

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

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**MARVIN ROY FELDMAN KARPA,  
CLAIMANT**

**VS.**

**THE UNITED MEXICAN STATES,  
RESPONDENT**

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**SECOND SUBMISSION OF CANADA  
PURSUANT TO NAFTA ARTICLE 1128**

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## Introduction

1. NAFTA Article 1128 entitles a Party to the NAFTA to make submissions on a question of interpretation of the NAFTA. On June 5, 2001, Canada notified the Tribunal and the disputing parties that it intended to make submissions to the Tribunal on certain issues raised by the disputing parties in this phase of the arbitration.<sup>1</sup>
2. This submission is not intended to address all interpretative issues that may arise in this proceeding. To the extent that it does not address certain issues, Canada's silence should not be taken to constitute concurrence or disagreement with the positions advanced by the disputing parties.
3. Canada takes no position on any particular issues of fact or on how the interpretations it submits below apply to the facts of this case.

## General Principles of Interpretation

4. NAFTA Article 1131 stipulates that, "[a] Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law." The applicable rules of international law include the *Vienna Convention on the Law of Treaties*<sup>2</sup> ("*Vienna Convention*"), which is generally accepted as reflecting customary international law on the interpretation of treaties.
5. The first general rule of interpretation in the *Vienna Convention* requires that the language of a treaty be interpreted in good faith, in accordance with its ordinary meaning. It must be interpreted in the context of the object and purpose of the Treaty as a whole, as disclosed by its text and annexes.<sup>3</sup>
6. Thus, words used in NAFTA Chapter Eleven are to be interpreted according to their ordinary meaning in light of the object and purpose of the NAFTA as a whole. Tribunals arbitrating NAFTA Chapter Eleven claims to date have accepted the *Vienna Convention* as an applicable rule of international law within the meaning of NAFTA Article 1131.<sup>4</sup>

<sup>1</sup> Canada made its first submission to the Tribunal pursuant to NAFTA Article 1128 on October 6, 2000. This submission dealt with certain jurisdictional issues before the Tribunal at that time.

<sup>2</sup> *Vienna Convention on the Law of Treaties*, May 23, 1969, 1155 U.N.T.S. 331 (entered into force January 27, 1980). (Tab 1)

<sup>3</sup> *Vienna Convention*, Article 31(1): General rule of interpretation  
 "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." (See also the remainder of Article 31 and Articles 32 and 33).

<sup>4</sup> *Ibid.* See for example, *Pope & Talbot, Inc. v. Government of Canada*, Interim Award dated June 26, 2000 at paras 65-66 and *S.D. Myers v. Government of Canada*, Partial Award dated November 13, 2000 at paras 200-3. (Tab 2)

7. Article 31(3)(b) of the *Vienna Convention* is of particular relevance in the context of interpretations of NAFTA provisions in respect of which all three NAFTA Parties are in agreement. Such agreements on interpretation may be a matter of public record or may be evidenced through submissions pursuant to NAFTA Article 1128. The NAFTA Parties agree that such interpretations are authoritative.<sup>5</sup>
8. When interpreting the NAFTA, tribunals should recall that the NAFTA is a treaty among three Parties, namely the sovereign states of the United Mexican States, the United States of America and Canada. The obligations undertaken by the three Parties, including those under NAFTA Chapter Eleven obligations, are owed by the Parties to one another and are subject to the dispute settlement procedures in NAFTA Chapter Twenty. They are not owed directly to individual investors. Nor do investors derive any rights from obligations owed to the Party of which they are nationals. Rather, the disputing investor must prove that the Party claimed against has breached an obligation owed to another Party under Section A<sup>6</sup> and that loss or damage has thereby been incurred.<sup>7</sup>

#### **Article 1110 (Expropriation and Compensation)**

##### *Applicability of Iran- U.S. Claims Tribunal Decisions to the Interpretation of NAFTA Article 1110*

9. In its Memorial the Claimant appears to suggest to this Tribunal that mere interference by a state in the use of property or with the enjoyment of its benefits constitutes an expropriation for purposes of NAFTA Article 1110 by relying upon decisions of the Iran-U.S. Claims Tribunal.<sup>8</sup>
10. Canada agrees with Mexico that reliance on the decisions of the Iran-U.S. Claims Tribunal to support this proposition is misplaced. The NAFTA Parties have in various NAFTA Chapter 11 cases stressed the need for caution when referring to Iran-U.S. Claims Tribunal decisions. There are two principal

