeowners within the development who bought their houses directly from defendants. The Eagles Ridge homes suffer from design or manufacturing defects, including leaks in the windows and window systems, that have caused damage to each of the individual residences. These defects were discovered within three years before the lawsuit was filed. They may have developed earlier, but could not have been discovered sooner with reasonable diligence. “[A]s problems resulting from unknown defects were discovered,” ***368** defendants represented to plaintiffs that they would correct all problems, were experts in the construction field, and would take the steps required to ensure the quality and integrity of the residences. “[A]t various times [d]efendants have attempted to make repairs ... or advised plaintiffs that the ... windows were not defective and not to file a lawsuit.” Despite their promises and attempts to repair, defendants “have not properly completed [,] reconstructed, repaired and/or restored the windows, interior waterproofing systems, and walls associated therewith.” By their conduct, defendants are estopped to assert that the statute of limitations has expired. Damages are recoverable on theories of implied warranty, strict liability, and negligence.

Defendants demurred on two grounds. They urged the entire action was barred by [section 337.15](#)'s 10-year limitations period for latent construction defects. They also insisted the complaint's class allegations were insufficient. In support of their statute of limitations argument, defendants asked the court to take judicial notice that the Notices ****522** of Completion on the four homes owned by the individual plaintiffs were recorded in November 1988, some *****660** 10-years and 9 months before plaintiffs filed their original complaint.

In response, plaintiffs urged that the first amended complaint properly pled a class action. With respect to the statute of limitations, plaintiffs argued that the complaint sufficiently alleged both *equitable tolling* for repairs and *equitable estoppel* to assert the statute by virtue of defendants' conduct that forestalled a timely lawsuit.

On April 24, 2000, the trial court filed its "Order After Hearing on Demurrer." The order sustained the demurrer without leave to amend on grounds that the action was barred by the statute of limitations. The order reasoned: The parties "appear to agree" that, unless "tolled" for about nine months, [section 337.15](#)'s 10-year limitations period had expired before the complaint was filed.³ For two reasons, the allegations of the complaint are not *specific* enough to establish a repairs-based "estoppel." First, plaintiffs allege *in the alternative* that defendants *either* promised and attempted to repair *or* denied the defects and made demands not to sue; the latter conduct is insufficient to create an "estoppel." Second, by alleging simply that repairs were attempted "at various times," plaintiffs leave open the possibility this conduct occurred *after November 1998* (when the statute of limitations expired unless tolled), and thus was not timely to create a "tolling." Amendments might cure these factual deficiencies, but amendment would be futile here, because [section 337.15](#) is a "statute of repose," and thus is not subject to "equitable tolling" for repairs.

***369** Plaintiffs appealed, and the Court of Appeal reversed. Unlike the trial court, the Court of Appeal agreed with those decisions (*Grange Debris, supra*, 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515; *Cascade Gardens, supra*, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113) that extended equitable tolling for repairs to [section 337.15](#), and rejected the contrary reasoning of *FNB Mortgage, supra*, 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841. Moreover, the Court of Appeal concluded, just as [section 337.15](#) is subject to equitable tolling, the statute also is not immune from equitable estoppel. The Court of

Appeal ruled that plaintiffs had pled grounds for an equitable estoppel, sufficient to survive demurrer, by alleging that defendants' repeated promises to repair had caused them to delay filing suit.

We granted Centex's petition for review.⁴ We now conclude that the Court of Appeal's judgment must be reversed.

DISCUSSION

1. *Equitable tolling.*

[Section 337.15](#), enacted in 1971, provides generally that "[n]o action may be brought" against those involved in the design, supervision, or construction of an improvement to real property, or their sureties, for latent defects in the design or construction, or for injury to property caused by such defects, unless the suit is filed within 10-years after "substantial completion" of the project. (*Id.*, subd. (a).) *****661** The 10-year period begins to run no later than "[t]he date of recordation of a valid notice of completion." (*Id.*, subd. (g) (2).) [Section 337.15](#) "shall [not] be construed as extending the period prescribed by the laws of this state for bringing any action." (*Id.*, subd. (d).)

As we explained in *Regents, supra*, 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197, a suit to recover for a construction defect generally is subject to limitations periods of three or four years, depending on whether the theory is breach of warranty (§ 337, subd. 1 [four years: "action upon any contract, obligation or liability founded upon an ****523** instrument in writing"]) or tortious injury to property (§ 338, subs. (b), (c) (formerly subs. 2, 3) [three years: trespass or injury to real or personal property]). However, these periods begin to run only when the defect would be discoverable by reasonable inspection. (*Regents, supra*, at p. 630, 147 Cal.Rptr. 486, 581 P.2d 197.) On the other hand, "[section 337.15](#) ... imposed an absolute requirement that a suit ... to recover damages for a [latent] construction defect be brought within 10 years of the date of substantial completion of construction, regardless of the date of discovery of the defect." (*Regents, supra*, at p. 631, 147 Cal.Rptr. 486, 581 P.2d 197, fn. omitted.) "The ***370** interplay between these statutes sets up a two-step process: (1) actions for a latent defect must be filed within three years ... or four years ... of discovery, but (2) in any event must be filed within ten years ... of substantial completion." (*North Coast Business Park v. Nielsen Construction Co.* (1993) 17 Cal.App.4th 22, 27, 21 Cal.Rptr.2d 104.)

Section 337.15 states several situations in which the 10 year limit shall not apply (see text discussion, *post*), but it contains no provision for extension of the limitations period during periods of repair. Nonetheless, plaintiffs urge that the statute is subject to “equitable tolling” while the defendant's promises or attempts to remedy a defect are pending.

Equitable tolling is a judge-made doctrine “which operates independently of the literal wording of the Code of Civil Procedure” to suspend or extend a statute of limitations as necessary to ensure fundamental practicality and fairness. (*Addison v. State of California* (1978) 21 Cal.3d 313, 318–319, 146 Cal.Rptr. 224, 578 P.2d 941 (*Addison*); see also *Bollinger v. National Fire Ins. Co.* (1944) 25 Cal.2d 399, 411, 154 P.2d 399 (*Bollinger*).) This court has applied equitable tolling in carefully considered situations to prevent the unjust technical forfeiture of causes of action, where the defendant would suffer no prejudice. (E.g., *Lambert v. Commonwealth Land Title Ins. Co.* (1991) 53 Cal.3d 1072, 1080, 282 Cal.Rptr. 445, 811 P.2d 737 (*Lambert*) [claim against title insurer accrues upon insurer's refusal to defend title, but two-year limitations period is equitably tolled until underlying title action is resolved]; *Prudential–LMI Com. Insurance v. Superior Court* (1990) 51 Cal.3d 674, 687–693, 274 Cal.Rptr. 387, 798 P.2d 1230 (*Prudential–LMI*) [one-year period to sue on casualty insurance policy begins upon “inception of the loss,” but is equitably tolled from timely notice of loss until insurer denies claim]; *Addison, supra*, at pp. 317–321, 146 Cal.Rptr. 224, 578 P.2d 941 [six-month period for state court suit against public agency was equitably tolled during plaintiffs' timely federal suit raising both federal and state claims]; *Elkins v. Derby* (1974) 12 Cal.3d 410, 414–420, 115 Cal.Rptr. 641, 525 P.2d 81 (*Elkins*) [one-year period for personal injury action was tolled while plaintiff, acting in good faith, pursued worker's compensation remedy against defendant]; *Bollinger, supra*, at pp. 410–412, 154 P.2d 399 [15-month period ***662 to sue on fire insurance policy was tolled while timely prior action, erroneously dismissed as premature, was pending].)

As these cases illustrate, the effect of equitable tolling is that the limitations period *stops running* during the tolling event, and begins to run again only when the tolling event has concluded. As a consequence, the tolled interval, no matter when it took place, is tacked onto the end of the *371 limitations period, thus extending the deadline for suit by the entire length of time during which the tolling event previously occurred.⁵

**524 The Legislature may preclude equitable tolling by stating its intention “to disallow tolling under any circumstances not enumerated in the statute.” (*Laird v. Blacker* (1992) 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691 (*Laird*) [attorney malpractice limitations statute (§ 340.6) providing that limitations period shall “in no event” be tolled except as specified (*id.*, subd. (a))]; see also, e.g., *Battuello v. Battuello* (1998) 64 Cal.App.4th 842, 847, 75 Cal.Rptr.2d 548 (*Battuello*) [special one-year limitations statute (§ 366.2) for surviving action against deceased person, providing that period “shall not be tolled or extended for any reason” except as specified (*id.*, subd. (b))].)

Moreover, equitable tolling should not apply if it is “inconsistent with the text of the relevant statute” (*United States v. Beggerly* (1998) 524 U.S. 38, 48, 118 S.Ct. 1862, 141 L.Ed.2d 32 [quiet title action must commence within 12 years after discovery of government's title claim; generous limitations period, beginning only upon discovery, already provides for equitable tolling, and further tolling not warranted]; see also *Lampf v. Gilbertson* (1991) 501 U.S. 350, 363, 111 S.Ct. 2773, 115 L.Ed.2d 321 [where federal securities fraud action was subject to limitations of one year from discovery, or three years from violation, three-year period was “outside” limit not subject to tolling]) or contravenes clear legislative policy (cf. *Abreu v. Svenhard's Swedish Bakery* (1989) 208 Cal.App.3d 1446, 1456, 257 Cal.Rptr. 26 [equitable tolling would violate policy of uniform federal statute of limitations for suits claiming violations of labor contracts]).

“As with other general equitable principles, application of the equitable tolling doctrine requires a balancing of the injustice to the plaintiff occasioned by the bar of his claim against the effect upon the important public interest or policy expressed by the ... limitations statute.” (*Addison, supra*, 21 Cal.3d 313, 321, 146 Cal.Rptr. 224, 578 P.2d 941.)

