IN THE CASE OF THE DEFENSE OF THE CHAPTER XI ARBITRATION PROCEEDINGS UNDER THE NORTH AMERICAN FREE TRADE AGREEMENT

INTERNATIONAL THUNDERBIRD GAMING CORPORATION
CLAIMANT

vs.

UNITED STATES OF MEXICO
RESPONDENT

RESPONSE TO A COMPLAINT

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1. INTRODUCTION

1. This is an extraordinary case. Prior to its incursion into Mexico, the claimant undertook similar operations in the United States of America with the same type of machines, those commonly known as *"slot machines"*, until they had to abandon them when the competent United States authorities closed them down as they involved games of chance with betting. The claimant then tried to establish the same type of operations in Mexico, notwithstanding the fact that Mexican legislation established a clear and long standing prohibition of games of chance and games involving betting. The Mexican authorities closed down the claimant's establishments for having violated the Federal Law on Games and Raffles, as well as many others, which were closed down, and continue to be closed down.

2. The operations of Entertainmens de Mexico, S. de R.L. de C.V, Entertainmens Matamoros, S. de R.L. de C.V and Entertainmens Reynosa, S. de R.L. de C.V (together "EDM") were based specifically on chance and betting:

(a) The claimant bases its case on the machines used by EDM being of "ability and skill." Various documents prepared by the claimant himself demonstrate that they are involved with games of chance, and that characterizing them as "games of ability and skill" is nothing more than a label used in an attempt to avoid the legal prohibition.

(b) Nevertheless, even supposing that they were machines of "ability and skill" – a fact which is not conceded – EDM's operations were based on games involving betting. The claimant scarcely alluded to this in its Complaint, but admitted that the game consisted of inserting dollars into the machines to obtain "prizes" consisting of payments in United States dollars. This is sufficient for it to fall into the legal prohibition.

3. The Tribunal may appreciate that the operations of EDM are in fact no different from the operation of typical slot machines; the way in which the machines are arranged is identical to the typical arrangement of slot machines in casinos; the establishment has a "cage" in which the players can exchange pesos for dollars to deposit in the machines and where they can exchange the credits won for cash; the game consists of depositing cash and starting the movement of video "reels" which have to be stopped to achieve predetermined combinations of shapes; each machines showed the probabilities and prizes associated with each of the different combinations; if the player won, he obtained credits which he could use to continue playing or which he could exchange for dollars in cash; the amounts deposited in the machines, less the amount paid out in dollars, constituted the company's earnings. The respondent took photos of the "La Mina de Oro" establishment in Nuevo Laredo and of the games in this establishment, during its visit of 5th November 2003[1].

4. These types of operations have been prohibited in various jurisdictions in the United States where Thunderbird carried on business. It was repeatedly determined that the machines used were slot machines.

5. EDM subsequently imported into Mexico the same machines used by Thunderbird in the United States, but labeled them "of ability and skill". In fact the machines used in the

[1] Annex R-001

establishments of EDM were the machines used by the foreign partners as their contributions in kind to the capital of the company[2].

6. The claimant's arguments refer to the letter of the Secretary of the Interior ("SEGOB") dated 15th August 2000. The Tribunal will appreciate that, contrary to what is maintained by the claimant, EDM, in its application presented to SEGOB on 3rd August 2000, offered a simplistic and inaccurate description of the operations which it was already undertaking and wished to expand, as well as of the machines which it described as of "ability and skill" [3]. EDM did not show the machines or operations manuals to SEGOB, nor did they request that SEGOB visit the establishment which was already operating this type of machine, nor offered evidence of any type together with the document requesting SEGOB's opinion. EDM's application to SEGOB is based on the simple statement of its legal representative as to the nature of the operations and of the machines in question.

7. Even a superficial reading of the letter from SEGOB, reveals that it is not a license, permit or authorization to operate; it does not even contain the approval of the Secretary for the proposed operations or the machines which they were trying to use, as Thunderbird is now claiming[4]. Neither did SEGOB issue an opinion as to the nature or characteristics of the machines. Given the way in which EDM made the enquiry, SEGOB limited itself to responding that the machines operated in the way and terms described in the application, and did not therefore have the jurisdiction to prohibit them. Nevertheless the law expresses with absolute clarity the blunt prohibition of games of chance and of games involving betting and warns that establishments dealing with slot machines involving chance or betting may be closed down. In fact the Secretary referred to this prohibition in six out of the nine paragraphs of the letter.

8. The claimant cannot claim that he proceeded with his investment on the basis of the opinion of SEGOB as to the "propriety and legality" of the operations that it wanted to carry out. In fact, in the various *Subscription and Investment Representation Agreements* entered into after SEGOB's letter, EDM recognized that "it could not be sure that the Government of Mexico would continue to consider the operations of EDM as "machines of ability and skill" which were permitted, and not as games of chance[5].

9. The claimant also offers an inaccurate description of the legal position of other establishments, which it alleges have received more favorable treatment. It also omits that EDM commenced proceedings relating to the closing down of its establishments, which it lost. It points out that the owners of these establishments had obtained favorable judgments from Mexican courts, which declared their operations to be legal[6]. SEGOB closed down the establishments

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[2] For example, a letter of intent dated 5th February 2001, signed by Jack Mitchell relating to planning an EDM establishment in Puerto Vallarta, referred to the contribution by Thunderbird, Peter Watson and Mauricio Girault of machines which they had in stock, at 4,000 dollars per machine, in exchange for a 33.25% participation in the project. Complaint, Annex C-64.

[3] One characteristic of EDM's documents presented to the Mexican authorities, and those of the Claimant to this Tribunal is the use of euphemisms. For example the claimant refers to betting as "obtaining prizes" (see, for example, the Complaint, p. 8, line 9) and this is how EDM describes it to SEGOB (Id, line 17); in a similar way, Mr. McDonald describes the game of video poker as a game of *"lock down"* (see Mr. Kevin McDonald's testimony, ¶ 10, Complaint, Declaration G.

[4] See for example the Complaint pp. 1 line 16; 6, line 23; and 8, lines 2 and 3.

[5] *"There can be no assurance that the Mexican Government will continue to view EDM's operations as permitted "skill machines" and not a game of chance."* Annex C-28, Entertainmens de Mexico S. de R.L. de C.V. *Subscription and Investment Representation Agreement* of 20th June 2001, p.9.

[6] Complaint, pp4, line 25; and 5, line 1.

referred to by the claimant. The owners had brought proceedings pertaining to constitutional protection[7] and in some cases obtained a suspension of the action in respect of the complaint, pending conclusion of the proceedings[8]. None of these judgments were concluded definitively. EDM also initiated proceedings pertaining to constitutional protection against the closing down of its establishments. As will be explained later on, EDM initiated proceedings pertaining to constitutional protection, and proceedings for annulment against each administrative resolution of SEGOB and against each of the actions to close down the establishments.

10. Therefore, the case before the Tribunal is one in which the claimant is dedicated to an activity, which is highly regulated, and to a large extent prohibited, throughout the world. The claimant instigated an incursion into Mexico, having been forced to abandon its operations in the United States, initiating the same activities in Mexico, which had previously been declared to be illegal in the jurisdictions in which they had been operating. The claimant carried out these activities in the face of clearly expressed warnings that if they became involved in games of chance or games involving betting, they would place themselves within the category of activities prohibited by law, and could be closed down. SEGOB ensured that the law was complied with. EDM brought proceedings before Mexican courts to challenge the actions of SEGOB. The national courts found against EDM and later abandoned the pending proceedings and appeals. The actions of SEGOB have therefore been confirmed as legal and judicially valid under Mexican law.

11. Neither the prohibition contained in the law, the actions of SEGOB pursuant to these prohibitions, nor the action of the Mexican courts, in any way contravened NAFTA. If the Tribunal were to determine otherwise would be a surprising result, with significant consequences for the effective application of the law for the three Parties to NAFTA.

12. In addition, the claimant has not demonstrated that it either owns or controls any of the Mexican companies – the "investment" – and consequently does not enjoy the legal capacity to bring a complaint on their behalf under article 1117. From the time that the claimant gave notice of its intention to submit a claim for arbitration, the Government of Mexico requested documents which demonstrated that it owned or controlled EDM[9]. It has brought to the Tribunal's attention its objection to the referral to arbitration from the first session held on 29th April 2003. The documents provided by Thunderbird with the Complaint, contradict its affirmations and prove that Thunderbird was an investor that did not either own or control EDM. The Tribunal must not relieve the obligation to comply with an indispensable requirement of a complaint: to prove its right to represent the investment in question.

13. The respondent respectfully wishes to point out that, in its letter of 17th October 2003, it requested Thunderbird to provide documents relating to various allegations that are relevant to the issues in dispute and necessary to give a complete response to the complaint against it. It presented its request in strict adherence to the Rules of evidence of the IBA. The claimant refused

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[7] Generally a proceeding pertaining to constitutional protection is a process that takes place in federal court questioning the legality of the acts of the authorities.

[8] The law anticipates suspension of the action in respect of the complaint as a precautionary measure so that things are kept as they are pending conclusion of the judgment. This is an interlocutory decision, rather than a definitive decision.

[9] Letter from Lic. Carlos Garcia Fernandez to *International Thunderbird Gaming Corporation* of 4th April, 2002 in which "he requested that…copies of the following documents be presented…documents which prove that International Thunderbird Gaming Corporation is the owner and operator of the premises located in Matamoros, Nuevo Laredo and Reynosa, Tamaulipas." Annex R-002.

to provide them. The Tribunal rejected Mexico's petition that the claimant be ordered to provide them. This has prevented the respondent from enjoying complete knowledge of important aspects of the complaint against it, and has compromised its capacity to present a complete defense. The respondent established its position in its communications of 8th and 9th December 2003 and reserves its rights in this respect[10].

II RULES OF INTERPRETATION

14. Article 1113(1) of NAFTA states:

> A tribunal established under this section will decide on the disputes submitted for its consideration in accordance with this Treaty and with the applicable rules of international law.

15. In a similar manner, article 102(2) establishes:

> The Parties will interpret and apply the provisions of this Treaty in light of the objectives established in paragraph 1 and in conformity with applicable norms of international law.

16. In interpreting NAFTA, the Tribunal must apply the rules of international public law, in accordance with article 31 of the Vienna Convention on the Law of Treaties ("the Vienna Convention"), which indicates:

> 1. A treaty must be interpreted in good faith according to the current meaning which has been attributed to those terms of the treaty in their context, and taking into account their objective and aim.

17. In addition to the text, the context of the treaty includes its preamble and annexes, as well as the whole agreement or instrument upon which the entering into the treaty was based, accepted by all as the instrument referred to in the treaty[11].

18. Article 31(3)(c) of the Vienna Convention states that, precisely according to its context, "all relevant norms of international law applicable to the relationship between the parties" must be taken into account. The references in articles 102 and 1131 to "the applicable rules of international law" therefore require that the interpretation and application of the provisions of TLCAN require the application not only of its own provisions, but also that of the rules of relevant internationally recognized law.

III REGULATORY BACKGROUND TO THE SO CALLED "MACHINES OF ABILITY AND SKILL"

19. The claimant is basing its case on the fact that the machines which it operated in the establishments in Nuevo Laredo, Matamoros and Reynosa (and those which it claimed to operate in other locations) where permitted by the Federal Law on Games and Raffles, or rather, that they were permitted by SEGOB as machines of "ability and skill." The claimant would have us believe that there is a universally accepted definition of "machines of ability and skill" which demonstrates the legitimacy of its operations. It argues that the prohibition by the Mexican

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[10] Letter DGCJN.511.13.1357.03 dated 8th December 2003; letter DGCJN.511.13.1362.03 dated 9th December 2003.

[11] Article 31(2) and (3) of the Vienna Convention.

Government of what are essentially games of chance, and moreover, games of betting, in some way violates international law, and NAFTA in particular.

20. The claimant interprets the Federal Law on Games and Raffles in the following way.

> *Essentially the law of Mexico permits a gaming activity in which the player has some interaction with the machine, and can affect the outcome or the result of the play. The distinction between a "skill machine" and a "slot machine" (tragamoneda) [sic] is widely recognized and [sic] many jurisdictions (Guatemala, North Carolina, Switzerland) permit skill machines but do not permit slot machines. The slot machine is an operation whereby the player inserts money, pulls the arm or lever, and waits to see whether he has won anything. In contrast, the skill machine, although it resembles a slot machine in many ways, has no arm. Instead the skill machine player inserts money, can begin the video action by pressing buttons and can stop the action by also pressing buttons. A quick and skilful player can stop the action in a way that will cause him to win more frequently than simply at random. It is the player's responsibility to use his or her dexterity and hand-eye coordination in order to "skill stop" the video symbols at the desired moment in order to maximize the prize pay-out of the machine.*[12]

21. In the administrative hearing held on 10th July 2001, as part of the administrative proceedings that SEGOB carried out in connection with the operations of EDM, the testimony of Mr. James Maida is offered. Mr. Maida indicates that a game of skill is one in which the player "can affect the result of the game", where the ability is a "determinating factor", and requires "the player to take significant decisions". He added that he understood that the Federal Law of Games and Raffles did not prohibit "games in which the skill and ability of the player intervened"[13]. Nevertheless, Mexican law did not support his conclusions[14]

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[12] See annex C-64. Proposal Letter from Jack Mitchell to the members of the Rental Committee, Plaza del Sol, part 2. Albert Atallah expresses a similar "understanding" in paragraph 14 of his testimony. Declaration E of the Complaint.

[13] Annex C-69. Testimony of James R. Maida offered by EDM in the hearing of 10th July 2001, ¶¶ 5 to 7

[14] Mr. Maida is not a Mexican lawyer. In fact Mr. Maida's experience relates to United States legislation. In his testimony offered to the administrative hearing, Mr. Maida identified 19 cases relating to gaming in which he appeared as "expert witness". The respondent was able to locate eleven of these, based on incomplete information offered by Mr. Maida in his testimony. Each one involved the reviewing of games of the same type as those, which are the object of these proceedings (for example, slot machines, video poker machines and games with symbols). The courts decided, or rather the parties agreed that the machines in question were machines of games of chance involving betting, or "Class III" games, which could only be played in accordance with an agreement between an Indian tribe and states of the United States, being of this nature. *Poppen v. Walker, 520 N.W 2D 238 (S.D.1994); Yselta del Sur Pueblo v. Texas, 852. F. Supp. 587 (W.D. Tex. 1993) Yselta del Sur Pueblo v. Texas, 36 F. 3d 1325, 1329 (5th Cir. 1994); Rumsey Indian Rancheria of Wintun Indians v. Wilson, 1993 U.S. Dist. LEXIS 9877 (E.D. Cal. 1993).* In addition, a court expressly rejected the opinion given by Mr. Maida in the testimony presented by EDM that, if the game involved any level of skill, it did not constitute a game of chance. *(State of Florida, Department of Business and Professional Regulation, Division of Alcoholic Beverages and Tobacco v. Broward Vending, Inc., 696 So. 2d 851, 852 (Fla. App. 1997) ([w]hile skill will significantly improve the player's winning percentage, it does not eliminate the element of chance in the machine itself")).* The respondent cannot locate eight of the cases referred to by Mr. Maida and the assertion that he testified in all of them cannot be confirmed. *(State v. Hahn 221 Wisc. 2d 670, 690 (Wisc. Ct. App. 1998)*(in which the objection is made that the State "did not reveal at the appropriate time that its expert witness would be John Palmer and not James Maida.") In another case involving Mr. Maida's testimony, which was not included

22. Prior to its incursion into Mexico the claimant operated a business assembling and distributing this type of machine in the United States and affirmed that the United States legislation applicable in Texas and North Carolina, which made an exception of machines of ability and skill from the prohibition on slot machines and other games of chance, is similar to the Federal Law on Games and Raffles. The claimant presents an erroneous interpretation of the United States legislation in this respect, and in doing so, supports his also erroneous "understanding" of Mexican law.

23. The respondent explains below the Mexican regulations of the issue. It also considers it necessary to give a brief exposition of the United States regulations on the type of machines operated by EDM, in order to expose the real expectations of the claimant, and the credibility of his "understanding" of the Mexican law on this subject.

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on his list, the court expressly rejected his testimony on the basis that he was not really an expert legal witness:

> *The Crow rely on the expert testimony of James Maida who testified that a lottery encompasses any game with the elements of prize, consideration and chance…The Crow argue that we should accept the expert testimony that lotteries include all games with the elements of prize, consideration and chance. We disagree. The interpretation of a contract is an issue of law which this court reviews de novo* [references are omitted]. *Expert testimony is not proper for issues of law. "Experts 'interpret and analyze factual evidence. They do not testify about the law…'* [references are omitted]. *The Crow Tribe of Indians v. State of Montana, 87 F 3d, 1044-45 (9th Cir. 1996.*

A. Mexican Law

1. Administrative powers in relation to games and raffles

24. The Political Constitution of the United States of Mexico empowers the Congress of the Union to legislate on matters relating to games with betting and raffles[15]. In exercise of this power, Congress issued the Federal Law on Games and Raffles, which was published in the Official Gazette of the Federation on 31st December 1947.

25. SEGOB is an agency of the Federal Executive Branch and, in accordance with article 27 of the Organic Law of Federal Public Administration, is competent to:

> XXII.- Regulate, authorize and oversee gaming, betting, lotteries and raffles, within the terms of the relative laws…

26. In the same way the Federal Law on Games and Raffles establishes[16]:

> Article 3.- The Federal Executive Branch, acting through the Secretary of the Interior, is authorized to regulate, authorize, control and oversee games when they involve betting of any kind, as well as raffles, with the exception of the National Lottery, which will be governed by its own law.

27. The first paragraph of Article 7 of the law establishes that SEGOB "exercises oversight and control of games involving betting and raffles, as well as compliance with this law, through inspectors which it designates."

28. As far as SEGOB's internal organization is concerned, the Internal Regulations establish that the Department of the Interior (previously the General Directorate of the Interior) oversees, handles and authorizes those actions referred to in the Federal Law on Games and Raffles and other applicable norms[17].

29. The General Directorate of Games and Raffles depends on the Department of the Interior, whose functions include issuing authorizations for games and raffles permitted by law. There is a procedures manual, which specifies the format for applying to the Directorate of Games and Raffles to obtain these authorizations, as well as the requirements of the application. For example, in order to apply for a cock fighting or horseracing permit, the official form, duly completed and signed, must be presented to the Directorate of Games and Raffles, together with the corresponding duty.[18]

2. Federal Law of Games and Raffles

30. The law establishes in its first article:

> Games of chance and games involving betting are prohibited in the whole national territory, in the terms of this law.

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15 Article 73, section X. Available on the web page of the Chamber of Deputies, Congress of the Union, at internet address: http://www.camaradediputados.gob.mx.

16 Federal Law on Games and Raffles, Annex R-04. Available at http://www.camaradediputados.gob.mx.

17 Article 12, section XII. Available on the SEGOB web page http://www.segob.gob.mx.

18 General Directorate of Games and Raffles Procedures Manual. Annex R-03.

[Our emphasis]

31. The text of the law indicates two types of games that are clearly prohibited: (i) those games of chance; and, (ii) those games involving betting. For the prohibition contemplated by the law to come into effect it is sufficient for either of the two elements to be involved: betting or chance.

32. Article 2 establishes those games that are permitted:

Only permitted are:

1. The game of chess, checkers and others of a similar nature; dominoes, dice, bowling, bowls and billiards; ball games of all kinds and denominations; racing on foot, by vehicles or animals, and in general all kinds of sports.

II. Raffles.

Games not indicated are considered to be prohibited for the effects of this Law.

[Our emphasis]

33. The Law makes an exception to the prohibition of games when they are played in private homes for amusement or as a hobby among families or people who have a social relationship[19]. On the other hand, it states that SEGOB is responsible for authorizing games when they involve any kind of betting[20]. Only SEGOB may authorize the exchange of bets in respect of the list of games anticipated in article 2 of the Law.

34. The Law also empowers SEGOB to regulate, control and oversee games involving betting[21]. It prohibits the establishment of any house or place in which games involving betting are played without the authorization of the Secretary, and orders the closing down of such places when established, independently of any other sanctions which may be incurred[22]. It also orders the confiscation of the gaming tools and objects as well as the property and money, which constitute the interest in the game.[23]

35. Certain infractions of the Law constitute criminal actions, which are punishable by a prison sentence and a fine. Imposing these punishments is a function of the Federal court. SEGOB is responsible for imposing fines in respect of the other types of infractions.[24]

36. The Law does not refer to games "of ability and skill" or of the extent to which chance may be involved.

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19 Article 15.
Excluded from the preceding provisions are games played in private homes with the sole objective of amusement or occasional hobby, and which are not in any way practiced habitually, and do not involve people who do not have any family relationship or social dealings with the owners or inhabitants.

20 Articles 3 and 4.

21 Articles 3 and 7.

22 Articles 4 and 8.

23 Article 14.

24 Articles 12, 13, 16 and 17.

37. In exercise of its faculties, and on many occasions in response to complaints from citizens or local authorities, SEGOB has undertaken a series of inspections of different establishments, in order to verify compliance with the law, and to confirm whether they have the corresponding authorization. As a result, SEGOB has closed down 17 establishments in which the playing of games prohibited by Law has been proven.

B. Regulation of gaming machines in the United States

38. Thunderbird was dedicated to the manufacture and renting in the United States of the same machines operated by EDM. It administered gaming establishments particularly on Indian reservations in California. In testimony presented at the SEGOB administrative hearing on 10th July 2001, the Thunderbird legal representative stated that he had studied United States gaming legislation and had concluded that games of ability and skill were permitted. He used this reasoning to support his understanding of Mexican legislation. Mr. Atallah declared:

> *In my capacity as general counsel and in preparation for demonstration to the Director of Juegos y Sorteos of Gobernacion and their general counsel, I have researched jurisdictions which permit skill machines but which do not permit slot machines or other types of gambling activities. That the best cases in point, as illustrative examples are perhaps Texas (see affidavit of Attorney Ramie Griffin in that regard), and North Carolina…That the state of North Carolina has a law very similar to the Law de Juegos y Sorteos in Mexico, namely, that all games, machines, electronic devices, slot machines or other games of chance are strictly prohibited…[but] creates an exception for the operation of skill machines…In conclusion your affiant Albert Atallah believes that North Carolina is a very similar case in point with respect to International Thunderbird Gaming's operation of skill machines in Mexico, in which the player can interact with the machines, make choices with respect to the game played, and can affect the outcome of the play in accordance with his level of skill .Obviously the distinction between the general prohibition against games of chance and skill games is legally recognized both in Texas and North Carolina, as well as other jurisdictions which vary only slightly but allow skill machines to operate, or have in the past. These include South Dakota, Oklahoma and Switzerland*[25]
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> [Our emphasis]

39. The respondent has reviewed the United States laws cited by Thunderbird's legal representative. Contrary to the claimant's assertion, the fact that a machine may be classified as "of ability and skill" does not imply that its use is legal. As will be demonstrated below, these laws prohibit "slot machines"[26].

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[25] Testimony of Albert Atallah presented to the SEGOB administrative hearing on 10th July 2001, ¶¶ 5,6 and 8. Annex C-69.

[26] Both federal law and state legislation regulate gaming machines in the United States. The states have main powers to regulate betting games, and the level and nature of this regulation varies. This is why, for example, casinos are permitted in Nevada and Atlantic City, New Jersey, but are generally prohibited in other states. As a result, there is no general law on gaming involving betting, nor any standards adopted by all the states uniformly. The role of the Federal Government is principally to regulate games involving betting on Indian reservations, where it is subject to a combination of federal and state laws.

40. Regarding the laws cited by Thunderbird's legal representative:

- North Carolina law defines "slot machines" as those machines where there is no skill involved, and prohibits them unless they are used for amusement and do not give out any voucher which can be exchanged for prizes, or offer money of more than ten dollars.

- Texas law establishes the prohibition of betting machines, which are understood to be those played to obtain something of value, which is determined wholly or partly by chance, whether or not any degree of skill is involved.

- Californian law prohibits slot machines, which it defines as any machine involving any degree of chance, unless the machine is determined to be principally a game of skill.

41. Thus the United States laws mentioned generally prohibit games involving betting – a payment in money or in kind – and those involving chance.

1. North Carolina

42. In the State of North Carolina, it is considered illegal for any person or organization to operate or play any game of chance in exchange for money or that involves betting[27]. According to the legislation it is also illegal to operate (i) slot machines or (ii) any gaming machine in which the user may receive something of value[28]. The law generally defines a "slot machine" as one which, in exchange for money deposited in it, offers something of value, either in the form of money, in kind or something than can be exchanged[29]. The definition does not include:

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27 N.C. Gen. Stat. § 14-292. Annex R-005, p001.