<sup>5</sup> Reply Memorial of the Respondent United States of America in *Methanex v. USA* on Jurisdiction, Admissibility and the Proposed Amendment (hereinafter "U.S. Reply Memorial") dated April 12, 2001 at p. 24; Mexico's 1128 Submission in *Methanex v. USA* dated May 15, 2001 at para 1. Memorial on Jurisdiction and Admissibility of Respondent United States of America in *Methanex v. USA* (hereinafter "U.S. Memorial") dated November 13, 2000 at p.13. (Tab 3)

<sup>6</sup> *Desona v. United Mexican States*, November 1, 1999, ICSID ARB (AF)/97/2 (NAFTA Arbitral Tribunal), para. 84 where the Tribunal noted that the Claimants were required to "point to a violation of an obligation established in Section A of Chapter Eleven attributable to the Government of Mexico." (Tab 4)

<sup>7</sup> NAFTA Articles 1116(1) and 1117(1).

<sup>8</sup> Feldman Memorial at paragraph 155, footnote 51, paragraph 161, footnote 61, and paragraph 220, footnote 120.

reasons for this: (1) the Algiers Accord<sup>9</sup> establishing the Iran-U.S. Claims Tribunal granted the Tribunal broad authority to consider more than whether there had been expropriation of property. Its mandate was to decide claims that arose "out of debts, contracts...expropriation or *other measures affecting property rights*"; and (2) the Iran-U.S. Claims Tribunal dealt with actions taken in the context of revolutionary upheaval and the coup that overthrew the Shah of Iran.<sup>10</sup> [emphasis added]

11. The need for caution in relying on decisions of the Iran-U.S. Claims Tribunal for purposes of considering the scope of expropriation at international law is noted by Somarajah:

- (a) The awards of the Iran-U.S. Claims tribunal have been a fruitful recent source for the identification of such takings ["indirect takings", or "disguised" or "creeping expropriation"]. But the Iran-U.S. Claims Tribunal dealt with takings that took place in the context of a revolutionary upheaval and the propositions the tribunal formulated may not have relevance outside the context of the events that attended the Iranian upheaval following the overthrow of the Shah of Iran. Also, one has to be cautious in the making of any generalisation on the basis of dicta in the awards of this tribunal as its constituent documents gave the tribunal power to deal not only with direct takings of physical assets but "all measures affecting property rights". *It is clear that such a wide definition of taking will not be acceptable in international law for the simple reason that many normal activities of states, such as taxation, affect property rights and cannot be expected to give rise to international concern.*<sup>11</sup> [emphasis added]

12. The NAFTA Parties have made it clear in their respective submissions before various Chapter 11 Tribunals that Article 1110 does not give rise to liability beyond the customary principles of international law of expropriation. Mere interference with an investment's use or enjoyment of the benefits associated with property is not the standard for expropriation at international law. There

<sup>9</sup> *Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States and the Government of the Islamic Republic of Iran ("Claims Settlement Declaration")* January 19, 1981, (1981-1982) 1 Iran-U.S. C.T.R. 9. (Tab 5)

<sup>10</sup> "An international arbitral tribunal (the Iran-U.S. Claims Tribunal) is hereby established for the purpose of deciding claims of nationals of the United States against Iran and claims of nationals of Iran against the United States, and any counterclaim which arises out of the same contract, transaction, or occurrence that constitutes the subject matter of that national's claim, if such claims and counterclaims are outstanding on the date of this agreement, whether or not filed with any court, and arise out of debts, contracts (including transactions which are the subject of letters of credit or bank guarantees), *expropriation or other measures affecting property rights...*" [emphasis added]

<sup>11</sup> M. Somarajah, *The International Law on Foreign Investment*, (Cambridge: Cambridge University Press 1994), pp. 282-3 (footnotes omitted). (Tab 6)

must be a substantial deprivation of an investment's fundamental ownership rights in order to find expropriation.