*372 Plaintiffs insist that in construction defect cases, the rule of tolling for repairs is well established. As they observe, two Court of Appeal decisions, *Grange Debris*, ***663 *supra*, 16 Cal.App.4th 1349, 1360, 20 Cal.Rptr.2d 515, and *Cascade Gardens, supra*, 194 Cal.App.3d 1252, 1256–1258, 240 Cal.Rptr. 113, have concluded that the 10–year limitations period of section 337.15 is tolled while the defendant's promises or attempts to remedy the defect are pending. For this holding, *Grange Debris* relied solely on *Cascade Gardens*. *Cascade Gardens*, in turn, invoked the

“clear authority” of several earlier decisions, *Aced v. Hobbs–Sesack Plumbing Co.* (1961) 55 Cal.2d 573, 585, 12 Cal.Rptr. 257, 360 P.2d 897 (*Aced*), *Mack v. Hugh W. Comstock Associates* (1964) 225 Cal.App.2d 583, 589, 37 Cal.Rptr. 466 (*Mack*), and *Southern Cal. Enterprises v. Walter & Co.* (1947) 78 Cal.App.2d 750, 755, 178 P.2d 785 (*Southern Cal. Enterprises*). (*Cascade Gardens, supra*, at p. 1256, 240 Cal.Rptr. 113.)

But *Aced*, *Mack*, and *Southern Cal. Enterprises* are inapposite to the question before us. They predate the 1971 adoption of section 337.15, and were narrowly concerned with how to apply the limitations period for express or implied warranties. These cases simply confirmed that the statute of limitations for breach of warranty does not begin to run until discovery of the defect, and is thereafter tolled during periods the warrantor claims he can honor the warranty by repairing the defect, and attempts to do so. (*Aced, supra*, 55 Cal.2d 573, 577, 585, 12 Cal.Rptr. 257, 360 P.2d 897 [radiant heating system; plaintiff stipulated he was relying solely on a theory of implied warranty]; *Mack, supra*, 225 Cal.App.2d 583, 585, 589, 37 Cal.Rptr. 466 [radiant heating system; plaintiff alleged breach of express warranty]; *Southern Cal. Enterprises, supra*, 78 Cal.App.2d 750, 752–753, 755, 178 P.2d 785 [installed carpet; plaintiff alleged breach of express warranty].)

Aced, *Mack*, and *Southern Cal. Enterprises* did not consider how tolling should apply to an alternative, overarching limitations period later enacted specifically for suits alleging defects in the construction of improvements to real property—a limitations period measured, regardless of discovery, from the date the work of construction was completed.

****525** Contrary to the assumption of *Cascade Gardens, supra*, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, those earlier cases are not persuasive authority for extending a “tolling for repairs” rule to section 337.15.⁶

***373** In *FNB Mortgage, supra*, 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841, the Court of Appeal properly discounted the pre-1971 precedents, rejected the holding of *Cascade Gardens*, and concluded that the 10-year limitations period of section 337.15 is not equitably tolled for repairs. *FNB Mortgage* reached the correct result.⁷

*****664** At the outset, the plain language of section 337.15 suggests that the 10-year limitations period is not subject to extension for reasons not stated in the statute itself. Unlike subdivision (a) of section 340.6, the attorney malpractice

limitations statute (see *Laird, supra*, 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691; see also, e.g., §§ 340.5 [malpractice by health care provider], 366.2, subd. (b) [surviving action against deceased person]), section 337.15 does not ban nonstatutory tolling in so many literal words. But the structure and tone of section 337.15 do differ markedly from garden-variety California limitations statutes. The latter simply provide the various “periods prescribed for the commencement of [specified] actions.” (§ 335; see also, e.g., §§ 336, 336a, 337, 337.5, 338, 339, 341.) By contrast, section 337.15 declares, in stentorian terms, that “[n]o action [for latent construction defects] may be brought ... more than 10-years after the *substantial completion* of the development or improvement.” (*Id.*, subd. (a), italics added.)

Section 337.15 itself provides several clear exemptions from the 10-year limit. The limit does not apply to actions for personal injury. (§ 337.15, subd. (a)(1), (2); cf. § 337.1, subd. (a)(3) [four-year limitation period for *patent* construction defects].) It does not apply to suits based on “willful misconduct or fraudulent concealment.” (§ 337.15, subd. (f); cf. §§ 340.5, 340.6, subd. (a) [both permitting “tolling” for “fraud” or “intentional concealment”].) It does not apply to a cross-complaint for indemnity by one participant in the project against another, if the cross-complainant himself was sued directly within the 10-year period. (§ 337.15, subd. (c); *Valley Circle Estates v. VTN Consolidated, Inc.* (1983) 33 Cal.3d 604, 608–615, 189 Cal.Rptr. 871, 659 P.2d 1160 (*Valley Circle Estates*)). It cannot be asserted by “any person in actual possession or ... control ... of [the] improvement ... at the time any deficiency [therein] constitutes the proximate cause” of the damage for which recovery is sought. (§ 337.15, subd. (e).) An argument thus arises, under the maxim *inclusio unius est exclusio alterius*, that the Legislature intended to omit other exceptions.

374** But if doubt remains from the language of section 337.15, it is dispelled by reference to the well-known goal of this special limitations statute. “[T]he purpose of section 337.15 is to protect contractors and other professionals and tradespeople in the construction industry from perpetual exposure *526** to liability for their work. (*Regents[, supra]*, 21 Cal.3d 624, 633, fn. 2 [147 Cal.Rptr. 486, 581 P.2d 197]; *Wagner v. State of California* (1978) 86 Cal.App.3d 922, 929–930, 150 Cal.Rptr. 489.) The statute reflects a legitimate concern that ‘expanding concepts of liability could imperil the construction industry unless a statute of limitations was enacted.’ (*Moseley v. Abrams* (1985) 170 Cal.App.3d 355, 362, 216 Cal.Rptr. 40.) Such concerns legitimately include

the prohibitive cost of insurance against a perpetual and never ending risk.” (*Sandy v. Superior Court* (1988) 201 Cal.App.3d 1277, 1285, 247 Cal.Rptr. 677.)

The history of section 337.15 confirms that the statute is the result of general legislative concern about the economic effects of indefinite “long tail” defect liability ***665 on the construction industry. Section 337.15 was a response to considerable expansion of California's common law of construction liability. Traditionally, a builder's sole liability for his finished product was on an express or implied warranty, which required privity between plaintiff and defendant, and the builder thus owed no duty to third persons once the owner accepted the improvement. (See, e.g., *Kolburn v. P.J. Walker Co.* (1940) 38 Cal.App.2d 545, 550, 101 P.2d 747.) In the 1950's and 1960's, these limitations gave way to the principle that a builder may be liable to those foreseeably injured or damaged by construction defects under theories of negligence (*Dow v. Holly Manufacturing Co.* (1958) 49 Cal.2d 720, 724–728, 321 P.2d 736; *Oakes v. McCarthy Co.* (1968) 267 Cal.App.2d 231, 247–249, 73 Cal.Rptr. 127 (*Oakes*)) and, at least in the case of a mass home developer, strict tort liability (*Kriegler v. Eichler Homes, Inc.* (1969) 269 Cal.App.2d 224, 226–229, 74 Cal.Rptr. 749).⁸

At the same time, courts increasingly recognized ways to extend the limitations periods for suits on construction defects. As indicated above, *375 1960's decisions confirmed that the time to sue on a construction warranty was tolled while promises or attempts to repair were pending. (*Aced, supra*, 55 Cal.2d 573, 585, 12 Cal.Rptr. 257, 360 P.2d 897; *Mack, supra*, 225 Cal.App.2d 583, 589, 37 Cal.Rptr. 466.) Contemporaneous cases held that the statutes of limitations for the burgeoning theories of construction defect recovery did not begin to run until the defects were or should have been discovered (see, e.g., *Aced, supra*, at pp. 583–584, 12 Cal.Rptr. 257, 360 P.2d 897 [warranty]; *Avner v. Longridge Estates* (1969) 272 Cal.App.2d 607, 616–618, 77 Cal.Rptr. 633 [strict liability]; *Oakes, supra*, 267 Cal.App.2d 231, 254–255, 73 Cal.Rptr. 127 [negligence]; see also *Regents, supra*, 21 Cal.3d 624, 630, 147 Cal.Rptr. 486, 581 P.2d 197) or while they were fraudulently concealed (e.g., *Balfour, Guthrie & Co. v. Hansen* (1964) 227 Cal.App.2d 173, 189, 38 Cal.Rptr. 525).

In 1967, the Legislature responded in part to these developments by adopting section 337.1. (Stats.1967, ch. 1326, § 1, p. 3157.) This statute provides that recovery for death, injury, or damage caused by a “patent deficiency” (§

337.1, subd. (a), italics added) in the design, supervision, or construction of an improvement to realty must be sought within *four* years after substantial completion of the improvement. (*Id.*, subds. (a), (c).) A “patent deficiency” is defined as one “apparent by reasonable inspection.” (*Id.*, subd. (e).) Notwithstanding the general rule, if an injury to person or property occurs in the fourth year after completion, suit may be brought within one year after the injury, but no ***666 more **527 than five years after completion. (*id.*, subd. (b).) the limitations period provided by section 337.1 cannot be asserted by one who actually possesses or controls the property at the time the deficiency causes the actionable damage or injury. (*Id.*, subd. (d).) Owner-occupied single family residences are exempt from the four-year limit. (*id.*, subd. (f).)

Despite this 1967 legislation, members of the building industry still faced exposure to liability for all defects in their past projects so long as these defects remained undiscovered and undiscoverable by reasonable inspection. On April 14, 1970, Assemblyman Powers introduced Assembly Bill No. 2528 (1970 Reg. Sess.), seeking to limit suits for latent construction defects to an *eight*-year period after substantial completion. After numerous amendments in committee, the bill was placed in the inactive file at the request of Assemblyman Powers, and it died there on August 21, 1970. (See Assem. Final Hist. (1970 Reg. Sess.) p. 761.)⁹

*376 In October 1970, the Assembly Interim Committee on Judiciary, chaired by Assemblyman Hayes, convened a public hearing “to determine if a statute of limitations can be drafted in actions for hidden (or latent) construction defects.” (Assem. Judiciary Interim Com. Hearing on Application of the Doctrine of Strict Tort Liability to Building Construction (Oct. 23, 1970) p. 1 (1970 Committee Hearing).) Building industry representatives testified at length that the trend toward expanded and time-extended defect liability was producing a risk for which insurance was available only at prohibitive cost, if at all, thus threatening the industry's economic health. (1970 Com. Hearing, pp. 4–51.)¹⁰

Appended to the 1970 Committee Hearing transcript was a survey of construction defect limitations periods adopted in other states. According to this survey, the applicable statutes of limitations ranged from four to twelve years after substantial completion of the projects in question. (1970 Com. Hearing, appen. B, pp. 11–12.)

