I. INTRODUCTION AND SUMMARY OF CLAIMS

1. In this proceeding under Chapter 11 of the North American Free Trade Agreement (NAFTA)[1] and the rules of the United Nations Commission on International Trade Law ("UNCITRAL Arbitration Rules")[2], GAMI Investments, Inc. ("GAMI," "Investor" or "Claimant"), an investor of the United States, claims that the Government of the United Mexican States ("Mexico," "the Government" or "Respondent") has breached Articles 1102, 1105 and 1110 of the NAFTA in its treatment of GAMI's investment in Grupo Azucarero México, S.A. de C.V. ("GAM"), a Mexican holding company whose primary assets were five subsidiaries, each of which owned and operated a sugar mill.

2. At its core, this case is a simple one. By Presidential Decree issued on 3 September 2001, Mexico expropriated GAM's five subsidiaries and their mills as part of a sweeping nationalization of 27 of the nation's 61 sugar mills. GAMI was and is a minority shareholder in GAM. The expropriation of the mills thus effected an indirect expropriation of GAMI's investment, for GAMI's shares in a holding company with no productive assets are virtually worthless. In the 17 months since the expropriation, Mexico has not paid GAMI any compensation for its investment or even commenced a dialog with GAMI regarding compensation. Article 1110 of NAFTA unambiguously

[1] North American Free Trade Agreement, Chapter 11 (1993) (entered into force 1 January 1994) (Exhibit C-1).

[2] UNCITRAL Arbitration Rules available at http://www.unicitral.org/english/texts/arbitration/arb-rules.htm (last visited 9 February 2003) (Exhibit C-2).

proscribes exactly the conduct Mexico has engaged in. Accordingly, the only matter that should be at issue with respect to the expropriation is the measure of damages.

3. Even prior to the outright taking of GAMI's investment on 3 September 2001, Mexico repeatedly and systematically breached its obligations under NAFTA in the arbitrary and discriminatory administration of its sugar program, virtually destroying the value of GAMI's investment in GAM.

4. The commercial reality of the cane sugar industry is that sugarcane growers (*cañeros*) and cane refiners are mutually dependent, and neither can survive unless the other is viable. Mexican law on its face recognized that dependence. The law called for support of *cañeros* through high prices for sugarcane, which mills were obligated to pay. At the same time, the law provided measures to control the domestic supply of sugar and thus support its price, so that the mills would be able to earn a profit notwithstanding the fixed high price of their primary input, sugarcane.

5. The laws should have worked, but Mexico's implementation was deplorable and unlawful. Mexico implemented the measures dictating the price of sugarcane in a way that was favorable to *cañeros*, but arbitrarily and inequitably administered and enforced – or in some cases completely failed to administer and enforce – those provisions of the law that would support the domestic price of sugar at a level at which mills could be viable. In fact, the domestic price of sugar declined substantially, while the mills were compelled to pay a high percent of a bloated, rather than market-determined, "reference price" to *cañeros* for sugarcane. The result was the destruction of GAMI's investment, culminating in outright seizure of the mills.

6. Mexico's actions violate both the letter and the spirit of NAFTA. Having entered into the NAFTA treaty as a means to attract international investment capital, Mexico is not free to disregard the rights of foreign investors. The circumstances of this case are precisely what NAFTA was intended to preclude – favored treatment of domestic companies or individuals at the expense of foreign investors and their investments, and expropriation that was arbitrary and without fair and prompt compensation.

7. GAMI will show that:

- Mexico breached Article 1105 of the NAFTA, by failing to accord fair and equitable treatment and full protection and security in accordance with international law to GAMI's investment, both by Mexico's arbitrary conduct with respect to implementation and application of Mexico's sugar regime and by its arbitrary and discriminatory expropriation of GAM's sugar mills;

- Mexico has breached Article 1102 by treating GAMI and its investments less favorably than it treated Mexican investors and their investments in like circumstances, both by expropriating the sugar mills of GAM when investors in other sugar mill-owning enterprises in like circumstances did not have their sugar mills expropriated and by requiring GAM to fulfill its export requirements while not also requiring other investments in like circumstances to fulfill their requirements; and

- Mexico breached Article 1110 by indirectly expropriating GAMI's share in GAM in a manner inconsistent with the requirements of Article 1110.

8. As compensation for the damage caused by Mexico's breaches of these provisions of NAFTA, GAMI asks the Tribunal to award compensation in an amount not less than US$27.8 million, the value of GAMI's interest in GAM on 2 September 2001, as conservatively calculated by GAMI's valuation experts. In addition, GAMI is entitled to interest on this sum compounded from 3 September 2001 until payment, plus attorneys fees, expenses, and the costs of these arbitration proceedings.

9. This Statement of Claim will first address GAMI's compliance with the procedural requirements of the NAFTA and the UNCITRAL Arbitration Rules, then set out the factual background of the dispute, and then explain in detail how Mexico has breached each of the NAFTA provisions at issue. Finally, this Statement of Claim will explain the basis for the damages requested.

II. PROCEDURAL AND JURISDICTIONAL REQUIREMENTS

10. GAMI is an "investor of a Party" under Chapter 11 of the NAFTA, as defined in Article 1139. GAMI is a U.S. investment corporation created in November of 1986 and established under the laws of the State of Delaware, with its head office in Las Vegas, Nevada. GAMI is a wholly-owned subsidiary of Great American Management and Investments, Inc. ("Great American"), a company also based in Las Vegas, Nevada and established under the laws of the State of Delaware. Accordingly, GAMI qualifies as "an investor of a Party" for purposes of Article 1139 and Chapter 11 generally.

11. GAMI owns 14.18 percent of the common shares of GAM. GAMI acquired its investment in GAM for a total of US$30 million through a series of transactions between 5 December 1996 and 28 December 1998.[3] GAMI's 14.18 percent equity interest in

[3] *See* GAM 2000 Annual Report Pursuant to Section 13 or 15(d) of the Securities and Exchange Act of 1934 for Fiscal Year Ended 31 December 2000 at 56 (SEC Form 20-F) (29 June 2001) (listing all major shareholders in GAM) (hereinafter "GAM 2000 Annual Report") (Exhibit C-3); Letter from GAMI to Mexico at Annex 4 (12 November 2001) (Exhibit C-4).

GAM qualifies as an "investment" under (b), (e) and (f) of the definition of "investment" in Article 1139 for purposes of Chapter 11.[4] GAMI does not control GAM.

12. GAMI maks this claim pursuant to Articles 1116 and 1120 of the NAFTA and Article 3 of the UNCITRAL Arbitration Rules. GAMI's claims in this proceeding concern breaches of Mexico's obligations under Section A of Chapter 11, as a result of which GAMI has incurred loss or damage. GAMI's claims involve breaches and damage occurring (or which first became known to GAMI) not more than three years prior to the Notice of Arbitration, consistent with the requirements of Article 1116.[5]

13. GAMI has complied with all applicable procedural requirements of the NAFTA and the UNCITRAL Arbitration Rules. Pursuant to Article 1119, GAMI gave notice of

[4] NAFTA Article 1139 defines "investment" to include: ". . . (b) an equity security of an enterprise; . . . (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise; (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) and (d) . . ."

[5] NAFTA Article 1116 states:

1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:

    a. Section A or Article 1503(2) (State Enterprises), or

    b. Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the investor has incurred loss or damage by reason of, on arising out of, that breach.

2. An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.

its intent to submit a claim to arbitration on 1 October 2001.[6] When attempts to achieve a solution were unsuccessful, GAMI notified Mexico of the submission of a claim to arbitration on 9 April 2002 ("Notice of Arbitration" attached as exhibit C-7), together with its previously served consent to arbitration and waiver of its right to initiate or continue proceedings to the extent required by Article 1121(1).[7] In that Notice of Arbitration, GAMI informed Mexico, pursuant to Article 1120 of the NAFTA, that the applicable arbitration rules would be the UNCITRAL Arbitration Rules except as modified by Section B of the NAFTA.[8]

14. Pursuant to NAFTA Article 1122(1), Mexico has provided its general consent for the submission of investment disputes to arbitration under NAFTA Chapter 11. Moreover, in accordance with NAFTA Article 1122(2), the consent given by Mexico under Article 1122(1) and the submission by GAMI of its claim to arbitration satisfies the

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[6] Pursuant to NAFTA Article 1119, written notice of Investor's intent to submit this claim was properly served on Mexico on 1 October 2001. *See* Notice of Intent (1 October 2001) (Exhibit C-5). Mexico contested the validity of the 1 October 2001 notice on grounds that the notice was not translated into Spanish and did not include documentary proof that GAMI qualified as an "investor of another Party." Without prejudice to the Investor's position that the notice of 1 October 2001 was properly served, the Investor provided to Mexico a courtesy translation of the Notice of Intent to Submit a Claim on 16 October 2001 and a power of attorney declaration for Donald J. Liebentritt, as well as proof of the corporate nationality of GAMI, by letter served on the Government on 13 November 2001. *See* Letter to Mexico from GAMI re Courtesy Translation on Notice of Intent (16 October 2001) (Exhibit C-6); Letter from GAMI to Secretary of Economy at Annex 1 (12 November 2001) (Exhibit C-4).

[7] *See* Notice of Arbitration (9 April 2001) (Exhibit C-7).

[8] *See id.* at 1.

requirement of Article II of the New York Convention for an "agreement in writing" and Article I of the Inter-American Convention for an "agreement."[9]

15. Pursuant to NAFTA Article 1123,[10] on 11 June 2002, GAMI appointed Professor W. Michael Reisman to the Tribunal.[11] The Government of Mexico appointed Professor Julio Lacarte Muró on 19 July 2002.[12] The disputing parties agreed to appoint Jan Paulsson as the presiding arbitrator on 3 September 2002.[13] As of Mr. Paulsson's confirmation letter on 2 October 2002,[14] the Tribunal has been properly constituted.

16. On 17 January 2003, GAMI made its first document request on Mexico, asking Mexico to produce information regarding the expropriation and financial information of certain non-expropriated mills.[15] On 21 January 2003, Mexico responded by agreeing to

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[9] *Id.* at para. 4.

[10] *See* NAFTA Article 1123.

[11] *See* Letter from GAMI to W. Michael Reisman (11 June 2002) (Exhibit C-8).

[12] *See* Letter from Mexico to GAMI (19 July 2002) (Exhibit C-9).

[13] *See* Letter from GAMI to Jan Paulsson (3 September 2002) (Exhibit C-10).

[14] *See* Letter from Jan Paulsson to the Parties (2 October 2002) (notifying the parties of his acceptance as presiding arbitrator of the arbitral tribunal for this NAFTA Chapter 11 arbitral proceeding) (Exhibit C-11).

[15] *See* Letter from GAMI to Mexico (17 January 2003) with attachment "Claimant's First Request for Production of Documents from Respondent" (Exhibit C-12). In this request, GAMI asked that Mexico produce the following documents:

> 1. All documents and communications in the possession, custody or control of Mexico concerning the decision to issue the Expropriation Decree published in the *Diario Oficial de la Federación* on 3 September 2001.
>
> 2. All documents and communications in the possession, custody or control of Mexico or *Financiera Nacional Azucarera* concerning the

provide the administrative record, containing evidence compiled by the Government that allegedly is supportive of the Expropriation Decree. Mexico, however, objected to producing any additional documents, stating that GAMI's request was both overly burdensome and too broad, covering documents that Mexico considered to be irrelevant to the substantive arguments contained in the Notice of Arbitration.[16] On 22 January 2003, GAMI responded to Mexico's letter, explaining why Mexico's position was incorrect.[17] On 27 January 2003, Mexico produced for GAMI's counsel the Administrative Record, but Mexico has not otherwise responded to GAMI's request.

III. STATEMENT OF FACTS

A. Summary

17. The core facts underlying GAMI's claim can be summarized as follows. GAMI owns shares in GAM, a company whose productive assets consisted of five sugar mills, which Mexico expropriated without compensation on 3 September 2001.[18] At the same

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> financial condition, production levels and exports of the following mills between 1 January 1996 and 3 September 2001: Ingenio de Huixtla, S.A. de C.V.; Ingenio San Sebastián, S.A. de C.V.; Ingenio Santa Clara, S.A. de C.V.; Ingenio la Gloria, S.A.; Compañía Azucarera Independencia, S.A. de C.V.

Id. at 2.

[16] *See* Letter from Mexico to GAMI (21 January 2003) (Exhibit C-13).

[17] *See* Letter from GAMI to Mexico (22 January 2003) (Exhibit C-14).

[18] *Decreto por el que se exproprian por causa de utilidad pública, a favor de la Nación, las acciones, los cupones, y/o los títulos representativos del capital o partes sociales de las empresas que adelante se enlisten* ("Decree to expropriate, for the public purpose, and for the Nation, the shares, dividend coupons and/or negotiable instruments of capital or capital stock of the companies set forth herein"), published in the *Diario Oficial de la*

time, Mexico expropriated 22 other sugar mills, while leaving 34 sugar mills in private hands. Prior to the formal seizure of the mills, Mexico's conduct in the implementation – and non-implementation – of its sugar laws had significantly damaged GAMI's investment.

18. This factual section will summarize salient background points relevant to an understanding of the dispute, including: (1) the history of GAM and GAMI's investment in GAM; (2) the nature of the sugar industry in Mexico; (3) pertinent history of Mexican regulation of the industry; (4) the current regime; (5) the implementation of that regime and its effect on mills generally; (6) the effect on GAM; (7) the expropriation; and (8) the aftermath of the expropriation.

B. History Of GAM And GAMI's Investment In GAM

1. History of GAM and Its Assets

19. GAM is a Mexican corporation. Mr. Juan Gallardo, a Mexican citizen, directly or indirectly owns or controls approximately 65 percent of the company's stock.[19] Mr. Juan Cortina currently serves as GAM's Chairman and Chief Executive Officer.