28 Id. N.C. Gen. Stat. §§ 14-296, 304, Annex R-pp. 004 and 006.

29 Section 14-306 of the North Carolina gaming law defines a slot machine or device as:
…[O]ne that is adapted, or may be readily converted into one that is adapted, for use in such a way that, as the result of the insertion of any piece of money or coin or other object, such machine or device is caused to operate or may be operated in such manner that the user may receive or become entitled to receive any piece of money, credit, allowance or thing of value, or any check, slug, token or memorandum, whether of value or otherwise, or which may be exchanged for any money, credit, allowance or any thing of value, or which may be given in trade, or the user may secure additional chances or rights to use such machine, apparatus or device; or any other machine or device designed and manufactured primarily for use in connection with gambling and which machine or device is classified by the United States as requiring a Federal gaming device tax stamp under applicable provisions of the Internal Revenue Code. This definition is intended to embrace all slot machines and similar devices except slot machines in which is kept any article to be purchased by depositing any coin or thing of value and for which may be had any article of merchandize which makes the same return or returns of equal value each and every time it is operated, or any machine wherein may be seen any pictures or heard any music by depositing therein any coin or thing of value, or any slot weighing machine or any machine for making stencils by the use of contrivances operated by depositing in the machine any coin or thing of value, or any lock operated by slot wherein money or thing of value is to be deposited, where such slot machines make the same return or returns of equal value each and every time the same is operated and does not at any time it is operated offer the user or operator any additional money, credit, allowance, or thing of value, or check, slug, token or memorandum, whether of value or otherwise, which may be exchanged for money, credit, allowance or thing of value or which may be given in trade or by which the user may secure additional chances or rights to use such

…[C]oin operated machines, video games, pinball machines, and other computer, electronic or mechanical devices that are operated and played for amusement, that involve the use of skill or dexterity to solve problems or tasks or to make varying scores or tallies and that:

(1) Do not emit, issue, display, print out or otherwise record any receipt, paper, coupon, token, or other form of record which is capable of being redeemed, exchanged, or repurchased for cash, cash equivalent, or prizes, or award free replays; or

(2) In actual operation, limit to eight the number of accumulated credits or replays that may be played at one time and which may award free replays or paper coupons that may be exchanged for prizes or merchandize with a value not exceeding ten dollars ($10.00), but may not be exchanged or converted to money.[30]

43. Therefore a machine of this kind could only be considered legal if "it involved the use of ability or skill", while at the same time (i) being used for entertainment and (ii) did not issue any type of voucher exchangeable for prizes, money in cash or any other thing of value greater than ten dollars[31].

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machine, apparatus, or device, or in the playing of which the operator does not have a chance to make varying scores or tallies. [Our emphasis]. Annex R-005, p. 007

[30] Previously this legal precept, as far as the level of skill required to be present was concerned, required that the game depended on it; nevertheless, it was reformed in December 1993. Following the reform, the only requirement was for skill to be present in the game. N.C. Gen. Stat. § 14-306 (b); *Attorney General Advisory Opinion: Video Poker Machines:* N.C.G.S. §14-306; 1997 N.C. AG LEXIS 66, 5 November 1997: "*As noted, the 1993 amendment makes clear that the lawful operation of the machines no longer depends on the skill or dexterity of the player, or must be based upon the skill or dexterity of the player. The lawful operation of the machines must only involve the use of skill or dexterity. What the General Assembly clearly intended to do, and in fact did, was to lower the skill or dexterity standard involved in the lawful operation of these machines from skill and dexterity being, as the Collins Court put it, the "dominating elements that determine the results of the game," to "simply involving the use of skill or dexterity". In Collins Coin Music Co. v. North Carolina Alcoholic Beverage Control Commission, 451 S.E. 2d 306, 309 (N.C. Ct. App.)(1994),* the North Carolina Court of Appeal, in applying the law prior to its reform in December, 1993, declared that video poker which used the skill stop function, constituted an illegal game of chance, whose functioning did not depend on skill, as the "element of chance dominated the skill." Annex R-005, p. 017.

[31] N.C. Gen. Stat. § 14-306 (b); *Attorney General Advisory Opinion: Video Poker Machines:* N.C.G.S. §14-306; 1997 N.C. AG LEXIS 66, 5th November 1997: *"In order to be exempt under our present law from the definition of an illegal lot machine, the video poker machine must satisfy <u>each</u> of the following criteria [used for amusement, involve skill, limit replays to eight, and limit prizes to $10.00"* [Our emphasis]. In testimony before the SEGOB hearing in July 2001, Albert Atallah declared that the law of North Carolina "created an exception for the operation of machines of ability and skill"; but he did not mention the criteria which the machines had to meet in order for them to fall within the exemption. Annex C-69 [testimony of Albert Atallah ¶ 7]. See Attorney General Advisory Opinion; Video Poker Machines: N.G.C.S. 14-306, December 15th, 1993. Annex C-64 of the Complaint, which indicated: *"The video poker machines you describe meet three of the four statutory criteria required for exemption from the definition of illegal slot machines. You state that they are "used for amusement", "involve the use of skill", and reward a successful player with credits which "may be used for replays or may be exchanged for merchandize with a value not exceeding $10.00." If the video poker machines also limit to eight the number of credits which may be played at one time, they comply fully with the exemption criteria and will not be considered illegal slot machines."*

44. With effect from 2001, the laws of North Carolina prohibited any person from owning, operating or permitting the operation of certain "video games", such as (i) video poker (ii) video bingo, (iii) dice, (iv) "*keno*", (v) video lottery; (vi) "*Eight liner*", (vii) "*Pot of Gold*" and (viii) "[a] video game based on or involving luck in, by chance, matching different pictures, words, numbers or symbols, unless this depends on the ability or skill of the player[32]. These video machines are prohibited, except that among other requirements, (i) "they were legally in operation in North Carolina prior to 30th June 2000; or (ii) they could not print any record "capable of being changed, exchanged, or redeemed for money in cash, specie, prizes or additional free games[33].

45. The section of the gaming law of North Carolina which refers to "skill" (14-306) initially required that the game was dependent on ability or skill, but after its reform in 1993, it only required that to avoid the prohibition, the game involved ability or skill. In 1990, the Attorney General of North Carolina issued an opinion on the section on "skill" in relation to the game of video poker. Despite the analysis being based on the law prior to its reform, it is very illustrative, not least in the factor that the state would consider, in determining if a video poker machine is a game of ability or of chance:

> *The letter…addresses machines simulating the play of poker which allows the player to conceivably utilize dexterity and hand-eye coordination by selecting specific cards as they flash on the screen. <u>These machines may violate G.S. 14-306 if the card rotation is so fast that one is in actuality acquiring a hand at random</u> …If merely pushing a button will result in the random selection of a card, then the device is <u>not</u> exempt. If the player can select the card based on identifying the card and hitting the button in time to get that particular card, then the device will be exempt.*[34]

46. Under North Carolina law, if the cards in a video poker machine blink too rapidly, the game would not be considered to be one involving the ability of the player, but one which selected by chance.

2. Texas

47. The law on betting in the state of Texas establishes that a person commits the offence of betting if, among other things, "he plays and bets money or any other object of value in any game of cards, dice, ball or betting device[35]. The law defines a gambling device or apparatus for betting as:

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32 A Video Gaming Machine is defined as "that in which it is necessary to introduce a coin, token or the use of a credit card, debit card of any other method, to activate the game…" N.C. Gen. Stat. § 14-306.1 (c). Annex R-005, p.010.

33 N.C. Gen. Stat. § 14-306.1 (2), citing 14-306.1(b). Annex R-005 p. 010.

34 See Annex C-64. The Attorney General states that, if the rate at which the cards turn is very fast, it is a question of fact that would have to be determined on a case by case basis.

35 See Tex. Penal Code § 47.02. Annex R-006, p. 001. Ramie Griffin, who stated that he was a Texas lawyer, "familiar" with Texas gaming law, presented testimony to the SEGOB hearing in July 2001 in which he declared that this section of the law "must in my opinion be interpreted in the sense that a game involving any level of skill is exempted from the legal provisions which prohibit the machines". Nevertheless, the definition of a betting machine indicates that a game with <u>any level of chance</u> will be considered a gaming machine, without regard to whether or not skill is also involved in the machine. Annex C-69.

> *Any electronic, electromechanical or mechanical contrivance…that for a consideration affords the player an opportunity to obtain anything of value, the award of which is determined solely or partially by chance, even though accompanied by some skill…*

The definition of *gambling device* expressly includes, among other things, video poker or any similar game which (i) works wholly or partially based on chance; (ii) issues credits or free games as a result of playing or operating the game; and (iii) registers the number of free games issued or credited. The definition expressly excludes any game which is "designed, made or adapted solely for the *bona fide* object of amusement" if it only issues prizes which are not in cash, or "points exchangeable for prizes", the value of which is less than five dollars or up to ten times the amount charged to play a game[36].

48. According to Texas legislation, no offence has been committed if the game: (i) takes place in a "private place"; (ii) no-one receives any "economic benefit" apart from his winnings; and (iii) "except for any advantage of skill or chance, the risk of losing and chances of winning is equal for all participants"[37].

49. In the case *State v. Gambling Device* the Texas First District Appeal Court established the level of chance involved in any game for it to be considered an illegal gambling device:

> *We interpret the statute to apply to contrivances that incorporate any element of chance; even if the exercise of skill also influences the outcome…We do not read the definition at issue as requiring any quantitative comparison of the respective proportions of chance and skill involved in a particular contrivance. Rather, the statute requires only that the outcome of any trial be "determined by chance." A contrivance that is designed to incorporate the element of chance to influence whether an award is provided to a player is a contrivance whose outcome is determined by chance …Under the plain and ordinary meaning if its words, section 47.01(3) clearly encompasses certain contrivances whose outcomes are influenced by skill. According to the statutory language, a device is a gambling device if its outcome "is determined by chance, even though accompanied by some skill." (Emphasis added)…Thus, the definition of a gambling device explicitly includes a device whose outcome is determined by chance even though that outcome may also be influenced by an appreciable amount of skill. Even a contrivance that is predominantly a game of skill may be determined by chance…A player's level of skill may influence the degree of chance involved, but it does not eliminate the element of chance altogether. The outcome is always determined by chance because no player, through the exercise of skill alone, can control the outcome of any given trial. It is chance that finally determines the outcome of each and every trial. Thus, it is the incorporation of a particular proportion of chance and skill.*[38]

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36 Tex. Penal Code § 47.01. Annex R-006, p. 003.

37 No legal precept or precedent of Texas legislation defines the concept of *"chances of winning"*. In the case of *Gaudio v. State of Texas* the Texas Fifth District Court of Appeal declared that the jury decided that this precept was met in the case of a video poker game in an apartment; the opinion nevertheless focused more on the fact that the person hosting a game of poker among friends in his apartment received remuneration from this. 1994 Tex. App. LEXIS 3411. Annex R-006, p. 005.

38 859 S.W. 2d. 519, 523 (1st D. Tex)(1993). Annex R-006, p. 013.

50. Texas gaming law prohibits as gambling machines, those games whose final result is determined by chance, without considering the level of skill involved.

3. California

51. California legislation on gambling states that it is illegal, for any person among other things, to make, own, possess, sell or operate:

> *…[A]ny slot machine or device as hereinafter defined, or to make or permit to be made with any person any agreement with reference to any slot machine or device, as hereinafter defined, pursuant to which the user thereof, as a result of any element of hazard or chance or other outcome unpredictable by him, may become entitled to receive any money, credit, allowance, or thing of value or additional chance or right to use such slot machine or device, or to receive any check, slug, token or memorandum entitling the holder to receive any money, credit, allowance or thing of value…*[39]
> [Our emphasis]

52. The law defines a slot machine as any machine, apparatus or artifact which operates or may be operated (i) by the insertion of a coin, money, object or other resource; (ii) from which the user may obtain the right to receive something of value; or (iii) by the existence of any element of chance or any other result of said machine that is unpredictable[40]. The law excludes from such prohibition the game of "*pin ball and other amusement machines or devices which are predominantly games of skill, whether affording the opportunity of additional chances or free plays or not, are not intended to be and are not included within the term slot machine or device*"[41] California law does not exclude from this definition machines that issue low value prizes.

4. Legislation applicable to Indian reservations in the United States

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39 CAL. PENAL CODE § 330b (1). Annex R-007, p. 001.

40 The complete definition is as follows:

> *Any machine, apparatus or device is a slot machine or device within the provisions of this section if it is one that is adapted, or may be readily converted into one that is adapted, for use in any such way that, as a result of the insertion of any piece of money or coin or other object, or by any other means, such machine or device is caused to operate or may be operated, and by reason of any element of hazard or chance or of other outcome of such operation unpredictable by him, the user may receive or become entitled to receive any piece of money, credit, allowance or thing of value or additional chance or right to use such slot machine or device, or any check, slug, token or memorandum, whether of value or otherwise, which may be exchanged for any money, credit, allowance or thing of value, or which may be given in trade, irrespective of whether it may, apart from any element of hazard or chance or unpredictable outcome of such operation, also sell, deliver or present some merchandise, indication of weight, entertainment or other thing of value.*

CAL. PENAL CODE. § 330b(2) (our emphasis). The law contains a similar precept that establishes the same prohibition and adds that it is applicable if the machine *"is caused to operate or may be operated or played mechanically, electrically, automatically or manually."* CAL. PENAL CODE § 330.1. Annex R-007, p. 003.

41 CAL. PENAL CODE § 330B(4). The law contains another prohibition in § 330a against the "possession or safe keeping of a *'slot or card machine or card dice'* if the operation 'depends on luck or chance". The purpose of this other standard has not been determined, particularly as the opinions of the Attorney General as to what constitute slot machines are based exclusively on § 330b. Annex R-007, p. 002.

53. As already indicated, Thunderbird argues that the laws of North Carolina, among others, exclude machines of "ability and skill"[42] from their application. Referring specifically to North Carolina, Thunderbird also argues that the Cherokee Indian reservation in North Carolina operates machines of ability and skill in a casino operated in this state[43]. With these assertions, Thunderbird suggests that the laws in force in Indian reservations reflect the general situation in the territory of the state in which they are located. This is not the case.

54. Gambling games are permitted in Indian reservations under a system that incorporates aspects of federal legislation, and the legislation of the states in which they are located, based on compacts with the state governments.

55. The applicable law, *The Indian Gaming Regulatory Act*, establishes the regime under which United States Indian reservations can operate casinos in their territories. This law regulates three types of machines, each one with a different method of control. The denomination "Class III" expressly includes any type of slot machine, as defined in the *Gambling Devices Act*, and also includes *"electronic or electromechanical facsimiles of any game of chance"*[44] Class III games are only permitted if, among other things, they are: (i) permitted in the state in which they are located and (ii) are carried out in accordance with a *"Tribal State Compact"*[45]

56. *The National Indian Gaming Commission* issues opinions on the classification of Class III games. The Commission determines if a game is classified as Class III by means of a test carried out by the courts. If chance is involved in a game to a substantial extent, in such a way that ability in operating the machine does not matter, this is considered to be a slot machine[46]. If the Commission determines the game to be of ability, it falls outside its jurisdiction; if it is a game of chance, the machine if for gambling under Class III and can only be played legally within the territory of Indian reservations in accordance with a compact between a tribe and the state[47].

57. The Supreme Court of the United States ruled that Indian tribes of the United States are "sovereign" and free to establish terms for the regulation of these types of games in their territories, under compacts between the tribes and the states. The circumstances under which Class III games (limited prizes, etc.) are permitted in the territory of a reservation inside the states, are different from the way in which a state regulates these games (and conditions in the reservations are frequently less strict). Therefore the fact that the tribes are permitted to operate

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42 See Annex C-69, ¶¶ 7 and 8. Testimony of Albert Atallah presented to the administrative hearing held on 10th July, 2001.

43 Id.

44 "Class I" games and machines are those "social" games which issue prizes of minimal value, and include traditional indigenous games. "Class II" games include all types of "bingo" and some card games. *"Electronic or electromechanical facsimiles of any game of chance or slot machines of any kind"* are expressly excluded. 25 U.S.C.S. §§ 2703 (6), (7), (8); 25 C.F.R. §§ 502.3, 4. Annex R-008, pp. 001, 009 and 011.

45 Indian reservations in the United States have exclusive jurisdiction over Class 1 games, independently from the *Indian Gaming Regulatory Act* and its requirements on licensing, auditing and background investigation. 25 U.S.C.S. §2710(a), (d). Annex R-008, pp. 003 and 005.

46 *Notice of Decision and Order* in the case *Seminole Nation of Oklahoma*, 7th May, 2002, p. 7; reference *US v. Digger Merchandizing Machines*, 202 F 2d 647, 650 (8th Cir.)(1953). Annex R-008, p. 012.

47 *Challenger 9 Game Classification Opinion* page 1 (undated but probably after June of 1999) as it mentions correspondence of this date. Annex R-008, p. 035.

certain devices and games does not illustrate their general legality in the state. Annex 50 of this document contains a discussion on casinos in the territory of Indian reservations.

C. Application of the law in Mexico

58. SEGOB has closed down all premises which were either open or closed in which were found to be operating machines commonly known as "slot machines", "token machines", "bill machines" or "dollar machines", functioning in the same or a similar way as those operated by EDM in the establishments in Nuevo Laredo, Reynosa and Matamoros.

59. In the past year and a half, SEGOB has closed down across the whole of the national territory, 17 establishments in which slot machines were operated against the Federal Law on Games and Raffles. These acts of closing down included both those of EDM, as well as those of Messrs. Guardia and de la Torre, to which the claimant made reference in his document. A total of 2,294 [48] machines were closed down.

D. Application of the law in the United States

60. As in Mexico, the United States has carried out actions in which it has determined that certain machines described as "of ability and skill" (*"skill-stop machines"*) are in fact illegal slot machines. Some examples of this are described below.

61 In 1999, a man from Iowa was sentenced to five years in prison for possessing *Pachislo* machines, which were considered to be illegal gambling devices (the *Pachislo* machines are produced in Japan and have buttons "through the use of which a player of 'skill' can stop the reels" (*skill-stop buttons*)). Even though the accused argued that he thought that they were amusement machines, the state demonstrated that they were dealing with illegal devices, as: (i) they paid out prizes of greater than five dollars; (ii) they would allow the player to exchange cash for free games; and (iii) by increasing the amount paid, the player could increase his chances of winning. Agents of the Criminal Investigation Division of Iowa demonstrated at the trial the way in which the players had to stop the reels of the machines by pressing buttons[49].

62. Thanks to an advertisement that he was offering slot machines, in 2001, undercover agents of the Maryland police confiscated five *Pachislo* machines that an electrician had in his home. The arrested man claimed that the *Pachislo* machines were different from gambling machines in three ways. He indicated that (i) "instead of pulling a lever and waiting for the wheels of lemons and cherries to stop turning, a player of *Pachislo* could press a button to stop the movement"; (ii) the machines worked with game tokens instead of money, even though the companies selling *Pachislo* machines are able to modify them to accept twenty five cent coins in those states where slot machines are legal"; and (iii) they generally paid higher prizes than slot machines. The police answered:

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48 Letter No. DGAPC/177/03 of 12th December, 2003. Annex R-009.

49 Hicks Lynn. *Jurors hear arguments in slot case; The couple's attorney says their machines are for amusement and not for commercial gambling.* Des Moines Register, 8th April, 1999, p. 3M; Hicks Lynn, *Man draws prison term for having; Ronald Shepherd's incomplete report of his criminal record doesn't sit well with the judge.* Des Moines Register, 9th July, 1999, p. 3M. Annex R-010, pp. 001 to 003.

> *They are games of chance, take some form of currency and pay a reward. 'They are Japanese slot machines, period,' [a police sergeant] said. 'They are spinning too fast to be a game of skill.*[50]

63. In 2003, a Missouri businessman was discovered selling *"Pachisuro"* (another name for *Pachislo*). He asserted that the machines were legal according to state law because they required a level of ability, alluding to the fact that each machine had three buttons on the front which allowed the players to stop each reel independently. Nevertheless an expert declared that the operation of the machines depended more on luck than on ability "because the buttons used by the player to stop the game only make him believe that his ability and skill determine the outcome of the game"[51]. In this case the declaration of an employee of a company making *Pachisuro* machines was also available.

> *[C]omputer software that drives IGT's Pachisuro games randomly selects an outcome for each spin, much like the random number generator" software that predetermines winning and losing spins in American slot machines…Though Pachisuro players decide when each reel stops, [the official said] the computer decides where…within a range of options that fit the predetermined jackpot or no-jackpot outcome for that spin.*[52]

64. According to the article, a supervisor in the *Kansas City district office of the Missouri Division of Liquor Control* declared that "in 1984, a court in Missouri defined those games in which luck is a factor, albeit not the determining factor, as being prohibited games of chance".[53]. A deputy attorney general stressed the fact that "if someone inserts their money and wins something, and there is no license, this is gambling". It should be pointed out that this businessman required his customers to sign a disclaimer: (i) indicating their understanding that the machine and the metal coins which they purchased were for domestic use and exclusively for the purposes of amusement: and (ii) that State laws "could establish criminal and/or civil sanctions for operating the machine, if it were used in a way that was not in accordance with state legislation"[54].

IV. REVIEW AND ANALYSIS OF THE GAMES OEPRATED BY EDM

65. The competent authority in Mexico determined that the machines operated by EDM in Mexico are slot machines prohibited by the Federal Law on Games and Raffles, and that they deal with gambling games, and that the result is influenced by chance. The same machines operated by EDM had also been declared illegal in the United States.

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50 *Rona Kobell, Police say "no dice" to slot machines; Undercover officers seize home games. The Baltimore Sun, 20th February, 2001* at 1B. Annex R-010, p. 05.

51 The article mentions that James Maida, the United States expert, said of the slot machines that he did not know of any United States jurisdiction in which this type of game would be permitted, and that if chance was a greater factor than skill in determining the legality of a game, an experiment could offer a reply: "A player might as well play blindfolded?"

52 The article comments that a directive of the company declared that *"players' skill could influence the outcome of occasional bonus spins"*.

53 In 1984, the *Missouri Court of Appeals of the Eastern District of Missouri* found that *"video slot machines"* are games of chance and that chance is "*a material element in determining the outcome" Thole et. al. v. Westfall*, 682 S.W. 2d 33,37 (Mo. App. E.D. 1984). Annex R-010, p.010.

54 Rick Alm. *Merchant says sale of slots is legal: Japanese machines raise questions, Kansas City Star*, 8th June 2002, p C1. Annex R-010, p. 007.

66. The following analysis is supported by the testimony of the claimant itself and in the annexes to the Complaint, in which the machines operated by EDM in its establishments in Matamoros, Nuevo Laredo and Reynosa are described. Furthermore, during the visit made by both parties to EDM's installations in November, 2003, the respondent found copies of the operating manuals for the machines. On comparing these games with those that have been formally analyzed by various authorities in the United States – by courts, Prosecutors and the National Indian Gaming Commission – it can be concluded that the same games operated by EDM had been declared prohibited in the United States.

67. In its communication to SEGOB dated 3rd August, 2000, EDM declared that the games which were already operating in Matamoros were "Bestco" and "S.C.I." games[55]. The documents obtained from the establishments of EDM identified more than 100 machines made by "Bestco, S.C.I. or *Summit* operating in the three establishments[56]. There follows a review of each game in particular, and a comparison between the makers' descriptions and the way these type of machines were treated by the authorities in the United States.

68. In summary, the establishments of EDM operated the following gambling machines:

- *"eight-liner"* which have been determined as gambling machines in the states of North Carolina and Texas.
- *"Bestco", "Fantasy Five"* and *"reel game"* which have been classified as gambling machines by the National Indian Gaming Commission; and
- video poker, which the courts of North Carolina and California have found to be gambling machines[57]

A. Description of *"Eight Liner"* games

69. In his testimony, Mr. Kevin McDonald, who asserted that he had sold video games to Thunderbird's establishments in Mexico, declared in his capacity as President and General Director of S.C.I. (*Support Consultants Inc*.) that one type of the "skill machines" which were installed in the EDM establishments in Matamoros, Nuevo Laredo and Reynosa, was the *"Eight Line Game of Skill"*[58]. Mr. McDonald also presented testimony to the SEGOB administrative hearing in July 2001 in which he described this game in more detail: (i) *"The Multi-Action"* which consists of various similar games; (ii) *"Plum Crazy"*; (iii) "Burning Reels"; and (iv) "Riches of Freedom"[59]. The *Eight Liner* games get their name from the fact that the player wins

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55 Document by Juan Jose Menendez Tlacatelpa dated 3rd August 2000, addressed to the Director General of the Interior, of the Secretariat of the Interior. Annex C-17 of the Complaint.