13. That the concept of expropriation under NAFTA Article 1110 does not go beyond the customary principles of international law of expropriation and that reliance on decisions of the Iran-U.S. Claims Tribunal is misplaced in so far as they are used to suggest that mere interference with an investment may amount to an expropriation under NAFTA has been recognized by the NAFTA Chapter 11 *Pope & Talbot* Tribunal in its Interim Award dated June 26, 2000. To this effect, the *Pope & Talbot* Tribunal held:

The Tribunal is unable to accept the Investor's reading of Article 1110. "Tantamount" means nothing more than equivalent. Something that is equivalent to something else cannot logically encompass more. No authority cited by the Investor supports a contrary conclusion. References to the decisions of the Iran-U.S. Claims Tribunal ignore the fact that that tribunal's mandate expressly extends beyond expropriation to include "other measures affecting property rights". And, to the extent the Investor is correct in urging that the comments of Dolzer and Stevens suggest that measures "tantamount" to expropriation can encompass restraints less severe than expropriation itself (creeping or otherwise), those comments would not be well-founded under a reasonable interpretation of the treaties that the authors analyze.<sup>12</sup>

14. Therefore, based on the above reasons, Canada submits that no reliance may be placed on the Iran-U.S. Claims Tribunal decisions to support a lesser standard for determining whether a measure constitutes expropriation under NAFTA.

*The Scope and Content of U.S. Restatement and its Applicability to the Interpretation of NAFTA Article 1110*

15. Canada agrees with Mexico that the *Restatement of the Law (Third) of the Foreign Relations Law of the United States* is an important source of learned commentary of American views on international law. However, it is not necessarily indicative of the state of international law accepted by the international community. Nor is it restricted to addressing issues of expropriation.

<sup>12</sup> *Pope & Talbot, Inc. v. Government of Canada*, Interim Award, June 26, 2000, at paragraph 104 (footnotes omitted). The NAFTA Chapter 11 Tribunal in *S.D. Myers, Inc. v. Government of Canada*, at paragraph 286 of its Partial Award on Liability, dated November 13, 2000, agreed with the *Pope & Talbot* Tribunal that NAFTA Article 110 does not go beyond the customary international law of expropriation. (Tab 7)

16. Therefore, to the extent that the U.S. *Restatement* differs in scope and content from NAFTA Article 1110 or addresses matters beyond expropriation, it can not, as the Claimant has done, be used to expand the concept of expropriation under NAFTA.
17. The Claimant has not given sufficient attention to the differences between the *Restatement's* treatment of general international law on economic injuries to aliens and the actual wording of NAFTA Article 1110 which limits liability and compensation for expropriations recognized under customary international law.<sup>13</sup>
18. Subparagraphs (2) and (3) of Section 712 of the *Restatement* have no equivalent in NAFTA Article 1110. Moreover, these subparagraphs of the *Restatement* do not address expropriation, as suggested by the Claimant, but address economic injury to aliens that may, according to U.S. commentators, result from a repudiation or breach by the State of a contract and other arbitrary or discriminatory acts or omissions by the State that impair property or other economic interests.
19. As Mexico correctly points out the separateness of these different forms of economic injury to aliens is made clear in the commentary to the *Restatement*.<sup>14</sup> By merging separate forms of economic injury into expropriation, the Claimant is seeking to expand the scope of NAFTA Article 1110.<sup>15</sup> Such an expansion, Canada submits, is clearly not supported by the wording of NAFTA Article 1110 and does not reflect the intent of the NAFTA Parties.

#### **Article 1139 - definition of "investment"**

20. The disputing parties raise a question of interpretation respecting the definition of "investment" found in NAFTA Article 1139. The Claimant submits that CEMSA and CEMSA's business activities, including its business of exporting cigarettes constitute an investment for purposes of NAFTA Chapter 11.<sup>16</sup> Mexico submits that the investment's cigarette export business does not in and of itself constitute an investment under NAFTA Article 1139.<sup>17</sup>

<sup>13</sup> Feldman Memorial at paragraph 151.

<sup>14</sup> Mexico's Counter-Memorial at paragraphs 338 and 341.

<sup>15</sup> To this effect, comment g to the *Restatement*, when read in its entirety, explicitly provides that it applies to subsection (1) of Section 712. It does not as may be inferred from the Claimant's Memorial apply to the whole of Section 712. Moreover, the Reporter's Note 11 to the *Restatement* expressly states that paragraph 3 of Section 712 is intended to capture State actions that are unfair, unreasonable and inflict serious injury to established right of foreign nationals but falling short of an act that would constitute an expropriation.