20. Prior to the expropriation, GAM's assets consisted almost entirely of five Mexican sugar mills wholly owned as incorporated subsidiaries of GAM:

SUBSIDIARY	LOCATION OF MILL

Federación ("Federal Official Gazette") on 3 September 2001 (hereinafter "Expropriation Decree") (Exhibit C-15).

[19] *See* GAM 2000 Annual Report at 56 (Exhibit C-3).

Ingenio Presidente Benito Juárez, S.A. de C.V. ("Benito Juárez")	Cárdenas, Tabasco
Ingenio José María Martínez, S.A. de C.V. ("Tala")	Tala, Jalisco
Ingenio Lázaro Cárdenas, S.A. de C.V. ("Lázaro Cárdenas")	Lázaro Cárdenas, Michoacán
Ingenio San Francisco el Naranjal, S.A. de C.V. ("San Francisco")	Lerdo, Veracruz
Compañía Industrial Azucarera San Pedro, S.A. de C.V. ("San Pedro")	Lerdo, Veracruz

21. The GAM group also included four subsidiaries, of which two were devoted to marketing activities. *Corporación Azucarera de Tala* ("Tala Trading"), was responsible for purchasing and reselling the sugar produced by GAM's mills. *Proveedora de Alimentos México, S.A. de C.V.* ("PAMSA") is a packaging company that prepared sugar for retail sale.[20]

22. Prior to the expropriation, GAM was the fourth largest producer of sugar in Mexico, producing 433,833 metric tons of sugar during the 2000/2001 harvest, constituting approximately 8.81% of Mexico's total production for that harvest.[21] GAM's principal activities were production of standard ("*azúcar estándar*") and refined sugar from sugarcane. Refined sugar ("*azúcar refinada*"), which is generally marketed to

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[20] The other two subsidiaries are *Corporativo GAMSA, S.A. de C.V.* ("Corporate") provides corporate services for the entire group and *Empresas y Servicios Organizados, S.A. de C.V.* ("EMYSOR") provides personnel services to the GAM Group. *See* GAM 2000 Annual Report at 18 (Exhibit C-3).

[21] *See id.*; GAM Quarterly Report Pursuant to Rule 13a-16 or 15d-16 of the Securities and Exchange Act of 1934 for Period Ending 30 September 2001 22 (SEC Form 6-K) (30 November 2001) (hereinafter "GAM Quarterly Report for Period Ending 30 September 2001") (Exhibit C-16).

industrial consumers that require greater quality sugar, such as soft-drink bottlers, sells at a higher price than standard sugar ("*azúcar estándar*"), which is consumed by domestic households, and is the primary sugar consumed in Mexico.[22]

23. In December 1996, GAMI acquired a minority position in GAM, pursuant to a private placement.[23] The following year, in conjunction with GAM becoming a publicly traded company listed on the *Bolsa Mexicana de Valores* ("Mexican Stock Exchange"), GAM issued US$145 million in public debt in the United States to raise further capital and reduce its outstanding long-term Government debt.[24] This was part of a strategy to position GAM as an internationally recognized, investment-grade company.[25]

24. GAM has been a publicly held company since 1997 and has filed disclosures with the U.S. Securities and Exchange Commission ("SEC") since 1998.[26] Outside auditors have reviewed and certified its books and records since its inception.

C. <u>The Mexican Sugar Industry</u>

25. Sugar is the most important sweetener worldwide and its production has an important impact both socially and economically in Mexico. A variety of factors characterize the Mexican sugar economy, some due to the nature of the crop, some due to

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[22] *See* GAM 2000 Annual Report at 21-22 (Exhibit C-3). Tala, Lázaro Cárdenas, San Pedro and San Francisco produce standard sugar. *See id.* Benito Juárez produces primarily refined sugar. *See id.*

[23] *See* Mark Radzik Witness Statement at para. 6 (9 February 2003) (Exhibit C-17).

[24] *See* Juan Cortina Witness Statement at para. 15 (9 February 2003) (Exhibit C-18).

[25] *See id.* at para 13.

[26] *See id.* at paras. 14, 15.

unique social, economic, and political features of the Mexican industry, and some due to the long history of economic regulation of sugar production by Mexico. The expert report of Andrés Antonius González, attached as Exhibit C-19, describes the economics of the Mexican sugar industry in substantial detail. We summarize salient points here.

26. Sugarcane is a semi-perennial crop, requiring 12-18 months to mature from planting to first harvest, and then producing for a period of 4-8 years, after which the crop must be replanted.[27] This makes sugarcane supply slow to react to price signals because farmers are reluctant to convert sugarcane fields to other crops early in the cycle. Because sugarcane loses its sucrose content quickly after cutting, it must be processed within 24-48 hours of the harvest.[28] As a result, it is impractical to ship sugarcane any significant distance for processing, and mills must be located in close geographical proximity to sugarcane fields. This creates a relationship of mutual dependence between mills and *cañeros*. C*añeros* must have a nearby mill or their sugarcane is worthless, and the mills must have nearby *cañeros* to supply them sufficient sugarcane. Efficient production requires a high degree of coordination between mill operators and *cañeros* to ensure that mills have a steady supply of sugarcane during the harvest season.[29] The

[27] Andrés Antonius González, The Mexican Sugar Industry 1991-2001 3-4 (January 2003) (unpublished report prepared for GAMI Investments, Inc.) (hereinafter "Antonius Report") (Exhibit C-19).

[28] *See id.* at 5.

[29] *See id.* at 6.

harvest season for sugar mills typically runs from November to June.[30] Between July and October, the mills are then refurbished in anticipation of the following harvest.[31]

27. The principle variables affecting the profitability of sugar mills are the price they pay for sugarcane and the price they receive for the sugar they produce.[32] The difference between the price a mill receives for the sugar it sells and the price it pays for sugarcane is called the refining margin, and the size of that margin, as compared to the processing costs the mill incurs, determines the ultimate profitability of a sugar mill.

28. A sugar mill involves high levels of sunk costs for investment in mills, which creates barriers to entry and exit from sugar milling.[33] In Mexico, ownership of the sugarcane fields is highly fragmented by global standards, as sugarcane is grown on thousands of small, generally inefficient plots. This phenomenon results partly from the legacy of the 1910 Revolution and the former Article 27 of the Mexican Constitution, which barred corporate ownership or leasing of agricultural land. During the 1970s and 1980s, the Mexican Government directly and indirectly encouraged the fragmentation of the sugarcane fields into successively smaller and smaller plots, partially through the Government's land redistribution program, but primarily through the establishment of a series of Government health and welfare benefit programs for *cañeros*. Farmers could qualify for these programs simply by dedicating a portion of their land to sugarcane

[30] *See* GAM 2000 Annual Report at 21 (Exhibit C-3).

[31] *See id.*

[32] Typically, sugarcane accounts for 70% of a mill's costs. *See* Antonius Report at 6 (Exhibit C-19).

[33] *See id.* at 2.

production.[34] The *cañeros* have their own unions: (1) the *Unión Nacional de Cañeros* ("National Union of Sugarcane Growers") from the umbrella group *Confederación Nacional Campesina* ("National Farmers' Confederation") and (2) the *Unión Nacional de Productores de Caña de Azúcar* ("National Union of Sugarcane Producers") from the umbrella group *Confederación Nacional de Productores Rurales* ("National Confederation of Rural Producers").[35]

29. In much of the world, including Mexico, there is a high degree of Government involvement in the sugar market, both through international trade measures and programs to support the price for farmers and processors.[36] The European Union, the United States, Mexico and many other countries use restrictive trade policies and other forms of governmental intervention to support prices well above "world" sugar prices.[37] Over the last 30 years, sugar has faced increasing competition from other sweeteners, notably high fructose corn syrup ("HFCS"), which has also been the subject of governmental restrictions, especially in trade.[38]

30. Mexican mills can obtain the highest prices by selling in the protected domestic market or in the U.S. market, but the United States restricts the quantity of sugar that can be imported from all sources, with tariff rate quotas allocated by country, including an

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[34] *See id.* at 11.

[35] *See id.*

[36] *See id.* at 2.

[37] *See id.* at 7-8.

[38] *See id.* at 3-4.

allocation for Mexican sugar. The Mexican market generally has prices that are much higher than world prices but not quite as high as those in the United States. World prices for a number of years have been well below U.S. and Mexican prices. Therefore, exporting to the world market is the least desirable outlet for Mexican mills.[39]

31. To maintain prices above world levels for sugar requires Government intervention; otherwise, low-price imports would decrease local prices to the world level. For countries that are net importers of sweeteners, such as the United States, the domestic price can wholly or largely be supported by using import restrictions to decrease supply. However, for countries with higher production than demand, sustaining high prices requires not only import restrictions but also government intervention to reduce domestic supplies, either through production controls or mandatory exports.

D. <u>Previous Economic Regulation Of The Mexican Sugar Industry</u>

32. Between 1971 and 1980, the Mexican Government took over the majority of Mexican sugar mills as they defaulted on government-issued debt.[40] These defaults largely were caused by the government's deliberate setting of input and output prices at levels that made mills insolvent.[41] The milling industry continued under state control, while sugarcane production remained in the hands of *cañeros*. There were administered

[39] *See id.* at 23-24.

[40] *See id.* at 9.

[41] *See id.* at 9-10.

prices for sugarcane and for sugar, and a state marketing monopoly through the end of the 1980s.[42]

33. Beginning in the late 1980s, as part of an intended shift away from state-ownership and toward more market-oriented economic policy, Mexico began to privatize many of the government-owned sugar mills.

34. This newly privatized sugar industry was to operate under the legal framework created by the *Decreto por el que se declaran de interés público la siembra, el cultivo, la cosecha y la industrialización de la caña de azúcar*, published in the Diario Oficial de la Federación,[43] on 31 May 1991 (the "Sugarcane Decree") and later amended in 1993 (the "Amendment to the Sugarcane Decree").[44]

35. The Sugarcane Decree established a regime governing the economic relationship between the *cañeros* and the mills. The Decree declared the sowing, cultivation, harvest and industrialization of sugarcane to be "of public interest."[45] Article 2 of the Sugarcane Decree created the *Comité de la Agroindustria Azucarera* ("CAA"),[46] a committee chaired by the *Secretaría de Agricultura, Ganadería, Desarrollo Rural, Pesca y*

[42] *See id.* 11.

[43] ("Decree whereby it is declared that the sowing, cultivation, harvest and industrialization are of public interest"), published in the Federal Official Gazette on 31 May 1991 (hereinafter "Sugarcane Decree") (Exhibit C-20).

[44] *See Decreto por el que se reforma el diverso por el que se declara de interés público la siembra, el cultivo, la cosecha y la industrialización de la caña de azúcar*, published in the *Diario Oficial de la Federación*, ("Federal Official Gazette") on 27 July 1993 (hereinafter "Amendment to Sugarcane Decree") (Exhibit C-21).

[45] Sugarcane Decree, art. 1 (Exhibt C-20).

Alimentación ("SAGARPA"),[47] which casts the deciding vote, and includes participation by the *Secretaría de Economía*,[48] to establish all implementing rules for the Sugarcane Decree and to "aid in the strict compliance" with the Decree and all implementing rules. The CAA includes representatives of *cañeros*, mills and mill workers.

36. In addition, Article 7 of the Sugarcane Decree designated the *Junta de Conciliación y Arbitraje de Controversias Azucareras* ("JCACA")[49] as the competent authority to resolve all economic disputes between *cañeros* and mills.

37. The Sugarcane Decree declared, *inter alia*, that:

> . . . it is necessary to promote the [sugar] industry by giving *economic certainty* to the different sectors that participate in production thereof, such that said production be *profitable*, and also be able to foment its own growth.[50]
>
> That it is necessary for trade policies to allow for a permanent sugar supply, thus it is prudent to link the price of sugarcane to that of sugar so as to ensure *equity* to all participants in the production chain.[51]

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[46] "Committee of the Sugar Agriculture Industry."

[47] "Secretary of Agriculture, Livestock, Rural Development, Fish and Nutrition."

[48] The *Secretaría de Economía* ("Secretary of the Economy") was known as the *Secretaría de Comercio y Fomento Industrial* ("Secretary of Commerce and Industrial Promotion") ("SECOFI") until 2000. Because the decrees and *acuerdos* cited herein refer to SECOFI, both names are used interchangeably in this brief.

[49] "Panel of Conciliation and Arbitration of Sugar Controversies."

[50] Sugarcane Decree at para. 2 of the *Considerandos* ("Considering") (emphasis added) (Exhibit C-20).

[51] *Id.* at para. 7.

38. The stated objectives of certainty, profitability, and equity under the Sugarcane Decree require the intervention and direction of the Government, either directly, or through the CAA that it controls.

39. Article 5 of the Sugarcane Decree required uniform contracts between the *cañeros* and millers, subject to the rules issued by the CAA.[52] Pursuant to the uniform contract, mills were required to purchase all sugarcane produced by *cañeros* in a certain tract of land.[53] The Sugarcane Decree provided for payment of 54% of the price of sugar (or a price determined by the CAA if, as was the case, there was no official bulk price) to *cañeros* for their cane.[54]

40. To remedy perceived problems, especially in determining the price of sugar, the Sugarcane Decree was amended in 1993, notably to raise over time the percentage of the reference price paid to *cañeros* from 54% to 57%. The reference price continued to be determined by the CAA under the Government's control, despite the intent to track the market.

41. Mexico had been a net deficit producer of sweeteners, but this had changed. Adoption of increased import protection pursuant to a NAFTA requirement to adopt a similar trade regime to that of the United States helped increase prices in Mexico,

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[52] *Id.,* art. 5.