On April 15, 1971, Assemblyman Hayes introduced Assembly Bill No. 2742 (1971 Reg. Sess.) (Assembly Bill No. 2742), which, as amended, became [section 337.15](#). (See Assem. Final Hist. (1971 Reg. Sess.) ***667 p. 873.) As originally drafted, Assembly Bill No. 2742 provided that suits for latent construction defects, other than those based on willful misconduct or fraudulent concealment, would be subject to a limitations period of *six* years after substantial completion. (Assem. Bill No. 2742, as introduced Apr. 15, 1971.) A subsequent Assembly amendment removed personal injury actions from the limitations period, increased the period to 10–years, and provided for cross-complaints beyond the 10–year period by persons sued directly within that time. (Assem. Amend. to Assem. Bill No. 2742, July 22, 1971.)¹¹

377** *528** The above-described survey of the laws of other states was made part of the legislative record of Assembly Bill No. 2742 in both the Assembly and the Senate. (See Assem. Com. on Judiciary, Analysis of Assem. Bill No. 2742, appen. B; Sen. Com. on Judiciary, Analysis of Assem. Bill No. 2742 as amended Oct. 22, 1971, pp. 1–4.) Analyses of the bill consistently described it as “bar[ring]” or “[p]rohibit[ing]” latent defect suits brought beyond the proposed limitations period. (Assem. Com. on Judiciary, Analysis of Assem. Bill No. 2742, p. 1; Sen. Com. on Judiciary, Analysis of Assem. Bill No. 2742 as amended Oct. 22, 1971, p. 1; Assemblyman James A. Hayes, letter to Governor Reagan (Nov. 9, 1971) requesting signature on Assem. Bill No. 2742; Enrolled Bill mem. to Governor on Assem. Bill No. 2742, Nov. 16, 1971.)

Thus the Legislature, faced with a developing body of common law on the subject, carefully considered how to provide a fair time to discover construction defects, and to sue upon such defects if necessary, while still protecting a vital industry from the damaging consequences of indefinite liability exposure. For latent deficiencies, the lawmakers rejected shorter periods in favor of a limit in the upper range of those previously adopted by other jurisdictions. Moreover, by placing exemptions in the latent defect statute for personal injury, willful misconduct, and fraudulent concealment, the legislators demonstrated an intent to pick and choose the particular exceptions they wished to allow and those particular aspects of the prior case law they wished to embrace. The implication arises that except as stated, and for important policy reasons, the Legislature meant the generous 10–year period set forth in [section 337.15](#) to be firm and final.

Significantly, the adopters of both [sections 337.1](#) and [337.15](#) knew that the case law had engrafted a “tolling for repairs” rule onto the four-year discovery-based limitations period for breach of a construction warranty. Yet, despite the Legislature's careful attention to other issues raised by prior court decisions, it did not provide a “repairs” extension in either [section 337.1](#) or [section 337.15](#).

On the contrary, the Legislature specified in [section 337.15](#) that *whatever limitations periods might otherwise apply*, “no action” for injury to property arising from latent construction defects “may be brought” more than 10 years after substantial completion of the project. (§ [337.15](#), subd. (a); see also *id.*, subd. (d); ***668 *Regents, supra*, 21 Cal.3d 624, 631, 147 Cal.Rptr. 486, 581 P.2d 197.) The inference arises that regardless of whatever *tolling rules* might otherwise apply *within* the 10–year ***378** period, the Legislature intended no such extension of the “absolute” (*Regents, supra*, at p. 631, 147 Cal.Rptr. 486, 581 P.2d 197) 10–year limit itself. The legislative failure to ratify tolling for repairs under these circumstances is another indication that a judicial doctrine extending the 10–year limitations period for this reason would contravene the intent of [section 337.15](#).

In one common circumstance, an equitable tolling rule would directly undermine the statutory purpose. As we have seen, [section 337.15](#) allows one sued directly within the statutory period to cross-complain for indemnity against another project participant, even if the statute of limitations for direct actions has by then expired, so long as the cross-complaint is filed before a trial date has been set. (§§ [337.15](#), subd. (c), [428.10](#), subd. (b), [428.50](#), subd.(b); *Valley Circle Estates, supra*, 33 Cal.3d 604, 608–615, 189 Cal.Rptr. 871, 659 P.2d 1160.)¹² Thus, potential ****529** indemnitors can never be entirely certain they are safe once the 10–year period passes. But they should generally be able to assume that any suit which may give rise to cross-complaints against them was filed within 10–years after substantial completion of the project.

A general rule that the limitations period is tolled for repairs would destroy such an assumption. As was emphasized in *FNB Mortgage, supra*, 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841, such a rule would allow “[a]n unsuspecting subcontractor [to] be sued for indemnity, long after the statute's 10–year limitations period had passed, and despite the absence of any action alleging defects within the 10–year period, simply because the indemnitee (the subsequent cross-complainant) was deemed to have tolled the 10–year

period [by offering or attempting to repair] and was thus subject to subsequent suit.” (*Id.* at p. 1133, 90 Cal.Rptr.2d 841.) The “unsuspecting subcontractor[s]” caught in this net might include architects and engineers who, as in the example provided during the 1970 Committee Hearing, had since retired, but were still forced to maintain expensive errors and omissions coverage to meet their potential “long tail” liability for alleged defects in projects completed many years in the past.

Hence, the purpose of section 337.15, as revealed by its history, weighs against a judicially imposed rule that the 10–year limitations period set forth in this statute is tolled for repairs. On the other hand, countervailing policies *379 of practicality and fairness do not compel such a rule. If the defendant’s acts or promises occurred well before expiration of the 10–year limit, an extension *at the end* of the limitations period is unnecessary to protect the plaintiff’s ***669 rights.¹³ And because the limitations period provided by section 337.15 is so “exceptionally long” (*Aas, supra*, 24 Cal.4th 627, 653, 101 Cal.Rptr.2d 718, 12 P.3d 1125), it indicates the Legislature’s effort to provide, within the strict statutory period itself, a reasonable time to discover, adjust, and, if necessary, sue upon latent defects. Given the particular considerations that led the Legislature in 1971 to seek a generous but firm cutoff date for construction defect lawsuits, further extension of the period by judicial fiat is not warranted.

This case contrasts starkly with those in which we found a special need for equitable tolling. In each prior instance, the *brevity* of the literal limitations period would otherwise have caused forfeiture of a cause of action, or other undue hardship, despite the plaintiff’s diligent efforts to pursue his claim in a correct and orderly way. In *Lambert, supra*, 53 Cal.3d 1072, 282 Cal.Rptr. 445, 811 P.2d 737, absent equitable tolling, literal application of the *two-year* statute of limitations for actions against a title insurer would have forced the insured “to defend the underlying [title] action, at [his] own expense, and *simultaneously* to prosecute—again at [his] own expense—a separate action against the title company for failure to defend.” (*Id.* at p. 1078, 282 Cal.Rptr. 445, 811 P.2d 737.) In *Prudential–LMI, supra*, 51 Cal.3d 674, 274 Cal.Rptr. 387, 798 P.2d 1230, the insured had only *one year* after inception of the loss to sue his insurer for coverage, but that period could easily run out while the insurer, having received a timely notice of loss, conducted the investigation necessary to determine whether the claim should be paid or denied. (*Id.* at pp. 687–693, 274 Cal.Rptr. 387, 798 P.2d 1230.)

**530 In *Bollinger, supra*, 25 Cal.2d 399, 154 P.2d 399, the insured *did* sue within the *15 months* allowed by the policy, but that action was dismissed, after the limitations period had expired, on a false technicality urged by the insurer. (*Id.* at pp. 404–411, 154 P.2d 399.) Similarly in *Addison, supra*, 21 Cal.3d 313, 146 Cal.Rptr. 224, 578 P.2d 941, the plaintiffs *did* sue in *federal* court within the *six-month* period for actions against public agencies. Just after this brief limitations period expired by its literal terms, the government defendant moved to dismiss the federal action, whereupon plaintiffs immediately filed their state court complaint. As plaintiffs feared, the federal court subsequently dismissed their federal causes of action and *380 declined to retain their pendent state claims, leaving them without a remedy unless equitable tolling was applied. (*Id.* at pp. 317–319, 146 Cal.Rptr. 224, 578 P.2d 941.)

Finally, in *Elkins, supra*, 12 Cal.3d 410, 115 Cal.Rptr. 641, 525 P.2d 81, the plaintiff, acting in good faith, first pursued a timely worker’s compensation remedy against the defendants, thereby foreclosing resort to tort litigation. After the *one-year* statute of limitations for personal injury actions had expired, the worker’s compensation referee found that the plaintiff was not the defendant’s “employee” within the meaning of the worker’s compensation ***670 statutes, and was thus not entitled to benefits. The plaintiff then promptly filed his court action. We applied the well-established California principle that “the running of the limitations period is tolled ‘[w]hen an injured person has several legal remedies and, reasonably and in good faith, pursues one.’ [Citations.]” (*Id.* at p. 414, 115 Cal.Rptr. 641, 525 P.2d 81.)

No similar issues are presented here. Because plaintiffs had *three* or *four* years *after discovery*, and up to *ten* years after the project’s completion, to bring their suits for latent construction defects, many of the concerns that might warrant equitable tolling are ameliorated. Indeed, were we to conclude that the generous limitations period of section 337.15 is equitably tolled for repairs, despite the absence of any specific indication that the 1971 Legislature so intended, the implication would arise that *all* statutes of limitations are similarly tolled or suspended in progress while the parties make sincere efforts to adjust their differences short of litigation. We find no such general principle in California law.

Plaintiffs and the dissent urge several reasons why section 337.15 should be equitably tolled for repairs. None is persuasive.

First, it is urged that if the Legislature had intended to disallow equitable tolling of [section 337.15](#), it would have done so expressly, as in sections 340.5 (health care malpractice) and 340.6, subdivision (a) (attorney malpractice; see *Laird, supra*, 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691; see also *Battuello, supra*, 64 Cal.App.4th 842, 847, 75 Cal.Rptr.2d 548 [§ 366.2; one-year limitations period for surviving action against deceased person]). But an *express* legislative ban on equitable tolling is not the only circumstance in which courts will decline to apply this judicially developed doctrine. As is explained above, they will also do so where, as here, tolling would contravene the legislative purpose. Of course, the no-tolling result we reach under [section 337.15](#) is *consistent* with our construction of the similar *but shorter* “two-step” statute of limitations (one year from discovery or four years from wrongful act or omission, whichever occurs first) for attorney malpractice. (§ 340.6, subd. (a); see *Laird, supra*, 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691.)