<sup>16</sup> Feldman Memorial, paragraph 142 and 145.

<sup>17</sup> Mexico's Counter-Memorial, paragraphs 323-325.

21. Article 1139 lists eight legal interests that are to be considered an investment for the purposes of NAFTA Chapter Eleven. Only those legal interests listed in the definition of the word "investment" are protected through the obligations set out in Section A of NAFTA Chapter Eleven.
22. The NAFTA Parties have expressly recognized that the definition of "investment" in NAFTA Article 1139 is exhaustive, not illustrative.<sup>18</sup> This has also been recognized by at least by one noted commentator, Mr. Antonio Parra, Deputy Secretary General of the International Centre for the Settlement of Investment Disputes (ICSID).<sup>19</sup>
23. The Claimant relies on the *Pope & Talbot* Interim Award of June 6, 2000 equating access to the market of another NAFTA Party with intangible property to support its expansive interpretation of NAFTA Article 1139.
24. Canada submits that the tribunal arbitrating *Pope & Talbot, Inc. v. Canada*, erred in equating "access to the ... market [of a NAFTA Party]" to intangible property.<sup>20</sup> The fundamental characteristics of property, be it tangible or intangible, include the ability to acquire, own and use that property at the exclusion of others. Access to the market of another NAFTA Party is not something that can be owned and used by an investor to the exclusion of others and therefore lacks the fundamental characteristics of property.
25. Examples of intangible property rights recognised at law include trademarks, copyrights, patents and contract rights. Intangible property is capable of being acquired and owned by a person. An owner of intangible property is able to exclude others from its use.<sup>21</sup>
26. Therefore, to the extent that the Claimant argues that CEMSA's ability to export is a property interest protected by NAFTA<sup>22</sup>, this should, in Canada's view, be rejected for the aforementioned reasons.

#### **Article 2103 (Taxation)**

27. Canada generally agrees with the position of Mexico expressed in paragraphs 45 to 55 of its Counter-memorial regarding the limits imposed by the NAFTA on a tribunal's jurisdiction *ratione materiae* with respect to taxation measures.

<sup>16</sup> For example, in *Methanex Corporation v. United States of America*, the three NAFTA Parties agreed that NAFTA Article 1139 provides an exhaustive definition of "investment" for NAFTA Chapter 11.

<sup>19</sup> Antonio R. Parra, "Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment" (1997) 12 No. 2 ICSID Rev. 287, pp. 355-356. (Tab 8)

<sup>20</sup> *Pope & Talbot, Inc. v. Canada*, Interim Award dated June 26, 2000 at pp. 33-35. (Tab 9)

<sup>21</sup> Bruce Ziff, *Principles of Property Law*, (Ontario: Carswell, 1996), p. 72. (Tab 10)

<sup>22</sup> Feldman Memorial, page 6.

28. It is necessary to recall that the general rule in the NAFTA is that it does not apply to taxation measures.<sup>23</sup> Indeed, Article 2103(1) of the NAFTA provides that "[e]xcept as set out in this Article, nothing in this Agreement shall apply to taxation measures."
29. Article 2103 specifies what provisions of Chapter 11 may find application in respect of taxation measures. Those provisions are Article 1102 (national treatment), Article 1103 (most-favoured-nation treatment), Article 1106(3), (4) and (5) (performance requirements), and Article 1110 (expropriation).<sup>24</sup> Article 1105 is not mentioned and therefore it cannot apply in respect of taxation measures.
30. Had the NAFTA Parties wanted to allow a claim under Article 1105 with respect to taxation measures, they would have specifically and expressly said so. They did not. Therefore, any claim in this dispute based on a violation of Article 1105 of the NAFTA would be inadmissible and outside the jurisdiction of this Tribunal.<sup>25</sup>
31. It is true that Article 1110, which may find application in respect of taxation measures, refers to Article 1105(1).<sup>26</sup> However, that simply means that the provision is relevant to the extent that it relates to a claim of expropriation. In other words, Article 1105 may not apply to taxation measures outside the context of evaluating whether an expropriation was consistent with Article 1110.
32. As regards Article 1110, the NAFTA further provides that an investor may not submit a claim under Section B of Chapter Eleven on the basis that a taxation measure of a Party is an expropriation, and thus breaches Article 1110, unless the review by the competent authorities of the NAFTA Parties involved has occurred in accordance with Article 2103(6).<sup>27</sup>
33. The review under Article 2103(6) is a condition precedent to an investor having any right to submit a claim to arbitration. It is mandatory and cannot be circumvented, no matter how an investor characterizes the taxation measures at stake or his claims.
34. It must be recalled that Article 2103(6) is of fundamental importance as it protects NAFTA Parties against totally unsupported claims brought by investors, thereby unjustifiably and unnecessarily obstructing their ability to regulate normally in a field so important and sensitive as that of taxation.