[53] *See Contrato Uniforme de Siembra, Cultivo, Cosecha, Entrega y Recepción de Caña de Azúcar* ("Uniform Contract of Sowing, Cultivation, Harvest, Supply and Receipt of Sugarcane"), arts. 17 and 19 (Exhibit C-22).

[54] *See* Sugarcane Decree, art. 9 and *Tercero Transitorio* ("Third Transitional Rule") (Exhibit C-20).

particularly after the Government dropped sugar price controls in 1995.[55] The NAFTA also promised increased access over time into the U.S. market.

42. Nevertheless, it was clear that if the Sugarcane Decree was to meet its objectives, reforms would be important to deal with the situation of a net surplus producer and to achieve the objective of making the prices in the system responsive to market conditions.

E. The 1997 And 1998 Acuerdos

43. On 25 March 1997, the Mexican Government published the *Acuerdo por el que se establecen reglas para la determinación del precio de referencia del azúcar para el pago de la caña de azúcar* (the "1997 Acuerdo")[56] setting forth several important reforms of the law. An "acuerdo" is a government measure, in this case issued at the ministerial level, which legally binds affected parties.[57] A ministerial acuerdo is subordinate to a Presidential Decree or regulation, and in practice can be used to implement the terms of a Decree.

44. The 1997 *Acuerdo* provided two important modifications in the sugar program. First, it created a methodology and a formula for determining a national reference price for sugarcane that was to apply from the 1997/1998 harvest onward, and that would be responsive to actual market conditions.[58] The reference price was to be determined by a

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[55] *See* NAFTA Annex 703.2 at para. 17 (Exhibit C-1).

[56] ("Agreement whereby the regulation for determining the reference price for sugarcane payment is hereby established"), published in the Federal Official Gazette on 25 March 1997 (hereinafter "1997 *Acuerdo*") (Exhibit C-23).

[57] *Enciclopedia Jurídica Mexícana* 138-141 (2002) (Exhibit C-24).

[58] *See* 1997 *Acuerdo*, art. 3 (Exhibit C-23).

weighted average of the prices received in the domestic market, the price for the exports to the United States market within the restricted U.S. quota, and finally, prices from exports of surpluses to the (low-priced) world market. Such a formula would in principle mean that, to the extent increased production required a higher proportion of that production to go to low-priced world markets, that would tend to lower the reference price and hence the return to *cañeros*, providing a first market "signal" to *cañeros* against continuous increases in sugarcane production.[59]

45. The 1997 *Acuerdo* also required that sugar mills comply with export quota requirements set by SECOFI. Under the *Acuerdo*, any mill that did not comply with the export requirements had to pay a substantial penalty price, equal to 2.5 times the difference between Mexican and world prices for the deficit from the export requirement. If enforced, this would erase the temptation of sugar mills to sell their surplus on the domestic market.

46. In 1998, the Government amended the 1997 *Acuerdo*, most significantly to provide for maximum production ceilings, with penalties for mills that increased their sugar production over the ceiling and a reward for mills that reduced production below the ceiling.[60] Thus, a sugar mill that reduced production levels below the ceiling would

[59] *See id.,* art. 3(V).

[60] *See Acuerdo que reforma al diverso que establece las reglas para la determinación del precio de referencia del azúcar para el pago de la caña de azúcar* ("Agreement to reform the earlier Agreement that established the regulation for determining the reference price for sugarcane payment"), published in the Federal Official Gazette on 31 March 1998 (hereinafter "1998 Acuerdo") (Exhibit C-25).

have its export quota requirement reduced by that amount.[61] The 1998 *Acuerdo* stated that no later than the first of October of each year, SECOFI and SAGARPA would be responsible for determining a maximum production level for each sugar mill.[62]

47. The 1997 *Acuerdo,* as modified by the 1998 *Acuerdo,* remains in force. These *Acuerdos*, if implemented, would have provided for a system that protects the interests of *cañeros* and mills in an equitable way as called for in the Sugarcane Decree, implemented in the context of a net surplus of Mexican production. The Government had the authority and duty to implement the export controls and production limits, so that prices could be sustained at a level sufficient for mills, in the light of the price that had to be paid to *cañeros*.

F. <u>Failure To Implement The Regulatory Scheme</u>

48. While the reforms of 1997 and 1998 should have made the system function as contemplated by the legal regime, the Government flagrantly and systematically failed to implement and enforce the law. First, as discussed below, the Government negated the benefit of the revised reference price by using unrealistic estimates that inflated what mills had to pay *cañeros*. Second, the benefit of the export requirement was nullified because the Government never took the steps necessary to enforce it. Third, the Government simply never implemented the production limitation requirement introduced in 1998.

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[61] *See id.* art. 3(VI).

[62] *See id.* at Sixth Transitional Rule ("*Sexto Transitorio*").

1. The Government's Reference Price Calculation

49. Mexico altered the reference price formula by making unrealistic assumptions regarding its variables (*e.g.*, anticipated domestic production of sugar, NAFTA export quotas, expected domestic consumption and surplus to be exported) and utilizing statistics that overstated the price of sugar, with the effect that the reference price increased even as actual price decreased.[63] As a result, prices GAM received for sugar in both the domestic and export markets were substantially below the government-set reference prices from which the price of sugarcane was derived.[64]

2. Failure To Enforce Export Requirements

50. To deal with the problem of price depressing surpluses of sugar production, the 1997 *Acuerdo* provided (and still provides) that each mill must export a certain percentage of its output so that surplus production would not be sold into the Mexican market, destabilizing the price.[65]

51. Absent such a mechanism, even if the surplus sugar was stocked by the mills, it would overhang and depress prices below levels necessary for mills to be viable. The Government controlled the enforcement system in key respects. First, SECOFI was the official depository of the only reliable production and export data that would permit a determination whether there was non-compliance. Second, SAGARPA also controlled the JCACA, which was the entity in charge of enforcement of the export requirements in

[63] *See* Valuation Report at section VII.A (Exhibit C-26).

[64] *See id.* at section VII.B.

[65] *See* 1997 *Acuerdo*, art. 4(III) (Exhibit C-23).

the event of a breach. *Cañeros* had the right to obtain the penalty price for non-compliance from a mill in an action before the JCACA.[66] However, without access to reliable data, and expeditious adjudication by the JCACA, penalties could not be applied in a timely manner and the export requirement could not function.

52. In fact, there were severe problems of non-compliance, but the Government failed to act and even contributed to the problem.[67] GAM and other mills complied fully with their export requirements,[68] but the system was undermined by non-compliance on the part of several mills, including mills operated by the Government itself.

53. Both of the government-owned mills, La Joya and Rosalía, failed, for example, to comply with their export obligations,[69] thereby contributing to the domestic surplus while

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[66] *See* Sugarcane Decree, art. 7 (Exhibit C-20).

[67] *See, e.g.*, Letter from National Union of Sugarcane Producers to SAGARPA (27 August 1999) (requesting SAGARPA's intervention for the resolution of disputes arising due to the failure on the part of certain mills to comply with export quotas during the 1997/98 harvest) (Exhibit C-27); *Cañeros*'s Suit filed before the JCACA on 4 December 2000 re: Non-Compliance on the Part of the Mills with Export Quota Requirements in the 1998/1999 Harvest (demanding the adjustment of the sugarcane price as a result of failure on the part of sugar mills to comply with the export quota requirements) (Exhibit C-28); *Cañeros*'s Suit filed before the JCACA on 4 December 2000 re: Non-Compliance on the Part of the Mills with Export Quota Requirements in the 1999/2000 Harvest (same) (demanding the adjustment of the sugarcane price as a result of failure on the part of sugar mills to comply with the export quota requirements) (Exhibit C-29); Testimony of Congressman Jorge Schettino Pérez (Fall 2001) (stating that even before the expropriation the *cañeros* were demanding the resolution of the suits filed by the *cañeros* unions regarding non-compliance by mills with the export quotas as well as information regarding export quotas for 2000/2001) (Exhibit C-30).

[68] *See infra* Table at para. 53; *see also* Juan Cortina Witness Statement at para. 20 (Exhibit C-18).

[69] As of the date of expropriation, the Government owned two mills, La Joya and Santa Rosalía, through *el Fideicomisio Liquidador* ("FIDELIQ"). The Government had taken

enabling the mills to avoid the need to accept lower prices for exports. In addition, numerous privately-held mills, such as those held by the CAZE and Jimenez Sainz groups, consistently failed to export the amounts that the law required of them. The following chart illustrates the degree of compliance of a sampling of mills, including all the mills of GAM, which fully complied:

Mexican Sugar Mill Export Quota Compliance 1997 to 2001

Sugar Mill	Group	1997/98 harvest[70]	1998/99 harvest[71]	1999/2000 harvest[72]	2000/01 harvest[73]
La Joya	**FIDELIQ**	25.07%	60.10%	0.00%	0.0%
Santa Rosalía	**FIDELIQ**	21.03%	95.06%	5.76%	10.82%
Atencingo	**CAZE**	100.00%	4.94%	52.65%	0.00%
Casasano La Abeja	**CAZE**	100.00%	4.94%	51.60%	0.00%
El Modelo	**CAZE**	100.00%	4.94%	52.58%	0.00%
El Potrero	**CAZE**	100.00%	29.71%	68.76%	0.00%
Emiliano Zapata	**CAZE**	100.00%	13.05%	73.25%	20.14%
La Providencia	**CAZE**	100.00%	12.48%	53.79%	0.00%
Plan de San Luis	**CAZE**	100.00%	6.59%	52.13%	0.00%
San Cristobal	**CAZE**	100.00%	5.15%	48.90%	11.39%
San Miguelito	**CAZE**	100.00%	4.94%	53.27%	0.00%
Dos Patrias	**Jimenez Sainz**	2.44%	4.94%	4.68%	0.00%
Azsurmex (Tenosique)	**Jimenez Sainz**	2.44%	0.00%	4.68%	0.00%
Benito Juárez	**GAM**	100.00%	100.00%	100.00%	100.00%
Tala	**GAM**	100.00%	100.00%	100.00%	100.00%
Lázaro Cárdenas	**GAM**	100.00%	100.00%	100.00%	100.00%
San Francisco El Naranjal	**GAM**	100.00%	100.00%	100.00%	100.00%
San Pedro	**GAM**	100.00%	100.00%	100.00%	100.00%

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control of these mills when they became insolvent. Antonius Report at 14, 24 (Exhibit C-19).

70 *See* Export Quota Compliance Chart 1996/1997 – 1999/2000 (Exhibit C-31).

71 *See id.*

72 *See id.*

73 Export Quota Compliance Chart 2000/2001 (Exhibit C-32).

54. These trends of non-compliance became especially severe during the 2000/2001 harvest where mills that had previously been in, or close to, compliance, fell out of compliance. Thus during the 2000/2001 harvest, Grupo Machado only exported 56.4% of its requirements,[74] Santos, 81.58%, AGA, 47.09%,[75] Seoane, 85.72%[76] and independent mills, 81.90%.[77]

55. The Government failed to perform the necessary actions to allow the *cañeros* to take timely enforcement action to stop these violations. In the case of the CAZE mills, the Government ignored repeated complaints, even from the *Cámara Nacional de las Industria Azucareras y Alcoholeras* ("CNIAA"),[78] that CAZE had falsely claimed to have met its export requirements when it was quite apparent it had not. In October 1999, the CNIAA notified SECOFI that CAZE had tried to establish its compliance with its export requirement of 114,037 tons of sugar by presenting false official documents. Several communications were issued by the CNIAA denouncing CAZE's illegal behavior.[79] Notwithstanding these efforts, the Government has never taken enforcement action against CAZE.

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[74] Export Quota Compliance Chart 1996/1997 – 1999/2000 (Exhibit C-31).

[75] *Id.*

[76] *Id.*

[77] Export Quota Compliance Chart 2000/2001 (showing that for the 2000/2001 harvest, the exports of the mills of AGA, García González, Jimenez Sainz, Seoane, and Independents (also called "No Agrupados") fell short of their respective quotas) (Exhibit C-32).

[78] "National Chamber of the Mexican Sugar and Alcohol Industries."

56. *Cañeros* did bring an action before the JCACA on 4 December 2000, but the JCACA, a Government-controlled organization, has taken no action on the case.[80]

57. The effect of not enforcing the export requirements is that surplus sugar depressed prices in Mexico below remunerative levels for the mills. The non-complying mills benefited, in the sense that the Mexican prices, though depressed, were still well above world prices that would have been received if the mills had complied, and they faced no penalty despite the requirements of the *Acuerdos*.

3. Failure To Establish Maximum Production Ceilings To Encourage Reductions in Production

58. The Government similarly thwarted, rather than implemented, the production controls introduced as a requirement in the 1998 *Acuerdo*. The 1998 *Acuerdo* specifically required the CAA, SECOFI and SAGARPA to jointly issue the maximum production ceilings for each mill by 1 October 1998.[81] Notwithstanding this express requirement, the Government did not set production ceilings by the applicable deadline, or at any time since.

59. On 9 March 2000, the Government published the *Acuerdo por el que se ponen a disposición de los ingenios azucareros las cuotas de exportación por ingenio para la*

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[79] The Government was informed by other producers of CAZE's fraud. What action other than the expropriation the Government took is unclear.

[80] *Cañeros*'s Suit filed before the JCACA on 4 December 2000 re: Non-Compliance on the Part of the Mills with Export Quota Requirements in the 1998/1999 Harvest (Exhibit C-28); *Cañeros*'s Suit filed before the JCACA on 4 December 2000 re: Non-Compliance on the Part of the Mills with Export Quota Requirements in the 1999/2000 Harvest (Exhibit C-29).