Next, plaintiffs and the dissent assert that the legislative history of [section 337.15](#) focuses exclusively upon the problem of a statute of limitations that ***381** *began* only when the *plaintiff discovered* the defect. There is no indication, plaintiffs assert, that the Legislature meant to preclude the *defendant* from tolling the limitations period, once begun, by his own voluntary action.

But while delayed discovery was an important issue, the legislators' concerns, as indicated above, were broader. They sought to ensure ample time to discover and sue upon latent construction defects, while still establishing a predictable period within which the construction and insurance industries must make provision for such suits. And though a defendant who promises or undertakes repairs might be said to “control” the time for ****531** suit *against him*, his conduct, as we have noted, would have consequences for unsuspecting coparticipants in the project, whose exposure to indemnity liability would thereby be extended.

Plaintiffs and the dissent emphasize our statement in *Regents, supra*, 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197, that [section 337.15](#) is not a “substantive limit upon the plaintiff's cause of action” (*Regents, supra*, at p. 640, 147 Cal.Rptr. 486, 581 P.2d 197), but merely an “ordinary, *****671** procedural statute of limitations” (*id.* at p. 641, 147 Cal.Rptr. 486, 581 P.2d 197) to which, they assert, equitable tolling may thus properly apply. However, their reliance on *Regents* is misplaced. The issue there was whether the

surety on a contractor's bond—then not among the persons specifically mentioned in the statute—nonetheless could claim the protection of [section 337.15](#)'s 10-year limitations period. The *Regents* majority answered that question no. (*Id.* at pp. 632–643, 147 Cal.Rptr. 486, 581 P.2d 197.) The dissenters argued that because [section 337.15](#) was a substantive limit on legal rights and duties, it precluded the plaintiff, in any suit brought after expiration of the 10-year period, from proving a contractor's breach of duty which the surety must make good. (*Regents, supra*, at pp. 644–649, 147 Cal.Rptr. 486, 581 P.2d 197 (conc. & dis. opn. of Clark, J.); see *id.* at p. 640, 147 Cal.Rptr. 486, 581 P.2d 197 (maj. opn.).) The majority rejected *that* contention (*id.* at pp. 640–642, 147 Cal.Rptr. 486, 581 P.2d 197), but nothing in the holding of *Regents* compels a conclusion that where [section 337.15](#) does apply, it should be subject to equitable tolling.¹⁴

Plaintiffs and the dissent note that the Legislature has not expressly disagreed with the equitable tolling rule set forth in *Cascade Gardens, supra*, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, and *Grange Debris, supra*, 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515 (but see *FNB Mortgage, supra*, 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841). Of course, the Legislature has not revisited [section 337.15](#) at all since 1981, well before these cases were decided.¹⁵ There are many reasons why the Legislature fails to address intervening judicial constructions of a statute, including inattention, press of ***382** other business, and trust in the courts to correct their own errors. (*People v. King* (1993) 5 Cal.4th 59, 77, 19 Cal.Rptr.2d 233, 851 P.2d 27; *County of Los Angeles v. Workers' Comp. Appeals Bd.* (1981) 30 Cal.3d 391, 404, 179 Cal.Rptr. 214, 637 P.2d 681.) Hence, “‘legislative inaction is a “‘weak reed upon which to lean.’”’” (*Harris v. Capital Growth Investors XIV* (1991) 52 Cal.3d 1142, 1156, 278 Cal.Rptr. 614, 805 P.2d 873, quoting *Troy Gold Industries, Ltd. v. Occupational Safety & Health Appeals Bd.* (1986) 187 Cal.App.3d 379, 391, fn. 6, 231 Cal.Rptr. 861.) Here, mere legislative silence fails to dissuade us from our conclusion that [section 337.15](#) is not subject to equitable tolling for repairs.

Plaintiffs suggest that equitable tolling for repairs protects homeowners from unscrupulous builders who might otherwise make false promises or “band-aid” repairs in order to forestall suit until after the 10-year period had passed. Tolling for repairs is also good policy, plaintiffs maintain, because it encourages resolution of construction defect disputes without resort to the courts. But a tolling rule seems just as likely to *discourage* a potential defendant from

undertaking voluntary remedial efforts before the limitations period expires. If his efforts failed, he would only have prolonged the already lengthy ***672 period during which he was exposed to suit.¹⁶

*383 **532 Moreover, if a plaintiff can show, in a particular case, that the defendant's promises or attempts to repair prevented a timely suit, the defendant may be equitably estopped from invoking the protection of the statute of limitations. (See discussion, *post.*) Thus, an automatic rule of equitable tolling is not necessary to counteract fraudulent assurances of repair.

We therefore conclude that the 10-year limitations period set forth in section 337.15 is not subject to tolling in progress while a potential defendant's promises or attempts to repair the defect are pending. The distinct question remains whether a defendant may nonetheless be equitably estopped to assert this statute of limitations if he prevented a timely suit by his conduct upon which the plaintiffs reasonably relied.¹⁷

2. Equitable estoppel.

Plaintiffs assert that even if equitable tolling does not apply, their first amended complaint states facts which should estop these particular defendants from relying on the limitations period of section 337.15. Plaintiffs invoke the venerable principle that “ [o]ne cannot justly or equitably lull his adversary into a false sense of security, and thereby cause his adversary to subject his claim to the bar of the statute of limitations, and then be permitted to plead the very delay caused by his course of conduct as a defense to the action when brought.” ***673 (*Carruth v. Fritch* (1950) 36 Cal.2d 426, 433, 224 P.2d 702, quoting *Howard v. West Jersey & S.S.R. Co.* (N.J.Ch.1928) 102 N.J. Eq. 517, 141 A. 755, 757–758.)

Equitable tolling and equitable estoppel are distinct doctrines. “ Tolling, strictly speaking, is concerned with the point at which the limitations period begins to run and with the circumstances in which the running of the limitations period may be suspended.... Equitable estoppel, however, ... comes into play only after the limitations period has run and addresses ... the circumstances in which a party will be estopped from asserting the statute of limitations as a defense to an admittedly untimely action because his conduct has induced another into forbearing suit within the applicable limitations period. [Equitable estoppel] is wholly independent of the limitations period itself and takes its life ... from

the equitable principle that no man [may] profit from his own wrongdoing in a court of justice.’ ” (*Battuello, supra*, 64 Cal.App.4th 842, 847–848, 75 Cal.Rptr.2d 548, quoting *Bomba v. W.L. Belvidere, Inc.* (7th Cir.1978) 579 F.2d 1067, 1070.) **533 Thus, equitable estoppel is *384 available even where the limitations statute at issue expressly precludes equitable tolling. (*Leasequip, Inc. v. Dapeer* (2002) 103 Cal.App.4th 394, 405–408, 126 Cal.Rptr.2d 782 [§ 340.6; attorney malpractice statute of limitations]; *Battuello, supra* [§ 366.2; special one-year limitations period for surviving actions against deceased person].)

One aspect of equitable estoppel is codified in Evidence Code section 623, which provides that “[w]henver a party has, by his own statement or conduct, intentionally and deliberately led another to believe a particular thing true and to act upon such belief, he is not, in any litigation arising out of such statement or conduct, permitted to contradict it.” (See *DRG/ Beverly Hills, Ltd. v. Chopstix Dim Sum Cafe & Takeout III, Ltd.* (1994) 30 Cal.App.4th 54, 60, 35 Cal.Rptr.2d 515.) But “ [a]n estoppel may arise although there was no designed fraud on the part of the person sought to be estopped. [Citation.] To create an equitable estoppel, “it is enough if the party has been induced to refrain from using such means or taking such action as lay in his power, by which he might have retrieved his position and saved himself from loss.” ... “... Where the delay in commencing action is induced by the conduct of the defendant it cannot be availed of by him as a defense.” ’ ” (*Vu v. Prudential Property & Casualty Ins. Co.* (2001) 26 Cal.4th 1142, 1152–1153, 113 Cal.Rptr.2d 70, 33 P.3d 487 (*Vu*), quoting *Benner v. Industrial Acc. Com.* (1945) 26 Cal.2d 346, 349–350, 159 P.2d 24, italics omitted; see also *Ginns v. Savage* (1964) 61 Cal.2d 520, 524–525, 39 Cal.Rptr. 377, 393 P.2d 689.)¹⁸

Accordingly, (1) if one potentially liable for a construction defect represents, while the limitations period is still running, that all actionable damage has been or will be repaired, thus making it unnecessary to sue, (2) the plaintiff reasonably relies on this representation to refrain from bringing a timely action, (3) the representation proves false after the limitations period has expired, and (4) the plaintiff proceeds diligently once the truth is discovered (cf. ***674 *Vu, supra*, 26 Cal.4th 1142, 1153, 113 Cal.Rptr.2d 70, 33 P.3d 487), the defendant may be equitably estopped to assert the statute of limitations as a defense to the action.¹⁹

*385 The Court of Appeal concluded that plaintiffs' first amended complaint adequately pled the prerequisites

of equitable estoppel. According to the Court of Appeal, “[plaintiffs] alleged in their complaint that Centex had repeatedly promised to repair the damage to their homes. Based on these allegations, [plaintiffs] argued Centex was equitably estopped to assert the statute of limitations as a defense because ... Centex's promises caused them to delay filing suit.... [T]hese allegations were sufficient to overcome a demurrer based on the statute of limitations contained in [section 337.15](#).”

We disagree. The complaint's sole allegation on this issue is “that *at various times* Defendants have attempted to make repairs ... or advised Plaintiffs that the defective windows were not defective and not to file a lawsuit,” but have not properly repaired the leaking windows and associated damage, and “are [therefore] estopped to assert that Plaintiffs have not commenced this action in a timely fashion.”