56 Annex R-049.

57 Photographs of these gaming machines, taken during the visits to EDM establishments. Annex R-001.

58 Testimony of Kevin McDonald, ¶10. Declaration G of the Complaint.

59 See testimony presented to the hearing with Interior held in July 2001, ¶ 4. Annex C-69.

A document obtained from the Nuevo Laredo establishment identified the game "Fantasy Five" as one of the machines in the EDM installations. It also identified "Blue Lightening", "Broadway Lights", "the Gold Mine", "Multi touch screen", "Pretty Penny", Rainbow Reels", "Red Hot Reels", "Red, White and Blue 7's", "7' Eight ways", and "Very Cherry Bonus". Annex R-049.

when the same symbols match in one of eight reels: three horizontal, three vertical and two diagonal.

70. In the installations of EDM, the litigating parties found an operating manual for the machines, published by S.C.I. for the *"4205 Game Board Series Eight Line Skill/Mina de Oro Skill Games"*. The manual covers the following games: *"8 Line with Bonus", Blue Lightning", Broadway Lights", "Red Hot Reels", "Red, White and Blue Sevens" and "XX."* The operating instructions for the games leave no doubt that the player is gambling. The manual indicates:

> *1. Insert bills into Bill Acceptor. The Bill acceptor can be set up to accept denominations from one dollar to one hundred-dollar bills [reference omitted].*
>
> *2. Press BET 1 or MAX BET to enter the number of credits you wish to wager. You may bet one to eight credits with BET 1 or bet all 8 at once using MAX BET.*
>
> *3. Press SPIN to start the game.*
>
> *4. To play another game you have two options: either press SPIN to REBET and wager the same number of credits as in the previous game, or press BET 1 or MAX BET to wager a different amount. If your number of remaining credits is less than the amount you wish to re-bet, you must use the BET button, or insert more money.*
>
> *5. If you wish to stop playing the game, but you still have credits remaining, press PAYOUT and the machine will either print out a ticket showing the value of the remaining credits, or dispense coins if it is a hopper machine. You may redeem the cash ticket*[60].

71 In the establishments a manual published by *Summit Ltd.* was also found, for the game called *"Mexico Multi-Action"* (originally *"Dynamo Multi-Action"*). Even though the cover bore the hand written date of 29th December 2000, the manual itself had a publication date of 1995. A *Multi-Action* machine offers the player the choice between various games. In this case the instructions explain the objective and mode of operation for each of three games:

> *This video terminal offers a selection of three games and dispenses a printed ticket that may be redeemed. The player may choose from: Fantasy Five Reel, Super Eight (8 line), and Dogs and Diamonds (8 Line). The terminal is housed in a casino cabinet. A CRT is used to display all information. The terminal has one internally mounted bill validator that accepts 1.00, 5.00, 10.00 and 20.00 bills.*[61]

72. Some of the manuals offer only a very simple description of the games, for example: "the player's ability to stop the reels determines the outcome of the game."

1. "Dogs and Diamonds"

73. The *"Dogs and Diamonds"* manual establishes:

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60 *Support Consultants, Inc* Manual, p. 10. Annex R-011.

61 *Mexico Multi Action* instructions, section 1.0. Annex R-012.

The 8 liner game called "DOGS AND DIAMONDS" has nine windows arranged three by three. Each window displays part of one of the nine internal reels. The symbols on the reels include: ***Cherries, Oranges, Plums, Bells, Melons, Red Bars, Blue Bars, Green Bars, Sevens, Triple Sevens and Diamonds…***

The player pushes the ***SPIN*** *icon (or START button) starting the 9 reels spinning. The player must stop each of the three vertical reels (containing the 3 windows) by touching any of the windows. The player's skill at stopping the reels determines the outcome of the game played. Credits are awarded for each line played with a winning combination.*

A Progressive Jackpot is available to a player by playing a minimum of 2.00 in any of the three denominations (0.05, 0.25 and 1.00 credits). The player must have seven, eight or nine 7's showing after the reels have stopped spinning. The value of the progressive is operator-adjustable and increments at 1%.[62]

2. *"Super Eight"*

74. For the game *"Super Eight"* the instructions establish:

The 8-liner game called "Super Eight" has nine windows arranged three by three. Each window displays part of one of the nine internal reels. Each reel has 32 symbols on it. The symbols include: ***Cherries, Oranges, Plums, Bells, Melons, Single Bars, Double Bars, Triple Bars and Sevens…***

The player pushes the ***SPIN*** *icon (or START button) starting the 9 reels spinning. The player must stop each of the three vertical reels (containing the 3 windows) by touching any of the windows. The player's skill at stopping the reels determines the outcome of the game played. Credits are awarded for each line played with a winning combination. The player has the option to play the maximum of whatever credits that may be available, up to a maximum of 16.00. <u>The player also has the option of changing the wager</u> before the game has begun by touching the* ***PLAY UP*** *or* ***PLAY DOWN*** *screen menu icons.*[63]

B. Considerations in the United States on *"Eight Liner"* Games

75. According to what has already been demonstrated, legislation in North Carolina prohibits *any game of chance* and in fact expressly prohibits *"Eight-liner video gaming machines"*[64]. The Texas gaming and raffles law prohibits those games the result of which may be affected wholly or in part by chance, even though a degree of skill may be involved. The courts of Texas have declared that *"eight liner"* games are illegal gambling games.

76. In the case of *Hardy v. Texas* the Texas authorities confiscated games called *"eight liner"* because they were gambling devices. According to the Supreme Court of Texas, "winning at *eight liners* requires matching symbols in one of eight lines – three horizontal, three vertical and two diagonal - which give it the name." The decision of the Court that these were prohibited machines was based principally on the fact that the prizes violated the types and exceeded the

62 Id. Section 2.3.

63 Id. Section 2.1.

64 The law defines *"video gaming machine"* as "a video machine which requires a coin or token to be inserted, or the use of a credit or debit card, for it to work". N.C. Gen. Stat. § 140306.1(c). Annex R-005.

limits permitted under Texas law. The court also pointed out that the operator of the games testified that *eight liners* are electronic devices that involve some form of chance[65]. The Court found that as they involved gambling games, the confiscation of these games was within the law[66].

77. In the case of *Texas v. One Super Cherry Master Video 8-Liner Machine* the state authorities also confiscated games called *"eight liner"*[67]. The Court of first instance found:

> *The eight liners resemble slot machines and require quarters or paper currency in denominations of one, five, ten or twenty dollars to play. The eight liners operate on a combination of skill and chance, according to some evidence; according to State witnesses, they operate purely by chance and a player can do nothing to enlarge his chances of winning.*[68]
> [Our emphasis]

78. On appeal, the Texas Supreme Court confirmed that the machines were confiscated legally on the grounds that they were illegal gambling devices[69].

C. Description of the "*Fantasy Five Reel*" game

79. In his testimony, Mr. McDonald declared that the other type of machines found in the installations of EDM was games of the type *"Five Line Game of Skill"*, and the game called *"The Multi-Action"*[70]. The *"Multi-Action"* manual which as already indicated also applied to the other *"five-liner"* game called *"Fantasy Five Reel"*. The explanation given is as follows:

> *This video reel game has 5 reels with 5 possible win lines…*
>
> *The lines are numbered from 1 to 5. As each credit is played, additional win lines are enabled in sequence. The first credit played allows the player to win on Win line #1. The second credit played allows the player to win on Win Line #2 and so on.*
>
> *The player pushes the **SPIN** icon (or START button) starting the 5 reels spinning. The player must stop each of the 5 vertical reels by touching any part of the reel(s). The player's skill at stopping the reels determines the outcome of the game played.*
>
> *A progressive jackpot is available to a player by playing the minimum of 2.50 in either 0.05 or 0.25 credits or 3.00 in 1.00 credits. The player must have 5 gold bars in a row on either the three horizontal wine [sic] lines **or** the two diagonal win lines.*[71]
> [Emphasis in the original]

80. The *"Fantasy 5 Game"* instruction was published by *Intuitive Corporation* in 1998. It explains how the operator (not the player) controls the way in which a machine is played, and

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65 102 S.W. 3d 123, 125 (Tex. 2003). Annex R-013, p. 001.

66 The testimony of Kevin McDonald offered with the Complaint indicates that the games in the EDM establishments included *"Eight Line Game of Skill"*. Declaration G of the Complaint, p. 2, lines 13-16.

67 The Bestco comp any developed the game "Super Cherry Master" about which information can be obtained at http://www.bestcogames.com/reelgame.htm (consultation of 9th October, 2003) Annex R-014.

68 55 S.W. 3d 51, 54 (Tex. App.) 2001). Annex R-013, p. 13.

69 102 S.W. 3d 132 (Tex. 2003). Annex R-013, p. 20.

70 Testimony of Kevin McDonald. Declaration G of the Complaint. ¶¶ 4 and 10

71 *Fantasy 5 Game* manual, section 2.2. Annex R-015.

what is given as a prize. The explanation of *"REEL SPEED"* indicates that "the reels come from the factory set to normal speed, by default. The reels have four speeds: normal, fast, very fast and *use doors"*. The section on prizes stipulates:

> *BASE PAY RATE:*
>
> *The base pay rate is the percentage of points to be awarded the player. If set to 75%, the player would win, on the average, 75 points for every 100 points played. Actual credit in/credit out ratio is difficult to guess, but the game will regulate itself to the setting. The higher the number, the longer the player will play. The default value is 75%.This can be changed to a value within the range of 50-95%.*[72]

The instruction also indicates that the total in prizes that a machine can pay out is predetermined by the operator, not the player. A section headed "*MAX WIN/GAME"* establishes:

> *The maximum dollar amount that can be won for each start. The game automatically knows the number of starts since it was last cleared and will only print the total number of tickets allowable for that number of starts. Any credits left over, even if they may equal a whole ticket(s), are either kept on the machine or tossed.*[73]

D. Considerations in the United States on the reel game "*Fantasy Five*"

81. As has already been pointed out, the National Indian Gaming Commission is responsible for classifying games, including Class III games which are those involving gambling and are permitted only in the Indian reservations, and provided that there is a compact between the Indian reservation and the state. [74] The Commission has classified the Bestco game of *"Fantasy Five"* as a gambling game.

82. In 2002, the Commission issued a *Notice of Decision and Order* which classified various types of electronic gaming machines with reels, including two games made by *Bestco Games Company*, *"Fantasy 5"* and *"Rainbow Reels"*[75]. In classifying these games as Class III, the Commission observed:

> *Rainbow Reels is a five-reel, five-line machine [the reference is omitted]. When the player presses the start button the five video reels begin to rotate [the reference is omitted]. The player stops each reel individually by pressing a button. There are 8 different icons in the reel rotation. In a sequence of over 380 icons, no repeating pattern could be identified. Furthermore, as the icons rotate through the video window,*

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72 Id. p. 13 and 14.

73 Id. p. 20.

74 All opinions of the Commission on the classification of games may be reviewed on: http:///www.nigc.gov/nigcControl?option-OPINIONS

75 The Commission also declared that *"Reels of Skill"* is based on "the code and *software* of a game called *"Cherry Master"* made by a company called DYNA". As already indicated, Bestco produced a game called *"Super Cherry Master"*. Bestco's reel games are listed, together with their profiles, on http://www.bestcogames.com/reelgame.htm (date of consultation 9th October 2003). The Commission has also declared that *"Crazy Reels"* is a Class III machine, even though the Commission declared that it was issuing a "courtesy" opinion, not a formal decision *("decision of the commission")*. Letter from Richard Schiff, Legal Advisor, *National Indian Gaming Commission* to Mr. D.K. Thomas, Eurotek designs USA, 7th April, 1999. Annex R-013, p. 053.

individual icons change into other icons, referred to as "morphing" by the Chairman's expert [the reference is omitted]. Finally the operator can establish a pay level – the retention ration.[sic]

Fantasy 5 is also a five-reel, five-line machine manufactured by the same company as Rainbow Reels, Bestco Games Company [the reference is omitted]. It is operated in similar manner to Rainbow Reels [the reference is omitted]. In addition, it has a graphic on the bottom of the video screen that is a bonus round. The operator controls the bonus percentages.[76]

…

Not only do the games look and act like classic slot machines, the successful play of the games involves a substantial element of chance. Each of these games exhibit combinations of characteristics that are indicia of chance, including reels that morph, reels that spin rapidly, reels that contain a large number of icons that tend to blur, games that are predetermined and contain retention or award ratios, and devices that contain an all stop button. [77]

83. The Commission classified these games as Class III gambling machines for five reasons:

- The similarity to slot machines, with icons grouped together on reels which appear on the screen and turn very rapidly.
- The outcome of the game is the result of chance, and excludes the possibility that ability can be an important component in the game; as "when a player presses the button to stop the machine that drives the reels of the game: (i) he does not follow the sequence of the icons that change; and (ii) the reels do not stop immediately, but continue turning on the screen after the button is pressed.
- "The pattern of the icons varies from game to game." The Commission determined that this "impedes the possibility that a person could develop the ability or memorize or decipher the pattern of the icons", and, therefore "impedes the ability to stop the machine on the exact icon desired[78].
- The Commission found that the machines had "proportions of retention or prizes" which indicated that the games "had a predetermined outcome", and consequently "the only thing that the player has to do to stop the machine is indicate the result that has already been selected by the operator.

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[76] The list of Bestco reel games and their descriptions can be found at: www.bestcogames.com/reelgame.htm (date of consultation 9th October, 2003). Annex R-014.

[77] *Notice of Description and Order, in the matter of the Seminole Nation of Oklahoma*, 7th May, 2002, p. 10. Annex R-013, p. 022.

[78] The Commission pointed out that "in a sequence of 380 icons no pattern of repetition could be detected."

- The Commission concluded that the machines had "a button that stopped all the reels when it was pressed", and as a result, the game itself "determined its own outcome"[79].

84. In its decision, the Commission also revised the classification of games of chance that had been given to the Bestco game *"Reels of Skill"*. The Commission described the game in the following way:

> *Reels of Skill is similar in outward appearance to a traditional slot machine. The machine consists of a white cabinet with a video screen with nine (9) windows arranged in a 3x3 pattern, and has a dollar bill acceptor and a ticket printer which dispenses credits via a paper receipt. The front of the machine has a start/play points button and four "skill buttons" which are used to play the game, including a "hold all stop button", a "stop left" button, a "stop center" button and a "stop right" button. There is a sequence of 27 icons of various shapes and colors (10 symbols, including a gold bell, a purple plum, a red cherry, a green watermelon) which appear in each of the nine (9) windows and when the game is in play they simulate three (3) rapidly spinning reels. The rate of simulated rotation is 1.5 seconds for completion of the 27 icon sequence through the window. The "all stop button" was intended to be used to stop the movement of the icons in all nine (9) windows simultaneously. Each of the other three (3) skill buttons was used to stop the icons located in the three window [sic] in one of the three (3) vertical rows or columns. Once the play is started the reels do not stop spinning until the player pushes a button…The device also has a hold feature which can be utilized to "hold" two similar symbols in one line for replay during the next spin*[80].

85. The Commission found that there was no substantial difference between the games in question and the game *"Reels of Skill"*, and cited this finding as a precedent in finding that *"Rainbow Reels"* and *"Fantasy 5"* are also games of chance.

86. The Commission classified another game of reels as a game of chance. It indicated that *"Challenger 9"* was similar in physical appearance to the slot machine *"8-liner"* as it had "a video screen, a slot for a dollar bill, ticket printer…and buttons for playing", including "two buttons to stop the reels." According to the Commission, "a sequence of 81 icons (27 icons repeated 3 times) of various shapes and colors, appeared in each of the nine windows, and when the game was functioning, the icons simulated a reel that turned rapidly and passed through a series of 27 icons in 1.8 seconds, and allowed 67 microseconds per icon." The Commission described the operation of this game in the following way:

> *Once the START button is activated, the nine reels begin to rotate in a top to bottom simulation of mechanical reels spinning…There are nine independent windows spinning in a fixed pattern of 27 symbols. The premise is that reels continue to spin until the player activates the "STOP" button at which time the first reel stops on a symbol on the video reel. The second reel begins to spin until*

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[79] Be aware that the Commission found that *Challenger 9* was also considered a game of chance in spite of having a button to stop the game on each reel, in place of a single button for all three reels.

[80] *Notice of Decision and Order, In the Matter of the Seminole Nation of Oklahoma,* p. 8. Annex R-013, p. 022.

the player again depresses the "STOP" button. The player continues this process of depressing the "STOP" button until all nine reels have stopped.[81]

87. The Commission found that *"Challenger 9"* is a game of chance on four counts:

- The buttons to stop each reel (in place of one to stop all the reels simultaneously) "do not have an impact on the substantive element of luck present in the game" as the tests carried out showed that the 27 icons "turned at such a speed as to basically eliminate any element of ability which the player might try to use to affect the outcome of the game"[82].

- Slow motion camera recordings allowed the Commission to find that the speed of rotation of the reels increased in proportion to the length of time that the player waited before pressing the button which stopped them" with the objective of preventing the player from improving his performance by trying to memorize the sequence of the icons.

- After activating the button to stop the game, the reel continued spinning, following the correct sequence of the icons, and stopped when some of them had passed. Finally, the number of icons which passed before the reels stopped varied with each one.

- The game has a mathematic proportion which retains a fixed percentage of all money inserted throughout the mathematical cycle of the game[83].

E. Description of Video Poker

88. Mr. McDonald declared that in the EDM installations were also *"The symbol Lock Game of Skill"* called *"Gold Mine"*[84]. Mr. McDonald indicated that in this game *"the player is given five symbols and has the opportunity to lock down (hold) any or all symbols in an attempt to create a winning combination on the pay line."* Mr. McDonald's description makes it clear that this is the same as a game known as *video poker*, but using symbols instead of cards[85].

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81 *Challenger 9 Game Classification Opinion,* pp. 3 to 5. Annex R-013, p. 035.

82 The decision indicated that it was based in part on *"the expertise of Gaming Labs International, a game testing company"* even though it did not clarify what type of expertise was involved, and neither did it comment on the conclusions of this consultation. James Maida, who supported Thunderbird as expert witness and who delivered testimony on the definition of "games of ability and skill" to the hearing before SEGOB in July, 2001, was the President of *"Gaming Laboratories International"* according to his testimony. Be aware that Mr. Maida declares that "he appeared before the Missouri Legislature when it was considering Senate Initiative 740, which identified and defined games of ability and skill for the purposes of gaming on ships navigating rivers in the State of Missouri". The relevant Missouri law includes video poker, among others, in the list of "games of ability and skill". Nevertheless, Missouri allows gambling games on ships, and for this reason it is irrelevant whether it involves ability or chance. According to the law, a game of skill is also considered a gambling game. § 313.800 R.S. Mo. (12); Mo. Const. Art. 3, § 39(e): *Riverboat gambling authorized on Missouri and Mississippi rivers,--The general assembly is authorized to permit upon the Mississippi and Missouri Rivers only, which shall include artificial spaces that contain water and that are within 1000 feet of the closest edge of the main channel of either of those rivers, lotteries, gift enterprises and games of chance to be conducted on excursion gambling boats and floating facilities* (Our emphasis). Testimony of Mr. Maida,¶4. Annex R-013, pp. 041 and 042

83 *Challenger 9 Game Classification Opinion,* pp. 3 to 5. Annex R-013, p. 035.

84 Testimony of Kevin McDonald, ¶¶ 4 and 10. Declaration G of the Complaint.

85 Id. ¶ 10.

89. In the EDM establishments a version of a manual was found, which was called *"4205 Game Board Series Instructions"* with Thunderbird's name on the cover. This included descriptions of video poker games of the following five types: *"Jacks or Better", "4th of July", "Joker Poker", Deuces Wild",* and *"Flush Fever:*

> *Jacks or Better Poker is a standard draw poker type of game. The player is dealt five cards. He may keep the cards or discard to receive new cards. If the DOUBLE-UP feature is turned on, he is then given the option to double his winnings. He may continue to try to double until he loses or decides to take his winnings.*
>
> *All poker games may optionally be set to use Auto Hold (smart hold). The game computer suggests the best cards to hold for the easiest win according to the cards shown. If the player does not like the way the game computer has suggested, he may change the cards held by making his own selection.*
>
> *4th of July Fours is a standard Jacks or Better poker game with the addition of a second (or bonus) screen. If either three or four fours are dealt, the bonus screen appears. The player can choose one of three fire crackers using the BET button. After selecting his fire crackers, he touches DEAL DRAW to select it. The three fire crackers randomly become 1X, 2X or 3X multipliers of the winning combination award. If the DOUBLE-UP feature is turned on he is then given the option to double his winnings. He may continue to try to double his winnings until he loses or decides to take his winnings.*
>
> *Joker Poker is a joker's wild game using a single joker. The Joker substitutes for any card to make a winning combination. If the DOUBLE UP feature is turned on, he is then given the option to double his winnings. He may continue to try to double until he loses or decides to take his winnings.*
>
> *Deuces Wild is a wild card type game. All four deuces are wild cards and substitute for any card to make a winning combination. Joker Poker is a joker's wild game using a single joker. If the DOUBLE-UP feature is turned on, he is then given the option to double his winnings. He may continue to try to double his winnings until he loses or decides to take his winnings.*
>
> *Flush Fever is a standard Jacks or Better Poker game with the addition of a second screen bonus. If the player receives either three or four 4's, the game enters a second screen. This is a city-scape with three fire crackers at the bottom of the screen. The player selects either #1, #2 or#3 using the BET button. The selected fire crackers contain multipliers of 1X 2X or 3X. If the double-up feature is turned on in the game, the player has the option of trying to double his winnings. If he loses the double-up attempt, he wins nothing. If he wins the attempt, he can continue trying to double or take his winnings (including the bonus multiplier).*[86]

90. The instruction demonstrates that this is the only type of game that it deals with.

F. Considerations of Video Poker games in the United States

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86 *4205 Game Board Series Instructions*, p. 12. Annex R-016.

91. North Carolina legislation prohibits "any game of chance" and expressly prohibits "*video poker*"[87]. California legislation prohibits games that "involve any element of chance", except those which are games "predominantly of ability". Video Poker is illegal in California.

92. In 1983, the Attorney General of California examined "a coin operated video game which simulated the games of *"blackjack, draw poker, hi-lo and craps"*. It described the game in the following way:

> *[T]he device is essentially a video screen and a computer combined in a single cabinet. By placing a coin in a slot, the machine is activated and the player may select one of four games: blackjack, draw poker, hi-lo or craps. Each game is played by pressing the appropriate buttons with the video screen displaying representations of cards or dice in a manner consistent with the rules of the game and the choices of the player.*[88]

As the game neither gave the player a prize nor rewarded him with games or extra time to play free, the Attorney General found that it was not illegal. Nevertheless he declared that if the video game was used for betting, "for example to receive something of value… it would in such case be a prohibited game"[89].

93. The Attorney General concluded that the game of video poker involved "an element of hazard or chance" and therefore did not fall within the exception to games of skill and ability:

> *In our view, the operation of the four game machine described to us involves an "element of hazard or chance or of other outcome of such operation unpredictable by [the player]…" Skill is not the dominating factor in determining the results of the games.*
>
> *The rolling of dice on a craps table does not suggest any measurable skill: the practice of kissing the dice or blowing on them merely beckons luck. A simulated roll of the dice on a television screen is no more artful. When poker is played with cards and with competitors, it would be helpful to the player if he or she possessed a skill such as an ability to count cards or knowledge of psychology. However, the number of cards in a poker computer program is unknown; a bluff or a poker face is not likely to change the outcome of a game when the opponent is a computer.*[90]
>
> [Our emphasis]

94. The United States authorities have therefore determined that the games *"eight-liner"* and *"Fantasy Five"* of Bestco, and video poker, are all gambling games. The tests indicate that they are also games of chance, even though they could involve elements of ability or skill – although this is doubtful - ; but this latter is, in reality, irrelevant given that gambling is involved. For this reason, Mexico respectfully considers it inappropriate for the Tribunal itself to be given the task of carrying out an analysis to determine whether the games operated by EDM constitute, under Mexican law, legal games of "ability and skill" or prohibited games of chance or gambling games. Furthermore, the Tribunal should not ignore the fact that this question has been clearly answered in the judgments of the Mexican Federal Courts in respect of the actions brought by EDM. As

87 See Annex R-05, pp. 010.
88 66 Op. Atty. Gen. Cal. 276, 1983 Cal. AG LEXIS 38, 1-2 (Sept. 5, 1983) Annex R-013, p. 046.
89 Id. p. 1.
90 Id. p. 21.

will be explained below, this Tribunal does not have jurisdiction to act as a court of appeal in respect of judgments of national courts.