[81] *See* 1998 *Acuerdo* at Sixth Transitional Rule ("*Sexto Transitorio*") (Exhibit C-25).

zafra 1999-2000 y los niveles de producción base por ingenio que surtirán efectos a partir de la zafra 2000-2001 (the "2000 Acuerdo"),[82] which specified that SECOFI would provide the specific production ceilings to those mills that inquired.[83] This information, however, was not made available at that time and, indeed, was never made available at any time before the expropriation in September 2001.[84] The Government also never promulgated the regulations required by Article 2 of the 2000 Acuerdo.[85] In the absence of any specified maximum production ceilings, no mill had any incentive or obligation to reduce production, and none ever did so.

60. The consequence of all the Government's failure to comply with its own laws was twofold. First, the price paid to *cañeros* was too high relative to the domestic price of sugar because a high reference price inflated the cost of cane. Second, excess supplies depressed the domestic price of sugar as a result of the failure to implement export requirements and production controls.

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[82] ("Agreement that makes available to sugar mills export quotas for each mill for the 1999-2000 sugar harvest as well as the base production levels for each mill that will apply for the 2000-2001 sugar harvest"), published in the Federal Official Gazette on 9 March 2000 (hereinafter "2000 *Acuerdo*") (Exhibit C-33).

[83] *See id.,* art. 2.

[84] *See* Juan Cortina Witness Statement at para. 19 (Exhibit C-18).

[85] *See id.*

G. Effects On GAM And GAMI

1. Mexico's Conduct Reduced GAM's Refining Margin Creating a Severe Liquidity Crisis in the Spring of 2000

61. The Government's failure to implement the 1997 and 1998 *Acuerdos* and enforce the export requirements was highly damaging to GAM's financial results. The average blended price GAM received for sugar (both standard and refined) on the Mexican market fell from M$ 4698 per metric ton in 1997 to M$ 4080 per metric ton in 2000, a decrease of 13.2 percent.[86] This occurred over a period where the consumer price index in Mexico rose a cumulative 74 percent. Furthermore, the domestic component of the government mandated price of sugarcane rose during this same period from M$ 3339 per metric ton in the 1997/97 harvest to M$ 4633 in the 1999/00 harvest, a 38.8 percent increase.[87]

62. The combination of the severe declines in the price it could obtain for its finished product and the simultaneous increase in the cost of its primary input – sugarcane – had a disastrous effect on GAM's financial performance. Adjusted for inflation, GAM's operating profits declined from a profit of over M$368 million in 1996 to an operating loss of over M$302 million in 2000.[88]

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[86] *See* Valuation Report at 8 (Exhibit C-26).

[87] *See id.* exhibit 4.3.

[88] *See id.* exhibit 6.1.

2. Suspensión de Pagos

63. This substantial decrease in revenues led to an acute cash flow crisis for GAM in 2000. Rather than allowing this cash shortage to force GAM to default on some of its obligations, and to protect the ongoing viability of GAM's operations for all interested parties, GAM instead filed for *suspensión de pagos* on 9 May 2000.[89]

64. Under the *Ley de Quiebras y Suspensión de Pagos*[90] in effect at that time, a temporarily insolvent company could apply for s*uspensión de pagos*, a judicial procedure to convene a company's debtors to negotiate and execute a general restructuring agreement, thereby allowing it to return to normal economic activity and avoid declaring bankruptcy. The purpose of this procedure was to enable companies in financial distress to pay their debts and continue operating. When a company is in *suspensión de pagos*, a judge appoints a trustee (*síndico*) to oversee its accounting and administration. The company continues to maintain control over its assets and operations under supervision of the trustee.

65. Under *suspensión de pagos*, GAM was not required to pay interest or principal on its debt. This provided significant relief from the liquidity crisis, and enabled GAM to make all required payments to its mill workers and *cañeros*. GAM promptly began negotiations with its senior creditor, Bancomext, on debt restructuring, and reached a tentative agreement within a few months. In September 2000, however, there was a change of administration and the new managing director of Bancomext declined to

[89] *See* GAM 2000 Annual Report at 18. (Exhibit C-3).

[90] "Law of Bankruptcy and Suspension of Payments" or "LBSP."

finalize the agreement. GAM sent numerous proposals to Bancomext during 2001, but Bancomext never provided a substantive response or counterproposal.[91]

H. Expropriation Law And Decree

66. The Mexican Government formally expropriated GAM's five sugar mills, as well as 22 mills held by other investors, under the Expropriation Decree, a measure published in the *Diario Oficial de la Federación* on 3 September 2001 (the "Expropriation Decree").[92]

67. The Preamble to the Expropriation Decree listed seven criteria, five of which were substantive, purporting to explain the reason for expropriation of the 27 mills. The Expropriation Decree related to GAM states that the Government expropriated the sugar mills on the grounds of the public purpose listed in paragraphs V, VII, IX and X of Article 1 of the *Ley de Expropiación* ("Expropriation Law").[93] In addition, the Government created an Administrative Record ("*Expediente Administrativo*"),[94] pursuant

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[91] Juan Cortina Witness Statement at para. 26 (Exhibit C-18).

[92] *See* Expropriation Decree, art. 1 (Exhibit C-15).

[93] *See* Expropriation Law, as amended, published in the Federal Official Gazette on 4 December 1997 (Exhibit C-34). Paragraphs V, VII, IX and X of Article 1 establishes that as public purpose "…V. [t]he satisfaction of the collective needs in the event of war or domestic conflicts; the supply of food and of other articles of necessary consumption to the cities and urban centres, and other procedures used to combat or prevent the spread of epidemics, diseases, fires, plagues, floods and other public calamities; …VI [t]he defence, conservation, development and use of natural resources susceptible to exploitation;…X. [t]he creation, fostering or conservation of an enterprise for the collective benefit; XI. [n]ecessary measures to avoid the destruction of natural resources and damage to the property that may cause prejudice to the collective;…"

[94] *See, e.g.,* Summary of Administrative Record for San Francisco El Naranjal Sugar Mill (Exhibit C-35); Summary of Administrative Record for Lázaro Cárdenas Sugar Mill (Exhibit C-36); Summary of Administrative Record for San Pedro Sugar Mill (Exhibit C-

to Article 3 of the Expropriation Law, which under the law should contain evidence supporting the conclusion that each expropriated mill (or group of mills) satisfied the applicable criteria.

68. The criteria purportedly justifying the expropriation, and their inapplicability to GAM, are discussed below in section IV.C.

I. Domestic Law Challenges To The Expropriation: The Amparos

69. Mexico has a federal judicial review system for the protection of individual rights guaranteed under the Mexican Constitution, known as *amparo*. The *amparo* proceeding allows claimants to request certain remedies, including specific performance, for violations of constitutional rights.[95]

70. Many mill owners, including GAM, filed *amparo* proceedings following the expropriation. On 24 September 2001, GAM submitted its *amparo* claim challenging the constitutionality of the Expropriation Law and of the Expropriation Decree.[96]

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37); Summary of Administrative Record for Benito Juárez Sugar Mill (Exhibit C-38); Summary of Administrative Record for Tala Sugar Mill (Exhibit C-39).

[95] *See Ley de Amparo, Reglamentaria de Los Artículos 103 y 107 de la Constitución Política de los Estados Unidos Mexicanos* ("*Ley de Amparo*, Implementing Articles 103 an 107 of the Constitution of the United States of Mexico"), published in the Federal Official Gazette on 10 January 1936, as amended on 17 May 2001 (Exhibit C-40). An *amparo* may be brought in regard to: (1) any law or action by authorities that violates an individual right guaranteed under the Mexican Constitution or federal laws; (2) laws or federal official actions that violate or restrict the sovereignty of the states or that of state laws; or (3) official actions that invade the sphere of federal authority.

[96] On 15 November 2002, GAM abandoned the amparo with respect to the San Pedro and the San Francisco mills. Witness Statement of Juan Cortina at para. 33 (Exhibit C-18).

71. GAM claims, among other grounds, that the authorities did not prove the public purpose that the government claimed to justify the expropriation of GAM's mills. In fact, neither the Expropriation Decree, nor the documents and information contained in the corresponding Administrative Record sustain the government's actions.

72. Although GAM's *amparos* have not yet concluded, other mill operators have succeeded in their claims. Indeed, in two cases Mexican courts have found the expropriation to be unlawful:

- On 30 October 2002, a Federal Judge rendered judgment in favor of CAZE, declaring the Expropriation Decree was done in violation of the Mexican Constitution and was thus null and void.[97]
- On 2 January 2003, another Federal Judge rendered judgment in favor of one of Grupo Machado's mills, declaring that the Government had not established that the expropriation was done for a public purpose.[98]

73. Under Mexican law, these judgments are binding only with respect to the parties before the court. They are, however, persuasive authority for the simple proposition that Mexico's nationalization of half the nation's sugar milling capacity was illegal.

IV. <u>MEXICO'S TREATMENT OF GAMI'S INVESTMENT VIOLATED MEXICO'S OBLIGATIONS UNDER ARTICLE 1105</u>

74. Mexico has breached Article 1105 in two respects. First, prior to the formal seizure of sugar mills, Mexico severely damaged GAMI's investment and breached its

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[97] *Juez Séptimo de Distrito en Materia Administrativa en el Distrito Federal* ("Seventh Administrative District Judge"), January 2, 2003, *Amparo* proceeding No. 850/2001 at 10 (Exhibit C-41).

[98] *Juez Séptimo de Distrito en Materia Administrativa en el Distrito Federal* ("Seventh Administrative District Judge"), 30 October 2002, *Amparo* Proceeding No. 851/2001 at 15 (Exhibit C-42).

obligation to accord, fair and equitable treatment and full protection and security by implementing its sugar laws in a grossly unfair way including failing to implement at all key provisions, and acting in an arbitrary and discriminatory way. Second, Mexico likewise flagrantly ignored its own law and procedures in expropriating the mills of GAM and GAMI's shares in GAM, and blatantly discriminated against GAMI's investment by seizing the mills of GAM, but leaving similarly-situated mills in private hands.

A. NAFTA Article 1105

75. Article 1105(1) provides:

> Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

It requires the NAFTA parties to afford foreign investors a minimum level of protection consistent with basic principles of international law.[99]

76. In *Mondev International, Ltd. v. United States*, a recent NAFTA Chapter 11 case where the claimant had challenged a domestic court decision as violating Article 1105,

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[99] In July 2001, the NAFTA Free Trade Commission (the "FTC") issued its Notes of Interpretation of Certain Chapter 11 Provisions (the "Interpretation") (Exhibit C-43), stating, *inter alia*, that Article 1105 is not intended to require treatment of aliens "beyond that which is required by the customary international law minimum standard," and further that a determination that there has been a breach of another provision of NAFTA or some other treaty does not *per se* establish a breach of Article 1105. GAMI's claims here satisfy the standard set forth in the interpretation. Accordingly, it is not necessary for purposes of this dispute to enter into the debate over whether the Interpretation is a proper exercise of the interpretive power in Article 1131 or is an improper attempted amendment of Article 1105 without observing the NAFTA requirements for an amendment.

the tribunal addressed application of the minimum standard of customary international law required under Article 1105:

> In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment. [100]

The *Mondev* tribunal confirmed that the minimum standard of treatment required by Article 1105 is not "frozen in time" but is an "evolving" standard in the sense that international law itself evolves.[101] Thus, a claimant need not establish that the government's conduct was "egregious" or amounted to "bad faith" in order to demonstrate a breach of Article 1105. According to the *Mondev* tribunal:

> [B]oth the substantive and procedural rights of the individual in international law have undergone considerable development. In light of these developments it is unconvincing to confine the meaning of "fair and equitable

[100] *Mondev International, Ltd. v. United States,* Award, ICSID Case No. ARB (AF)/99/2 at para. 127 (11 October 2002) ("*Mondev*") available at http://www.naftalaw.org (last visited 10 February 2003) (Exhibit C-44). In *Mondev*, a Canadian company sued the United States under chapter 11, resulting from the City of Boston's alleged breach of contract. Although claimant won at the trial level, the Massachusetts Supreme Judicial Court subsequently ruled in favor of the City on appeal. Claimant then filed for arbitration, claiming that the Massachusetts court decision amounted to a denial of justice, in violation of Article 1105. *See generally id.* at paras. 128-150.

[101] Each NAFTA Party concedes this point. *See e.g.,* Letter from Hugo Perezcano Diaz, on behalf of the United Mexican States, to the *Pope & Talbot* Tribunal pursuant to NAFTA Article 1128 (3 December 2001) (Exhibit C-45) (stating that "Mexico also agrees that the [*Neer*] standard is relative and that conduct which may not have violated international law {sic} the 1920's might very well be seen to offend internationally accepted principles today"); *ADF Group Inc. and United States of America*, Award, ICSID Case No. ARB(AF)/00/1 at para. 179 (9 January 2003) ("ADF") (stating that the United States, Canada, and Mexico conceded that the standards reflected in article 1105 are not "frozen in time") (Exhibit C-46).

> treatment" and "full protection and security" of foreign investments to what those terms – had they been current at the time – might have meant in the 1920s when applied to the physical security of an alien. To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitable without necessarily acting in bad faith.[102]

77. The failure of a government to follow its own domestic law clearly is an example of unfair treatment, though tribunals applying Article 1105 appear to agree that a state's failure to comply with its own law or authority in a particular situation does not automatically constitute a violation of Article 1105 or international law. For instance, the *ADF* tribunal stated its view that even if the claimant in that case had been able to show a violation of local law:

> [S]omething more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of Article 1105(1), even under the Investor's view of that Article.[103]

78. Because the coverage of Chapter 11 and Article 1105 is broad, just what makes up that "something more" to constitute a breach of Article 1105 beyond isolated failure to follow domestic law necessarily depends on the circumstances of the case. The *ADF*

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[102] *Mondev* at para. 116 (Exhibit C-44); *see also Pope & Talbot and The Government of Canada,* Final Merits Award, ("Pope & Talbot Final Award") (10 April 2001) at para. 116 available at www.naftaclaim.org (last visited on 10 February 2003) ("It is doubtful that the NAFTA parties would want to present to potential investors and investments from other NAFTA countries the possibility that they would have no recourse to protection against anything but egregiously unfair conduct. The aim of NAFTA seems to be quite the opposite, that is, to present the investors the kind of hospitable climate that would insulate them from political risks or incidents of unfair treatment.") (Exhibit C-47).