This is insufficient. Contrary to the Court of Appeal's reasoning, the complaint is devoid of any indication that defendants' conduct *actually and reasonably induced plaintiffs to forbear suing within the 10-year period of [section 337.15](#)*. There is no suggestion that ****534** the repair attempts alleged, if successful, would have obviated the need for suit. Moreover, for all that appears, the “various times” at which defendants' alleged conduct occurred were times well before the statute of limitations ran out, or even, as the trial court suggested, after it had expired. And there is no claim that the inadequacy of these repairs, or the falsity of defendants' alleged “no defect” representations, remained hidden until after the limitations period had passed.²⁰ Hence, plaintiffs have pled no facts indicating that defendants' conduct directly prevented them from filing their suit on time. Accordingly, the first amended complaint establishes no basis to estop defendants from asserting that plaintiffs' causes of action are barred by the 10-year statute of limitations.

3. Amendment of complaint.

As noted above, the trial court sustained defendants' demurrer to plaintiffs' first amended complaint without affording plaintiffs an opportunity to amend. The court found, among other things, that the complaint failed to state facts sufficient to estop defendants from asserting that the statute of limitations had expired. The court conceded that amendment might cure the purely factual ***386** deficiencies, but it ultimately reasoned that tolling for repairs was simply not available, as a matter of law, to extend the limitations period of [section 337.15](#).

****675** In reversing, the Court of Appeal determined that *both* tolling *and* estoppel were available, and that the first amended complaint was sufficient on both theories. We, on the other hand, have concluded that while [section 337.15](#)'s 10-year limitations period is not *tolled* for repairs, defendants might be *estopped* under particular circumstances to invoke this statute of limitations. However, we have agreed with the trial court that the current complaint fails to state sufficient facts to establish such an estoppel.

Without stressing the point, plaintiffs have urged at all stages that if their complaint is deficient, but could be remedied by additional factual allegations, a chance should be afforded to assert such facts. The question thus arises whether plaintiffs should be allowed an opportunity to amend to state facts sufficient to set forth an equitable estoppel. In the specific circumstances of this case, we conclude the answer is “no.”

Of course, “[i]t is axiomatic that if there is a reasonable possibility that a defect in the complaint can be cured by amendment ..., a demurrer should not be sustained without leave to amend. [Citations.]” (*Minsky v. City of Los Angeles* (1974) 11 Cal.3d 113, 118, 113 Cal.Rptr. 102, 520 P.2d 726.) But the particular history of this case persuades us there is no reasonable possibility plaintiffs can state credible facts to support an equitable estoppel.

We realize that after the trial court sustained defendants' demurrer to the first amended complaint—the ruling at issue here—plaintiffs did offer more specific estoppel allegations in a proposed second amended complaint. This proposed complaint made express claims that, from the time plaintiffs purchased their homes until expiration of the 10-year limitations period, defendants engaged in a pattern of falsely promising repairs, or making sham repairs they knew would fail, and then refused to respond further once the 10-year period had passed, all with the purpose and effect of inducing plaintiffs to forbear suing within the statutory time. The trial court rejected the proposed complaint, both as untimely and on the incorrect assumption that if [section 337.15](#) could not be *tolled* for repairs, equitable *estoppel* was equally unavailable.

But even if the new allegations of the proposed second amended complaint were technically sufficient to establish an estoppel, several circumstances negate any inference that these new assertions had a substantial basis in fact. In the first place, the gravamen of the new allegations—that defendants' promises and attempts to repair continued ****535**

throughout the entire 10–year *387 period, that plaintiffs were thereby induced to forbear suing until the period expired, and that defendants then abruptly refused further cooperation—must have been within plaintiffs' personal knowledge at the time they filed their lawsuit. No reason appears why these assertions, if true, were not presented sooner.

Doubt about the credibility of the new allegations is heightened by developments in this court. During oral argument, plaintiffs' counsel was asked what additional facts, not included in the first amended complaint, could be asserted to support a theory of equitable estoppel. At a minimum, counsel could have referred us to the claims set forth in the proposed second amended complaint. He did not do so. Instead, he responded only that repairs promised or attempted by defendants *at any time* during the 10–year period gave rise, as a matter of law, to a form of *implicit reliance* by plaintiffs that defects in the construction of plaintiffs' homes would be remedied. This, counsel argued, should extend the statute of limitations by ***676 a time equivalent to the period during which repairs were pending. In short, counsel simply reiterated a theory of equitable *tolling* which we have rejected in this opinion.

Under these circumstances, we are convinced there is no reasonable possibility plaintiffs can assert new, credible facts suggesting that defendants are equitably estopped to assert the 10–year statute of limitations for latent construction defects. Accordingly, no basis appears to allow a remand for purposes of amendment.²¹

*388 CONCLUSION

Equitable tolling does not apply to the 10–year statute of limitations set forth in [section 337.15](#). The Court of Appeal decisions in *Grange Debris Box & Wrecking Co. v. Superior Court*, *supra*, 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515, and *Cascade Gardens Homeowners Assn. v. McKellar & Associates*, *supra*, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, are disapproved to the extent they concluded otherwise. Moreover, plaintiffs have failed to plead facts that would equitably estop defendants from asserting this limitations period, and there appears no reasonable possibility the deficiency can be remedied by credible amendment of the complaint. The trial court thus correctly sustained defendants' demurrer to plaintiffs' first amended complaint without leave to amend, and dismissed the action. The Court of Appeal erred

by overturning the judgment of dismissal. The judgment of the Court of Appeal is therefore reversed.

GEORGE, C.J., CHIN, BROWN and MORENO, JJ., concur.

**536 Dissenting Opinion by WERDEGAR, J.

I respectfully dissent. I cannot join the majority in rejecting application of equitable tolling to the 10–year limitation on actions for latent construction defects ([Code Civ. Proc., § 337.15](#)).¹ Accordingly, I would affirm the judgment of the Court of Appeal. Second, while I agree with the majority that in an appropriate case a defendant may be equitably estopped to ***677 assert that [section 337.15](#)'s 10–year limitation has expired, I disagree that there is no reasonable possibility plaintiffs in this case can allege sufficient facts to establish such an estoppel. Consequently, I would allow plaintiffs an opportunity to amend their complaint in order to correct any deficiencies the majority purports to identify.

Tolling

Statutes of limitations are not so rigid as they are sometimes regarded. (*Bollinger v. National Fire Ins. Co.* (1944) 25 Cal.2d 399, 411, 154 P.2d 399.) It is well established that statutes of limitation are not to be applied inflexibly where equity and justice favor the application of equitable tolling, and suspension of the running of a particular statute will not frustrate its purpose of preventing surprise through the revival of stale claims. (See *Elkins v. Derby* (1974) 12 Cal.3d 410, 417–419, 115 Cal.Rptr. 641, 525 P.2d 81.) For instance, [t]he statute of limitations is tolled where one who has breached a warranty claims that the defect can be repaired and attempts to make repairs. (*Aced v. Hobbs–Sesack Plumbing Co.* (1961) 55 Cal.2d 573, 585, 12 Cal.Rptr. 257, 360 P.2d 897 (*Aced*).) Another established application of the general principle—today repudiated by the majority—has been that, *389 “[i]n cases involving construction defects ... the statute of limitations is tolled during each period the defendant attempts to repair the defect.” (3 Witkin, Cal. Procedure (4th ed. 1996) Actions, 684, p. 871.)

The majority argues that “the purpose of [section 337.15](#), as revealed by its history, weighs against a judicially imposed rule that the 10–year limitations period set forth in this statute is tolled for repairs. On the other hand, countervailing policies of practicality and fairness do not compel such a rule.” (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 668, 73 P.3d at p.

529.) I disagree. As Justice Richardson long ago explained in a unanimous opinion for this court, “the equitable tolling doctrine fosters the policy of the law of this state which favors avoiding forfeitures and allowing good faith litigants their day in court.” (*Addison v. State of California* (1978) 21 Cal.3d 313, 320–321, 146 Cal.Rptr. 224, 578 P.2d 941 (*Addison*).)

As its opinion nowhere specifies the elements of equitable tolling, the majority leaves the inaccurate impression that, unless we in this case categorically bar that remedy in construction defect cases, it will appear by judicial “fiat” (maj. opn., *ante*, 2 Cal.Rptr.3d at p. 668, 73 P.3d at p. 529) or happen automatically whenever “a potential defendant's promises or attempts to repair the defect are pending” (*id.* at p. 672, 73 P.3d at p. 532). The majority misdescribes the law. Courts do not enjoy unfettered discretion to toll a statute of limitations. Rather, “application of the doctrine of equitable tolling requires timely notice, and lack of prejudice, to the defendant, and reasonable and good faith conduct on the part of the plaintiff.” (*Addison, supra*, 21 Cal.3d at p. 319, 146 Cal.Rptr. 224, 578 P.2d 941.)

According to the majority, “the plain language of [section 337.15](#) suggests that the 10–year limitations period is not subject to extension for reasons not stated in the statute itself.” (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 525.) I discern no such suggestion. [Section 337.15](#) does not mention tolling, equitable or otherwise. The omission is significant; had the Legislature meant to preclude equitable tolling, it easily could have said so, as it has in other statutes of limitation. (See §§ 340.5 [“no event” shall toll limit on actions against health care providers except those specified], 340.6 [same for attorney malpractice actions], 366.2, subd. (b) ***678 [limit on actions on liability of a deceased person “shall not be tolled or extended for any reason” except as specified in certain code sections].)

**537 Thus, contrary to the majority, equitable tolling in this case is not inconsistent with the text of the statute. (See maj. opn., *ante*, 2 Cal.Rptr.3d at p. 662, 73 P.3d at p. 524.) The majority in any event is not actually relying on [section 337.15](#)'s plain language, but, rather, on its perception of that statute's “structure and tone” (maj. opn., *ante*, 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 525), which the majority characterizes as “stentorian” (*ibid.*). Such observations are at best irrelevant, since, as the majority *390 concedes, the tolling remedy at issue “is a general equitable one which operates independently of the literal wording of the Code of Civil Procedure.” (*Addison, supra*, 21 Cal.3d at p. 318, 146

Cal.Rptr. 224, 578 P.2d 941; see maj. opn., *ante*, 2 Cal.Rptr.3d at p. 661, 73 P.3d at p. 523.)

The majority also advances a legislative intent argument, based on the Legislature's asserted failure when enacting [section 337.15](#) to provide an express repairs extension, despite knowing that case law had earlier “engrafted a ‘tolling for repairs’ rule onto the four-year discovery-based limitations period for breach of a construction warranty” and its asserted “careful attention” to other (unspecified) issues raised by prior court decisions. (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 667, 73 P.3d at p. 528.) But in California it “is established that the running of the statute of limitations may be suspended by causes not mentioned in the statute itself” (*Bollinger v. National Fire Ins. Co., supra*, 25 Cal.2d at p. 411, 154 P.2d 399),² and the Legislature is presumed to have been aware of that principle when it enacted [section 337.15](#) (*People v. Seneca Ins. Co.* (2003) 29 Cal.4th 954, 972, 129 Cal.Rptr.2d 842, 62 P.3d 81).