V. THE ISSUE OF CERTAINTY AND THE MEANING OF "REASONABLE EXPECTATIONS"

95. Various conclusions can be drawn from what is set out above. First, the business of gaming machines and raffles is highly regulated in any part of the world, and in fact, widely prohibited. It is clearly an extremely risky business. Thunderbird itself includes a section on "legal risks" in its 1996 Annual Report which sets out the following:

> *The legal issues surrounding gaming have not been fully resolved. The probability that new regulations and laws will be created is high. In addition, the Company's business plan is based to a large extent on its ability to market its products and services to gaming operations conducted on Native lands. The permissible scope of gaming permitted on Native lands varies from state to state and is not clearly defined within the individual states. Until the issues are resolved, either through legislation or the courts, the future of gaming on Native lands is uncertain. The outcome of the law in this area will obviously have an impact on the operations of the Company. Negative rulings, restrictive legislation and decisions by regulators to prosecute in these legal areas (particularly in the US) could adversely affect the operations of the business of the Company. Separately, as of the date of this Annual Information Form, one of the Company's revenue sharing arrangements with Tribes has been reduced to a written agreement. As such, if any disputes arise with respect thereto, the enforceability of the arrangements is uncertain.*[91]

96. Thunderbird recognized other risks:

> *Regulatory: The ability to sell or place the VGTs in any country is dependent on the regulatory authorities of various levels of government. The rulings made by the government continue to fluctuate and are dependent upon a number of political, economic and public oriented factors. The Company is dependant upon the government ruling in favor of allowing casino gaming and specifically VGTs and slot machines in their jurisdiction. Adverse government rulings may have a significant impact on the Company's ability to generate revenue.*[92]

97. As detailed below, Thunderbird has constantly encountered legal and regulatory problems in the United States and other countries – and could face criminal responsibility in relation to its operations in California with the same type of machines that are the subject of this proceeding – and in recent years has entered and abandoned a considerable number of markets in quick succession, both inside and outside the United States.

98. Thunderbird argues that it requested SEGOB's opinion as to the legality of its operations and that it received this in their letter of 15th August, 2000. It alleges that it based its decision to proceed with the investment on the assurance given in this document. However the facts demonstrate that this is not the case. Thunderbird made its investment (i) on the basis of legal and financial advice from its lawyers, and Mexican and United States partners; and (ii) specifically,

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91 *Annual Information Form. Fiscal year ended December 31, 1996,* dated 1st May, 1997, pp. 16 and 17. Annex R-017.

92 Id. P. 17.

on the basis of its own business strategies. [93] For example, after having been sued for breach of contract by *A-1 Financial*, a company owned by Doug Oien and Ivy Ong (the two United States citizens who admit "introducing" to Thunderbird the "opportunity" of "skill machines in Mexico")[94]. [sic] Mr. Atallah wrote to *A-1 Financial's* lawyers threatening to counter sue them for having used deception and fraud to induce Thunderbird to enter Mexico. [95] In fact, Thunderbird had begun to operate even before receiving the above mentioned letter from the Secretary of the Interior.

99. For various reasons it is important to analyze the investor's expectations. In respect of its claim for violation of article 1110, Thunderbird argues that regulatory actions interrupted the operation of those businesses in which it had participated. It is necessary to explain to the Tribunal the reasonable, realistic expectations of Thunderbird in undertaking its business in Mexico, and the risk of operating slot machine establishments which are prohibited under Mexican law.

100. Thunderbird's expectations are equally relevant to the argument presented about article 1105. In evaluating whether Mexico's conduct in regulating games of chance and gambling games could be construed as contravening the minimum level of treatment recognized by generally accepted international law, the fact has to be taken into account that Thunderbird was fully aware – or should have been so – of the risk that these games which were to be operated, could be considered to be prohibited. Thunderbird's conscious acceptance of this risk must exclude the possibility that the materialization of this risk could have resulted in an unfair way.

101. Thunderbird's experience in the gaming industry, and the precise circumstances in which it entered Mexico are relevant in evaluating the reasonable expectations which it could have in relation to the Mexican legal framework and the development of its operations in Mexico.

VI. DESCRIPTION OF THE RELEVANT FACTS

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93 Thunderbird had omitted to tell the Tribunal that in a session of its General Board on 17th March, 2002, a discussion took place as to whether Thunderbird should make a claim for professional negligence against Baker & McKenzie, the law firm that had been advising it in Mexico, on the grounds that it had relied on the guidance given by this firm in proceeding with its investment in Mexico. Section 5 of the minutes states:

> *Baker & McKenzie understand that our position is that they gave us a legal opinion that has gone completely wrong for us and we intend to hold them accountable. Now that we have made our position clear, this has become a high priority with this law firm. As a result we may now see more positive results in the next 90 days. But we don't have a lot of confidence in them because they have been wrong until now.*
> *Albert Atallah informed the group that our investors and Thunderbird have two choices. One is to pursue a legal malpractice action against Baker & McKenzie. However the investors do not want to spend any more money on legal actions and if we file against Baker & McKenzie they will bow out of working on these legal actions for us. Up until this point, Sr. Velasco has only concentrated on getting their bill paid, but Mr. Atallah believes his focus has now changed and they are concentrating on winning our cases.*
> *Mr. Mitchell says that Baker & McKenzie has informed them that they are now in this to the end and they say they believe that they can win in the end. They say if they do not get the chance to pursue the cases in the Mexican courts then we cannot file an action against them because we have not allowed them to win in the Mexican courts.*

Annex R-018.

94 Complaint p. 4.

95 Annex R-019.

A. History of Thunderbird's Operations

102. The complaint reveals little of the claimant's corporate history, with the exception of a brief reference by Mr. Atallah in his testimony: *"in the early 1990s Thunderbird was involved in Indian gaming activities in California and in the late 1990s"Thunderbird shifted its activities to exclusive involvement in Latin American gaming and entertainment operations"* [96] This declaration omits relevant information of which this Tribunal should be aware.

103. A review of the declarations presented by the claimant under the Ontario Securities Act as well as the evidence on file, reveal important aspects of the claimant's corporate history which are directly relevant to central aspects of the case:

- The fact that the claimant had himself previously described as gambling machines, those which he now called "machines of ability and skill."

- The fact that the claimant knew the risks he was running, including that his operations with "machines of ability and skill" were closed down pursuant to legal action.

1. Products of Thunderbird's gaming stations

104. Thunderbird's 1996 Annual Report includes a glossary of the following definitions:

> ***Button control VGT*** *– a VGT machine that allows operation of the machine's functions by pressing various buttons located on the machine.*
>
> ***Net drop*** *– the amount of money received by a VGT or slot machine net of amount paid out as prize money.*
>
> ***Progressive jackpot VGT*** *– a group of similar VGTs where the software programs can be networked, offering a big grand prize that progressively increases as the group of machines are played.*
>
> ***Slot machine*** *– a machine, providing a game of chance, worked by the insertion of a coin and a random payout of coins based on the correct alignment of a number of reels.*
>
> ***Touch screen VGT*** *– a VGT machine that allows operation of the machine's functions by touching the video screen of the machine rather than buttons or levers.*
>
> ***VGT or Video Gaming Terminal*** *– a computerized slot machine that incorporates a video terminal screen, central processing unit, memory and computer software to determine the frequency and amount of payout of prizes.* [97]
>
> [Our emphasis]

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96 Testimony of Albert Atallah, Declaration E of the Complaint. ¶ 9.

97 It should be pointed out that Thunderbird subsequently modified the glossary, eliminating definitions of "electromagnetic slot machines", changing that of "VGTs" and adding one for "skill machines". See *Annual Information Form, Fiscal Year ended December 31, 1996, dated 1st May, 1997. p. 1. Annex R-017. See also Annual Information Form, Fiscal Year ended December 31, 2000, dated 4th May, 2001. p. 1. Annex R-020.*

105. The gaming machines are described as follows:

> *A VGT or Video Gaming Terminal is a computerized slot machine that incorporates a video terminal screen, central processing unit, memory, computer software and a random generator to determine the frequency and amount of payout of prizes. A user will input money, tokens or credit into the machine and play a game of chance in the hope of obtaining a return in prize money or credit. The games include the traditional slot-machine type games (that visually provides for the spinning of reels), card games (poker or black jack) and Keno. Presently in the market place there are single game versions and multi game versions.*
>
> ...
>
> *Button Control VGTs assembled by the Company for the gaming industry include Native Dimes, Native Nickels, Native Quarters, Broadway Lights, Wet'N'Wild, Red Hot Poker, Blue Lightening, 7's 8 Ways, Western Trains, Rack 'em Up, Keno, Flying Aces, Raising 7's, Multi Poker, Match Suit, Super Bonus, Lady Bug, Very Cherry Bonus, Red White and Blue 7's and the Wizard series of button control VGTs (includes the Wizard 8 Line, the Wizard Poker, the Wizard Poker/8 Line, The Wizard Poker/Blackjack, the Wizard Lucky Lines and the Wizard Dream Catcher). The Company also assembles the Hot Play touch screen VGT. Each machine has a similar assembly process, with the only variation in parts being the size of the terminal screen, whether a bill acceptor or a coin acceptor is installed, whether the machine dispenses coins or a cash ticket as the prize, the software program and the promotional sign on the machine. In addition the customer may choose to assign the machine as a progressive jackpot VGT…*[98]

106. The machines which were installed in EDM's establishments and which are now described as "machines of ability and skill" are of this type. In addition, the available evidence suggests conclusively that the machines contributed by Thunderbird to the EDM establishments were its surplus equipment which had previously been declared illegal in the United States.

2. Thunderbird introduced gaming machines into Mexico that it used in the United States

107. According to Mr. McDonald, *Support Consultants Inc.* (SCI) supplied the machines used in Mexico by EDM[99]. The President and General Manager of SCI, Kevin McDonald, was also offered as a witness in the administrative hearing before SEGOB.

108. Notwithstanding Mr. McDonald's recognition in this proceeding that SCI had some form of investment in Thunderbird's operations in Mexico[100] (a fact that he did not declare to SEGOB during the administrative hearing), neither he nor the claimant testified as to the extent of the relationship between SCI and Thunderbird. In fact:

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98 Annex R-024, pp. 6 and 7.

99 Testimony of Mr. McDonald, ¶¶ 6 and 7:"…SCI sold and maintained skill machines for Thunderbird's operations in Mexico. SCI also bought skill machines from other suppliers, sold them to Thunderbird and maintained them for Thunderbird's operations in Mexico. Finally SCI often acted as consultant to Thunderbird in respect of its operations in Mexico. SCI manufactured, distributed and maintained several of the skill machines used."

100 Id. ¶ 6.

109. The inspection by the litigating parties of the Mina de Oro establishment in Nuevo Laredo in November 2003 revealed that, among the machines in use, were found *"Very Cherry Bonus"* and *"Red White and Blue Sevens"*, machines operated by buttons[101]. These are some of the machines described in Thunderbird's 1996 Annual Report as *"[b]utton control VGTs assembled by the company for the gaming industry…"* (our emphasis). The same document defines "VGT" as a computerized slot machine[102].

110. The Nuevo Laredo establishment also had various VGTs called "Mina de Oro" which worked with buttons. They were described in the manuals found in the installations during the visits by the litigating parties. There are two sets of instructions, one with the name of Thunderbird and the other with the name of *Support Consultants Inc.* The SCI manual is simply a copy of the Thunderbird manual, except for the following differences:

- the cover of the SCI manual refers to games of "skill", but the Thunderbird original does not make this reference; and

- even though both manuals contain tables of prizes (on page 15) for five different types of video poker (*"4th July", "Joker Poker", "Deuces Wild", "Jacks or Better"* and *"Flush Fever"*) the page headed *"Poker Game Descriptions"* (page 12 in the Thunderbird manual) has been excluded from the SCI manual and the words *"poker"* and *"Keno"*, repeated on pages 11 to 22, were modified in the SCI version[103].

111. Mr. McDonald described this game as a "*symbol lock game of skill*" but the Tribunal can appreciate that it is no more than a game of poker. The Mina de Oro game provided the participants with the opportunity to play, among other things, video poker. Thunderbird's "*corporate disclosure statement*" recognizes that video poker played for money is a gambling game:

> *A VGT or Video Gaming Terminal is a computerized slot machine that incorporates a video terminal screen, central processing unit, memory, computer software and a random generator to determine the frequency and amount of payout of prizes. A user will input money, tokens or credit into the machine and play a game of chance in the hope of obtaining a return in prize money or credit. The games include the traditional slot-machine type games (that visually provide for the spinning of reels), card games (poker or black jack) and Keno. Presently in the market place there are single game versions and multi game versions.*[104]

112. Thunderbird attempted to introduce more gaming machines into Mexico which it had as excess inventory in the United States. In its *corporate disclosure statement* it announced that under the terms of an arrangement with a tribe from California with which SCI was engaged in litigation, 404 gaming machines had been returned[105]. In a draft of the Puerto Vallarta Letter of Intent, the section relating to the cost of the machines indicates:

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101 Annex R-033.

102 See the footnote on page 97 of this document.

103 Id.

104 Annex R-017, p. 6.

105 Id.

> *…the Group 1 investors (Thunderbird, Girault and Watson) will contribute 150 refurbished skill game machines provided by ITG [Thunderbird] at $4000 per machine. This cost is $2000 less than if brand-new machines were purchased from an independent contractor. The total cost for these machines will be $600,000*[106].

The Letter of Intent continued:

> *In conclusion, it should be noted that we have substantially re-worked the numbers to try to make this as favorable as possible for each of you. We have agreed to share the investment on an equal basis. If you have any question or disagree about the valuation of the machines, we will also agree to buy new machines, although new machines cost approximately $7000 each and are not significantly different from what we are about to obtain in our inventory.* [107]

113. The final version of the Letter of Intent signed by Mr. Mitchell states:

> *Group 1 investors may contribute their existing machines in inventory at $4000 per machine as a portion of their investment.*[108]

114. A later declaration by Mr. Mitchell included in the President's annual statement to Thunderbird's shareholders (after the acts of closure carried out by SEGOB) advised of the company's decision to reduce the value of its investment in Mexico on the balance sheet to zero. It also pointed out:

> *The company also wrote off $209,000 in gaming equipment that was intended to be refurbished for the Mexican market.*[109]

3. Thunderbird did not have any expectations of the right to operate in Mexico

115. As previously indicated by the respondent, the recent history of Thunderbird's operations in other countries is relevant in evaluating the reasonable expectations that it could have had on entering the Mexican market. Thunderbird's corporate documents indicate that they had entered and withdrawn from numerous markets and businesses because of legal problems related to gaming.

a. California

116. In the nineties, Thunderbird entered into five agreements for the installation and maintenance of video game terminals with Indian tribes in the United States. They rented machines that were used in the casinos run by the tribes in California. By 1998, the legal authorities had already threatened to take legal action to enforce the legal prohibition of casinos in California. During the meeting of Thunderbird's Administrative Board held in Vancouver on 16th April, 1998, Jack Mitchell informed the Board that the legal

106 Annex C-63.
107 Id.
108 Id.
109 Annex R-057.

authorities had warned him that if the Indian reservations did not comply with the law, they would face criminal proceedings. The minutes of the meeting stated:

> *He [Mr. Mitchell] indicated that the U.S. Attorney's Office would start enforcing the gaming laws in California sometime between May 13 and 16, the actual date being 60 days following the date on which the initial Pala Compact was signed. He indicates that now that the Compact has been signed, all of the tribes have been told that they must sign a similar compact by the May deadline. The United States Attorney's Office has presented the tribes with two options: (i) sign the Pala compact in which case they will be able to continue doing business provided they comply with the compact, or (2) shut down operations and negotiate their own compact which is unlikely to be on terms any more favorable than the Pala Compact.*
>
> *He indicated further that the Attorney's Office advised that if the tribes did not choose either option, they will face criminal action. Similarly, any company dealing with them on any level, such as Thunderbird, will also be at risk for criminal and civil prosecution in California after the May date. The Company retained criminal counsel to provide assistance with respect to this matter. Mitchell said that the message from the four State's Attorneys for California was that they would be taking enforcement action immediately following the May deadline. He indicated that they had not been concerned with activities of vendors such as Thunderbird in the past but they would be so once the deadline passed. "The message was clear", if you are not doing business with compacted Tribes after the deadline, then you'd better not be doing business in California.*
>
> *To explain what this meant, Jack indicated that the Company would not be able to supply parts of machines, sell machines or even collect receivables. He further indicated that the State's Attorney's Office would like a letter from Thunderbird to themselves as well as to the Tribes saying that Thunderbird would be dropping its support of those machines at the deadline and demanding the return of the machines. He indicated that the State's Attorney's Office wanted to make it very clear to the Tribes that they would not be doing business with them on any basis other than the two options presented above.*
>
> *In summary, Jack indicated that it was his belief that the Indian Tribes would win in the long run. However, that did not solve the immediate problem which is that business may cease entirely at the May deadline. It is very unlikely that they will be seizing machines or arresting the local populace. In fact the more likely scenario would be that they would take steps to interfere with the running of these casinos including such things as blocking the roads and possibly freezing bank accounts. Jack indicated that the Board needs to decide how it would proceed with any of the Tribes that it deals with should they decide not to elect one of the two options that have been presented. He indicated that he thought of the Tribes being dealt with only one might possibly elect to follow the compact. He thought the others would probably refuse to sign the compact but it is not clear what they will do.*
>
> *The Board resolved that the Company should cease conducting business in California and take all steps to comply with the requirements of State's Attorney's Office once the May deadline is passed unless the matter is resolved*

in a manner that would permit the Company to continue operating without a reasonable threat of prosecution.[110]

117. The Board resolved that the company suspend its business activities in California and take all necessary steps to comply with the requirements of the Attorney General, no later than May, unless the issue could be resolved in a way that would allow the operations to continue without facing the risk of legal action[111].

118. The Board also resolved to write off 100% of the value of the machines in California, given the uncertainty of this market[112]. Thunderbird later announced these decisions through various press releases:

> *The Tribes with which ITGC did business have indicated they will not sign a Pala Compact or enter into negotiations with the State and are at risk of enforcement actions by the U.S. Attorneys, including seizure and forfeiture of gaming devices. As a temporary cessation of income is possible, management has decided to take a write-down provision of $12.6 million in relation to the Company's California operations.*[113]
>
> *The U. S. Attorneys in California have commenced forfeiture proceedings against Tribes that failed to accept that Pala compact process, including several that did business with the Company. To ensure compliance with the stated positions of the Justice Department, the Company has advised each of the Tribes with which it has revenue sharing agreements that will no longer accept any payments nor perform any of its obligations under the agreements under the current legal environment.*[114]
>
> *The Company continues to collect revenue from one of its five revenue sharing agreements as one tribe entered into a Pala compact to avoid legal confrontations with the U.S. government. The Company averaged $30,000 per month revenue from that tribe during the six months ended June 30, 1998.*[115]
>
> *The Company recently sold and assigned all of its rights in its California-based Revenue Share Agreements with various Tribes to Support Consultants, Inc., a California corporation ("SCI"), in furtherance of its commitment to honor the mandate set by the U.S. Attorney in California. The assignment included transfer of the Company's rights to revenue from the revenue share agreements with various tribes as well as assignment of loans. Title to the machines was not transferred to SCI. In consideration for the assignment to SCI, the Company accepted a note payable in the amount of U.S. 4.5 million to be paid in installments over three years, contingent upon SCI's success in collecting such from the various tribes*[116].

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110 Minutes of the Board Meeting of 16th April, 1998, pp.2 to 4. Annex R-021.
111 Id., p. 4, ¶¶ 2 and 3.
112 Id., p. 4.
113 Thunderbird Press Release, 22nd April, 1998, Annex R-088.
114 Thunderbird Press Release, 14th May, 1998, Annex R-088.
115 Thunderbird Press Release, 30th September, 1998, Annex R-088.
116 Id.

The Company's prior activities in unsettled markets and its stipulated denial of a license in Colorado create challenge for it to be licensed in certain jurisdictions in the United States. The Company has taken all steps possible to operate responsibly in regulated markets, including divestiture of its Internet business and removal of all officers and directors responsible for moving the Company into unsettled markets.

The Company was conservative in ceasing its operations in May, 1998 in California and ceasing collection of substantial revenues from its Tribal clients.[117]

b. South Carolina

119. On 17th August, 1998, Thunderbird announced that its participation in operations in South Carolina were at risk due to a complaint against the gaming industry attempting to prohibit video poker. The complaint was upheld on the grounds that the machines which were operated were illegal lottery devices[118]. As a consequence, the company announced that it would liquidate its surplus inventory:

We have completed the closing of our assembly plant and are continuing to liquidate excess inventory. The company will continue with its plans to exit the competitive machine and casino products sales business.

120 It is noteworthy that Thunderbird started to liquidate its operations in South Carolina before the State Supreme Court had even ruled on the legality of its video poker machines. On 1st July, 1998, the State's Department of Treasury started to inform holders of licenses for dispensing alcoholic drinks, that gambling, and specifically video poker, would no longer be permitted in their establishments. Thunderbird announced:

We believe the future political and judicial risks do not justify further investment and have begun to liquidate our limited operations in South Carolina.[119]

c. Guatemala

121. In a letter to shareholders included in the 1999 Annual Report, Mr. Mitchell declared that Thunderbird had defended its operations in Guatemala against the legal action brought by the Federal Government. In the letter he stated: "*The government was changed in a democratic election in August 1999. Early indications from the new government are that it is more favorably disposed to gaming operations, and we are expecting an end to the legal challenges*"[120].

d. Brazil

122. In 1997, Thunderbird entered into two separate agreements to develop activities in Brazil. One was a Representation and Marketing Agreement with *C.H.R Eazy Comercio e ImportaÇao Ltda.* ("CHR") to provide gaming machines through a revenue sharing scheme. The other was an

117 Thunderbird Press Release, 6th November, 1998, Annex R-088.

118 Annex R-022.

119 Id.

120 See letter dated 13th April, 2000 addressed to the shareholders, *1999 Annual Report, p. 1, Annex R-023*.

agreement to buy 50% of *Burgeon do Brasil ParticipaÇoes Ltda (Burgeon)*, a Brazilian gaming and raffle company with operations in Brazil.

123. These agreements were however terminated due to the company's scarcity of resources and uncertainty about the regulatory environment: *"the Company's limited financial and other resources, coupled with an uncertain regulatory environment relating to gaming in Brazil"*[121]. Specifically Thunderbird's 1998 Annual Report indicated: *"the agreement with Burgeon was terminated and the Company has written off associated costs of US$500,000 pertaining to the project. Further the Company does not intend to pursue the business opportunities presented under the agreement with C.H.R. and has written off costs of approximately US$400,000 associated with the project."*[122].

c. Internet gambling business

124. Thunderbird was also involved in the establishment of Internet casinos. In June 1997, it announced a joint venture with *IGN Internet Global Network Inc.* to develop a virtual casino on the Internet which was already proceeding. The joint venture had obtained a license to install a server for the casino in St. Kitts. It was thought that the virtual casino, www.winstreak.com, would start operations in the second half of 1997.[123]

125. In April 1998, Thunderbird announced that it had tried to obtain licenses to operate a virtual casino but that *"The United States considers Internet gaming illegal because gaming is conducted over telephone lines. Gaming conducted over telephone lines is strictly prohibited in the United States and is being challenged in the Courts."*[124]. The company indicated that this was the reason for its decision to relinquish its ownership in *Winstreak*.

126. According to its own testimony, some of the casino operations in which Thunderbird has invested in other parts of the world, for example Panama, are permitted. Nevertheless it is obvious that Thunderbird would know perfectly well that this type of machine, and casinos in general, are not permitted in many jurisdictions – in fact in the majority of them – and it appears to have consciously followed a business strategy which is against the law.

B. EDM's decision to establish operations with "machines of ability and skill" in Mexico

127 The claimant argues that it developed its operations based on the 15th August, 2000 "opinion" of SEGOB. According to the claimant, *"Mexico reversed course and reneged upon its prior approval of Thunderbird's activities"*[125]. Before analyzing the contents of SEGOB's letter, it is important to understand the roles played by various individuals – Douglas Oien, Ivy Ong, Julio Aspe Hinojosa and Oscar Arturo Paredes Arroyo – in the decision to open the establishments of EDM.

128. According to the claimant, the Mexico project was started on the basis of advice and guidance received from these two individuals, not from the Mexican government:

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121 *Annual Information Form, Fiscal Year ended December 31, 1997*, dated 19th May, 1998, p. 21. Annex R-024.

122 Id.

123 Id. p. 20.

124 Id.

125 Complaint, p. 1, lines 16-17.

"Oien/Ong were looking for investors to open and operate a skill machine facility similar to Guardia's. They proposed a revenue-sharing arrangement under which Thunderbird would back financially and operate one or more skill machine parlors in Mexico. Aspe and Arroyo would be utilized to obtain necessary local permits and deal with Gobernacion."[126]

129. In the case which the claimant presents, the question as to whether he really relied on the guidance from his business partners or whether he relied on assurances from SEGOB, is a central theme, directly related to the responsibility which he attributes to the Government of Mexico in accordance with Chapter XI of NAFTA.

1. The role of Messrs Oien and Ong

130. Douglas Oien is (or was) President of a limited liability company called *A-1 Financial International, Ltd.*[127]. Ivy Ong is a casino designer, known for having collaborated with Indian tribes in the states of Oklahoma and New York in their efforts to open casinos in these territories. He collaborated with Mr. Oien in *A-1 Financial International, Ltd*[128].The claimant explains that Messrs. Oien and Ong created EDM-Mexico[129]. The role that they played is therefore a key aspect in this complaint.