[103] *ADF at* para. 190 (citations omitted) (Exhibit C-46).

Tribunal itself implies, and other international law corroborates, that the arbitrariness of the violations may constitute that "something more" that renders the conduct inconsistent with the minimum standard.

79. It has long been accepted that when a state has acted in an arbitrary manner, especially when that conduct has led to significant injury, the state has not treated the investor or investment in the fair and equitable manner that Article 1105 requires. The *ADF* Tribunal itself, in discussing the absence of any allegation of *ultra vires* act under local law, stated, "we observe that the Investor did not try to prove, for instance, that the rejection of its request for waiver of the Buy America requirements . . .was flawed by arbitrariness." [104] The implication was that a demonstration of arbitrariness might provide that "something more" to constitute a breach of international law standards.

80. The *Third Restatement,* in commenting on what the state is obligated to do in order to provide an investment "full protection and security," provides that a "state is responsible under international law" for "arbitrary or discriminatory acts or omissions by the state that impair property or other interests of a national of another state."[105] The

[104] *Id.* at para. 191.

[105] Restatement (Third) of The Foreign Relations Law of the United States "Third Restatement," § 712(3) and cmt. i (Exhibit C-48); *see also* United Nations International Covenant on Civil and Political Rights, Views of the Human Rights Committee, CCPR/C/65/D/633/1995 (5 May 1999) (regarding the principles of fair and equitable treatment under the *International Covenant on Civil and Political Rights*, the Committee noted that in order for a regulatory scheme not to be arbitrarily imposed, it should be specific, fair and reasonable, and its application should be transparent) (Exhibit C-49).

Third Restatement defines an "arbitrary" act as one that is "unfair and unreasonable, and inflicts serious injury to established rights of foreign nationals."[106]

81. As demonstrated below, Mexico's conduct in this case is far more egregious than a simple or isolated failure to follow some provision of the Sugarcane Decree. Mexico's actions and failures to act individually and cumulatively undermined the fundamental balance of the sugar laws, effectively turning GAMI's investment in GAM into a large contribution for the benefit of *cañeros,* and the Mexican Government itself, and those mills that were left unexpropriated. This is precisely what NAFTA prohibits. Such conduct is arbitrary, grossly unfair and far below the minimum standard required under Article 1105 and international law.

B. <u>Mexico Has Breached Article 1105 By Failing To Provide Fair And Equitable Treatment To GAMI With Respect To the Administration and Enforcement Of Its Sugar Laws</u>

82. As a general matter, the Sugarcane Decree called for implementation of the legal regime for the Mexican sugar industry in an equitable way that enabled all participants to be profitable.[107] The sugar mills could not be profitable unless the domestic price of sugar was high enough to cover the price they were compelled by law to pay for sugarcane, plus the costs of refining the cane and marketing the finished product.[108] The Sugarcane Decree, however, contained requirements and tools sufficient to enable

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[106] Third Restatement, § 712, rep. note 11 (Exhibit C-48).

[107] *See infra* section III.D.

[108] *See infra* section III.C.

refiners to operate profitably if the Government fulfilled its duties under the law in a fair and equitable manner.[109]

83. The Mexican Government did not fulfill its duties under the law. It arbitrarily and discriminatorily implemented certain aspects of the law and capriciously refused to implement and enforce others, thereby substantially destroying GAMI's investment.

84. Mexico's persistent corruption of the sugar program constitutes a breach of Article 1105. The Government breached the obligation of fair and equitable treatment in at least three specific ways. First, Mexico set the price of sugarcane at a level that was both higher than permitted under Mexican law and too high to permit profitable operation of sugar mills. Second, Mexico failed to enforce the minimum export requirements, resulting in excessive domestic supply. Third, Mexico failed to implement the production controls required under Mexican law. The cumulative result of these failures was to suppress the domestic price of sugar so that the mills could not cover the high Government-fixed price that they were required to pay the *cañeros* for sugarcane. Mexico's arbitrary conduct falls far short of the baseline protections of the fair and equitable standard and constitutes a breach of Article 1105.

1. Mexico arbitrarily **and discriminatorily** set the price of sugarcane too high.

85. Since the 1997 *Acuerdo*, Mexican law has required that the reference price be computed according to a formula set out in the 1997 *Acuerdo*. However, Mexico did not observe the formula, setting the reference price significantly above the level required by

[109] *See infra* section III.D.

the 1997 Acuerdo itself for the 1998/1999, 1999/2000, and 2000/2001 harvests.[110] As a result, the price that the refiners paid for cane was inflated (since it was a proportion of the reference price), while the actual market price was significantly lower and insufficient to cover the costs of the refiners.

2. Mexico arbitrarily failed to implement and enforce the export requirements established in the 1997 and 1998 Acuerdos.

86. The 1997 *Acuerdo* compelled sugar mills to pay higher prices for sugarcane, which would erode the mills' refining margin if not accompanied by measures to assure that the domestic price of sugar would be maintained at a level sufficient to allow for profitable operation of the mills. To this end, the 1997 *Acuerdo* provided that SECOFI would establish a minimum export requirement for each mill, so that surplus production of standard and refined sugar would not be sold into the Mexican market, depresssing the domestic price for sugar.[111] If a mill did not export its proper quota amount as assigned by SECOFI, Article 5(II) of the 1997 *Acuerdo* required a defaulting mill to pay a very high penalty price for cane to the *cañeros* supplying its mills. The defaulting mills also were to have less access to preferential financing of inventories and to the relatively high priced American sugar market through Mexico's NAFTA quota allocation.

87. In theory, such a system could be effective, since the punitive price far exceeded the benefit of selling into the domestic market (even at the risk of depressing that market) instead of exporting into the much less remunerative world market. In practice, however,

[110] Valuation Report at 12 (Exhibit C-26).

[111] *See* 1997 *Acuerdo*, art. 4(III) (Exhibit C-23).

the efficacy of the system depended on assured compliance of all mills, because cheating would result in a glut of sugar on the domestic market with corresponding price-depressing effects. Obtaining compliance, in turn, required an effective enforcement system with the full cooperation and participation of the Government, including the setting of export requirements at levels sufficient to assure that the market price would be adequate, compliance by the Government-owned mills with their respective export requirements, and timely provision of information on non-compliance to the *cañeros,* who had the authority and the economic motivation to enforce the export requirements.[112] In addition, the Government-controlled JCACA had the duty to act on *cañeros* complaints that mills were not in compliance with their export requirements. None of these things happened, with the result that in the period from 1999/2000 harvest year up to the expropriation of the mills in September of 2001, the domestic price of sugar was never sufficient to enable the mills to be profitable.

88. Among the most telling of the Government's transgressions was that neither of the Government's own mills complied with its export requirements, nor was either ever punished. As can be seen in the chart at section III.F.2, Government mills exported on average only 4.1% of their export requirements in the 1999/2000 and 2000/2001 harvests. The Government's unwillingness to comply with its own regulations and the lack of any enforcement action against the government-owned mills is the epitome of arbitrary and discriminatory action in violation of Article 1105.

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[112] *See supra* section III.F.3.

89. Similarly, while each of the GAM mills were in full compliance with its export requirements from the 1997/1998 through the 2001/2001 harvests,[113] many other mills were not. Thus, Jimenez Group exported less than 5% of its export requirements between the 1997/98 and 2000/01 harvests[114] and other mills, while better, often failed to reach even 50% compliance.[115] As a result, thousands of tons of excess sugar ended upon on the domestic market, creating immense surpluses and putting substantial downward pressure on the domestic price.

90. To the best of GAMI's knowledge, no mill has suffered any consequences for failure to comply with export obligations. Even when the Government was confronted with strong evidence that the CAZE Group, the largest single producer in the nation, had been engaged in a long-term practice of forgery in order to dump its surpluses onto the market nothing was done.[116] Instead of reacting to CAZE's fraud in particular, and the non-compliance with the regime in general, the Government chose to do nothing, in flagrant disregard of its duties, and to the great detriment of GAM, which fully complied with its export requirements.

91. Furthermore, the Government failed to take the necessary steps with regard to the admission and adjudication of *cañero* suits before the JCACA for enforcement of the

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[113] *See supra* Mexican Sugar Mill Export Quota Compliance 1997 to 2001 chart at section III.F.2.

[114] *See id.*

[115] *See generally* Export Quota Compliance chart 1996/1997-1999/2000 (Exhibit C-31); Export Quota Compliance chart 2000/2001 (Exhibit C-32).

[116] *See supra* section III.F.2.

penalty price.[117] Specifically, the Government did not produce the official export numbers in a timely fashion, frustrating the efforts of the *cañeros* to enforce the export requirements. Through these various acts and failures to act, the Government effectively prevented all enforcement of the export requirements during the 1999/2000 and 2000/2001 harvests, precipitating the financial crises that destroyed the value of GAMI's investment.

92. The arbitrary and capricious administration of the export program resulted in serious injury to GAMI's investment, and breached Mexico's obligations under Article 1105(1).

3. The Government arbitrarily failed to implement the production restrictions.

93. The Government also refused to implement the requirements of the 1998 *Acuerdo* mandating reduction of sugar production.[118] This provision required mills either to reduce production to a ceiling level or to export all sugar produced in excess of each mill's government-established production ceiling. Mills failing to comply with this requirement were to be subject to penalties (in terms of higher cane prices in the next harvest) for non-compliance.

94. The law required (and still requires) the *Secretaría de Economía* and SAGARPA to make timely determinations of production ceilings for each sugar mill in a given

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[117] *See supra* section III.F.2.

[118] *See supra* section III.F.3.

harvest year.[119] Without explanation or basis, the Mexican Government arbitrarily frustrated the operation of this mechanism by failing to timely and effectively comply with its obligation to establish production ceilings. The result, again, was the continued increase in domestic sugar inventories, depressing the price and further injuring GAMI's investment.

95. Individually and cumulatively, Mexico's arbitrary and unreasonable refusal to set a proper reference price, to implement and enforce the export requirements, and to implement the production ceiling levels effectively destroyed the entire value of GAMI's investment and constitute a breach of the international law minimum standard for fair and equitable treatment and full protection and security under Article 1105. Mexico's conduct went beyond simple illegality or lack of domestic authority. In the two-year period prior to the expropriation, Mexico repeatedly and systematically violated the requirements of its own law, arbitrarily and discriminatorily conferring huge benefits on some participants in the industry (largely the *cañeros*) and imposing great costs on others like GAM and GAMI.

C. Mexico Has Breached Article 1105 By Arbitrarily And Discriminatorily Expropriating The GAM Mills.

96. Mexico's seizure of GAM's mills and indirect expropriation of GAMI's investment, breached Article 1105 in two respects. First, it was done arbitrarily and in complete disregard of the fundamental protection provided even under Mexican law, including the criteria set forth in the Expropriation Decree itself. Second, the

[119] *Id.*

expropriation of GAM's assets was arbitrary and discriminatory in that Mexico did not expropriate other mills in like circumstances.

1. Mexico's Expropriation of GAM was arbitrary and unlawful under the Expropriation Decree.

97. The Expropriation Decree sets out several criteria which the Government purportedly used to justify which privately-held mills would be expropriated. The Decree claims justification for the expropriations based on the importance of the sugar industry in Mexico and several direct and implied criticisms of the expropriated mills, which can be summarized as follows:

- whether mills were being honestly managed;[120]
- whether the financial state of a mill was such that the livelihood of those that depended on the mill had been put at risk;[121]
- whether the financial state of the mill was such that the mill would be unable to make the necessary repairs prior to the 2001/2002 harvest;[122] and

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[120] *See* Expropriation Decree, preamble at para. 2. ("That the Federal Government seeks good and honest administration as a common denominator of the national sugar agricultural industry, eliminating the improper practices of a group of persons dedicated to this agricultural industry, which have profoundly affected the sector.") (Exhibit C-15).

[121] *See id.* at paras. 3 and 6 ("That the owners of the companies listed in article 1 of this Decree led their enterprises to lose their financial soundness, by contracting considerable debt from diverse financial institutions and government agencies, thus placing at risk not only the patrimony of rural workers but also the patrimony of all the Mexicans. . . . That proper transformation of the sugar cane owned by tens of thousands of sugar farmers in the country, to supply the companies listed in this Decree, whose financial difficulty will prevent efficient operation and fulfillment of their commitments, endangering the jobs of mill workers, related service providers and the economic activity in large regions of the states where they are located.").

[122] *See id.* at para. 4 ("That in eve of commencement of the 2001-2002 harvest next fall, there is a considerable likelihood that a certain number of mills, which account for a strong share of domestic production, do not have the necessary resources to repair the factories so as to secure the effective and timely processing of over 20 million tons of

- whether the mill is one with which the local *cañeros* have indicated that they will not continue to work with so long as it continues to be managed by its current owners.[123]

98. Under Mexican law, the Government's decision to expropriate must be based on evidence contained in an Administrative Record.[124] The Administrative Record concerning the expropriation of GAM, however, contains no allegations or evidence at all with respect to GAM in regard to most of the criteria of the Expropriation. Further, what little evidence is provided regarding GAM is patently false.

99. First, the Administrative Record puts forth no evidence that GAM or its officers have acted dishonestly or improperly.[125] Nor could it. To the contrary, the facts show that GAM, having made a conscious decision to position itself to attract international investment capital, had voluntarily complied with the disclosure and auditing requirements attendant to public ownership and financing in both Mexico and the United

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sugar cane currently growing and maturing in Mexican rural areas to be harvested as the culmination of the efforts of over 50 percent of the farmers.") (Exhibit C-15).