Framing the legislative intent argument somewhat differently, the majority asserts the Legislature's silence respecting equitable tolling when enacting [section 337.15](#) bespeaks its intent to bar application of that long-established doctrine in this context. “We can rarely determine from the failure of the Legislature to pass a particular [provision] what the intent of the Legislature is with respect to existing law.” (*Ingersoll v. Palmer* (1987) 43 Cal.3d 1321, 1349, 241 Cal.Rptr. 42, 743 P.2d 1299.) For that reason, we should not presume the Legislature intended to overthrow long-established principles of law unless such intention is made clearly to appear either by express declaration or by necessary implication (*Juran v. Epstein* (1994) 23 Cal.App.4th 882, 896, 28 Cal.Rptr.2d 588.)

The majority does not deny the Legislature has acquiesced for many years in *Cascade Gardens Homeowners Assn. v. McKellar & Associates* (1987) 194 Cal.App.3d 1252, 240 Cal.Rptr. 113 (*Cascade Gardens*) and *Grange Debris Box & Wrecking Co. v. Superior Court* (1993) 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515 (*Grange Debris*), cases confirming that courts may apply the doctrine of equitable tolling to [section 337.15](#). (See *Cascade Gardens, supra*, at p. 1256, 240 Cal.Rptr. 113; *Grange Debris, supra*, at p. 1360, 20 Cal.Rptr.2d 515.) Sixteen years ago, *Cascade Gardens* held on the basis of “[c]lear authority” that “under certain circumstances” and where “principles of equity ***679 and justice ... allow,” [section 337.15](#) is subject to equitable tolling while repairs are undertaken. (*Cascade Gardens, supra*, at p. 1256, 240 Cal.Rptr. 113, citing *Aced, supra*, 55 Cal.2d at p.

585, 12 Cal.Rptr. 257, 360 P.2d 897; *391 *Mack v. Hugh W. Comstock Associates* (1964) 225 Cal.App.2d 583, 589–590, 37 Cal.Rptr. 466 (*Mack*), and *Southern Cal. Enterprises v. Walter Co.* (1947) 78 Cal.App.2d 750, 755, 178 P.2d 785 (*Southern Cal. Enterprises*).) As the majority concedes, the Legislature has never expressly disagreed with *Cascade Gardens* or taken any action to overrule or limit its holding. (See maj. opn., ante, 2 Cal.Rptr.3d at p. 671, 73 P.3d at p. 531.) Accordingly, it would be reasonable for us to presume the Legislature is aware of the judicial construction and approves of it. (See *People v. Williams* (2001) 26 Cal.4th 779, 789, 111 Cal.Rptr.2d 114, 29 P.3d 197; *People v. Hallner* (1954) 43 Cal.2d 715, 720, 277 P.2d 393.)

**538 The majority, however, seeks to repudiate *Cascade Gardens* on grounds that three cases on which that court relied are inapposite because they were breach of warranty cases that predate the adoption of section 337.15. (Maj. opn., ante, 2 Cal.Rptr.3d at p. 663, 73 P.3d at p. 524, discussing *Aced*, supra, 55 Cal.2d 573, 12 Cal.Rptr. 257, 360 P.2d 897; *Mack*, supra, 225 Cal.App.2d 583, 37 Cal.Rptr. 466, and *Southern Cal. Enterprises*, supra, 78 Cal.App.2d 750, 178 P.2d 785.) But that *Aced*, *Mack*, and *Southern Cal. Enterprises* were decided before section 337.15 was enacted is irrelevant, as *Cascade Gardens* relied on these cases not for any conclusion respecting section 337.15's legislative history or wording, but solely as authority for the proposition that “repairs, such as those undertaken by [the defendants there] toll statutes of limitations as a matter of law” (*Cascade Gardens*, supra, 194 Cal.App.3d at p. 1256, 240 Cal.Rptr. 113). The majority does not dispute that *Aced*, *Mack*, and *Southern Cal. Enterprises* so held.

The majority characterizes *Cascade Gardens* ' authorities as “narrowly concerned with how to apply the limitations period for express or implied warranties” (maj. opn., ante, 2 Cal.Rptr.3d at p. 663, 73 P.3d at p. 524), but that does not tell the whole story. While *Cascade Gardens* cited warranty cases, it did so not for peculiarly warranty-related principles, but, rather, as “cases involving [or discussing] construction defects, defective products, and other breaches of warranty [in which] the defendant attempts to repair the defect” (3 Witkin, Cal. Procedure, supra, Actions, 684, p. 871). For example, the *Mack* opinion expressly addressed tolling of other “Code of Civil Procedure sections ... relating to the tortious injury or damage to person or property” (*Mack*, supra, 225 Cal.App.2d at p. 589, 37 Cal.Rptr. 466 [considering “the application of these statutes” and concluding “the proper one to apply” “was tolled during the entire period when the

respondents attempted to repair the heating plant” involved in the case]; see also *Cascade Gardens*, supra, 194 Cal.App.3d at p. 1257, fn. 4, 240 Cal.Rptr. 113 [analogizing *Mack*].) In *Aced*, although we cited several cases showing that construction contracts “ordinarily ... give rise to an implied warranty” (*Aced*, supra, 55 Cal.2d at p. 582, 12 Cal.Rptr. 257, 360 P.2d 897), we also noted the rule that “[t]he statute of limitations is tolled when one who has breached a warranty claims that the defect can be repaired and attempts to make repairs.” (*Id.* at p. 585, 12 Cal.Rptr. 257, 360 P.2d 897.) And the Court of Appeal in *Southern Cal. Enterprises* actually was at pains to distinguish the case of the “ ‘typical warranty’ ” (*Southern Cal. Enterprises*, supra, 78 Cal.App.2d at p. 757, 178 P.2d 785) from the rule governing that case, which it *392 stated as: “ ‘if the seller promises that something shall happen ***680 or shall not happen to the goods within a specified future time, the promise though it may be called a warranty cannot be broken until that time has elapsed and until then the statute will not begin to run’ ” (*id.* at p. 758, 178 P.2d 785; see also *id.* at p. 757, 178 P.2d 785). In sum, the reasoning of *Cascade Gardens* and the warranty cases on which it relied—that promises to repair extend the limitations periods for suits on construction defects (maj. opn., ante, 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 526, describing, inter alia, *Aced* and *Mack*)—is fully applicable in this case.

Pointing to section 337.15's express exceptions, the majority invokes the maxim *inclusio unius est exclusio alterius*, apparently to suggest that, by including express statutory exceptions, the Legislature meant to displace established, generally applicable equitable exceptions. (See maj. opn., ante, 2 Cal.Rptr.3d at p. 664, 73 P.3d at 525.) The majority does not develop the argument, perhaps realizing that the [cited] maxim, while helpful in appropriate cases, is no magical incantation, nor does it refer to an immutable rule. (*California Fed. Savings Loan Assn. v. City of Los Angeles* (1995) 11 Cal.4th 342, 351, 45 Cal.Rptr.2d 279, 902 P.2d 297.) As the Court of Appeal pointed out, a recognized exception to the maxim arises when its application would conflict with well-established legal principles that the Legislature has not expressly repudiated. (*Juran v. Epstein*, supra, 23 Cal.App.4th at p. 896, 28 Cal.Rptr.2d 588; see also *Battuello v. Battuello* (1998) 64 Cal.App.4th 842, 848, 75 Cal.Rptr.2d 548.) Accordingly, as the Court of Appeal concluded, the presence of enumerated exceptions in **539 section 337.15 does not imply legislative intent to exclude equitable tolling.

Confirming trial courts' discretionary access to equitable tolling, contrary to the majority, would not undermine the legislative purposes underlying [section 337.15](#). (See maj. opn., *ante*, 2 Cal.Rptr.3d at pp. 664–668, 73 P.3d at pp. 525–528.) The majority's lengthy recitation of [section 337.15](#)'s legislative history confirms “the statute is the result of general legislative concern about the economic effects of indefinite ‘long tail’ defect liability on the construction industry” (maj. opn., *ante*, 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 526), but it ultimately does not support the majority's position. Plaintiffs argue persuasively that the Legislature's primary aim when enacting [section 337.15](#) was to eliminate generalized application of the “discovery rule” in construction defect litigation. Retention of equitable tolling would not undermine [section 337.15](#)'s impact on the perceived evils of that rule, because, as the majority acknowledges, a defendant who promises or undertakes repairs is generally able to control the time of any suit against it. (See maj. opn., *ante*, 2 Cal.Rptr.3d at p. 670, 73 P.3d at p. 530.)

Ultimately, the majority can point to but one circumstance—that involving the so-called unsuspecting subcontractor—in which it can credibly claim an equitable tolling rule would undermine the statutory purpose. (See maj. opn., ***393** *ante*, 2 Cal.Rptr.3d at p. 668, 73 P.3d at p. 528.) The majority's objection, however, depends on the questionable assumption that subcontractors responsible for defects generally will neither participate in nor be informed about repairs contractor defendants might promise or undertake. Common sense suggests that such a circumstance, if it ever occurs, is likely to be the exception. In any event, the majority does not persuade me this theoretical possibility should drive our construction of [section 337.15](#).

*****681** As we long have understood, [section 337.15](#) is an “ordinary statute of limitations, subject to the same rules ... as other statutes of limitations.” (*Regents of University of California v. Hartford Acc. Indem. Co.* (1978) 21 Cal.3d 624, 642, 147 Cal.Rptr. 486, 581 P.2d 197.) One such generally applicable rule has been that statutes of limitations may be subject to equitable tolling during periods of repair. (*Cascade Gardens, supra*, 194 Cal.App.3d at p. 1256, 240 Cal.Rptr. 113.) Given the Legislature's long-standing acquiescence in *Cascade Gardens* and its progeny, the absence of an express reference to equitable tolling in [section 337.15](#) affords no justification for barring that generally available remedy in construction defect cases. I conclude that equitable tolling of [section 337.15](#) to protect homeowners from unscrupulous builders and to encourage amicable resolution of construction

defect disputes should remain available in appropriate cases when plaintiffs can demonstrate the remedy's required elements.