131. Messrs. Oien and Ong proposed that Thunderbird and EDM get together to open "ability and skill machine" establishments in Mexico. A June 2000 agreement "*Revenue Participation and Consulting Agreement* establishes: *"the Parties* [referred to as *"The Thunderbird Parties"* and *"A-1 Financial Parties"] agree to participate in the development and operation of video machine games of skill and ability…throughout Mexico"*[130].In April of 2001, Thunderbird and EDM entered into an agreement with Doug Oien, Ivy Ong and *A-1 Financial International Ltd.* which rescinded the agreement of June 2000. In a letter of 20th November 2001 addressed to D. Scott Carruthers, lawyer for *A-1 Financial International Ltd.,* Albert Atallah declared, *"Thunderbird and its investor group invested well over $6,000,000 in cash and $2,000,000 in capital equipment based upon the representation made to your client concerning the viability of this business"*[131](our emphasis). In its 2001 Annual Report, Thunderbird communicated to its investors that these individuals had induced the company to take the decision to invest in Mexico to open establishments of "ability and skill machines":

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126 Complaint, p. 5, lines 2-5.

127 *Termination, Settlement and Release Agreement,* 12th April, 2001, p. 9, Annex R-019.

128 In 1996, Mr. Ong was found guilty of having counterfeited baby formula. Rosamaria Mancini, *Oklahoma Developer Confirms Shinnecock Casino Deal Long Island Business News,* 18th July, 2003; *Casino Proponent's Spotty Past Questioned*, Newsday.com 18th February, 2003; *Call for East End Intervention Online Casinos Network,* 6th May, 2003, Annex R-024 *Termination and Settlement and Release Agreement,* 12th April, 2001, p. 6. See also Annex R-019.

129 Complaint, p. 7, lines 1-2.

130 *"The Thunderbird Parties"* were Juegos de Mexico Inc., *International Thunderbird Gaming Corporation,* Entertainmens de Mexico Matamoros and Entertainmens de Mexico –Laredo. *The "A-1 Financial Parties"* were Doug Oien, Ivy Ong *and A-1 Financial International Ltd.. Termination, Settlement and Release Agreement of 12th April, 2001. Annex R-019.*

131 Letter from Albert Atallah to D. Scott Carruthers of 20th November 2001. Annex R-019. These documents are part of the record of the complaint lodged by Thunderbird against A-1 International. Mexico obtained them from the judicial record of the Superior Court of California in Orange County.

Thunderbird and its investor group invested well over $600,000 in cash and $2,000,000 in capital equipment based upon the representation made by A-1 Financial concerning the viability of business in Mexico. Based upon that representation, Thunderbird opened three locations and is currently battling the Government of Mexico in its attempt to shut the entire operation down. Thunderbird intends to file a cross complaint against A-1 Financial to seek not only the payments that have been made to date, but also for damages arising from fraud, intentional misrepresentation, interference with contractual relations, the cost to re-open the facilities, among other charges. Attorney James D. Crosby filed a Motion to Quash Service of Summons for Lack of Personal Jurisdiction on behalf of Thunderbird.[132]

2. The role of Messrs. Aspe and Arroyo

132. In its reply to the respondent's request for additional documents, Thunderbird provided a letter dated 10th August 2000, addressed to Messrs. Aspe and Arroyo in the opinion of Peter Watson, in which the payment of a success fee is mentioned. It sets out the following:

On behalf of International Thunderbird Gaming I wish to confirm payment, which will be made at your direction, and upon your written instructions, of the sum of $300,000 (Three Hundred Thousand) USD, payable as a success fee upon your delivery on behalf of Thunderbird, of a letter from Gobernacion, no later than August 15, 2000, which shall be acceptable and to the full satisfaction of ourselves and our counsel Baker McKenzie, S.C. which indicates that, according to the applicable laws of Mexico, there is no opposition or limitation to operate our skill machine venture in the Republic of Mexico. In the event, for any reason, in contravention of the said letter, the Mexican authorities should close the operation, any additional payment would be waived, in which case it would be at Thunderbird's discretion to appeal and defend with or without your services. If we prevail in any such defense, no additional success fee would be owed.

It is our mutual understanding that the above-mentioned letter will be granted exclusively for the benefit of Thunderbird and/or its subsidiaries or designees in Mexico, and that no other such permission would be granted to other potential competing parties; otherwise no additional fees would be owed. If, however, no other such letter is granted, then Thunderbird agrees to pay additional success fees at the rate of 1,000 USD per machine…

This commitment to pay additional fees shall commence from the day hereof, and until April 30, 2001, unless there is a law enacted and enforced allowing or limiting such type of machines, in which case, the additional success fee shall be inapplicable.

It is understood and agreed that Thunderbird will install a minimum of 650 machines by October 15, 2000, and an additional 350 machines by December 1st , 2000, for which payment of $350,000 USD will be due on or before October 15th ,2000 and [sic] additional payment of $350,000 will be due on or before December 1, 2000. Such additional fees shall also be paid at your discretion and upon your written instructions.[133] [Our emphasis]

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132 *International Thunderbird Gaming Corporation, Annual Information Form, Fiscal year ended December 31, 2001*, dated 12th May, 2002. 17 (our emphasis) Exhibit R-026.

133 Letter from Peter Watson dated 10th August, 2000. Annex R-027.

133. Annex B of the EDM Subscription Agreement contains a document on Thunderbird letterhead, titled *"Matamoros Skill Game Operations"*, which states that:

> *LEGAL COSTS. The original plan contemplated a potential legal challenge (Amparo process) resulting in substantial and ongoing legal fees and costs. This process was avoided through an application filed by EDM-Matamoros to Gobernacion. EDM-Matamoros ultimately paid a success fee of $300,000 to a group of attorneys who pursued the application to Gobernacion and secured a letter from Gobernacion to the effect that Gobernacion "blessed" the operation so long as Skill Games were used. Gobernacion determined it did not have jurisdiction over "Skill Machines" (i.e. it is a local municipal matter). EDM-Matamoros is taking on responsibility for the payment of the $300,000 success fee irrespective of the fact that future Skill Game Operations benefit from the payment of the fee but expects to recover such costs. (See item 3C).* [relating to the franchise agreement].[134]

134. Even though the draft of the letter was dated 10th August 2000, EDM presented its brief to SEGOB on 3rd August 2000. Juan Jose Menendez Tlacatelpa (who was a shareholder in EDM and its Sole Administrator) was the one who signed it, not Messrs. Aspe and Arroyo. The fact that Thunderbird had paid a success fee to two individuals for obtaining an authorization from SEGOB, notwithstanding the fact that another individual had already presented the "request", raises doubts about the role played by Messrs. Aspe and Arroyo, and why they were paid 300,000 thousand [sic] dollars (potentially up to 1 million dollars), and how they would be in a position to ensure that SEGOB did not issue a "permit" to other of EDM's competitors.

135. The respondent has repeatedly requested that the claimant provide documents relating to the participation of Messrs. Oien and Ong, Aspe and Arroyo, to enable a clear understanding of the role they played in Thunderbird's decision to invest in Mexico, and of EDM to open and operate "ability and skill machines" establishments. The claimant has refused to provide any of these documents.

136. The respondent is not responsible for revealing the true history behind the decision of Thunderbird to open establishments for games of chance and gambling games in Mexico. It is sufficient to demonstrate that the claimant had not been truthful in explaining its business decisions (as it had also not been in other aspects, as will be discussed below).

C. Legal proceedings brought by EDM

137. On 11th October 2001, after having commenced an administrative proceeding under the terms of the Federal Law on Administrative Proceedings, SEGOB closed down EDM's establishments in Matamoros and Nuevo Laredo, on the grounds that they were in violation of the Federal Law on Games and Raffles as prohibited games were being played in them. On 18th January 2002, SEGOB also closed down the establishment in Reynosa.

138. Mexican legislation offers to individuals a defense against the acts of the authorities. EDM challenged the administrative resolution on 10th October 2001, in the national courts. The judges found against EDM, who subsequently abandoned the appeals against the respective sentences. The question of the legality of EDM's operations according to Mexican law has been definitively resolved.

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134 Annex C-28, section 2.C.

1. Nuevo Laredo

a. Proceeding pertaining to constitutional protection

139. On 15th October 2001, EDM instituted a proceeding for constitutional protection[135] before the Fourth District Court in the State of Tamaulipas against the order of inspection and closure issued in the administrative resolution of 10th October 2001, the act of inspection and closure of 11th October and the closure of the Nuevo Laredo establishment[136].

140. The judge of first instance denied the provisional suspension[137] of the acts detailed in the complaint of 18th October 2001. He argued:

> …that for the effects of resolving the current question of the provisional suspension, I conclude that there is contravention of public order dispositions, and in accordance with the first article of the said Federal Law on Gaming and Raffles, games of chance and gambling games are, within the terms of this body of law, prohibited in the whole national territory; in addition, their operation continues to prejudice the public interest, given the addiction to which the players are exposed and the economic losses which could be considerable; with the weakening of the national economy and the affliction that could affect society as a whole[138].

141. It should be pointed out that EDM challenged questions relating to the administrative procedure as it was followed, but did not challenge the basis of the administrative resolution of SEGOB, and on this basis, the District Judge considered that EDM had tacitly accepted that it was operating games which were prohibited by the Federal Law on Games and Raffles:

> It is also evident from the lawsuit itself that the petitioner for constitutional protection validates as the basis for his disagreement the concept of violation, and the infringement of his associated right, but in no way challenges the content or considerations of the administrative resolution issued by the Director General of the Interior of the Interior Secretariat in its letter DGG/2010/1986/01 which has already been referred to…
>
> Because the petitioner did not challenge or deny the basis of the referenced administrative resolution as such, even though this was a proceeding of first instance, the company ENTERTAINMENS DE MEXICO S. DE R.L. is found to be operating games prohibited by the Federal Law on Games and Raffles.[139]

He concludes:

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135 The petition for constitutional protection is a system of judicial review of the actions of authorities (whether they relate to laws, administrative actions or judicial resolutions) before Federal courts for the protection of individual guarantees, fundamental rights of the individual, established in the Constitution for the benefit of individuals, including the guarantee of a hearing and due legal process.

136 Petition for indirect constitutional protection, 300/2001. p. 1. Annex R-028/1.

137 A fundamental aspect of the petition for protection is the ability of the individual to request the suspension of the act detailed in the petition, to maintain the status quo ante for the period of the proceedings. The suspension of the act will be conceded if this will not prejudice the social interest or contravene public order dispositions, and when the damages which the act would cause are difficult to reinstate. On receiving the petition, the court may order the provisional suspension of the act detailed in the petition, pending definitive suspension if this is conceded.

138 Decision denying provisional suspension, p. 4. Annex R-028/2.

139 Id.

> It is lawful to conclude that the interests of society and of public order must rank above the interests of an individual, and this justifies the denying of the provisional suspension of the acts mentioned in the complaint.[140]

142. In response to the denial of provisional suspension, EDM filed a petition for a review before the competent collegiate circuit court.[141] The Collegiate Court confirmed the decision of the District Judge to deny the provisional suspension.

143. The Judge denied the definitive suspension based on the same reasoning on which the provisional one was based. EDM once again appealed this interlocutory judgment. This was not successful.

144. The District Judge gave his judgment on 30th May 2002. He rejected the complaint without resolving its basis, because EDM had filed a motion to annul the acts detailed in the complaint before the Federal Court of Fiscal and Administrative Justice, and as a consequence, the judge of protection was prevented from having knowledge of an issue which had also been reviewed by another judicial authority.

> ……the concepts of the challenge contained in the petition for annulment practically reproduce the concepts of the violation contained in the current proceeding. Therefore, the intention of the claimant is clear, to exhaust both the legal and administrative avenues of challenge at the same time, which is not permitted by the law protecting guarantees. Following this line of thoughts, at the moment of filing the motion against the action, the procedure is to order the dismissal of the case under consideration, in terms of article 73, section III of the Law of Protection.[142]

145. EDM filed a petition for review. The Collegiate Court confirmed the judgment given on 30th May 2002. No other appeals against this judgment were filed.

b. Proceeding of annulment

146. According to the explanation of the judge of protection, EDM simultaneously petitioned for the annulment of the administrative resolution of 10th October, 2001 through litigation in the Federal Court of Fiscal and Administrative Justice.[143]

147. On 10th May, 2002, the Third Regional Metropolitan Court rejected the petition as EDM had also filed the motion for protection against the same SEGOB resolution:

> …..it is confirmed that the subject of the action filed a Petition for Indirect Protection against the inspection and closure order dated 10th October 2001, issued by the Director General of the Interior of the Secretariat of the Interior, which resolution is being challenged in this current proceeding, consequently, the motion against the action and the dismissal is filed, because it was challenged in a judicial proceeding for which the closure of the business establishments located in Matamoros and Nuevo Laredo is ordered, on the

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140 Id.

141 The petition for review is, in essence, an appeal. The collegiate courts are composed of three justices.

142 Judgment in the protection proceeding 300/2001, pp. 10 and 11. Annex R-028/3.

143 Writ of annulment proceeding, 19869/01 7 04 7 indent II. Annex R-029/1.

> grounds that they contravene the provisions of the Federal Law on Games and Raffles. At the same time, it is clear that the concepts of violation contained in the petition for protection argue that Articles 5, 14 and 16 of the Constitution, 2, 3 section V and 83, of the Federal Law of Administrative Procedures and 2 and 3 of the Federal Law on Games and Raffles, have been infringed which also support the concepts of annulment in the initial writ of this current proceeding.[144]

148. EDM filed a petition for protection against this judgment. Nevertheless this was withdrawn before the resolution of the Collegiate Court.

2. Matamoros

149. On 23rd October 2001, EDM filed another motion for protection against the inspection and closure order issued in the administrative resolution of 10th October, 2001, the 11th October act of inspection and closure of the Matamoros establishment.[145]

150. The judge issued a provisional suspension. SEGOB filed a complaint[146], considering that EDM's action prejudiced the social interest and contravened public order dispositions, as machines prohibited by the Federal Law on Games and Raffles were being operated. The Collegiate Court found in favor of SEGOB, and revoked the decision which had issued the provisional suspension. The reasoning of the Collegiate Court was as follows:

> The fact that the petitioner tries to carry out a business whose operations, in the opinion of the competent authorities, contravene the Federal Law on Games and Raffles, alone and according to the express wish of the legislator, constitutes grounds for the closure of the establishment, which precipitates the interruption of the activities prohibited by law; the pretension of the claimant in obtaining a suspension of the said closure, after its execution, is therefore inappropriate, in that to concede it would be acting against public order dispositions.
>
> In effect, the exploitation of games of chance is regulated by the cited body of law which expressly provides for the closure of the premises within which the contravention is assumed, which reflects the intention of the legislator immediately to obstruct the operation of centers for games of chance and gambling of any type, contrary to legal regulations; the foregoing without doubt flows from the interest of society that the said business not be established arbitrarily, as they could constitute centers of vice, given that the existence of this type of business in which such activities are carried out will bring about economic losses for the people who will visit there to the prejudice of the family assets.
>
> For this reason, the suspension of the decreed closure is not authorized as with such an action the claimant would be authorized to carry on an activity that the Secretariat of the Interior (the only entity legally empowered to authorize, regulate, and oversee games of chance and gambling) considers to be in contravention of the law, which could result in a

144 Judgment of annulment proceeding 19869/01 p. 8 Annex R-029/2.

145 Petition for indirect protection, 471/2001. Annex R-030/1.

146 The complaint proceeds against the decision that concedes the provisional or definitive suspension, among others.

contravention of the norms of public order contained in the Federal Law of Games and Raffles. [147]

151. On 25th January 2002, the District Judge denied the definitive suspension based on the Collegiate Court's resolution of the complaint. [148] EDM filed a petition for review. The interlocutory judgment of 30th April 2002 ordered the process to be re-instituted. The judge confirmed the denial of the definitive suspension through an interlocutory judgment of 10th June, 2002. [149]

152. On 21st August 2002, EDM withdrew the petition for protection. With this the District Judge's judgment remained in force. The withdrawal came after the petition for constitutional protection in respect of the Nuevo Laredo establishment was resolved against EDM, and after the Administrative Court pronounced the judgment of annulment which also went against EDM.

3. Reynosa

153. The company filed various petitions for protection relating to the Reynosa establishment. After SEGOB closed the establishments in Nuevo Laredo and Matamoros, EDM tried to obstruct the closure of the Reynosa establishment, using judicial means. It filed two unsuccessful petitions for protection. Both were dismissed. [150]

154. After SEGOB closed the establishment, EDM once again petitioned for constitutional protection against the closure. Nevertheless this was dismissed by the District judge when he learned that EDM had filed for annulment against the resolution of 10th October 2001 and its effects. [151]

155. Before the judgment dismissing the petition for protection was pronounced, EDM petitioned for a review, but this was withdrawn before a resolution was obtained.

4. The conditions of the resolutions of SEGOB

156. EDM committed fundamental errors in its strategy of having tried simultaneously to challenge the same acts in two different courts. All proceedings commenced by EDM were dismissed and the resolutions of SEGOB have remained in force as judicially valid and legal.

157. This is a fundamental question, as the complaint that Thunderbird has presented turns on the legality of its operations under Mexican law, and specifically, under the Federal Law on Games and Raffles, and the supposed "approval" of SEGOB contained in their letter of 15th August 2000.

158. SEGOB is the Mexican authority responsible for interpreting and applying the Federal Law on Games and Raffles, and of overseeing its compliance. In exercise of its legal powers, SEGOB determined that EDM's operations involved games of chance and gambling games, on the basis of which it proceeded to close the establishments and the machines used in them, as

147 Resolution of Appeal of a Complaint 17/2001-V, pp. 39 and 40. Annex R-030/2.
148 Interlocutory Judgment of the Suspension Event, p. 6. Annex R-030/3
149 Interlocutory Judgment of the Suspension Event, Annex R-030/4.
150 Protection proceedings 676/2001 and 809/2001.
151 Annex R-029.

ordered by the Law (see articles 8 and 14). EDM exhausted all internal avenues, and as a result, the actions of SEGOB have been supported by the Mexican courts.

159. One judge expressly indicated that EDM had tacitly agreed that it was operating prohibited games. In addition, having withdrawn from the various proceedings which it initiated, EDM has expressly admitted the validity and legality of the actions of SEGOB. This has been confirmed by the Supreme Court of Justice through solid case law.[152]

160. The claimant did not inform this Tribunal of the defense measures that were available to it, and that it used to the point of exhaustion. Neither did it communicate that the national courts rejected its suits and that the pending proceedings and attempted appeals were subsequently withdrawn.

161. EDM's access to the Mexican justice administration system and the outcome of the proceedings instigated, are relevant to the consideration that this Tribunal gives to the complaint and to the question of international responsibility which Mexico has in respect of the EDM situation under NAFTA.

D The legality of the operations of EDM and other establishments

1. SEGOB did not "approve" EDM's operations

162. It must first be pointed out that EDM did not apply to SEGOB for a permit, license or authorization to develop its operations, and neither did SEGOB issue one. This is how it was explained to its investors:

> *Based on this letter, although no specific entitlement was granted to the Company either directly or indirectly by approving EDM's franchise System, the Company believes that is operations of the Business as contemplated will also be permitted in Mexico.*[153]
>
> [Our emphasis]

163. In its letter of 3rd August 2000, EDM requested the opinion of SEGOB as to the operations that had already started – and which it was trying to expand – with machines called "of ability and skill", whose functioning was cursorily described.

164. EDM indicated that it was dealing with "video machines … recreation apparatus whose objective is amusement and entertainment", and declared: "In these video games no chance or gambling is involved., but only the skill and ability of the operator…so that the operator manages to match symbols in an optimum combination, and is given a ticket with points which can be exchanged for goods or services…"[154]. Later on he repeats: "The nature of the video machines for games of ability and skill does not constitute games of chance, or gambling or raffles…" and specifies that the objective was to "obtain points which could be exchanged for a prize as recompense". He indicated that, "from an analysis of the nature of our machines and the legal

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152 Abandoning the petition in protection proceedings. Implies express consent to the acts contained in the petition, with the result that a new action against them cannot proceed. Full Session of the Supreme Court of Justice. *Federal Judicial Seminal:* Ninth Period, Part III, thesis P/J. 3/96, February 1996, p. 22. Annex R-090.

153 Annex C-28, p 9.

154 Annex C-17, p. 1.

dispositions, we [i.e. EDM] have concluded that this is not within the scope of the application of the Federal Law on Games and Raffles, and consequently does not fall under the regulation of the Interior Secretariat or any other Federal authority…"[155] (our emphasis in all cases). It has to be pointed out that EDM did not offer evidence, or present the machines to demonstrate their functioning, nor invite SEGOB to inspect the establishment where they were already in operation, or presented the operating manuals, etc.

165. SEGOB, as already indicated, did not issue a permit, license or authorization, and neither did it approve the operations of EDM or the use of the machines described. Based on the declaration offered by EDM's representative in his letter of 3rd August, SEGOB stated:

> …if the machines which are being commercially exploited by the company which you represent operate in the way and under the conditions expressed by you [i.e. apparatus for recreation whose objective is amusement and entertainment, which do not involve chance or gambling] this authority does not have jurisdiction to prohibit them…[156]

Nevertheless after clearly explaining the legal prohibition with express references to the respective articles of the Federal Law on Games and Raffles, EDM was warned categorically:

> …that the machines that it operates do not involve the ingredients of chance and gambling…[157]
> [Our emphasis]

He expressly pointed out that if EDM did not heed this warning:

> …some of the legal provisions of the relevant federal law could be incurred, with the legal consequences which could be derived from their application in the terms of article 8 of the law in question.[158]

166. As already explained, article 8 of the Law places the obligation on SEGOB to "close down all premises which are open or closed, in which prohibited games or gambling games or raffles are being carried out without legal authorization…"

167. The Tribunal will be able to appreciate the contrast between the way that EDM described the machines to SEGOB on the one hand, and to its investors on the other: While declaring categorically to SEGOB that "in these video games, there is no chance or gambling involved" (our emphasis), EDM expressed its "understanding" of the Law to its investors in the following terms:

> *Currently, "slot machines" are not permitted in Mexico primarily because they are viewed as gaming and betting machines which are games of chance requiring no skill. If the game requires some degree of skill by the user, generally it will not be deemed a prohibited slot machine in Mexico. Through the Franchise Agreement with EDM, the*

155 Id. p. 2.
156 Annex C-18, p. 2.
157 Id.
158 Id.

Company will operate video game "skill machines" which require some degree of the user's ability and skillfulness to obtain a prize.[159]

[Our emphasis]

168. As to the element of gambling, the Tribunal may also appreciate that EDM declared to SEGOB that the objective of the game was to obtain "points that could be exchanged for a prize as recompense", a prize which, he indicated, consisted of "goods or services", but he omitted the information that in exchange for inserting dollars in cash into the machine, the prize could consist of a payment of dollars in cash for the points won, and that in effect, the earnings of EDM arose money "deposited in the machines less the prizes paid out in United States dollars"[160].

2. The decision to undertake operations in Mexico with the machines in question was not based on the supposed "approval" of SEGOB

169. The claimant has expressly recognized that both he and EDM commenced the actions necessary to start operating the establishments before SEGOB had issued its letter of 15th August 2000. For example, before this date (i) bank accounts had been opened; (ii) local permits had been obtained, for example for land use; and (iii) machines had been imported[161]. In addition, the letter of 3rd August 2000 indicated that the EDM establishment in Matamoros was already in operation.

170. Contrary to what Thunderbird is now affirming, it proceeded with the investment on the basis of the opinion and legal advice of its business partners and lawyers. As has already been explained, the evidence demonstrates that the claimant based his decision on the advice of Messrs. Oien and Ong, as well as on the advice and efforts of Messrs. Aspe and Arroyo (to whom he paid between 300,000 and 1,000,000 dollars).

3. SEGOB had not authorized Mexicans – or anybody whatsoever – to operate machines such as those operated by EDM

a. The operations of Jose Maria Guardia

(i) Huixquilucan, State of Mexico

171. The claimant argues that Mexico has permitted Mr. Jose Maria Guardia to continue operating the establishments which he opened with machines similar to those operated by EDM, while closing down EDM's establishments.

172. In February of 2001, Jose Maria Guardia, who formed a company called Cesta Punta Deportes S.A. de C.V. ("CPD"), opened an establishment in Mexico City. On 12th July of the same year, SEGOB visited the establishment. The inspector requested the manager of the establishment to give him a demonstration of the way the machines worked, following which he close the premises down. The Act [of closure] sets out:

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159 EDM Subscription Agreement, article 3 (b) (viii), p. 9. EDM-Laredo Subscription Agreement, article 3 (b) (viii), p. 9., and EDM-Reynosa Subscription Agreement, article 3 (b) (viii), p. 10.