<sup>23</sup> "Taxation measures" is broadly defined in NAFTA Article 2107.

<sup>24</sup> NAFTA Article 2103(4)(b), (5) and (6).

<sup>25</sup> Cf. Paragraphs 49, 50 and 73 to 77 of Mexico's Counter-memorial.

<sup>26</sup> NAFTA Article 1110(1)(c).

<sup>27</sup> In this case the Deputy Minister of Revenue of the Ministry of Finance and Public Credit of Mexico and the Assistant Secretary of the Treasury (Tax Policy), Department of the Treasury of the United States. NAFTA Article 2103(6) and Annex 2103.6.



That objective can only be achieved if the procedure set out in Article 2103(6) is strictly conformed with.

35. To the extent that the Investor has not specifically referred the issue of whether a particular taxation measure is not an expropriation to the competent authorities of the NAFTA Parties involved, the issue of whether that particular measure constitutes an expropriation under Article 1110 is outside the jurisdiction of this Tribunal.<sup>28</sup>

### Jurisdiction to Investigate Violations of Domestic law

36. This dispute concerns, in part, the application of Mexican domestic law relating to tobacco tax rebates and domestic court decisions on this issue. This, gives rise to issues respecting the jurisdiction of NAFTA Chapter 11 to consider matters of domestic law and the status, if any, that should be accorded domestic court decisions.
37. NAFTA Article 1131(1) provides that: "A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law." This is entirely consistent with the traditional role of an international panel: examining whether the parties to the dispute have complied with international law, specific or general. To decide whether there has been a breach of international law, a tribunal will frequently be required to "examine", "interpret", "investigate" or "take judicial notice of" domestic legislation. If a tribunal does so in accordance with its mandate to decide on whether there has been a breach of international law, that examination or interpretation is consistent with international law and practice.<sup>29</sup>
38. It is also clear that an international tribunal would require explicit jurisdiction to apply, or rule on, domestic law. This might be provided by a special agreement<sup>30</sup>, or where international law designates a system of domestic law as the applicable law.<sup>31</sup> It is only in these very circumscribed situations that the "application" of domestic law by international tribunals is accepted: because there is clear jurisdiction. An international tribunal cannot overrule the decisions of domestic tribunals, or act as an appellate body from domestic courts. The jurisdiction of international tribunals relates to international law.
39. That NAFTA Chapter Eleven respects this division of responsibility is expressly recognized by NAFTA Article 1131.

<sup>28</sup> Cf. Paragraphs 66 to 72 of Mexico's Counter-memorial and paragraphs 26 to 29 of the Investor's Reply to Mexico's Counter-memorial.

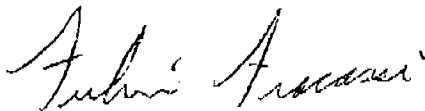
<sup>29</sup> Ian Brownlie, *Principles of Public International Law* (4<sup>th</sup> ed), pp. 41-42. (Tab 11)

<sup>30</sup> *Lighthouses case*, PCJ, Series, A/B, no. 62, pp 19-23, and see also the ICSID Convention. (Tab 12)

<sup>31</sup> *Serbian Loans case*, (1929) PCJ, Annual Digest of Public International Law cases, p. 466. (Tab 13)

40. Domestic court decisions may only be challenged to the extent that they themselves constitute a violation of international law. This was recognized by the NAFTA Chapter 11 Tribunal in *Azinian et al. v. United Mexican States* which held that the decisions of the domestic courts must be accepted as valid determinations of rights unless the court themselves are disavowed at the international level.<sup>32</sup>

All of which is respectfully submitted,



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June 28, 2001

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<sup>32</sup> *Azinian et al. v. United Mexican States*, ICSID Case No. ARB(AF) 97/2 (1 Nov. 1999) at paragraph 97. (Tab 14)