Estoppel

I agree with the majority that a defendant whose conduct induces plaintiffs to refrain from filing suit within the statutory period may, depending on the circumstances, be equitably estopped to assert that [section 337.15](#)'s 10-year limitation on latent construction defect actions has expired. (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 659, 73 P.3d at p. 521.) The majority concludes that plaintiffs' first amended complaint alleges insufficient facts to establish such an estoppel. (*Id.* at p. 674, 73 P.3d at p. 533.) Assuming that conclusion is correct, I would allow plaintiffs an opportunity to amend their complaint.

The majority correctly notes that “plaintiffs did offer more specific estoppel allegations in a proposed second amended complaint. This proposed complaint made express claims that, from the time plaintiffs purchased their homes until expiration of the 10-year limitations period, defendants engaged in a pattern of falsely promising repairs, or making sham repairs they knew would fail, and then refused to respond further once the 10-year period had passed, all with the purpose and effect of inducing plaintiffs to forbear suing within the statutory time.” (Maj. opn., *ante*, 2 Cal.Rptr.3d at pp. 675–676, 73 P.3d at pp. 534–535.) “It is axiomatic that if there is a reasonable possibility that a ****540** defect in the complaint can be cured by amendment or that the pleading liberally construed can state a cause ***394** of action, a demurrer should not be sustained without leave to amend.” (*Minsky v. City of Los Angeles* (1974) 11 Cal.3d 113, 118, 113 Cal.Rptr. 102, 520 P.2d 726.)³ The majority acknowledges this axiom (see maj. opn., *ante*, 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534), but fails to apply it.

Conceding that plaintiffs' proposed allegations may be “technically sufficient to establish an estoppel,” the majority nevertheless denies plaintiffs that remedy, partly on the ground that plaintiffs' belated presentation of the proposed second amended complaint gives rise to doubt about the credibility of its allegations. (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 535.) But elsewhere the majority acknowledges that plaintiffs have urged “at *all stages* that if their complaint is deficient, but could be remedied by additional *****682** factual allegations, a chance should be

afforded to assert such facts.” (*Ibid.* at p. 675, 73 P.3d at p. 534, italics added.)

The record contains a declaration, submitted to the superior court by one of plaintiffs' counsel, stating that only five days *after* defendants' demurrer was granted without leave to amend did counsel become aware, through conversations with another attorney, of the facts plaintiffs proposed to allege in their second amended complaint. Moreover, we previously have stated, in a case where the defense of estoppel set out in the amendment was known for a considerable time before the trial, that the fact the new matter set up by the amendment was well known to the [party] when he filed his original [pleading] was no good reason why he should not have been permitted to amend. (*Tolbard v. Cline* (1919) 180 Cal. 240, 245, 180 P. 610; see also 49A Cal.Jur.3d (2002) Pleading, 224, p. 371.) The majority on the other hand cites no authority for its apparent implication that plaintiffs' failure to supply a reason why the second amended complaint was not “presented sooner” (maj. opn., *ante*, 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534) is grounds for denying them an opportunity to amend their complaint, nor do I know of any such authority. To the contrary, “[a]ny judge, at any time before or after commencement of trial, in the furtherance of justice, ... may allow the amendment of any pleading” (§ 576.)

The majority also professes doubt about the credibility of the new allegations for the reason that, when plaintiffs' counsel was asked at oral argument what additional facts, not included in the first amended complaint, could be asserted to support a theory of equitable estoppel, he responded that “repairs promised or attempted by defendants *at any time* during the 10-year period gave rise, as a matter of law, to a form of *implicit reliance* by plaintiffs,” thus reiterating a theory of equitable tolling, rather than specifically referring us to *395 the claims set forth in the proposed second amended

complaint. (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534.) The majority concludes that this omission and the proposed amendment's timing “negate any inference that these new assertions had a substantial basis in fact.” (*Ibid.*) The conclusion does not follow. After all, the majority does not claim that plaintiffs *abandoned* or *repudiated* the allegations of the proposed second amended complaint, nor, indeed, did plaintiffs do so.

I am aware of no requirement that an issue or position that has been briefed before this court must be reiterated at oral argument in order to be preserved, nor of any principle that counsel who is nonresponsive to the courts question concerning a position is deemed to have abandoned that position. In addressing the topic of reliance before us, plaintiffs certainly were entitled to argue implicit reliance and even to reiterate their tolling theory, without being deemed to abandon the alternative, and perfectly consistent, position respecting amendment that they have urged at all stages of this litigation— **541 viz., “that if their complaint is deficient, but could be remedied by additional factual allegations, a chance should be afforded to assert such facts.” (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534.) In accordance with our liberal rules respecting amendment of the pleadings (see, e.g., §§ 473, 576), I would afford plaintiffs that opportunity.

For the foregoing reasons, I dissent.

KENNARD, J., concurs.

All Citations

31 Cal.4th 363, 73 P.3d 517, 2 Cal.Rptr.3d 655, 03 Cal. Daily Op. Serv. 6914, 2003 Daily Journal D.A.R. 8638

Footnotes

- 1 All further unlabeled statutory references are to the Code of Civil Procedure.
- 2 Section 337.15 continues to apply fully to many construction projects, including all nonresidential projects, but certain categories of residential construction, including (1) common interest developments and (2) residential units first sold after January 1, 2003, are subject to separate, more recent legislation affecting the applicable limitations periods for suit upon latent defects in those projects. (Civ.Code, §§ 895 et seq., 941, 1375; see further discussion, *post*.) The homes at issue here were first sold before January 1, 2003, and no party has suggested they are part of a common interest development. Hence, as the parties do not dispute, section 337.15 applies to this case.
- 3 The trial court never expressly ruled on defendants' request for judicial notice of the November 1988 completion notices on plaintiffs' homes. However, as the trial court indicated, there seems no dispute that plaintiffs' suit is untimely under the 10-year statute of limitations except for the possibility of equitable tolling or equitable estoppel.

- 4 No other defendant has appeared on appeal, either in the Court of Appeal or in this court. The California Building Industry Association, the National Home Builders Association, and the Civil Justice Association of California have filed amicus curiae briefs in this court on behalf of Centex.
- 5 As the text indicates, tolling extends the limitations period *no matter when* the tolling event occurred. This produces generally fair results where, as in the usual equitable tolling situation, the underlying limitations period itself is quite short. (See text discussion, *ante* and *post*.) But where a lengthy limitations statute such as [section 337.15](#) is at issue, automatic tolling bears a far less direct relationship to fundamental fairness. The facts of [Cascade Gardens, supra, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113](#), demonstrate the point. There, a certificate of completion of a construction project was recorded on July 13, 1973. If not tolled, the 10–year limitations period of [section 337.15](#) would thus have expired on July 12, 1983. However, during the four-month period from January 1974 until April 1974, the contractor attempted repairs. The plaintiffs finally brought their suit on August 12, 1983. The Court of Appeal deemed the suit timely under [section 337.15](#) because the 1973–1974 repair efforts had postponed expiration of the 10–year period by four months, from *July to November 1983*. ([Cascade Gardens, supra, at pp. 1254–1258, 240 Cal.Rptr. 113](#).)
- 6 Although the dissent concedes that [Aced, Mack](#), and [Southern Cal. Enterprises](#) were “warranty cases” (dis. opn., *post*, 2 Cal.Rptr.3d at p. 679, 73 P.3d at p. 538), it insists [Cascade Gardens, supra, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113](#), properly cited those early decisions to support a general “tolling for repairs” rule that applies even against the later-adopted “absolute” 10–year limitations period of [section 337.15](#). We disagree. The dissent splices together isolated snippets from the early cases to suggest that their reasoning on tolling issues extended beyond warranty principles. But this strained treatment of the early authorities obscures their overall context. [Aced, Mack](#), and [Southern Cal. Enterprises](#) were *warranty cases in fact*, and they justified their holdings on the tolling-for-repairs issue by applying *warranty law* ([Aced, supra, 55 Cal.2d 573, 577, 582–586, 12 Cal.Rptr. 257, 360 P.2d 897](#); [Mack, supra, 225 Cal.App.2d 583, 588–590, 37 Cal.Rptr. 466](#); [Southern Cal. Enterprises, supra, 78 Cal.App.2d 750, 758–759, 178 P.2d 785](#)) to statutes of limitations not influenced by the special concerns that prompted enactment of [section 337.15](#) (see discussion, *post*).
- 7 In a decision rendered after both [Cascade Gardens, supra, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113](#), and [Grange Debris, supra, 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515](#), but before [FNB Mortgage, supra, 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841](#), the court in [A & B Painting & Drywall, Inc. v. Superior Court](#) (1994) 25 Cal.App.4th 349, 30 Cal.Rptr.2d 418 refused to extend the tolling rule of [Cascade Gardens](#) to a situation in which the repairs were made by someone other than the defendant. ([A & B Painting, supra, at pp. 354–355, 30 Cal.Rptr.2d 418](#).)
- 8 In recent cases, decided long after adoption of [section 337.15](#), we have refined the respective purviews of warranty and tort theories as they apply to construction defects. Under the so-called economic loss rule, tort recovery is available only insofar as a defect causes personal injury or damage to *property other than the defective product*, while “the law of contractual warranty governs damage to the product itself.” ([Jimenez v. Superior Court](#) (2002) 29 Cal.4th 473, 483, 127 Cal.Rptr.2d 614, 58 P.3d 450; [Aas v. Superior Court](#) (2000) 24 Cal.4th 627, 639, 101 Cal.Rptr.2d 718, 12 P.3d 1125 (Aas).) The applicability of those theories appears further affected by new legislation applicable to individual housing units first sold on or after January 1, 2003. (See [Civ.Code, § 895 et seq.](#), as enacted by Stats.2002, ch. 722, § 3.) The new law sets detailed quality and performance standards for new residential construction and provides that a homeowner may sue for (1) specific violations of the statutory standards ([Civ.Code, § 896](#)) and (2) any other “function or component of [the] structure,” to the extent inadvertently omitted from the standards, that causes damage (*id.*, § 897).
- 9 Centex asked us to take judicial notice of various legislative materials, including documents from the enactment histories of (1) Assembly Bill No. 2528 (1970 Reg. Sess.) (see text discussion, *ante*), (2) Assembly Bill No. 2742 (1971 Reg. Sess.), which became [section 337.15](#), and (3) Assembly Bill No. 312 (1979–1980 Reg. Sess.), which amended [section 337.15](#), in response to our decision in [Regents, supra, 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197](#), to provide that the sureties of persons involved in construction projects are also protected by the 10–year limitations period for latent construction defects. It is not clear that we must take judicial notice of these materials in order to consider them. However, they are relevant to the legal arguments Centex advances, and they appear to be proper subjects of judicial notice. ([Evid.Code, §§ 452](#), subd. (c) [official acts of legislative, executive, and judicial departments of the United States or any state], 459.) Plaintiffs did not object, and we therefore granted the request for judicial notice.
- 10 For example, Jack Barrish, President of the Structural Engineers of California, testified about “an architect in Sacramento [who] retired some five years ago and is still having to carry coverage. There is no statute of limitations. So in order to protect his estate, he is still carrying insurance covering his old projects.” (1970 Com. Hearing, p. 48.) Barrish further testified that “[i]n my particular case, I was forced to take out coverage with a new carrier and for half the coverage I pay more than three times the rate, because of the exposure the engineer has. [¶] We have been informed by our factors ...