160 Complaint, pp. 31, lines 14-15; 332, lines 16-17; and 3
3, lines 12-13.

161 Complaint, p. 7.

> Accompanied by the supervisor of the area of machines, one of these was operated using a five dollar bill, the result of repeated events indicated that the game is free from the will of the inspector, and it is therefore clear that the machine obeys the unavoidable circumstances of the said machine's electrical system, not the will of whatever player who wishes to line up equal symbols on the screen … due to the behavior of the said machines infringement of articles 3, 4, 7 and 8 of the Federal Law of Games and Raffles is evident, as we are dealing with a closed location in which games are practiced without a permit from the Interior Secretariat.[162]

173. CPD filed a petition for protection against the closure order. The judge of first instance granted the provisional suspension, which was later revoked by an appeal by SEGOB. The Court of Appeals found:

> The foregoing is based on the fact that because in accordance with written legal precepts, games of chance and gambling games are not included within games permitted under article 2 of the Federal Law on Games and Raffles, which relates to gaming machines of ability and skill, in terms of the same article they are considered to be prohibited by the law in question, since according to article 8 their operation requires the authorization of the Interior Secretariat, it follows that if CESTA PUNTA DEPORTES S.A. DE C.V. does not have the permission of the competent authority (Interior Secretariat) to operate the said machines for games of ability and skill at the premises marked as no. 20 of the Isla Roof Garden at the Interlomas Mall, on Paseo de la Herradura S/N, Lomas de Anahuac, Municipio de Huixquilucan, State of Mexico, he lacks legal grounds for requesting the provisional suspension of the closure of said machines which operate in the referenced location[163].

174. The District Judge denied the definitive suspension. Nevertheless CPD filed an appeal for review and a collegial court revoked the decision and granted the definitive suspension. The CPD establishment had therefore been operating because it obtained the suspension of the act pending conclusion of the proceedings.

175. On 28th September 2001, the District Judge issued a decision against CPD. CPD filed an appeal for review. The Collegiate Court which was aware of the review revoked the judgment of first instance and ordered the proceeding to be reinstated. On 11th June 2003, the district Judge once again ruled against CPD. He ruled:

> In this context it is clear that the claimant, without any of the evidence previously described and recognized by the law, managed to demonstrate the legal interest to which he made reference above, but none of them show that he had the permission of the Interior Secretariat to operate … the forty nine video game machines which were closed and the only one who affirms this is the one who is now left exposed.
>
> On the other hand it is worth pointing out that with the evidence that the claimant did offer…neither is this able to demonstrate that the forty nine machines the subject of closure are such as not to require the permission of the Interior Secretariat, being games

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162 Annex R-009.

163 Resolution of Complaint number 52/2001. Annex R-031/1.

of ability and skill, and as such did not involve gambling as found by the authority in ordering and executing the act which is the subject of the complaint.

...

A reading of these articles leads to the Interior Secretariat having the power to close all those locations, whether closed or open, in which games of chance, gambling games or raffles are being carried out without legal authorization, in such a way that, as the petitioner for protection could not prove that he had a permit issued by the aforesaid Secretariat to operate the type of machines which were found in the premises…as he could not demonstrate that they fell within a legal category other than games of chance, which he would have to do as the burden of proof of the existence of a judicial interest lies with the claimant, as it is he who brings the petition for protection; as there was insufficient proof that the operation of the gaming machines referred to did not depend on the ability and skill of the player, neither are they as referred to in article 2 of the Federal Law on Games and Raffles, it is clear that regulation in this case falls to the Interior Secretariat and not the Municipal Treasury of Huixquilucan, State of Mexico, which issued the operating license and, moreover for this reason, this document is not sufficient to prove a legal interest[164].

176. CPD once again appealed the judgment. The case is still going on and the suspension of the act [of closure] continues in effect.

(ii) City of Juarez, Chihuahua

177. On 15th April 2002, SEGOB undertook a visit to the establishment that CPD opened in the City of Juarez, Chihuahua, which also operated machines similar to those operated by EDM. This was also closed down for being in violation of the Federal Law on Games and Raffles.

178. On 22nd April 2002, CPD filed a petition for protection and requested suspension of the act of closure. Even though the District Judge first granted the provisional suspension, and then the definitive suspension, SEGOB managed subsequently to have it revoked in the collegial circuit courts.

179. On 26th July 2002 the judge handed down an interlocutory judgment on the suspension. He granted the definitive suspension to CPD. SEGOB filed an appeal against this resolution on the grounds that it was against the law to go against the public order dispositions established in the Federal Law on Games and Raffles. On 31st October 2002, the Collegial Court issued its resolution adopting SEGOB's arguments and denied the definitive suspension[165]. The proceeding continues.

b. Rio Bravo, Tamps, Operacion y Distribucion Total S. R.L.

180. Thunderbird also argues that Mexico has permitted an establishment in Rio Bravo, Tamaulipas, belonging to Mr. Alfonso de la Torre, to operate.

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164 Judgment of 11th July, 2003, pp. 12 and 13. Annex R-031/2.

165 Judgment of 31st October, 2002 p. 209. Annex R-032.

181. SEGOB has acted in the same way as in all of the other cases involving the operation of machines similar to the ones in question. The establishment in Rio Bravo was closed down in October, 2003.[166]. The company filed a petition for protection, which is still under consideration.

VII. LEGAL ARGUMENTS

A. Introduction

182. Before responding to the three principle complaints of the claimant, it is important to review the role of Chapter XI of NAFTA in relation to regulatory actions.

1. NAFTA recognizes and protects the right of each Party to regulate

183. NAFTA recognizes the right of each of the Parties to it, to regulate activities of a commercial or other nature within their territory. Each Party to NAFTA is free to decide how to regulate commercial activities, and under what conditions they may be permitted, as well as to prohibit certain activities. In the territory of one Party to NAFTA the regulation of the same activity may differ from one state to another - or from one province to another, as the case may be. For example, the states of New Jersey and Nevada have laws which permit companies to operate commercial gaming and gambling establishments, which in other states of the United States are strictly prohibited. NAFTA establishes certain measures for the protection of investors and their investments in accordance with international law[167]. Nevertheless this does not restrict the right of each Party to regulate commercial activities as it considers best, while complying with the obligations of the treaty dealing with investment[168].

184. The claimant interprets NAFTA widely in indicating that "it offers protection to a wide range of property interests included in the definition of "investment" according to article 1138[169]. Article 1139 (not 1138) in effect contains a wide definition of "investment". Nevertheless it does not define what type of investment an investor can make. It limits itself to enumerating different types of investment. It is possible for a person to invest capital in a company, and as such, to have an investment recognized by the objectives of Chapter XI; but at the same time, this company

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166 Act of inspection and closure of 28th August 2003. Annex R-009.

167 Professor Philippe Sands Q.C. stated: *"It is…important to recall that international law only aims to establish minimum standards, a floor below which no state should go in relation to the treatment of aliens and alien property."* Sands. P. *"Searching for Balance: Concluding Remarks"* in a seminar on NAFTA and the case of *Metalclad. 2002 NYU Environmental Law Journal*, Vol. II pp. 198 to 210. In a similar way, The Tribunal in the case of *Marvin Roy Feldman Karpa v. The United Mexican States*, Caso CIADI No. ARB (AF)/99/1, decision of 16th December, 2002, highlighted (¶ 103):

…the governments must have the freedom to act in the wider public interest through the protection of the environment, new or modified taxation systems, issuing or canceling government subsidies, reduction or increase in tariff levels, the imposition of restricted zones and similar measures. No reasonable government regulation of this type can be successful if the businesses which will be adversely affected seek an indemnity, and it is worth affirming absolutely that internationally accepted law recognizes this circumstance…

168 For example, article 1101(4) establishes that "no disposition of this chapter shall be interpreted so as to obstruct one Party from providing services or carrying out functions such as the execution and application of laws, social readjustment services, unemployment pension or insurance or social security services, social welfare, public education, public training, health and child protection, when they are carried out in a way that is not incompatible with this chapter."

169 *Claim, p. 62.*

could be involved in an illegal commercial activity according to the legislation of the NAFTA Party in question.

185. The treaty's preamble reflects the decision of the Parties to "PRESERVE their capacity to safeguard the public welfare". Nothing in NAFTA limits the options of one Party to protect the public order and morals. NAFTA does not prevent one Party to the treaty from interfering in an investment if, for example, an investor of one Party participates in a company involved in drug trafficking.

2. NAFTA Tribunals have delimited their role and jurisdiction in relation to the tribunals of the first Party.

186. The tribunals of NAFTA have uniformly established the need to carefully delimit their sphere of competence in relation to domestic courts, so as not to act as courts with the full right to hear appeal. The Tribunal in the case of *Robert Azinian et. al v. The United States of Mexico* established:

> The possibility of considering a State internationally responsible for legal decisions does not however give the claimant the right to request an international review of domestic legal decisions, as if the international tribunal taking cognizance of the case had full competence to hear an appeal. This is not generally so, and neither is it the case with NAFTA.[170]

187. In the words of the Tribunal "what has to be demonstrated is that the legal decision itself constitutes an infringement of the treaty" (original emphasis)[171].

188. This finding has been expressly adopted by four tribunals established in accordance with NAFTA. One more, although it did not cite the *Azinian* Decision, reached the same conclusion.

189. The Tribunal in the case of *Mondev International, Inc. v. United States of America* applied the Tribunal's criteria in *Azinian* in the following way:

> *126…. As noted already, in applying the international minimum standard, it is vital to distinguish the different factual and legal contexts presented for decision. It is one thing to deal with unremedied acts of the local constabulary and another to second-guess the reasoned decisions of the highest courts of a State. Under NAFTA, parties have the option to seek local remedies. If they do and lose on the merits, it is not the function of NAFTA tribunals to act as courts of appeal.*[172]
> [Our emphasis]

The Tribunal therefore refers to a paragraph in the *Azinian* decision, mentioned above.

190. In the same way, the Tribunal in *Waste Management, Inc. v. The United States of Mexico (Waste Management II),* indicated:

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170 *Robert Azinian et. al v. The United States of Mexico* Case CIADI No. ARB(AF)/97/2 decision of 1st November, 1999 ¶ 99.

171 Id.

172 *Mondev International, Inc. v. United States of America* Case CIADI No. ARB(AF)/97/2 decision of 11th October, 2002 ¶ 126.

> …the Tribunal calls attention to what was said in Azinian [v] the United States of Mexico: a NAFTA tribunal does not have "full competence to hear appeals" in respect of decisions of domestic courts, and what has been decided by such courts in accordance with domestic legislation will take precedence unless it can be shown to be contrary to NAFTA itself.[173]

191. The Tribunal in the case of *ADF Group Inc. v. United States of America* in citing *Azinian*, maintained that a tribunal of NAFTA cannot usurp the role of domestic courts and find that a government agency has violated internal law:

> *…..…even had the Investor made out a prima facie basis for its claim [that a U.S. agency acted ultra vires], the Tribunal has no authority to review the legal validity and standing of the U.S. measures here in question under U.S. internal administrative law. We do not sit as a court with appellate jurisdiction with respect to the U.S. measures.*[174]

192. The Tribunal in the case of Marvin Roy Feldman v. The United States of Mexico also expressly approved the *Azinian* Decision on this point. [175]

193. Finally, the Tribunal in the *Loewen Group, Inc. and Raymond L. Loewen v. The United States of America* reached the same conclusion, even though no specific reference was made to *Azinian:*

> *242…. Subject to explicit international agreement permitting external control or review, these latter responsibilities [the domestic responsibilities of every nation towards litigants of whatever origin who appear before its domestic courts] are for each individual state to regulate according to its own chosen appreciation of the end of justice. As we have sought to make clear, we find nothing in NAFTA to justify the exercise of this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation. Too great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however serious) will*

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173 *Waste Management, Inc. v. The United States of Mexico* Case CIADI No. ARB(AF)/00/3 Decision on the Preliminary Objection of Mexico relating to the Previous Proceedings (26th June, 2002) ¶ 48.

174 *ADF Group Inc. v. United States of America* Case CIADI No. ARB(AF)/00/1 (9th January, 2003) ¶ 190. The Tribunal expressly cited the Azinian case in the footnote on page 182.

175 *Feldman* Decision of the Tribunal, ¶ 139.

> Assuming that Article 1110 should be interpreted in accordance with international law, as made clear in Article 1131(1), no denial of due process or of fair and equitable treatment (this latter by reference to Article 1105 which makes [sic] Article 1110(1)(c)) constitutes a violation of international law. In this case those arguments of denial of due process or justice are weakened by various factors. Here, as in the Azinian case, the Claimant could not clearly affirm that there had been a denial of justice by the Mexican courts, either in relation to the Supreme Court protection judgment or with the later decisions of various lower courts in relation to the claims for annulment and of liquidation of taxes. In the case before us, The Claimant's affirmations of denial of justice are due more to acts of the SHCP than to acts of the courts…In the Azinian case, it was confirmed that "A public authority cannot be blamed for carrying out an act backed up by the courts, unless the courts themselves lack internationally recognized authority." In addition, the Azinian case gives us to understand that evidence is required that the decision of the court violates NAFTA, or that the competent courts refused to hear the petition, or that there has been "a clear, malicious and incorrect application of the law"…

damage both integrity of the domestic judicial systems and the viability of NAFTA itself.[176]

194. All the tribunals of NAFTA who have analyzed this issue are therefore in agreement that it is not the function of a NAFTA tribunal to act as an international court of appeal with jurisdiction to review the decisions of domestic courts.

195. Neither is it the function of international courts to resolve violations of internal law. The Tribunal in the case of *Feldman* established this in the following terms:

> The Tribunal…observes that by virtue of Article 1117 (1) (a) of NAFTA upon which this arbitration is based, its jurisdiction is limited to complaints arising out of a supposed violation of an obligation based on Section A of Chapter XI of NAFTA. Therefore in principle the Tribunal does not have jurisdiction to decide complaints which originate in a supposed violation of international law or Mexican law. Both legal systems mentioned (international law and Mexican law) may have relevance as far as any relevant disposition of Section A of Chapter XI may refer to them, or in compliance with the requirements of Article 1131 (1) in the sense that : "A Tribunal established under this section will settle disputes submitted for their consideration in accordance with this Treaty and with the applicable rules of international law". Beyond this, the Tribunal is not authorized to investigate supposed violations of international or Mexican law.[177]

B. There has been no denial of national treatment

196. The claimant's argument about denial of national treatment is based on the assertion that there are two other establishments, operated by Messrs. Guardia and de la Torre, which operate with gaming machines similar to those which EDM operated in Nuevo Laredo, Matamoros and Reynosa. The claimant initially identified establishments operated by Mr. Guardia and by Don Bradley as those with which he wished EDM to be compared. Nevertheless, after SEGOB had closed down Mr. Bradley's operations, Thunderbird had to find another establishment which it could use as a point of comparison.[178]

1. Article 1102 should be applied with particular attention to the facts of the case

197. Article 1102 requires that the Tribunal determine if the investor or his investment has received any treatment less favorable that that given to domestic investments or investors in similar circumstances. It is vital for the Tribunal to ensure that it makes an appropriate comparison. If no comparison is established, article 1102 does not apply.

198. The question of "similar circumstances" if particularly important in cases in which, like this one, the treatment complained of involves compliance with municipal law. In the execution of the law, the authorities, by definition, react to actions of physical and moral persons. They

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176 *Loewen Group, Inc. and Raymond L. Loewen v. The United States of America* Case CIADI No. ARB(AF)/98/3 Decision (26th June, 2003), ¶ 242. In the same sense, stated *"The Tribunal cannot under the guise of a NAFTA claim, entertain what is in substance an appeal from a domestic judgment"* ¶ 51.

177 Provisional Decision on Preliminary Jurisdictional Matters (6th December, 2000).

178 The Board Minutes of a session of the Administrative Board held on 2nd May 2003, reflected that Albert Atallah stated: *"Don Bradley's places were in fact shut down this week"* Annex R-034.

respond to illegal conduct within the limits permitted by law, in accordance with the available resources and the priorities of execution and prosecution. The execution of the law also involves individual rights, and naturally, this involves the domestic courts when these rights need to be protected.

199. As already indicated, various people have tried to operate slot machines in Mexico. SEGOB has taken legal action against 18 businesses of this type, including those of Messrs. Bradley, Guardia and de la Torre. It has acted in the same way in all of these cases.

200. The illegal operation of this type of establishment is a continuing problem. SEGOB has taken actions to combat them as they have become aware of the increase in activities of this type. In all cases they have done so energetically, following the same procedures based on the same legal dispositions.

2. International law assumes good faith in the administration of the law.

201. As such, States do not participate in illegal acts. Their role is essentially reactive. As indicated in this case involving closing down the establishments Mr. Bradley and Mr. Guardia, it is probable that one person commits an illegal act more frequently than the other; but the authorities act with regularity and continuity, based on the information and resources available to them. This does not imply that one person receives better treatment than the other, in violation of international law. It is simply a fact that is explained by the chronology of events and the distribution of available government resources. This situation is common to all acts in which the authorities require effective compliance with the law. It is clearly the claimant who has the burden to prove that his situation was any different.

202. It is a fundamental principle of internationally accepted law that the laws of a State are presumed to meet the requirements of international law[179]. The claimant has the onus to prove that he operated "alongside the judicial presumptions of innocence and the legal doctrine of *"omnia prasumuntur rite esse acta"* which applies to government acts.[180]

203. In the same way, if compliance with the Federal Law on Games and Raffles is achieved through acts of the administration, the domestic courts also play an important role. The different legal systems – and the Mexican system among them – offer individuals the right of defense in the domestic courts in the face of actions by the authorities. The courts then review these actions in the light of the legislation and other applicable legal dispositions. There are also mechanisms to control legal activity through appeals which the individual can bring within the same legal process.

204. In the case before us, all these mechanisms were available and Messrs. Guardia and de la Torre, as well as EDM, activated them to defend each one of their rights.

3. The facts of this case do not demonstrate that there was any violation of article 1102

205. SEGOB has dealt with EDM, Bradley, Guardia, de la Torre and others in the same way: After becoming aware of the illegal operations of these businesses, it has proceeded to close down the installations and subsequently to defend its actions when the individuals have appealed

179 See Alwyn V. Freeman, *International Responsibility of States for Denial of Justice*, p. 74 (1970).

180 *Methanex Corporation v. United States of America*, First Partial Decision, ¶ 45.

through legal channels pursuant to their rights. The claimant has not offered evidence showing that SEGOB discriminated against EDM based on the claimant's nationality.

206. The fact that in one case the court granted a definitive suspension of the act [of closure] to CPD, that is to say that in one case the court suspended SEGOB's closure pending final resolution of the case, does not imply discriminatory treatment. It is obvious that in judicial administration systems not all judges' decisions are identical; but the fact that there are differences in individual cases does not affect the cohesion and uniformity of the system as such. In the case of slot machine operations, there is complete cohesion: No court has found such operations to be legal in the terms of the Federal Law on Games and Raffles.

207. EDM had full access to the domestic courts in order to challenge the actions of SEGOB. It activated all the defense measures that were available to it. It was not successful. The actions of its lawyers and EDM's decisions to appeal via legal channels, and subsequently to withdraw from them, are relevant to the analysis of whether EDM and other businesses to which it compares itself are in "similar circumstances."

208 The Tribunal will appreciate that article 1121 expressly permits proceedings for the settlement of disputes to be initiated and continued, in which the application of precautionary measures to suspend or to declare, and extraordinary measures, may be requested, in accordance with Mexican legislation, always providing that this does not imply the payment of any damages to the administrative or judicial tribunal. The writs for protection issued by EDM fall into this category. The voluntary withdrawal of the local appeals by EDM is not an action attributable to the Government of Mexico, and has no place within the international responsibility of the State. [181]

209. In any case, EDM is not in similar circumstances to those of CPD. It did not benefit from a judgment that granted temporary suspension of the act [of closure]. CPD did obtain one. There is no appropriate comparison.

4. The *Feldman* case does not help the claimant

210. The complaint is based to a large extent on the majority decision of the Tribunal in the *Feldman* case[182]. There are three reasons for the analysis of national treatment to be limited to the particular facts of the case (leaving on one side the question that the majority improperly inferred a series of adverse facts[183]).

211. An analysis of the facts demonstrates that the facts in the *Feldman* case are different from those in this case:

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[181] See *Draft Articles on State Responsibility for Illegal International Acts*, approved by the International Law Commission in its 53rd period of sessions (the "Articles of State Responsibility").

[182] For example, see the Complaint p. 50.

[183] In the opinion of Mexico, the majority of the Tribunal concluded that there had been a violation of article 1102 based on inferences that were incorrectly drawn, and which the Dissenting Opinion dealt with in detail. The Government of Mexico submitted the question to a judicial review before the Superior Court of Ontario. The Court undertook its review and declined to interfere with the majority decision. Nevertheless the Government of Mexico maintained its view that the majority of the Arbitration Tribunal committed an error in this matter (but as for the rest of the issues, the decision was found to be well founded) and other courts should be reluctant to give too much consideration to the arguments to which the question refers.

- In the first place, the majority ruled as a matter of fact that the parties to the dispute were in agreement that CEMSA, Mr. Feldman's company, and three other companies owned by and under the control of the Mexicans, were in similar circumstances[184]: all these companies were contributors involved in the claim for the return of a particular tax[185]. There is no such commonality between the parties in this case. Mexico categorically denies that EDM is in circumstances similar to the Mexican companies with which it is trying to make a comparison.

- Secondly, the majority ruled as fact that there was an extremely small universe of people who were in similar circumstances and that the tax authorities knew all of them: "In this case, the known "universe" of investors is composed of only two parties or at the most three, one foreigner (the Claimant) and the other local (the companies of Grupo Poblano), and the Tribunal must reach its decision based on the evidence in front of it.[186]

- Finally, the majority found that the evidence "demonstrated a pattern of official action (or inaction) over a number of years[187].

212. In this case it is not possible to know the size of the "universe" of people who could become involved in gambling and raffles in an illegal way. The authorities detected these illegal operations; they acted in the same way. Neither is there any evidence of a "pattern of official action (or inaction) over a number of years". On the contrary, the evidence demonstrates that SEGOB has applied the Federal Law on Games and Raffles in the same way in all cases.

213. The complaint regarding violation of article 1102 should be dismissed.

C. Mexico has not violated the minimum level of treatment

214. Article 1105 establishes the minimum standard of treatment according to internationally accepted practice. The Tribunal in the case of *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v the Republic of Estonia* observed:

> *While the content of this standard is not clear, the Tribunal understands it to require an "international minimum standard" that is separate from domestic law, but that is, indeed, a minimum standard. Acts that would violate this minimum standard would include acts showing a willful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith.*[188]
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> [Emphasis in the original]

215. The claimant has not identified any rule of internationally accepted law that Mexico has violated in relation to the treatment received by EDM.

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184 Decision of the Tribunal, ¶¶ 171 and 172.

185 Id. ¶¶ 174 to 176 and 180.

186 Id. ¶ 186.

187 Id. ¶ 188.

188 *Alex Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v the Republic of Estonia,* Case CIADI No. ARB/99/2 ¶ 267. The decision was upheld in Brownlie and in the decision of a Chamber of the International Court of Justice in the case of ELSI, a decision that has been cited with approval by the courts in *Mondev, Loewen and ADF.*

1. The minimum level of treatment in accordance with article 1105

216. On 31st July 2001, the Commission of Free Commerce issued an interpretation of article 1105. Article 1131 (2) states:

> The interpretation composed by the Commission on a disposition of this Treaty, will be obligatory for a tribunal established under this section.

217. The Commission's note clarified that article 1105 establishes a standard of internationally accepted law. In particular it stipulates: "the concepts of 'fair and equitable treatment' and 'complete protection and security' do not require any strengthening to achieve the minimum level of treatment of foreigners established by internationally accepted law, or to go further than this[189]. The Tribunal must apply article 1105 in a way that is consistent with the CLC Note.[190]

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189 Note of the Commission of Free Commerce of 31st July 2001 ("The CLC Note) department B, ¶ 2.