[123] *See id.* at para. 5 ("That sugar cane farmers that supply companies listed in this Decree have indicated by several means their decision not to conduct the harvest with these companies so long as they are directed by their current owners."). The other two criteria, contained in paragraphs 1 and 7, are merely declaratory and are not addressed herein. *See id.* at paras. 1, 7.

[124] Expropriation Law, art. 3 (Exhibit C-34).

[125] *Compare* Expropriation Decree at Preamble at para. 2 (Exhibit C-15), *with* Administrative file related to expropriation. Document within Administrative File entitled *Expediente Administrativo – Téchnico, en el que obran las constancias documentales que dan sustento a la instrumentación del procedimiento de expropriación por causa de utilidad pública y de interés social y en el que pueden ser affectados bienes propriedad del ingenio materia del presente expediente.* Administrative Record – Technical file providing documentary proof supporting the implementation of the expropriation procedure by cause of public and social interest and in the way it may affect the property of the sugar mills mention in this administrative file at 3 (failing to mention this criteria in the section devoted to GAM) (Exhibit C-50).

States. Having been a public company since 1997, GAM's financial situation was an open book, and a long history of audits by public accounting firms confirms that the company was soundly managed."[126] In point of fact, GAM's books and records met both Mexican and U.S. Generally Accepted Accounting Principles and thus refute Mexico's unsupported assertion of a lack of business integrity.[127] As a further example of GAM's integrity, GAM fully complied with its export requirements, unlike many other mill operators, including the Government-owned mills and other privately-owned mills that were not expropriated.[128]

100. Second, the Administrative Record asserts that GAM's financial situation was one of the reasons for the expropriation, and alleges that GAM's filing for *suspensión de pagos* precluded it from obtaining further financing, leaving it unable to pay its *cañeros*.[129] This is incorrect. Although GAM was in *suspensión de pagos* at the time of expropriation, this had no effect on its ability to pay *cañeros* or mill workers.[130]

[126] Mexican law requires that GAM provide audited financial statements for the three years prior to GAM's public offering in 1997.

[127] *See, e.g.*, GAM 2000 Annual Report, auditors notes at F-2 ("In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of [GAM] as of December 31, 1999 and 2000, and the results of their operations, the changes in their stockholders' equity and the changes in their financial position for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in Mexico.") (Exhibit C-3).

[128] *See supra* section III.F.

[129] Technical file within the Administrative Record at 3 (Exhibit C-50).

[130] Juan Cortina Witness Statement at para. 27 (Exhibit C-18).

101. The Government's assertions were based on an arbitrary and erroneous calculation of GAM's total indebtedness. Specifically, the Administrative Record incorrectly claims that GAM owns six mills, not five, erroneously listing the Eldorado mill as a GAM mill. Eldorado, however, is not owned by GAM, but rather by *Controladora de Negocios Azucareros, S.A. de C.V.* ("CNA"), an entity separate and distinct from GAM.[131] In tallying GAM's debt to FINA, the Government apparently added $412 million pesos of Eldorado debt to GAM's debt of $38 million pesos. The Government thus based the expropriation on the contention that GAM's debt to FINA was $450 million pesos, when in reality it was dramatically less.

102. If the Government had properly analyzed the debt of GAM, it could have reached only one conclusion – that the expropriation was not justified by GAM's financial condition. Although GAM was carrying substantial debt at the time of expropriation, GAM was managing its debt responsibly. Indeed, GAM's filing for *suspensión de pagos* prevented exactly the circumstances that the Expropriation Decree cited as risk factors. With the deferral of debt payments under *suspensión de pagos*, GAM was able to free up cash flow to make payments to *cañeros,* pay wages to mill workers, and maintain its equipment. Furthermore, as of the date of expropriation, the financial condition of GAM had stabilized and was actually showing signs of improvement, notwithstanding the continued poor prices for sugar in the domestic market. At the time of expropriation, GAM had:

[131] CNA is controlled by Juan Gallardo Thurlow, GAM's controlling shareholder, but the two companies are separate. GAMI has no interest in CNA or the Eldorado mill. *See, e.g.,* GAM 2000 Annual Report at 29 (providing a list of the complete subsidiaries and assets of GAM) (Exhibit C-3).

- only US$4,120,000 in FINA debt;[132]
- US $139,540,000 in overall debt;[133] and
- a debt production ratio of $325/ton, a figure that had declined from $647/ton in 1998.

103. Furthermore, the Government never established that GAM's financial state put the livelihoods of either its *cañeros* or its mill workers at risk. Neither the filing for *suspensión de pagos*, nor any other financial factor endangered the payment of the *cañeros*. All payments to *cañeros* for the 2000/2001 harvest were guaranteed with GAM's own sugar inventories, a mechanism that GAM and the *cañeros* had used successfully the year before.[134] Moreover, although GAM had to delay payments to *cañeros* due to the government-induced crash of domestic sugar prices, its payment schedule was in accordance with its agreement and comparable to numerous other mills that were not expropriated.

104. Nor did GAM's financial condition have any detrimental effect on its ability to repair its mills in time for the next harvest.[135] The Administrative Record contains no

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[132] *See* GAM's Debt Calculation Worksheet as of September 30, 2001 (Exhibit C-60).

[133] *Id.*

[134] Juan Cortina Witness Statement at para. 28 (Exhibit C-18); Minutes of Meeting held in SAGARPA on 27 August 2001 re: Lázaro Cárdenas (agreeing upon payment to *cañeros* no later than 13 October 2001) (Exhibit C-52); Minutes of the Meeting held in SAGARPA on 28 August 2001 re: Benito Juárez (agreeing upon payment to *cañeros* (Exhibit C-53); Minutes of the Meeting held on 29 August 2001 re: Tala (agreeing upon the schedule of payment to *cañeros* no later than 31 August 2001) (Exhibit C-54); Minutes of the Meeting held in SAGARPA on 28 August 2001 re: San Pedro and San Francisco El Naranjal (agreeing upon the schedule of payment to *cañeros* in a period of 3 weeks from 3 September 2001 (Exhibit C-55).

[135] *See* Technical file within the Administrative Record at 3 (Exhibit C-50).

mention whatsoever of this issue with regard to GAM.[136] The facts amply demonstrate that GAM was maintaining its mills properly and had adequate resources to conduct the necessary repairs.[137] Those repairs were on schedule to be completed before the commencement of the 2001-02 harvest.[138]

105. The Government's criticisms that the *cañeros* distrusted some owners so much that there was risk of strikes and stoppages likewise was not even alleged to apply to GAM, and there was no evidence whatsoever in the Administrative Record to support this allegation.[139]

106. Thus, it can be seen that the only criteria alleged to apply to GAM were based on false information and a false understanding of the situation, while other general criticisms of the industry, whatever their merit in relation to other expropriated mills, had no application at all to GAM.

107. Mexico's seizure of GAM's mills also violated Article 1105 because Mexico arbitrarily seized GAM's mills but did not expropriate other mills in similar circumstances. This arbitrary discrimination, infringes Article 1105 as well as Article 1102. We address this issue below in our discussion of Article 1102.

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[136] *See id.* at 3-4.

[137] *See* Maintenance Program for GAM mills for 2001 (showing that GAM had properly budgeted and planned for all necessary maintenance and repairs) (Exhibit C-56).

[138] Juan Cortina Witness Statement at para. 29 (Exhibit C-18); Letter from Juan Cortina re: Maintenance of GAM Mills (11 October 2001) (stating that the Government has not been properly repairing the mills) (Exhibit C-57).

[139] Expropriation Decree, para. 5 (Exhibit C-15).

V. MEXICO'S TREATMENT OF GAMI AND GAMI'S INVESTMENT VIOLATED MEXICO'S OBLIGATIONS UNDER ARTICLE 1102

A. Article 1102

108. Article 1102 of the NAFTA provides in relevant part:

> 1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 2. 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.

109. Mexico has breached Article 1102 by treating GAMI and GAMI's investment in GAM less favorably than Mexican investors and the investments of Mexican investors in like circumstances in that: (a) GAMI's investment was expropriated while the ownership interests in sugar mills of many Mexican investors were not; and (b) sugar mills of many Mexican investors were not required to comply with minimum export requirements, while the mills of GAM were.

B. Mexico's Expropriation Of GAMI's Investment Breached Article 1102

110. Mexico violated Article 1102 when Mexico expropriated the GAM mills and did not expropriate other mills in like circumstances that were owned by Mexican investors.

111. It is scarcely debatable that an investor whose investment is expropriated without compensation is treated less favorably than an investor who is permitted to retain his investment. In the circumstances of this dispute, investors whose investments were not

expropriated were treated more favorably in at least three specific ways. First, those investors retained their sugar mills. Second, investors in those mills that were not expropriated have seen the value of their investments increase as the Government finally took action to strengthen the domestic market, once it controlled half of it.[140] Third, the increase of the sugar quota to the United States pursuant to the phased opening of the U.S. market under the terms of the NAFTA will benefit those private investors who retain their mills, but GAMI will not share in those benefits because its investment has been expropriated.

1. GAMI's investment was "like circumstances" with the investment of Mexican investors

112. GAMI's investment was in like circumstances with the ownership interest of Mexican investors in sugar mills that were not expropriated. GAMI's investment was in modern mills capable of efficiently processing sugar at a profit, if the Government had acted evenhandedly and in accordance with its own laws. The unexpropriated mills, like those that were expropriated, all expected that the Government would finally take the necessary steps to make possible profitable operations essential to the whole Mexican sugar industry. In that sense, GAMI's investment was in like circumstances with the investments of all investors in sugar mills in Mexico.

[140] *See, e.g.,* Beta San Miguel's Financial Information for the Third Trimester 2001-2002 at 4 (25 October 2002) (stating that BSM's net results rose from negative $59,233,000 pesos in the first nine months of 2001 to a positive $146,036,000 pesos in the first nine months of 2002) (Exhibit C-58).

113. Alternatively, even by the narrower standards of the Government's own Expropriation Decree, GAMI's investment was in like circumstances with at least some of the unexpropriated mills of Mexican Investors.

114. Mexico's putative basis for issuing the Expropriation Decree was its conclusion that the expropriated mills had become so indebted that they would cease to operate, endangering the livelihoods of the *cañeros*, mill workers and others that depended on these mills.[141] The Government asserted in the tersely worded Administrative Record that these concerns justified expropriation of GAM.[142] However, as discussed above in section IV.C, GAM was as capable of meeting its obligations to its *cañeros* and mill workers as other unexpropriated mills, and GAM's financial situation was no worse than certain of those unexpropriated mills. Indeed, GAM had availed itself of the *suspensión de pagos* proceeding – relief expressly authorized under Mexican law – to preclude its indebtedness from affecting payments to *cañeros* and to preserve the jobs of mill workers. Thus, GAM acted responsibly and, by the time of expropriation, was well on the way toward concluding a consensual plan of financial restructuring with its creditors.[143]

[141] *See* Expropriation Decree, paras. 3, 6 (Exhibit C-15).

[142] *See* Technical file within the Administrative Record at 3 ("[GAM] found to have ceased payments since 2 May 2002. Its liabilities as of June 30 of this year, merely with the Federal Government, reached approximately 450,000,000 pesos, and it could not receive credit via a trust (due to the fact that it has suspended payments, it is not eligible for credit) to pay its debts with the cane harvesters, which amount to approximately 463,000,000 pesos.") (Exhibit C-50). However, as established in section III.C., the Government's contentions in this regard are completely erroneous.

[143] *See* Juan Cortina Witness Statement at para. 26 (Exhibit C-18).

115. The degradation of the sugar price dramatically reduced the refining margins of all sugar mills, leading to high levels of indebtedness for many companies. Nevertheless, the Government did not expropriate all sugar mills that were similarly situated. GAMI has requested that Mexico produce financial and other information pertaining to certain other mills, which Mexico has not provided as of the date of this submission.[144] Even without this information, however, GAMI has been able to review publicly available information indicating that at least one other company owning multiple non-expropriated mills was in like circumstances to those of GAM, as measured by the criteria of the Expropriation Decree itself.

116. Specifically, Beta San Miguel ("BSM"), a company that owns five unexpropriated mills accounting for approximately 9.34% of nation-wide production, had incurred debt comparable to that of GAM. Also, like GAM (and other companies), BSM negotiated an agreement with its *cañeros* to extend the period for payment for sugarcane. Mexico did not expropriate the investment the Mexican investors had made in the BSM mills, thereby providing preferential treatment to BSM and its investors in violation of Article 1102 of NAFTA.

117. As a general matter, BSM and GAM are very comparable companies in that as of the date of expropriation:

- both[145] companies owned the same number of mills (five) and controlled a similar share of the market[146] based on similar net sales;[147]

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[144] *See supra* at para. 16.

[145] *See, e.g.,* BSM Financial Statements for 2000 and 2001 at 8 (12 September 2002) (Exhibit C-59).

- the information of both companies was publicly available;[148] and

- both companies were generally in compliance with their export requirements.[149]

118. Furthermore, as of the date of expropriation, both companies were in very similar financial situations:

- BSM had an outstanding overall debt of US$116,134,000 compared to GAM's overall debt of US$139,540,000;[150]

- BSM had a debt to production ratio of $278/ton, compared with GAM's ratio of $325/ton; and [151]

- both firms operated at a loss during 2001.[152]

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[146] BSM's production constituted 9.34% compared to GAM's 8.81% of the market. *Compare* Export Quota Compliance Chart 2000/2001 (Exhibit C-20), *with* GAM Quarterly Report for Period Ending 30 September 2001 at 22 (Exhibit C-16).

[147] BSM's net sales of 1,493,131 were approximately the same as GAM's net sales of 1,571,977. BSM and GAM Comparative Worksheet for the Third Quarter of 2001 (Exhibit C-60).