that were the statute of limitations to be passed, then there would be more coverage at less rate for more people against possible suits of this nature.” (*Ibid.*)

- 11 As originally enacted in 1971, [section 337.15](#) measured the limitations period from the time of “substantial completion” of the improvement, but did not define “substantial completion.” Subdivision (g), added in 1981 (Stats.1981, ch. 88, § 1, pp. 204–205), modified the measurement period to provide that the 10–year period would commence upon “substantial completion ..., *but not later than* the date of one of the following, *whichever first occurs*: [¶] (1) The date of final inspection by the applicable public agency. [¶] (2) The date of recordation of a valid notice of completion. [¶] (3) The date of use or occupation of the improvement. [¶] (4) One year after termination or cessation of work on the improvement.” (Italics added.)
- 12 As this court recognized in [Valley Circle Estates, supra](#), 33 Cal.3d 604, 189 Cal.Rptr. 871, 659 P.2d 1160, the rule of [section 337.15](#), subdivision (c), allowing cross-complaints for indemnity beyond the 10–year period, is consistent with the common law rule that an action for equitable indemnity does not accrue, for purposes of the statute of limitations, until the indemnitee pays a judgment or settlement that entitles him to indemnity, and that a tort defendant retains the right to seek equitable indemnity from another tortfeasor even if the plaintiff’s action against the cross-defendant is barred. ([Valley Circle Estates, supra](#), at p. 611, 189 Cal.Rptr. 871, 659 P.2d 1160; see also [People ex rel. Department of Transportation v. Superior Court](#) (1980) 26 Cal.3d 744, 748, 751, 163 Cal.Rptr. 585, 608 P.2d 673, and cases there cited; [Watts v. Crocker–Citizens National Bank](#) (1982) 132 Cal.App.3d 516, 524, 183 Cal.Rptr. 304.)
- 13 At oral argument, plaintiffs’ counsel made clear their position that the 10–year limitations period should automatically be tolled, or suspended in progress, during any time a defendant’s promises or efforts to repair were pending, *no matter when these events occurred*. In support of this view, counsel urged that a homeowner’s “acceptance” of the defendant’s promises or repairs *at any time* during the 10–year limitations period is a form of *implicit reliance* which justifies a corresponding additional time, at the end of the limitations period, to determine whether the repairs were successful. But a policy judgment of that magnitude is for the Legislature, not the courts. For reasons we have detailed, we cannot conclude the Legislature made such a judgment when it adopted [section 337.15](#).
- 14 The year after [Regents, supra](#), 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197, was decided, the Legislature obviated the holding of that case, at least for the future, by expressly extending the protection of [section 337.15](#) to sureties. (Stats.1979, ch. 571, § 1, p. 1797.)
- 15 Plaintiffs insist that [section 337.15](#) has been amended “on numerous occasions” since [Cascade Gardens, supra](#), 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, was decided, but this simply is not so. [Section 337.15](#) was last amended by Statutes 1981, chapter 88, section 1, pages 204–205. [Cascade Gardens](#) was decided six years later, in 1987.
- 16 As evidence that the Legislature supports the principle of tolling for repairs in construction defect cases, plaintiffs direct our attention to new [Civil Code section 895 et seq.](#), adopted in 2002. (See fns. 2, 8, *ante*.) This statutory scheme comprehensively revises the law applicable to construction defect litigation for individual residential units, other than condominium conversions, first sold after January 1, 2003. ([Civ.Code, §§ 896, 938](#).) Where it applies, the new scheme expressly *supersedes* [section 337.15](#), though it retains the basic premise that suit may commence no later than 10–years after substantial completion of the project. ([Civ.Code, § 941](#), subs.(a), (d).) Among other things, the new law *requires*, as a prerequisite to suit, elaborate “nonadversarial procedure[s]” to try to resolve the dispute (*id.*, §§ 910 et seq., 914), including a prelitigation opportunity for the builder to effect repairs (*id.*, §§ 917–928). [Civil Code section 927](#) states that if the statute of limitations runs *during the repair process*, the time for filing a suit for an actionable defect, or for inadequate repairs, is tolled from the date the claimant originally notified the builder of his claim until 100 days after the repair process is complete. The new scheme further provides, in cryptic fashion, that “[e]xisting statutory and decisional law regarding tolling of the statute of limitations shall apply to the time periods for filing an action ... under this title,” but that *repairs shall not toll the limitations period except as specifically provided in section 927*. ([Civ.Code, § 941](#), subd. (e).) [Civil Code section 895 et seq.](#) demonstrates only that the Legislature knows how to toll the statute of limitations for repairs when it wishes to do so. Moreover, a 2002 statute that provides for a limited form of *statutory* tolling while *mandatory* dispute resolution efforts proceed, but otherwise explicitly *excludes* tolling for repairs, affords little support for the premise that *equitable* tolling should apply under a 1971 statute of limitations to a defendant’s *voluntary* efforts to remedy alleged defects. We reach a similar conclusion with respect to [Civil Code section 1375](#), specially applicable to common interest developments, which includes somewhat similar express provisions for tolling while *mandatory* dispute adjustment procedures go forward in timely fashion. (*Id.*, subs. (a), (c).)
- 17 We need not and do not decide here whether [section 337.15](#) is subject to the several separate *statutes* that specify when certain limitations periods will be tolled. (E.g., §§ 351 [defendant’s absence from state], 352 [plaintiff’s minority or

insanity], 352.1 [plaintiff's incarceration], 352.5 [pending restitution order against defendant], 354 [plaintiff's disability by virtue of state of war], 356 [injunction against commencement of action].)

- 18 The defendant's statement or conduct must amount to a misrepresentation bearing on the *necessity* of bringing a timely suit; the defendant's mere denial of *legal liability* does not set up an estoppel. (*Vu, supra*, 26 Cal.4th 1142, 1149–1153, 113 Cal.Rptr.2d 70, 33 P.3d 487; *Neff v. New York Life Ins. Co.* (1947) 30 Cal.2d 165, 174–175, 180 P.2d 900.)
- 19 Because equitable estoppel, unlike equitable tolling, operates independently of the limitations period itself (see text discussion, *ante*), it is not clear that a defendant who is directly sued beyond the 10–year period of [section 337.15](#), but is estopped by his personal conduct from asserting the statutory bar, may thereafter cross-complain against another project participant for indemnity pursuant to subdivision (c) of the statute. That issue is not before us, and we do not address it.
- 20 As indicated above (see fn. 18, *ante*), to the extent defendants' alleged advice that the windows were not defective, and that a lawsuit should not be filed, was a mere *denial of defendants' liability*, rather than a *representation of fact*, it was insufficient to establish an estoppel to assert the statute of limitations. (*Vu, supra*, 26 Cal.4th 1142, 1149–1153, 113 Cal.Rptr.2d 70, 33 P.3d 487.)
- 21 There is no ground to conclude that plaintiffs simply have not understood the distinction between tolling and estoppel, as they apply to this case. Though tolling was the principal issue debated in the trial court, and though the parties sometimes referred to the two theories as one, the record nonetheless suggests plaintiffs were aware of estoppel as a distinct concept, and understood it was prudent to allege facts supporting that theory. The first amended complaint alleged, *inter alia*, that defendants made promises to repair, assured plaintiffs they were construction experts and would remedy all defects, and “advised [p]laintiffs ... not to file a lawsuit.” As a result, the complaint asserted, defendants were “estopped” to assert the action was untimely. In opposition to defendants' demurrer, plaintiffs urged that the first amended complaint sufficiently alleged plaintiffs' “[r]eliance” on defendants' promises and attempts to repair, and that defendants' conduct, as alleged, “estopped” them from invoking the statute of limitations.

In papers supporting their later motion to amend, plaintiffs' counsel represented that they had recently learned of defendants' similar conduct in *other* residential developments, whereby defendants “wilfully lulled homeowners into a sense of security [by promising repairs] until [d]efendants were confident that these homeowners would refrain from instituting litigation until the applicable statute of limitations had expired.” This language suggests counsel understood the essential elements of equitable estoppel, while failing to explain why similarly relevant allegations *within plaintiffs' personal knowledge* were not presented sooner, if true.

Finally, plaintiffs' appellate briefs, both in the Court of Appeal and in this court, indicate their full awareness that tolling and estoppel are distinct theories. Hence, there could have been no confusion about the import of this court's question at oral argument.

- 1 All further statutory references are to the Code of Civil Procedure.
- 2 The majority inferentially acknowledges the point in recognizing the possibility that “[section 337.15](#) is subject to the several separate *statutes* [not mentioned in [section 337.15](#)] that specify when certain limitations periods will be tolled.” (Maj. opn., *ante*, 2 Cal.Rptr.3d at p. 672, fn. 17, 73 P.3d at p. 532, fn. 17.)
- 3 As the majority concedes, the trial court found there was a possibility that amendment could cure any factual deficiencies in plaintiffs' estoppel allegations. (See maj. opn., *ante*, 2 Cal.Rptr.3d at pp. 675–676, 73 P.3d at pp. 534–535) The majority also concedes amendment “might cure” any factual deficiencies in plaintiffs' allegations respecting equitable tolling. (*Id.* at p. 660, 73 P.3d at p. 522.)