190 The Tribunals established within the framework of Chapter XI have applied the CLC Note. The Tribunal in ADF observed (Decision of the Tribunal, ¶ 177):

> *We have noted that the Investor does not dispute the binding character of the FTC Interpretation of 31 July 2001. At the same time, however, the Investor urges that the Tribunal, in the course of determining the governing law of a particular dispute, is authorized to determine whether an FTC Interpretation is a "true interpretation" or an "amendment". We observe in this connection that the FTC Interpretation of 31 July 2001 expressly purports to be an interpretation of several NAFTA provisions, including Article 1105 (1) and not an "amendment" or anything else. No document purporting to be an amendment has been submitted by either the Respondent or the other NAFTA Parties. There is, therefore, no need to embark upon an inquiry into the distinction between an "interpretation" and an "amendment" of Article 1105 (1). But whether a document submitted to a Chapter II Tribunal purports to be an amendatory agreement in respect of which the Parties' respective internal constitutional procedures necessary for the entry into force in the amending agreement have been taken, or an interpretation rendered by the FTC under Article 1131(2), we have the Parties themselves –all the Parties- speaking to the Tribunal. No more authentic and authoritative source of instruction on what the Parties intended to convey in a particular provision of NAFTA, is possible. Nothing in NAFTA suggests that a Chapter II tribunal may determine for itself whether a document submitted to it as a interpretation by the Parties acting through the FTC is in fact an "amendment" which presumably may be disregarded until ratified by all the Parties under their respective internal law. We do not find persuasive the Investor's submission that a tribunal is impliedly authorized to do that as part of its duty to determine the governing law of a dispute. A principal difficulty with the Investor's submission is that such a theory of implied or incidental authority, fairly promptly, will tend to degrade and set at naught the binding and overriding character of FTC interpretations. Such a theory also overlooks the systemic need not only for a mechanism for correcting what the Parties themselves become convinced are interpretative errors but also for consistency and continuity of interpretation, which multiple ad hoc arbitral tribunals are not well-suited to achieve and maintain.*
> [Our emphasis]

The tribunal in *Mondev* also applied the CLC Note. After a discussion of the textual significance of article 1105, it stated: (Decision of the Tribunal, ¶¶ 121 and 122):

> *To this the FTC has added to clarifications which are relevant for present purposes. First, it makes clear that Article 1105(1) refers to a standard existing under customary international law, and not to standards established by other treaties of the three NAFTA Parties…. Secondly, the FTC Interpretation makes clear that in Article 1105(1) the terms "fair and equitable treatment" and "full protection and security" are, in the view of the NAFTA Parties, references to existing*

218. In general, internationally accepted law requires access to adequate mechanisms of defense to challenge government acts that affect their individual interests. It is clear that EDM had defense mechanisms available to it, and that it took advantage of them.

2. EDM was not successful in the legal proceedings in which the acts of SEGOB were challenged

219. The claimant recognizes that EDM instigated legal proceedings against the acts of SEGOB. It wrongly indicates that these were resolved in EDM's favor. It obtained a provisional suspension in respect of one of the petitions for protection which it filed; however SEGOB appealed and the court of second instance revoked it.

220. One of the petitions was dismissed and the dismissal was confirmed by the court of appeal, as a result of which the SEGOB resolutions are confirmed and have remained in force. EDM subsequently withdrew from the rest of the proceedings and appeals lodged. As a result, SEGOB's administrative resolutions are also confirmed and have remained in force. All are legal, and are judicially valid.

221. The complaint indicates this fact, but ignores the legal effect of the decisions of the Mexican courts in international arena. An analysis of the State's responsibility must take into account all of the acts of the State, including both the acts of the administrative authority as well as the domestic courts before which this action was challenged, and the fact that this action by the authorities has been backed up by the domestic courts.

222. The claimant claims that this Tribunal is ignoring the effect of the judgments of the Mexican courts, and therefore reaches its own conclusion that the type of operations that it was operating were permitted by the Mexican Federal Law on Games and Raffles, thereby disqualifying the actions of SEGOB.

223. The claimants in the *Azinian* case tried in a similar way to attack the legal substance of the municipal government's decision to rescind a concession for collecting and disposing of garbage. The question had already been analyzed by the Mexican courts which had ratified the legality of the action by the municipal council. The claimants sought to avoid the effect of the judgments of the Mexican courts by bringing proceedings under NAFTA. Nevertheless the Arbitration Tribunal found that the legal question was not limited to the administrative action, but also extended to the actions of the judicial authorities that had ratified it.

224. The Tribunal decided:

> The municipal council, as a legal entity, decided that it had valid powers to annul and rescind the concession contract, and declared it to be so. DESONA did not manage to get the courts of Mexico's three judicial levels to find that the decision of the municipal council was invalid. Taking this into consideration, does this Arbitration Tribunal have a basis for declaring that the Mexican courts acted wrongly in supporting the decision of

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elements of the customary international law standard and are not intended to add novel elements to that standard.
[Italics in the original]

the municipal council, and that the Government of Mexico should indemnify the claimants?[191]

225. The tribunal determined that it would not be sufficient for the claimant to be convinced that the actions or motivations of the administrative authority had been disapproved, or that the reasons set out by the Mexican tribunals are not persuasive. It is not enough for the claimant to prove that the actions or the motivation of the municipal council must not be allowed or that the reasons presented before the Mexican courts in the three instances were not convincing: "These considerations are useless while the claimants are not able to show non compliance of an obligation established in Section A, Chapter Eleven, attributable to the Government of Mexico."[192]

226. The legal question before the Tribunal includes consideration of the domestic judicial procedures:

> 96…the problem could be framed very simply. The municipal council thought that it had good reason to consider the Concession Contract void, by agreement with the Mexican legislation regulating public service concessions. At DESONA's initiative, this basis was reviewed by three levels of Mexican courts, and in each case, it was considered to be correct. How is it possible to affirm that Mexico did not comply with NAFTA when the Naucalpan municipal council declared a concession Contract to be void, which according to its terms, was subject to Mexican law and the jurisdiction of the Mexican courts, and these ratified the decision of the municipal council? On the other hand, the claimant neither alleged nor proved that the Mexican legal criteria for the annulment of concessions infringed Mexico's obligations under Chapter Eleven, nor that the Mexican law regulating such annulments is expropriator by nature.
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> 97. Framing the question in this way, it is clear that in order to agree with the claimant, it is not sufficient merely for the Arbitration Tribunal to disagree with the resolution of the municipal council. *A public authority cannot be blamed for carrying out an act which is backed up by its courts, unless the authority of the courts themselves is not internationally recognized*. In that the Mexican courts considered that the municipal council's decision to annul the Concession Contract was in accordance with the Mexican law regulating public service concessions, the question remains as to whether the decisions of the Mexican courts themselves infringe Mexico's obligations under Chapter Eleven. [193]
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> [Italics in the original, the emphasis is ours].

227. The claimants directed their complaints against the administrative authority; they did not object to the actions of the Mexican courts. This circumstance was fatal for the complaint, and rendered consideration of issues related to ownership of the concession unnecessary. The Tribunal pointed out that the rights of an individual under the protection of an international treaty are established by domestic law, and observed: *"if there is no objection to the decision of a competent court on the annulment – based on Mexican law – of a contract governed by that law, there is by definition no contract to expropriate…"*[194]

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191 *Azinian*, Decision of the Tribunal, ¶ 78.

192 Id. ¶ 84.

193 Id. ¶¶ 96 and 97.

194 Id. ¶ 100.

228 For the same reason, no violation of article 1105 can be alleged by the claimant in this case.

3. Mexico had not infringed any generally accepted norm of international law

229. It is a recognized principle that the party which alleges the existence of an internationally accepted rule of law is responsible for demonstrating the law. Consequently, it falls to Thunderbird, and not Mexico, to establish the internationally accepted rule of law relating to the minimum level of treatment applicable to the facts in this case. They must also demonstrate that Mexico has violated this norm. They have not done so.

230. In its complaint, Thunderbird tries to demonstrate that internationally accepted law establishes a minimum standard for administrative procedure, a standard which the claimant apparently expresses in isolation from the rest of the State judicial system, that is to say, that it is independent of the structure of the national legal system.

231. For example, Thunderbird recognizes that "an investor cannot present a complaint for violation of articles 1804 and 1805 of NAFTA" [195]. In fact, the Supreme Court of British Columbia dismissed part of the decision in the case of *Metalclad Corporation v. The United States of Mexico* which was based precisely in violations of Chapter XVIII of NAFTA[196]. The Tribunal in the *Feldman* case warned of this with approval[197]. Notwithstanding having recognized that the Tribunal lacks jurisdictional competence in relation to Chapter XVIII, Thunderbird considers that article 1105 incorporates articles 1804 and 1805. In other words, he is asking the Tribunal to apply Chapter XVIII without actually saying so. The focus clearly offends the basic rules for interpreting treaties, as well as the CLC Note.

232. The principle of effectiveness in international law requires that effect be given to all the provisions of a treaty, and that a precept is interpreted in such a way as to not depend on another for its effectiveness.[198]. The jurisdiction of this Tribunal is expressly delimited by article 1117,

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195 Complaint, p. 68.

196 *United States of Mexico v. Metalclad Corporation*, (2001) 89 B.C.L.R. (3d) 559, (2001) B.C.J. 950.

197 The Tribunal indicated (Decision of the Tribunal, ¶ 133):

> In its review of the judgment handed down in the case of Metalclad, The Supreme Court of British Columbia maintained that in Section A of Chapter XI, which contains the obligations of the governments of the countries which receive the foreign investment, no mention of any kind is made of the obligation of transparency for these investors, consequently the denial of transparency itself does not constitute a violation of Chapter XI. (United Mexican States v. Metalclad, Supreme Court of British Colombia, Reasons behind the judgment of the Honorable Judge Tysoe, 2nd May 2001, para. 70-74, http://www.naftalaw.org; in Chapter XVIII, NAFTA states that transparency is a general obligation for its Parties). If this Tribunal is not obliged to reach the same conclusion as the Supreme Court of British Columbia, this aspect of the decision is considered to be illustrative. [Our emphasis]

198 The International Court of Justice declared in the case of *Territorial Dispute* (Liberia v. Chad), 1994, ICJ 6¶51: *"one of the fundamental principles of interpretation of treaties, consistently upheld by international jurisprudence, [is] that of effectiveness."* In a similar way, in *Anglo Iranian Oil Co. (United Kingdom v. Iran)*, 1952 I.C.J. 93, p. 105, the Court argued the principle *"that a legal text should be interpreted in such a way that a reason and meaning can be attributed to every word in the text…should in general be applied when interpreting the text of a treaty."*

which only gives it jurisdiction in establishing whether or not there was any violation of Section A of Chapter XI (and two sections of chapter XV which do not have any application here)[199]. Simply put, the Tribunal does not have jurisdictional competence to resolve a petition based on any legal precept, including articles 1804 and 1805, which are beyond the limits established by article 1117.

233. For its part the CLC Note states:

> 2. The concepts of 'fair and equitable treatment' and 'complete protection and security' do not require any strengthening to achieve the minimum level of treatment of foreigners established by internationally accepted law, or to go further than this.
>
> 3. A resolution in the sense that a violation has existed of anther provision of NAFTA or a different international agreement does not mean that there has been a violation of article 1105(1)[200].

234. In any case, the way that articles 1804 and 1805 are drafted, must indicate to the Tribunal that the internationally accepted rule of law suggested by the claimant does not exist. For example, section (a) of article 1804 does not establish a categorical obligation, but rather qualifies it by terms such as "whenever possible" or "reasonable". For its part, article 1805 gives each Party the option to establish "tribunals or procedures of a judicial, quasi judicial or administrative nature" (our emphasis). In other words, according to NAFTA, the parties have a large degree of flexibility in structuring their administrative procedures for review and challenge.

235. The concept of denial of justice requires the Tribunal to consider the system of access to justice in an integrated way, and not its individual elements in an isolated way. Even if the administrative procedure commenced by SEGOB was deficient in the way alleged by Thunderbird – which is not admitted – this would not be sufficient to demonstrate that justice had been denied to EDM. Having the same structure for different legal systems recognizes that there could have been mistakes – including violations – in the governmental decision making chain in which Thunderbird was involved. Nevertheless the judicial system itself provides the means to correct them, through challenge and review of the actions through administrative and/or judicial channels.

236. In this case, EDM had both at his disposal, to challenge the resolutions of SEGOB. It took advantage of both. The courts decided against Thunderbird who finally withdrew from the pending proceedings and appeals. In other words, EDM exhausted the resources available to it.

237. In addition, the facts demonstrate that Mexico fully complied in granting the minimum level of treatment:

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199 In relation to the correct way of delineating jurisdictional competence of the court, see the Decision on the Preliminary Question of the Tribunal in the case of Fireman's Fund Company v. United Mexican States, Case CIADI No. ARB(AF)/02/1, and the Decision on Competence in United Parcel Services of America v. Canada, of 22nd November, 2002.

200 The Tribunal in the Loewen case after citing the CLC Note, stated: *"a breach of Article 1105(1) is not established by a breach of another provision of NAFTA. To the extent, if at all, that NAFT Tribunals in Metalclad…S.D. Myers…and Pope & Talbot…may have expressed contrary views, those views must be disregarded"*. (Decision of the Tribunal, ¶ 128). The complaint is based in an important way on decisions of tribunals that have been reversed by the CLC Note, according to what has been accepted by other tribunals e.g. in the *Loewen and ADF cases*.

a) The Tribunal should not ignore the way in which EDM characterized its operations to SEGOB in its statement of 3rd August 2000[201] which contrasts with the way it is now describing its performance[202]. In particular:

- omitted to inform SEGOB that, prior to its incursion into Mexico, Thunderbird had described and dealt with the machines contained in the application, as gambling machines in the United States;

- omitted to inform SEGOB that it had leased the same machines to Indian casinos for commercial purposes, and that the government of the State of California required Thunderbird to cease its activities on the grounds that they were prohibited;

- omitted to present a copy of the operation manuals for the machines, which indicate that they are gambling machines, and moreover contain numerous references to this term;

- omitted to inform SEGOB that the machines had a slot for inserting dollar bills and issued coupons which could be exchanged of dollars in cash.

b) SEGOB neither authorized nor approved the operations of EDM. Rather it issued a clear and detailed warning about the prohibitions established in the Federal Law on Games and Raffles, and warned them not to carry out prohibited activities, indicating the legal consequences that could follow if they acted contrary to this, including closure.

c) Following the first act of closure, SEGOB and EDM agreed to carry out an administrative procedure by which the Secretariat could evaluate the operations being carried out. They agreed that SEGOB would reverse the closure, EDM would withdraw the petition for protection and SEGOB would initiate an administrative procedure in accordance with the Federal Law of Administrative Procedure. This was done[203].

d) On 21st June 201, SEGOB gave notice of the beginning of the procedure[204].

e) An administrative hearing was held presided over by the Director General of the Interior, at which EDM provided evidence and presented arguments[205].

f) SEGOB weighed up the evidence and considered the arguments and on 10th October 2001 issued its resolution. It concluded that the operations of EDM involved games prohibited by the Federal Law on Games and Raffles[206]. The resolution of Interior explained its motives and the legal basis in a detailed and

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201 See section IV of this document.

202 *Thunderbird wished to undertake investment activities in Mexico. In good faith and seeking "certainty" as to the propriety of its proposed enterprise, Thunderbird made full disclosure to Mexico of its intended business activities. Thunderbird sought and obtained from the highest levels of the Mexican government an official opinion attesting to the propriety and legality of its intended operations. In reliance upon that official opinion, Thunderbird and its investors formed a series of Mexican entities to open and operate entertainment facilities where customers played "skill machines".* Complaint, p. 1 (our emphasis).

203 Complaint, p. 18, line 12.

204 See Annex R-049.

205 See Annex R-047.

206 See Annex C-70.

reasoned way, similar to the way this is done in other countries, for example by the National Indian Gaming Commission of the United States.

g) SEGOB proceeded to the immediate closure of the establishments in Nuevo Laredo and Matamoros, and subsequently also closed the establishment in Reynosa[207].

h) EDM subsequently appealed the proceeding for protection in the Mexican federal courts. It was not successful[208].

238. As the International Law Commission expressed: *"it is inconceivable that the State should have an unqualified duty to make reparation if the injury is the result of acts provoked by the alien himself[209]."* The Tribunal must reject the complaint in its entirety.

D, There was no expropriation

1. Reserve of an additional objection for lack of jurisdiction

239. The complaint of expropriation does not proceed. Nevertheless the Tribunal will observe that Thunderbird made the complaint based exclusively on article 1117 – that is to say, on behalf of EDM for the treatment that it received.

240. Nevertheless, the complaint of expropriation is presented as a complaint by Thunderbird in its own right, and not on EDM's behalf; but Thunderbird has not presented a complaint in accordance with article 1116. Consequently, the Tribunal lacks competence to consider the complaint, and should therefore reject it in its entirety.

241. Mexico objects to Tribunal's consideration of this complaint.

2. The legal system of one Party delimits the relevant judicial rights

242. The main judicial question resides in whether EDM had a legitimate and identifiable patrimonial right under applicable Mexican law to operate games of chance and gambling games in Mexico. The relevant law in Mexico prohibits these types of operations.

243. It is each Party's municipal law that defines mercantile law for their respective individuals. If State legislation does not establish a right to carry out a specific commercial activity, then it is not subject to protection by Chapter XI of NAFTA, or to expropriation. A complaint on the grounds of expropriation has to meet three conditions for it to be admitted in the context of international law: (i) State legislation must anticipate the right in question; (ii) it must be a patrimonial right and, in the NAFTA context, be protected by this; and (iii) an act of expropriation attributable to the State must exist.

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207 See Annex C-71, C-72 and C-73.

208 See section IV-2-C of this document.

209 *State Responsibility: International Responsibility,* [1958] II Y.B. Int'l L. Comm. 54, U.N. Doc. A/CN.4/111.

244. The NAFTA tribunals have repeatedly maintained that international courts do not have a broad mandate to question a State's regulatory policies. The tribunal in the case of *S.D. Myers Inc. v. Government of Canada*, observed:

> 261. *When interpreting and applying the "minimum standard", a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections…*
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> *263. The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders. The determination must also take into account any specific rules of international law that are applicable to the case*[210]. [Our emphasis].

245. The Tribunal in the Feldman case stated:

> …not every business problem experienced by a foreign investor constitutes a case of indirect expropriation under Article 1110, or a denial of the principal of legality or of fair and equitable treatment in accordance with Article 1110(1)(c). As the Tribunal in the Azinian case observed, "It is a common circumstance of life everywhere that people can be disappointed in their dealings with public authorities…We can be certain that there must be many Mexican companies that have had business relationships with government entities that have not ended up to their satisfaction…" (Robert Azinian and Others v. the United States of Mexico, Arbitral Decision of 1st November 1999, par. 83, 14 ICSID Review, FILJ 2, 1999.) Paraphrasing the Azinian case, not all government regulatory activity which makes it difficult or impossible for an investor to carry out a specific business constitutes an expropriation under Article 1110. In the execution of their regulatory powers, governments frequently change laws and regulations in response to changes in economic circumstances or political, economic or social aspects. These changes may well render some activities less profitable or not economic at all.[211].

246. The Federal Law on Games and Raffles establishes a clear prohibition, with exceptions limited in all cases to obtaining a permit from SEGOB. EDM presented SEGOB with a deliberately misleading description of the machines that it had been operating – and which operation it intended to expand – especially when considering the background to Thunderbird's operations in the United States and the reasons why they had to abandon them (which was not advised to SEGOB).

247. EDM stated categorically: "these games do not involve any chance or gambling"[212]. Nevertheless Thunderbird described the same machines to its investors in the following terms:

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210 S.D. Myers. Court Decision. pages 261 and 263.

211 *Feldman*, Court Decision, ¶ 112.

212 See Annex C-17.

> Actually "slot machines" are not permitted in Mexico, mainly because they are perceived to be gambling machines, which are games of chance that do not involve skill. If the game requires any degree of skill, it will generally not be considered to be a prohibited slot machine in Mexico. Through a Franchise Agreement with EDM, the Company will operate video game machines "of ability and skill" which require some degree of ability and skill on the part of the operator to obtain a prize. [213]
>
> [Our emphasis]

248. Additionally, EDM stated to SEGOB that the objective of the game was that the one who operated it would achieve the optimum combination of symbols "which would result in a ticket being issued with points which could be exchanged for goods or services…for a prize as a reward for his skill…. [214]. (our emphasis); but deliberately omitted to mention that the "goods and services" or the "prize" in fact consisted of dollars in cash.

249. Referring directly to the description of the machines and games provided by EDM in its statement of 3rd August, 2000, SEGOB responded:

> … the body of law contained in the Federal Law on Games and Raffles clearly establishes various provisions which strictly prohibits games of chance and gambling games throughout the national territory…
>
> In the same sense, article 4 gives it forceful in its warning "not to establish or operate any building or premises, whether open or closed, in which gambling games are practiced… of any type without a permit from the Interior Secretariat…
>
> Following on from what is written above, the express prohibitions set out in the Federal Law on Games and Raffles are current legal provisions which decisively prohibit games of chance and gambling games in the whole of the national territory… [215]

SEGOB then warned EDM:

> This Directorate General of the Interior advises you that the machines in operation must not involve the elements of chance or gambling… [216]

250. In addition, the Secretariat expressly warned that, if this were not the case, the establishments could be closed down pursuant to article 8 of the Law.

251. Therefore, not only did the relevant law not confer a right to operate machines of the kind that EDM was operating, but SEGOB as the agency competent to regulate, authorize, control and oversee the matter, was clear and categorical in its interpretation of the law. It is surprising that if EDM was really "looking in good faith for certainty in the legality and legitimacy of the proposed company" it had not been transparent in describing the operations which it intended to carry out, including the background to Thunderbird's operations in the United States and the reasons for abandoning them, as well as the background to the incursion by Thunderbird executives into

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213 EDM-Mexico Subscription Agreement, p. 9, Annex C-28; EDM-Laredo Subscription Agreement, p. 9, Annex C-35; EDM-Reynosa Subscription Agreement, p.10, Annex C-42.

214 Annex C-17.

215 Annex C-18.

216 Id.

Mexico. Equally that it not provided, for example, a copy of the operating manuals for the machines, particularly if, in the light of SEGOB's response, it had any doubt whether, for example, the law permitted games of chance involving "any degree of ability and skill", or whether SEGOB considered cash payment in dollars for playing and winning points exchangeable for dollars in cash, to be gambling. It is surprising that they did not do this, especially as, prior to Thunderbird's entry into Mexico, SEGOB had already closed down an establishment of this type ran by Mr. Guardia – who admittedly operated "machines of ability and skill substantially similar, if not identical" [217] – which had provoked "a significant legal dispute"[218] with the Secretariat; and above all, when Aspe and Arroyo proposed that they follow the same strategy of commencing operations and clashing in litigation with SEGOB.

252. Neither Thunderbird nor EDM could have had reasonable expectations of being able to continue operating. In addition, against the background of the litigation involving the "machines of ability and skill substantially similar, if not identical" to those of Mr. Guardia, and because of the express warning from SEGOB, given in light of their interpretation of the law, they knew that they ran the risk of their operations being closed down. Mexican law does not establish a right to operate these types of games. In the specific case of EDM, this has been confirmed through legal channels, following the litigation brought by them. SEGOB acted in response to EDM carrying out an illegal activity in Mexico. Therefore this was not an expropriation pursuant to international law.

3. The exercise of the law in good faith does not constitute expropriation

253. International law recognizes that legitimate governmental acts in execution of the law do not constitute an expropriation that could be subject to an indemnity. Brownlie states:

> *Expropriation for certain public purposes, e.g. exercise of police power and defense measures in wartime, is lawful even if no compensation is payable*.[219]

Sir Robert Jennings and Arthur Watts have made the following comments in this regard:

> *Thus a state may restrict the rights of aliens to hold property; and far-reaching interference with private property, including that of aliens, is common in connection with such matters as taxation, measures of police, public health, the administration of public utilities and the planning of urban and rural development*.[220]

254. The Tribunal of Complaints between Iran and the United States has recognized that a State's power to revoke licenses does not constitute confiscation:

> *A state is not responsible for loss of property or other economic disadvantage resulting from… any… action that is commonly accepted as within the police power of states, provided that it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price*.[221]

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217 Complaint, p. 53, lines 17 and 18.

218 Id. P. 4 line 21.

219 Brownlie, *Ian: Principles of Public International Law*: Oxford University Press (5th ed., 1998), p. 540.

220 OPPENHEIM, OPPENHEIM'S INTERNATIONAL LAW § 407 AT 911-912 (9th edition vol. 1 1996) (references are omitted).

221 *Too v. Greater Modesto Insurance Associates*, Decision No. 460-880-2 (29th December 1989) ¶ 26 (determined that the cancellation by the *Internal Revenue Service* of the Claimant's liquor license in California was not al illegal expropriation)

255. The European Court of Justice has recognized the right of a member State to restrict the operation of gaming and betting in its territory, regardless of the existence of an international agreement on economic cooperation. A British company which specialized in taking bets had an intermediary in Italy, whose business was closed down by the Italian Attorney General pursuant to an Italian decree regulating licenses for taking bets. The British company protested. It argued that the action violated the precepts of the treaty of the European Community. The Court found that the action of the Italian Government did not violate the treaty of the Economic Community, in spite of disadvantaging foreign business, and declared:

> *In so far as the potential demand for certain types of gambling activity is greater than is considered compatible with social order, it is permissible for member States to impose restrictions based on an assessment of needs informed by national social policy.*[222]

256. The Restatement of the Law on United States external relations indicates:

> *A State is responsible for an expropriation of property under Subsection (1) [discriminatory taking without public purpose and without compensation] when it subjects alien property to taxation, regulation or other action that is confiscatory or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory…A state is not responsible for loss of property or for other economic disadvantages resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory…and is not designed to cause the alien to abandon the property to the state or sell it at a distress price.*[223]

257. In the same way, Mexican legislation regulating games of chance and games involving betting, and the legitimate actions of the authorities which execute them in the interests of preserving social order, do not constitute a violation of Mexico's international obligations.