[148] Because GAM is a publicly listed company on the Mexican Stock Exchange, its financial information is publicly available. BSM, although not yet a publicly listed company, has taken steps to be listed, and in doing so, publicly disclosed certain financial information to the Mexican Stock Exchange pursuant to Mexican law. *See generally* Beta San Miguel Financial Information for the Third Trimester 2001-2002 (25 October 2002) (Exhibit C-58).

[149] *See* Export Quota Compliance Chart 1996/1997–1999/2000 (Exhibit C-31) *and* Export Quota Compliance Chart 2000/2001 (Exhibit C-32).

[150] *Compare* BSM Debt Calculation Worksheet (Exhibit C-61), *with* GAM Debt Calculation Worksheet (Exhibit C-51).

[151] *Id.*

[152] BSM and GAM Comparative Worksheet for the Third Quarter of 2001 (Exhibit C-60). Although BSM has not filed for *suspensión de pagos* that is irrelevant under the criteria for expropriation. Being in *suspensión de pagos* in no way made it more justifiable to expropriate GAM than BSM with respect to the criteria of the Expropriation Decree.

119. The effect that this debt had on GAM's ability to pay its *cañeros* was comparable to effects that BSM, as well as other firms, were experiencing as a result of their debts. Because of cash flow difficulties, GAM negotiated with its *cañeros*, and they agreed to deferred payment. Specifically, GAM's revised payment schedule provided that the payments of the final twenty percent owed the *cañeros* would begin on 3 September 2001 and that final payments would be completed during the fall of 2001.[153] As of the date of expropriation, a majority of the total payments for the 2000 – 2001 harvest had already been completed.[154] The deferred payments were guaranteed by a pledge of GAM's sugar inventory.[155] Accordingly, there was no risk of GAM defaulting on its payments to the *cañeros*.

120. BSM had made a similar deal with its *cañeros*. Specifically, the San Miguel del Naranjo mill agreed to pay the *cañeros* via partial payments with the final payment coming due on 28 September 2001.[156] Quesería agreed to pay by September 27.[157] The

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Most critically, the Government's essential reason for expropriating for GAM's mills was the putative concern that the indebtedness of GAM put at risk the livelihood of its *cañeros* and its mill workers. As GAMI has demonstrated, that was not the case, and *suspensión de pagos* in no way negatively affected GAM's ability to meet those responsibilities.

[153] *See supra* para. 105.

[154] Witness Statement of Juan Cortina at para. 28 (Exhibit C-18).

[155] *See supra* para. 105.

[156] *See* Minutes of the Meeting of the *Comité de Produción Cañera* ("Sugarcane Production Committee") held on 4 August 2001 (Exhibit C-62).

[157] *See* Minutes of the Meeting of the *Comité de Produción Cañera* ("Sugarcane Production Committee") held on 20 July 2001 (Exhibit C-63).

Constancia mill agreed to finish paying by October 5.[158] And finally, the San Rafael de Pucté mills agreed to finish paying by October 24.[159]

121. GAM and BSM were not the only mill owners that that had to make such arrangements. For example, the Puga and the Seoane Groups (whose mills were not expropriated) made the following arrangements:

- Puga, which owns one mill, accounting for 2.62% of nation-wide production, delayed payments made to its *cañeros,* making arrangements for final payment on the last day of October;[160] and
- Seoane, which owns two mills, accounting for 3.31% of nation-wide production, did not pay its *cañeros* under the terms originally agreed upon, but rather agreed to complete payment no later than August 31st.[161]

122. Nevertheless, Mexico did not expropriate the mills of BSM, Porres or Seoane or the equity interests of investors in those companies, but it did expropriate the mills of GAM and GAMI's equity investment in GAM. Accordingly, Mexico has treated GAMI and its investment less favorably than Mexican investors and their investments, in violation of Article 1102.

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[158] *See* Minutes of the Meeting of the "*Comité de Produción Cañera* ("Sugarcane Production Committee") held on 27 July 2001 (Exhibit C-62).

[159] *See* Minutes of the Meeting of the *Comité de Produción Cañera* ("Sugarcane Production Committee") (Exhibit C-65).

[160] Minutes of the Meeting of the *Comité de Producción Cañera* ("Sugarcane Production Committee") held on 17 July 2001 (Exhibit C-66).

[161] *See* Minutes of the Meeting of JCACA, held on 27 July 2001 (noting that before the agreement was reached, *cañeros* took over La Gloria, one of Seoane's mills) (Exhibit C-67).

2. Prior Case Law Supports the Conclusion that Mexico has breached Article 1102

123. It is true that some Mexican investors (including GAM's Mexican shareholders and Mexican shareholders of some other expropriated companies) and their investments were treated just as badly as GAMI and GAMI's investment. However, that does not justify more favorable treatment of *other* Mexican investors and investments. The text of Article 1102 does not require proof that all or even most local investors get more favorable treatment. If the rules were otherwise, the obligations of Article 1102 would have little meaning, as governments could escape the national treatment obligation merely by ensuring that at least some of their citizens and their investments also were treated less favorably.

124. In this regard, World Trade Organization (WTO) panels and the WTO Appellate Body both have firmly rejected the notion that less favorable treatment of imported like products can be justified on the basis that there is also adverse treatment of some or many domestic products.[162] In the alcoholic beverage tax cases examined in the WTO, the majority of the unfavorably taxed products were domestic, not imported, but more favorable tax treatment of some domestic products was still found to infringe the national

[162] *See United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/R at para. 61.4 (29 January 1996) (rejecting the U.S. argument that "the treatment accorded to gasoline imported under a statutory baseline was on the whole no less favourable than that accorded to domestic gasoline under individual refiner baselines," stating that "less favourable treatment of particular imported products in some instances could not be balanced by more favourable treatment of other imported products in other instances") (Exhibit C-68).

treatment provisions of Article III of the GATT 1994.[163] Thus, in *Chile - Taxes on Alcoholic Beverages*, the Panel found that:

> it is sufficient to find that *certain* of the imports are taxed dissimilarly compared to *certain* of the domestic substitutable products. It is *not* necessary to show that *all* of the imports are taxed dissimilarly to *all* of the domestic products.[164]

125. Further, "for greater certainty" Article 1102(3) confirms that a state or province cannot escape its national treatment obligations by discriminating against both foreign investors and investors of other states or provinces of the same country.[165] Accordingly, when Mexico expropriated the GAM mills and not the BSM mills, Mexico provided

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[163] *See Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R (4 October 1996); *Chile - Taxes on Alcoholic Beverages*, Report of the Panel, para. 7.97, WT/DS87/R, WT/DS110/R (15 June 1999) (Exhibit C-70); *see also United States – Measures Affecting Alcoholic and Malt Beverages*, DS23/R – 39S/206, at para. 5.6 (16 March 1992) ("[T]he fact that only approximately 1.5 per cent of domestic beer in the United States is eligible for the lower tax rate does not immunize this United States measure from the national treatment obligations of [GATT] Article III.") (Exhibit C-71).

[164] *Chile - Taxes on Alcoholic Beverages*, at para. 7.97 (Exhibit C-70); *see also United States – Section 337 of the Tariff Act of 1930*, L/6439 – 36S/345 at paras. 5.13-5.14 (January 1989) (Exhibit C-72), where the GATT panel found:

> that the "no less favorable" treatment requirement of Article II:4 has to be understood as applicable to each individual case of imported products. The Panel rejected any notion of balancing more favourable treatment of some imported products against less favourable treatment of other imported products. If this notion were accepted, it would entitle a contracting party to derogate from the no less favourable treatment obligation in one case, or indeed in respect of one contracting party, on the ground that it accords more favourable treatment in some other case, or to another contracting party. Such an interpretation would lead to great uncertainty about the conditions of competition between imported and domestic products and thus defeat the purposes of Article III.

[165] *See Pope & Talbot Final Award* at para. 42 (discussing that paragraphs 1, 2, and 3 of Article 1102 provide "identical" levels of treatment) (Exhibit C-47).

GAMI and its investment less favorable treatment than Mexican investors and their investments in like circumstances in violation of Article 1102.

C. Mexico's Enforcement Of The Export Regime Breached Article 1102

126. Mexico also breached Article 1102 by providing benefits (in the form of access to financing of inventories and access to the U.S. market) to certain Mexican-owned mills on terms more favorable than those benefits were accorded to GAM mills. Further, in a way analogous to the situation in *Marvin Feldman v. Mexico,*[166] Mexico also breached Article 1102 in failing to enforce its minimum export requirements against mills of Mexican investors while GAMI's mills complied.[167]

127. As noted above, Mexico established, beginning with the 1997 *Acuerdo*, a requirement for each mill to export minimum quantities of sugar to the world market. The world market was the least desirable market for Mexican sugar, because low prices prevailed in that market. To enforce the export requirement, there were three penalties: (1) denial of a portion of Mexico's share of the U.S. import quota (at relatively high U.S. prices);[168] (2) denial of favorable financing of inventories by the Government;[169] and (3) a requirement to pay a punitively high price for cane to *cañeros.*

[166] ICSID Case No. ARB(AF)/99/1 (16 December 2001) (Exhibit C-73).

[167] *See id.* at para. 169 ("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 cigarette resell/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.").

[168] *See Acuerdo por el cual se dan a conocer los cupos para internar a los Estados Unidos de América en 1999, dentro del arancel-cuota establecido en el Tratado de Libre*

128. In practice, the Government did not impose any of these penalties against mills that did not comply with the minimum export requirements.[170] Non-complying Mexican companies got the same benefits as GAM in terms of access to financing and to the U.S. market, but on more favorable terms than GAM because they did not comply with the requirement to export and instead sold their surplus sugar into the Mexican market at higher prices than the world market.[171] This difference in treatment represented less favorable treatment in the "conduct" and "operation" of GAMI's investment, since

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Comercio de América del Norte, azúcares, jarabes y productos con alto contenido de azúcar originarios de los Estados Unidos Mexicanos. ("*Acuerdo* by which it is provided the quota to introduce to the United States of America in 1999, within the tariff quota established in the North America Free Trade Agreement, sugars, syrups and products with a high content of sugar originating from the United States of Mexico") published in the Federal Official Gazette on 19 July 1999, art. 3 (Exhibit C-74); *see Acuerdo por el cual se dan a conocer los cupos para internar a los Estados Unidos de América 2000 dentro del arancel-cuota establecido en el Tratado de Libre Comercio de América del Norte, azúcares, jarabes, y productos con alto contenido de azúcar originarios de los Estados Unidos Mexicanos;*("the same for 2000" published in the Federal Official Gazette on 25 July 2000, art. 3 (Exhibit C-75).

[169] *Acuerdo para la asignación de un subsidio destinado a apoyar a los ingenios azucareros mediante la promoción de las exportaciones definitivas de excedentes de azúcar de ciclos anteriores a la zafra 1996/1997* ("*Acuerdo* for the assignment of a subsidy used to support sugar mills by the promotion of definitive exports of sugar surplus from former harvest 1996/1997") published in the Federal Official Gazette on 20 October 1997, art. 7 (Exhibit C-76); *Acuerdo para la asignación de un subsidio destinado a apoyar el manejo de inventarios de azúcar nacional* ("*Acuerdo* for the Assignment of a subsidy designated to support the management of inventories of national sugar") published in the Federal Official Gazette on 16 April 1998, art. 6 (Exhibit C-77); *Acuerdo para la asignación de un subsidio destinado a apoyar el manejo de inventarios de azúcar nacional* ("*Acuerdo* for the assignment of a subsidy designated to support the managing of investors of national sugar") published in the Federal Official Gazette on 27 December 1999, art. 6 (Exhibit C-78).

[170] As noted above, both Government-owned mills and other privately owned mills failed to comply with its requirements under the sugar regime, contributing to the domestic surplus while enabling these mills to avoid the need to accept lower prices for exports. *See supra* section III.F.2.

[171] *See supra* section III.E; *see supra* note 169.

similar investments of Mexican investors got the same benefits without having to meet those costly conditions.

129. The granting of a state-controlled benefit (such as financing or the access to a high-price market) on more favorable terms to domestic investors and their investments than to U.S. investors and their investments in like circumstances indisputably is a breach of Article 1102. Further, as the Tribunal found in *Feldman*, allowing domestic investors in like circumstances to avoid compliance while a foreign investor is required to comply is also contrary to Article 1102.[172] Here, as in *Feldman*, the arbitrary and discriminatory enforcement of a law has disadvantaged GAMI relative to Mexican investors in other non-complying and unpunished companies.[173]

130. Because all mills are subject to the export regime, all sugar mills and their investors are in like circumstances with the GAM mills for purposes of this part of the analysis. The relevant laws provide no basis for distinction between mills.

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[172] *See Feldman* at para. 187 (Exhibit C-73). In *Feldman*, Mexican law barred the Government from providing a tax rebate on certain processed tobacco sales unless the company requesting the rebate was able to produce invoices from its vendors explicitly stating the amount of tax included in the purchase price, which neither the claimant, a reseller and exporter of cigarettes, nor any of the Mexican-owned companies in like circumstances with the claimant, could provide. *See id.* at paras. 15, 21, 23 and 154. In its findings, the Tribunal noted that "it does not matter for purposes of Article 1102 whether in fact Mexican law authorizes [the Government] to provide . . . rebates [to the claimant and its competitors]. The question, rather, is whether rebates have in fact been provided for domestically owned cigarette exporters while denied to a foreign re-seller." *Id.* at para. 169. Finding that Mexico did not satisfy its burden of proving that it had not provided preferential treatment to domestically owned companies in like circumstances, *see id.* at para. 177, the Tribunal ruled that Mexico had breached Article 1102. *Id.* at para. 187.

[173] *See id*. at para.169.

131. Mexico's failure to enforce its sugar laws was not technical, periodic or aberrational, but material, chronic, and systematic. The effect of non-enforcement on GAMI's investment has been demonstrated in the discussion of the violation of Article 1105 above. It is a separate violation of Article 1102 that GAMI's investment suffered not just lower Mexican sugar prices as a result of Mexico's failure to enforce against other mills, but also discrimination harmful to its competitive position. Even though non-complying mills depressed the price of sugar in Mexico, that depressed Mexican price was nevertheless much higher than the price on the world market. GAM's mills thus were twice disadvantaged relative to non-complying mills, contrary to Article 1102.

VI. MEXICO'S EXPROPRIATION OF GAMI'S INVESTMENT VIOLATED MEXICO'S OBLIGATIONS UNDER ARTICLE 1110

A. Article 1110

132. Article 1110(1) provides that:

> 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) [of the NAFTA]; and (d) on payment of compensation in accordance with paragraphs 2 through 6 [of Article 1110].

133. For there to be a breach of Article 1110(1), there must be an investor of another Party, whose investment is expropriated directly or indirectly (or measures tantamount thereto), without compliance with any one or more of the aforementioned conditions listed in Article 1110(1).

B. Mexico Expropriated GAMI's Investment

134. Unlike many previous NAFTA proceedings, this is not a dispute in which the government has simply reduced the value of an investment temporarily or partially through regulations. Here, the expropriation was complete, explicit, and unambiguous. Rather than taking the necessary measures to rectify its own failure to implement its sugar laws and the damage caused to the mills thereby, the Government simply nationalized a large portion of the country's capacity to mill sugarcane. Thus, by Presidential Decree published in the Federal Official Gazette on 3 September 2001, Mexico expropriated all assets and capital stock of the five sugar mill operating subsidiaries of GAM.[174] Although Mexico did not formally seize GAMI's shares in GAM, Mexico's expropriation of these five mills rendered GAMI's investment in GAM virtually worthless because the five mills constituted substantially all of the productive assets of GAM.[175]

135. GAMI plainly is an "investor" of the United States. GAMI's shares in GAM clearly constitute an "investment" as that term is defined for purposes of Chapter 11 in Article 1139. There is no requirement that stock ownership entail majority ownership or control of an enterprise in order to qualify as an investment.

136. Article 1110 covers not only direct expropriation, but also indirect expropriation and measures that are "tantamount" to an expropriation.[176] The expropriation of the

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[174] *See* Expropriation Decree, art. 3 (Exhibit C-15).

[175] *See* GAM 2000 Annual Report at F-4 (29 June 2001) (Exhibit C-3).

[176] NAFTA Article 1110(1).

assets that account for virtually the entire value of GAMI's investment, depriving the investment of substantially all its value, constitutes an indirect expropriation or a measure tantamount to an expropriation of GAMI's shares in GAM. [177]

137. The plain language of Article 1110 makes clear that the drafters of the NAFTA intended to cover all forms of expropriation. If it were possible for a state to escape liability to foreign shareholders by the simple expedient of seizing the assets without seizing the shares, then the protections of Article 1110 would be illusory for any investor in a corporation. [178]

138. This case poses the clearest example of expropriation ever to be considered by a tribunal under Chapter 11 of the NAFTA. Most previous cases under Chapter 11 have involved more difficult questions involving situations in which governmental action reduced the value of a portion of a business, but the state had not ultimately directly seized anything.[179] In this dispute, Mexico irrefutably has seized the sugar mills, with the

[177] *Metalclad* at para. 113 (noting that when there is "a complete frustration" of the purpose of the investment, which in turn "negate[s] the possibility of any meaningful return" of the investment, "compensation is due under article 1110") (Exhibit C-79).

[178] *See Am. Int'l Group, Inc. v. Islamic Republic of Iran*, 4 Iran-U.S. Cl. Trib. Rep. 96, Part VI (1983) (awarding claimant, damages for its 35 percent interest in an Iranian insurance corporation, that was nationalized pursuant to the Law of Nationalization of Insurance Companies) (Exhibit C-80); *In the Dispute between Libyan American Oil Co. and the Government of the Libyan Arab Republic Relating to Petroleum Concessions 16, 17 and 18*, 20 I.L.M. 1, 84-86 (1977) (awarding compensation to the Libyan American Oil Company (LIAMCO) following Libya's nationalization by decree of LIAMCO's 25.5% minority interest in certain oil concessions) (Exhibit C-81).

[179] *See*, *e.g.*, *Feldman* at paras. 152-153 (finding that claimant's loss of its alleged right to engage in the gray market export of cigarettes from Mexico due to Mexico's denial of rebates does not constitute an expropriation under Article 1110 of NAFTA) (Exhibit C-73).

direct effect of substantially eliminating the value of GAMI's investment. Of course, in this case Mexico also constructively expropriated GAMI's investment before the actual seizure of the mills through the arbitrary and discriminatory enforcement and implementation of its sugar program.[180] Fair compensation for an expropriation must disregard damage to the value of the investment caused by a government's own malfeasance.[181]

C. **<u>The Expropriation Did Not Comply With The Requirements of Article 1110</u>**

139. Because there indisputably has been an expropriation, the only remaining issue under Article 1110 is whether the expropriation was done consistent with each of the requirements of Article 1110(1), *i.e.*, (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and NAFTA Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6 of Article 1110. Failure to meet any one of these conditions renders the expropriation inconsistent with Article 1110, and thus prohibited. The Expropriation Decree, and Mexico's actions subsequent thereto, meet none of these conditions. Of course, the Tribunal need not even reach these issues, because it is undisputed that Mexico has paid exactly zero compensation, rendering the expropriation illegal on that basis alone. Nevertheless we discuss each requirement briefly below.

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[180] *See supra* section III.F.

[181] That malfeasance in this case also independently breaches Articles 1105 and 1102, as explained above.

1. Mexico's expropriation of GAMI's investment was done without a public purpose

140. The Mexican courts have already found, in *amparo* proceedings brought by two other entities whose mills were expropriated by the same Decree and at the same time as GAM's, that Mexico failed to prove a public purpose for the expropriation.[182]

141. The Expropriation Law requires that the Government, before any expropriation, undertake all necessary actions to substantiate the public purpose on which it justifies the expropriation.[183] In the CAZE *amparo*, the judge found that the Government did not substantiate that such a public purpose existed, and that therefore the expropriation Decree was unconstitutional.[184] In particular, the judge concluded that there was insufficient evidence to support any conceivable public purpose and held that the expropriated property must be returned to its original owners.[185]

> "In view of all of the above, given that no evidence has been provided that the technical studies, blueprints or projects prove the existence of a public purpose being performed, or that [CAZE's] assets are indispensable to satisfy such public need, we conclude that the challenged measure breaches [CAZE's] rights under article 16 of the Constitution . . . [and] the guarantee of legality which translates in the instant matter into the absence of legal reasoning in the expropriation decree.

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[182] As discussed above, under Mexican law, claimants may file *amparo* proceedings alleging that the Government has infringed their Constitutional rights. *See supra* section III.I

[183] *See* Expropriation Law, art 1 (Exhibit C-34).

[184] *Juez Séptimo de Distrito en Materia Administrativa en el Distrito Federal* ("Seventh Administrative District Judge"), 30 October 2002, *Amparo* Proceeding No. 851/2001 (Exhibit C-41).

[185] The Government has appealed this Judgment. *See supra* section III.I.

142. With respect to paragraphs 3 and 6 of the Expropriation Decree, the Machado Court found that:

> [T]he fact that the State has an interest in preserving an enterprise for the benefit of the collective group, is not a sufficient reason to decide to expropriate an enterprise that had lost its "financial well-being," because, in the first place, the phrase "for the benefit of the collective group," is so ambiguous that any activity that generates a social benefit would fall within the meaning of the phrase, for example, public health, education, recreation, and that could not justify the expropriation of hospitals, schools or sports centers that do not have "financial well-being," because the taking of property must be such an extraordinary and restricted measure of the legislative body such that it does not leave any room for arbitrariness on the part of the administrative authority in order to assure certainty and legal security to private parties.[186]

143. The Government likewise has demonstrated no valid public purpose for the expropriation of GAM's mills. Accordingly, Mexico expropriated GAMI's investment without a public purpose in violation of Article 1110(1)(a).

2. Mexico expropriated GAMI's investment in a discriminatory manner

144. Mexico's action was discriminatory in that the mills of GAM were expropriated – and the shares of GAMI in GAM were indirectly expropriated – while other sugar mills in like circumstances were not expropriated. The requirement for non-discriminatory treatment under Article 1110 is, if anything, broader than that of Article 1102 as it is unconditional. Thus, the discriminatory nature of Mexico's expropriation is inconsistent

[186] *Juez Séptimo de Distrito en Materia Administrativa en el Distrito Federal* (Seventh Administrative District Judge), January 2, 2003, *Amparo* Proceeding No. 850/2001 at 10 (Exhibit C-42).

with Mexico's obligations under Article 1110(1)(b), for the same reasons explained above in our discussion of Article 1102.[187]

3. The expropriation was done in violation of due process of law and the minimum standard of treatment afforded foreign investors under international law

145. For reasons also explained above, the expropriation was not carried out in accordance with due process of law or with Article 1105, as required by Article 1110.1(c).[188] As noted, two Mexican courts already have concluded that the Expropriation Decree did not comply with Mexican law in that the Government had not substantiated a public purpose.[189]

4. Mexico has failed to pay compensation in accordance with Article 1110(1)(d)(2)

146. Even if the expropriation were otherwise in accordance with the conditions of subparagraphs a, b and c of Article 1110(1), Mexico has not even offered compensation, let alone provided compensation in accordance with paragraphs 2 through 6 of Article 1110, as required by Article 1110(1)(d). For this reason alone, Mexico's expropriation has breached Article 1110.

[187] *See supra* section IV.B.

[188] *See supra* section IV.C.

[189] *See supra* section III.I.

VII. DAMAGES OWED GAMI

147. Article 1110(1)(d) of NAFTA prohibits expropriation except "on payment of compensation in accordance with paragraphs 2 through 6." Paragraph 2 states that:

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

148. Paragraph 2 embodies the international law principle that "fair market value" is the measure of compensation for an expropriation.[190] Paragraph 2 does not require a particular methodology, but rather creates a flexible standard that permits the Tribunal to determine "fair market value" in the light of the circumstances of the particular case. Paragraph 2 confirms that an arbitral tribunal must choose the most "appropriate" methodology under the particular circumstances of the case.[191]

149. The appropriate measure of compensation in this case is the fair market value of GAMI's investment, without regard to reductions in that value attributable to Mexico's failure to implement and abide by its own laws prior to the expropriation. GAMI's valuation experts, Timothy H. Hart and Brent C. Kaczmarek of Navigant Consulting, have analyzed GAM's financial performance and values GAMI's investment. Their

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[190] *See e.g., Third Restatement* § 712(d) (Exhibit C-48).

[191] *See, e.g.*, *Metalclad Corporation and the United Mexican States,* Award, ICSID Case No. ARB(AF)/97/1 at paras. 113-125 (30 August 2000) (discussing the "appropriateness" of various methodologies) (Exhibit C-79).

conclusions are set forth in a Valuation Report attached at Exhibit C-26. The conservative analysis set forth in the Navigant Valuation Report demonstrates that the fair market value of GAMI's 14.18 percent equity interest in GAM was not less than US$ 27.8 million on 2 September 2001.

150. GAMI also is entitled to an award of damages to compensate it for damage to its investment caused by Mexico's failure to treat GAMI fairly and equitably and afford it full protection and security under Article 1105, as well as for damage caused by Mexico's discriminatory treatment of GAMI and its investment in breach of Article 1102.

151. As discussed in the Valuation Report, the valuation of GAMI's investment as of 2 September 2001 has been adjusted to control for the effects of Mexico's arbitrary, unlawful, and discriminatory conduct with respect to administration of its sugar programs. Accordingly, the adjusted value at expropriation – not less than US$ 27.8 million – also serves as an estimate of the damages suffered by GAMI on account of Mexico's breaches of Articles 1105 and 1102. Indeed, even if Mexico's conduct were not separately actionable under Article 1105 and 1102, the extent to which Mexico's own conduct reduced the value of the investment would be taken into consideration in determining the fair market value of GAMI's investment at the time of expropriation.

152. In addition, pursuant to Article 1110(4) of NAFTA, any award should include interest at a commercially reasonable rate from 3 September 2001, and the date Mexico seized GAMI's investment, to the date of actual payment. Article 40(1) of the UNCITRAL Arbitration Rules provides that costs of the arbitration generally should be charged to the unsuccessful party, but gives the Tribunal discretion to apportion costs. In

these circumstances, where Mexico has failed to pay any compensation at all despite its open and notorious taking of GAMI's property, it is appropriate for the Tribunal to allocate all costs of this arbitration to Mexico and to include in the award all attorneys fees, expert witness fees, and disbursements incurred by GAMI in bringing this Arbitration.[192]

[192] UNCITRAL, art. 40(2) (Exhibit C-2).

VIII. CONCLUSION

153. For the foregoing reasons, the Tribunal should find that Mexico breached Articles 1105, 1102, and 1110 of NAFTA and award compensation to GAMI in an amount not less than US$27.8 million, plus interest compounded from 3 September 2001, plus attorneys' fees, expenses and the cost of these arbitration proceedings.

Respectfully submitted,

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Dated: February 10, 2003

In the Matter of the Arbitration Proceedings Pursuant to NAFTA Chapter 11 and the UNCITRAL Arbitration Rules between:

GAMI INVESTMENTS, INC.

Claimant/Investor,

AND

THE GOVERNMENT OF THE UNITED MEXICAN STATES

Respondent/Party.

STATEMENT OF CLAIM
OF
THE INVESTOR

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