258. Issuing an indemnity to the Claimant in this case would suggest that the execution of the law in relation to all types of illicit business – including the illegal distribution of drugs, the manufacture and distribution of pirated merchandize, among many others – requires governments to indemnify those who have violated the law. The respondent requests the Tribunal not to lose sight of the fact that EDM was engaged in illicit activities.

259. The Tribunal must dismiss the claim in its totality.

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[222] *Questore di Verona v Diego Senate, Reference for a preliminary ruling* 199 ECJ CELEX LEXIS 9086, ¶ 31 (20th May, 1999)

[223] *Restatement Third) of the Foreign Relations Law of the United States* § 712 commentary g, p. 200-201 (1987)

VIII EXCEPTIONS OF INCOMPETENCE AND ADMISSIBILITY[224]

A. Customary international practice requires the Tribunal to distinguish between a company and its shareholders

260. The internationally accepted rule that companies have a separate legal personality from their shareholders is a well established principle. In the case of *Barcelona Traction*, the International Court of Justice determined that Belgium did not have the procedural legitimacy to present a claim against Spain, for the alleged expropriation of assets of a Canadian company whose shareholders were mostly Belgian. The Court determined that the Belgian shareholders did not have the right to claim for alleged damage to the rights of the company; if the company suffered damages, only the company itself could make a claim for them. For as long as the *Barcelona Traction Light and Power Company Limited* remained a company constituted in Canada, it was a Canadian company, and only Canada had the right to pursue a claim in the international arena, through diplomatic intervention.

261. In relation to municipal law, the Court declared:

> 41. *Municipal law determines the legal situation not only of such limited liability companies but also of those persons who hold shares in them. Separated from the company by numerous barriers, the shareholder cannot be identified with it. The concept and structure of the company are founded on and determined by a firm distinction between the separate entity of the company and that of the shareholder, each with a distinct set of rights. The separation of property rights as between company and shareholder is an important manifestation of this distinction. So long as the company is in existence, the shareholder has no right to the corporate assets.*
>
> *42. It is a basic characteristic of the corporate structure that the company alone, through its directors or management acting in its name, can take action in respect of matters that are of a corporate character. The underlying justification for this is that, in seeking to serve its own best interests, the company will service those of the shareholder too. Ordinarily no individual shareholder can take legal steps, either in the name of the company or his own name. If the shareholders disagree with the decisions taken on behalf of the company they may, in accordance with its articles or the relevant provisions of the law, change them or replace its officers, or take such action as is provided by law. Thus to protect the company against abuse by its management or the majority of shareholders several municipal legal systems have vested in shareholders (sometimes a particular number is specified) the right to bring an action for the defense of the company, and conferred upon the minority of shareholders certain rights to guard against decisions affecting the rights of the company vis-à-vis its management or controlling shareholders. Nonetheless the shareholders' rights in relation to the company and its assets remain limited, this being, moreover, a corollary of the limited nature of their liability*[225] (Our emphasis)

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[224] In his most recent communication the claimant indicated no objection to Mexico delivering its Reply to the Complaint three days later than the originally established date. In addition, as the respondent did not even present its defense based on lack of jurisdiction on the original date, it had therefore given up the right for it to be considered in a preliminary manner. Mexico had not given up anything, and it is the Tribunal that must decide if it considers questions of admissibility and competence in a preliminary manner.

[225] Id.

B. NAFTA conditions for submitting a claim to investor-state arbitration

262. States may modify internationally accepted rules of law by means of a treaty, and have done so on occasion in order to give foreign shareholders of national companies the right to present an international claim. Section B of Chapter XI is an example. Nevertheless, the Parties to the treaty maintained the distinction made by the International Court of Justice between injury suffered by the company and injury to the interests of its shareholders. For example, the *Statement of Administrative Action on the Implementation of the North American Free Trade Agreement* of the United States indicates:

> *Articles 1116 and 1117 set forth the kinds of claims that may be submitted to arbitration respectively, allegations of direct injury to an investor, and allegations in direct injury to an investor caused by injury to a firm in the host country that is owned or controlled by the investor. In both cases, investors may bring claims where the injury results from an alleged breach of Section A…* [226] [Our emphasis]

263. Section B of Chapter XI admits international claims in well defined circumstances. In accordance with recognized rules of internationally accepted law, under no circumstances may a company of one Part present an international claim against a State which shares the same nationality. Article 1117(4) states with absolute clarity: "an investment [sic] may not present a claim under the terms of this section."

264. Under specific circumstances, Article 1117(1) allows a claim derived in the name of a company which is an artificial person of the State where the investment was made. An investor of one Party may present a claim in representation of a company of the other Party, if the company is an artificial person, and the investor owns or controls the company, either directly or indirectly. [227] The nature of the claim must be maintained throughout the course of the arbitration, and must be reflected in the indemnity which the Tribunal may issue: Article 1135(2) requires that, if the award made in respect of a claim according to article 1117 is in favor of the company, restitution of property "is awarded to the company" or "the sum of money is paid to the company…without prejudice to any right that any person may have to be indemnified according to the applicable internal law." This provision is aimed at preserving the rights that the creditors of the company – established in Mexico – may have against this conformity with internal law. NAFTA clearly recognizes the distinction between the legal personality of the company and its shareholders[228].

265. The provisions which govern claims presented under article 1117 recognize that, in the three Parties of NAFTA (and universally) property and control of a company confer on the shareholder the right to retain the widest rights over the company, from the right to modify or liquidate the company, to the appointment and removal of directors and executives, and to direct

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[226] The Statement of Administrative Action is a declaration associated with the Executive Power of the United States, relating to a treaty which has been passed to the Congress of that country for approval. Even though it is not binding for international tribunals or the other Parties of NAFTA, who may differ on their viewpoints or opinions regarding NAFTA's rights and obligations, the Statement of Administrative Action is nevertheless contemporaneous with the signature and approval of the treaty, indicating the significance that can be attributed to certain of NAFTA's dispositions. In this case, the respondent agrees with the cited paragraph.

[227] Article 1117 was intended to allow a foreign investor to present a claim when, regardless of any injury or loss which he may have suffered, a company owned, or directly or indirectly controlled by him, has suffered injury or loss.

[228] There is no similar provision in the case of complaints presented under article 1116, because obviously the protected legal interest is different from that of the company.

its policies and administration. In this way, although the interests of the shareholder and company are not confused, NAFTA allows the investor of one Party which owns and controls a company of the other Party, to present a claim in the name of this company.

266. According to the decision of the International Court of Justice, a minority shareholder or one who does not control the company, does not enjoy these rights; even though he has others: the right to be notified of general meetings, to vote his shares, to participate in dividends declared for the class of shares which he holds, in proportion to his shareholding, and to participate in proportion to his shareholding in the distribution of shareholders' assets upon liquidation. Nevertheless, a minority shareholder cannot represent a company, and only has such rights as are conferred on minorities by the company's statutes or by law. Neither can NAFTA confer any such right on minority shareholders, or those who do not control the company.

267. Minority shareholders cannot exercise any right of action in relation to a derived claim, that is to say, cannot exercise any right of action in the name of the company. Such investor can therefore only present a claim for alleged violation of Section A which directly affects his own rights, and not simply the company's rights.

268. In this case, Thunderbird promotes the claim exclusively under the terms of article 1117. All of Thunderbird's claims relate to the treatment received by EDM – not Thunderbird. EDM is an artificial Mexican person which does not have the right to present a claim against Mexico, its own State. Only investors which own or control the company can present a claim on its behalf. Nevertheless, as discussed below, Thunderbird has not managed to establish that it owns or controls EDM. In fact, Thunderbird did not even present the waiver referred to in article 1121, which was signed by the legal representative of EDM. It tried to sign a waiver on behalf of EDM, in an attempt to comply with the conditions required for the submission of an arbitration claim in accordance with NAFTA.

C. Thunderbird has not managed to establish that it owns and controls the Mexican companies on whose behalf it supposedly made the claim

269. In its written claim, the claimant argues that "from 2000 to 2001, it owned, controlled and operated the establishments of 'machines of skill and ability' in the cities of Matamoros, Nuevo Laredo and Reynosa in Mexico[229]. Nevertheless, Thunderbird has not demonstrated that in fact it does own and control Entertainmens de Mexico ("EDM-Matamoros"), Entertainmens de Mexico-Laredo (EDM-Laredo) and Entertainmens de Mexico-Reynosa (EDM-Reynosa). The proof offered by the claimant itself showed that Thunderbird alone did not control any of the companies on behalf of which the arbitration claim was submitted in accordance with Chapter XI of the treaty, and that its minority shareholding is not sufficient for it to be considered as the owner. Among other things, Thunderbird has not proved that:

- It owns or controls *International Thunderbird Brazil (BVI) Ltd. ("Thunderbird Brazil"*) and Juegos de Mexico, Inc ("Juegos de Mexico");
- These companies acquired EDM;
- Thunderbird acquired the shares or capital of EDM which were supposedly the property of *Thunderbird Brazil;*

[229] "From 2000 to 2001 it owned, controlled and operated "skill machine" facilities in the Mexico cities of Matamoros, Nuevo Laredo and Reynosa." See the Complaint, p. 3, lines 14 and 15.

- Thunderbird has a sufficient interest in EDM-Matamoros, EDM-Laredo and EDM-Reynosa to be considered as their owner; and

- That it alone controls EDM-Matamoros, EDM-Laredo and EDM-Reynosa.

270. The Tribunal will recall that since Thunderbird presented notice of its intention to submit an arbitration claim one and a half years ago, the respondent requested documents demonstrating ownership and control of the companies referred to. As a consequence, it objected to the notice. To date, the claimant has not presented these documents in spite of repeated requests[230]. Mexico continues to object.

271. In the first session of the Tribunal with the parties which took place on 29th April, 2003, the respondent declared[231]:

> The Government of Mexico is not convinced that, in reality, the Claimant meets the criteria required by the Treaty, and should be considered as an investor on one part, which has made an investment. That is to say that it owns and controls an investment in Mexican territory. As the Tribunal had observed, a claim had been presented in accordance with Articles 1116 and 1117 of the Treaty. We do not know if it really is an investor which, for example owns and controls the companies on whose behalf it apparently presented the waivers required by Article 1121. In its statements it referred to installations and operations, but did not refer to any investment. We have not received any indication of the type of investment, whether it is an investment or a company, or shares in a company, assets of a company, etcetera.
> I insist that we have not been told if it owns or controls these supposed investments. For this reason we object to the admissibility of this claim and to the competence of the Tribunal"[232].

272. In accordance with the established procedural timetable, Mexico requested the documents once again in letters of 29th May, 29th August and 17th October, 2003[233]. The repeated refusal of the claimant to provide them raised doubts about the character of the claimant as "an investor of the first Part". This also applied to basic corporate documents that all companies are required by law to keep. The Tribunal must not ignore the behavior of the claimant.

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230 On 4th April 2002, the respondent requested Thunderbird to present documents confirming the ownership of the installations in Matamoros, Nuevo Laredo and Reynosa ("it is requested that…present copies of the following documents…documents confirming that International Thunderbird Gaming Corporation is owner and operator of the premises located in Matamoros, Nuevo Laredo and Reynosa Tamaulipas"). Letter No. DGTE.02.037 from Lic. Carlos Garcia Fernandez. Annex R-02.

231 As the respondent will explain in this section, the documents presented by Thunderbird in the session of 29th April 2003 (copies of the declarations to the National Register of Foreign Investments) confirm that Thunderbird has no ownership or control of EDM-Matamoros, EDM-Laredo and EDM-Reynosa.

232 Transcription of the first session of the Tribunal held on 29th April 2003, pages 37 and 38 (pages 79 and 80 of the English version).

233 Letter No. DGCJN.511.13.578.03 dated 29th May 2003; letter no. DGCJN.511.13.949.03 of 29th August 2003; letter no. DGCJN.511.13.1095.03 of 17th October 2003. See Annex R-002.

273. In recent months, the claimant has indicated that the documents relating to ownership and control of EDM could be "inside the installations shut down by the Secretary of the Interior"[234]. As advised to the Tribunal by the respondent, from 5th to 7th November 2003 representatives of both parties visited the two establishments which continued to be closed, together with the location where the Office of the Attorney General held the assets from the Reynosa establishment. Minutes were taken of the visit to each establishment, which listed the documents found in and taken from each one. The documents referred to by Thunderbird's legal representative were not in any of the establishments, and none of the documents which were found, made any reference to the ownership or control of the companies in question[235].

274. As the claimant has not managed to establish that he owns or controls any of the companies which allegedly constituted the "investment" in Mexican territory, the respondent objects to the competence of the Tribunal to hear the claim presented in accordance with article 117. It also objects to the admissibility of the claim because, to date, the claimant has not presented these proofs.

1. Acquisition of EDM-Matamoros

275. In his complaint the claimant argues that "on 10th August 2000, Thunderbird acquired all the shares of EDM through two wholly owned subsidiaries, Juegos de Mexico, Inc. and *International Thunderbird Brazil*". He also argues that on 11th August 2000, Thunderbird acquired the shares of EDM which were owned by *Thunderbird Brazil* and that; moreover, with effect from this date, Thunderbird owned the majority of the shares in EDM both through its direct ownership, and that of its subsidiary, Juegos de Mexico, Inc.[236]. EDM is one of the essential elements in Thunderbird's supposed investment in Mexico. The proof of ownership and control of this company is, therefore fundamental. Nevertheless this assertion is not supported by what has been offered during this process.

a. Juegos de Mexico, Inc. and *Thunderbird Brazil*

276 The claimant has not provided any proof of ownership or control over Juegos de Mexico, Inc. *The Memorandum and Articles of Association of Juegos de Mexico, Inc* which was offered as documentary proof (annex C11) does not identify the company's shareholders or contain any information about them[237].

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234 See the claimant's request for provisional protection measures in accordance with article 1134 of NAFTA dated 26th June 2003: *"[I]n its first document request the Government of Mexico ("Mexico") has asked the Investor to provide it with a number of documents which are currently under the care and control of Mexican government officials. These documents, along with other evidence of relevance to this Claim, have been in Mexican custody since the facilities controlled by the Investor in Mexico were forcibly closed by Mexico…The evidence that should be found in these facilities includes…[c]orporate documents, regulatory documents (such as licences0 and operational records…"* letter from James Crosby to Hugo Perezcano of 22nd September 2003: "to the extent they still exist, the documents requested are presently located at the sealed facilities of Matamoros, Reynosa and Nuevo Laredo."

235 Minutes dated 5th, 6th and 7th November 2003. Annex R-003.

236 *"…on August 11, 2000, Thunderbird acquired the EDM shares of Thunderbird Brazil. Thunderbird, through its direct ownership and that of its subsidiaries, Juegos de Mexico Inc., held the majority of EDM shares"*. Complaint page 7, lines 16, 17 and 19-21. The claimant sends Annexes 11-13 in support of these affirmations.

237 In the first session of the Tribunal held on 29th April 2003, Thunderbird delivered to the respondent a copy of the declarations presented by EDM-Mexico, EDM-Laredo and EDM-Reynosa to the National Register of Foreign Investments. These state that Juegos de Mexico is a Panamanian company,

277. Neither has the claimant provided the share sale and purchase agreement dated 10th August 2000 confirming that Juegos de Mexico acquired from Messrs. Juan Jose Menendez Tlacaltepa and Alejandro Rodriguez Velasquez all of the shares of EDM[238] (buys and acquires from the sellers, exactly 5 Class A shares…representing exactly 100% of the capital of Entertainmens de Mexico S.A. de C.V.)[239]. Mr. Ruiz de Velasco signed this document as representative of EDM, but did not indicate the existence of any relationship between Juegos de Mexico and the claimant.

278. In its additional request for documents dated 29th August 2003, Mexico required Thunderbird to provide the following documents relating to Juegos de Mexico: (i) list of the company's shareholders current as at 10th August 2000; (ii) corporate documents demonstrating the company's relationship with Thunderbird; and (iii) documents of Thunderbird and EDM demonstrating that the company acquired the shares of EDM. In its reply of 22nd September 2003, the claimant declared that it did not know who the shareholders of Juegos de Mexico were and that it "exercised control of Juegos de Mexico through its legal representative, Luis de

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whose main shareholder is a national of the United States. This contradicts the statement of the claimant that he is the owner of the company, and that this is a Virgin Islands company. See Annex R-035.

[238] It is necessary to point out the following: the company that Thunderbird argues having acquired is Entertainmens de Mexico S.A. de C.V. This company was established by Messrs. Juan Jose Menendez Tlacaltepa and Alejandro Rodrigo Velasquez on 5th April 2000. The sale and purchase agreement provided by the claimant in its additional request for documents from the respondent, was entered into by Messrs Rodriguez and Menendez with Juegos. See Annex R-036.

[239] The sale and purchase agreement raised another big doubt about the validity of the acquisition. According to what was referred to in it, Juegos de Mexico acquired 100% of the shares of Entertainmens de Mexico, S.A. de C.V. Annex G-11. Nevertheless on 1st June 2000, the then owners of EDM, Messrs Menendez, Tlacaltepa and Rodriguez, agreed to change the company from a corporation (S.A.) into a limited liability company (S. de R.L.) and to change its name from "Entertainmens de Mexico" to Entretenimientos de Mexico". Minutes of the Extraordinary General Meeting of Shareholders of 1st June 2000, notarized on 26th of the same month. Annex R-037. It therefore seems that Juegos de Mexico bought shares in a company that did not exist, and did not have shares (in accordance with the General Law on Commercial Companies, the capital of corporations is represented by share certificates which carry and transfer the interests and rights of the company (article III); the capital of limited liability companies is divided into member's shares of which no member may have more than one, unless they are of different classes conferring different rights, and these may not be represented by certificates of any kind, as they are not freely transferable, as is the case with shares. (articles 58, 62, 65 and 68)). The minutes of the members' meeting of 14th December 2000, indicate that the new members of EDM authorized legal action to be taken against the previous owners, who hid this fact at the time of the purchase until 13th December 2000:

> As the holding of the Extraordinary General Meeting of Shareholders on 1st June 2000 was not revealed by Messrs. Juan Jose Menendez and Alejandro Rodriguez Velasquez to Thunderbird (BVI) Ltd and Juegos de Mexico, when the sale and purchase of shares contract was entered into, following a broad discussion the Meeting passed the following unanimously:…Messrs. Luis Ruiz de Velasco and Mauricio Girault Esteva are given, jointly or severally, a special power of attorney in respect of its object, but a general power as far as its faculties are concerned, in the name of the company to carry out any act or commence any proceeding of any kind against Messrs. Juan Jose Menendez and Alejandro Rodriguez Velasquez relating to the entering into of said share sale and purchase contract or any actions derived there from, particularly as said persons did not reveal the agreements adopted by the Extraordinary General Meeting of Shareholders on 1st June 2000 to Thunderbird Brazil (BVI) and Juegos de Mexico, Inc. at the time of entering into said contract."
> [Our Emphasis]

Entretenimientos de Mexico, S. de R.L. de C.V., Ordinary and Extraordinary Shareholders Meeting, of 14th December 2000, Second Resolution. See Annex R-037.

Velasco"[240]. The respondent considers the fact that Thunderbird "was not aware of" the identity of the shareholders of a company which it had stated to be its subsidiary, and over which it assured it had absolute control, *Thunderbird Brazil*, to be revealing.

279. In its reply to the additional request from Mexico for documents [241], the claimant declared that "*Thunderbird Brazil is 100% owned by Thunderbird BVI*[242]. It affirms that Thunderbird BVI is, in turn, 100% owned by the claimant. None of the documents offered as proof indicate that on 10th August 200, the date on which Thunderbird Brazil supposedly acquired the shares of EDM, Thunderbird was the owner of *Thunderbird BVI*, or that *Thunderbird BVI* was the owner of *Thunderbird Brazil*[243]. In spite of repeated requests from the respondent, the claimant has not provided documents supporting these facts.

280. The claimant confirmed that Juegos de Mexico and *Thunderbird Brazil* acquired all the shares of EDM on 10th August 2000, and that on 11th August, *Thunderbird Brazil* transferred its four shares to Thunderbird. Nevertheless, the agreement for the sale and purchase of shares provided by the claimant in response to the additional request for documents contradicts this. *Thunderbird Brazil* did not participate in the purchase and sale. There is no proof that it acquired shares of EDM which it later was able to transfer to Thunderbird[244].

281. The minutes of the shareholders' meeting of 10th August 2000 approved the transfer by *Thunderbird Brazil* of four shares in favor of Thunderbird[245]. Nevertheless, this document lacks probative value, for which reason the claimant has not demonstrated that *Thunderbird Brazil* acquired shares of EDM.

282. It must also be born in mind that in declarations presented to RNIE, EDM indicated that *Thunderbird Brazil* is a United States corporation, whose main shareholder is of the same nationality[246].

2. Ownership and Control of EDM

283. The claimant asserts that it continued to have control over EDM after it confirmed the participation of new shareholders in the company. In its Complaint, Thunderbird declares:

> *In June 2001, EDM and investors executed a "Subscription and Investment Representation Agreement" and a "Members Quota Agreement" under which the investors secured various percentage interests in EDM. Membership certificates were issued to each of the investors indicating their share or quota percentages. Thunderbird*

240 See James Crosby's letter of 22nd September 2003, p. 3, Annex R-038.

241 Id.

242 As in the case of Juegos de Mexico, the documents delivered by the claimant to the respondent in the Tribunal's first session contradict their assertion as to the company's nationality. The declarations presented to the National Register of Foreign Investors indicate that Thunderbird is a United States company, whose principal shareholders are also of United States nationality. Annex R-035.

243 See Annex C-12 of the Complaint.

244 The acquisition of all of the "shares" of EDM by Juegos de Mexico raises more doubts as to the supposed investment by Thunderbird. According to the General Law on Commercial Companies, corporations may not have less than two members. Having only one member is grounds for dissolution of the company (articles 89 and 229). Juegos de Mexico could not therefore legally have acquired all the shares of EDM.

245 Annex C-13.

246 Annex R-035.

maintained its significant ownership interest in EDM. Further, pursuant to the agreements, Thunderbird retained complete control over EDM's operations [247].

284. Aspects of the *Subscription and Investment Representation Agreement, Members' Quota Agreement* and bylaws of the company are reviewed below. The respondent will demonstrate that these documents of the claimant do not prove that it either controlled or owned EDM.

a. Subscription and Investment Representation Agreement

285. The Subscription and Investment Representation Agreement (the "Subscription Agreement") establishes the terms and conditions according to which certain people could invest in EDM [248]. The Subscription Agreement refers to the issue of 300 shares[249] of the company: 130 of Class "A", and 170 of Class "B"[250]. The Subscription Agreement declares that "the control of the company is based on the combined participation in the combined capital of the holders of Class "A" and "B" shares[251]. Annex "A" indicates that with the exception of the subjects expressly listed, all decisions of the shareholders' meeting would require a majority of 65% of the votes. The subjects listed, which include the approval and modification of the financial statements, the business plan and the nomination of managers and external auditors, require a majority of 60%[252]. Annex A-1, entitled *EDM-Matamoros Division of Ownership and Cash Flows*, details the percentage participation in the company's capital and the voting rights of shareholders. "ITGC" (i.e. Thunderbird) holds an "ownership/voting" percentage of 36.67%[253].

286. The proof offered by Thunderbird therefore indicates that it does not have sufficient participation to give it ownership or control of EDM.

b. Shareholders' Agreement

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247 Complaint, p12, lines 19-25 (our emphasis) The claimant adds that *"the subscription agreement reflected and acknowledged Thunderbird's control of the investment"* and cites section 3(b)(v) of the same, which establishes: *"Thunderbird, through its key executives and management team including Messrs. Watson and Girault will manage all aspects of the development and ongoing operation of the company."*

248 The EDM Subscription Agreement which the claimant offered with the Complaint stated: *"[t]his Agreement is entered into by the Company and t he Subscriber in connection with the Subscriber's desire to acquire securities of the Company and as a condition of the issuance by the Company of such securities"*. The agreement signed by EDM and *MRG Entertainment of Matamoros, LLC* on 20th June 2001. Complaint Annex C-28, pages 4 and 22.

249 The General Law on Commercial Companies states that the capital of limited liability companies is divided into member's shares and establishes that no member can have more than one share, unless they confer different rights. See footnote on page 27 of this document.

250 Annex C-28, page 4.

251 Id article 3(b)(xv), p. 12.

252 Id Annex A.

253 Id Annex A-1. The other holder of Class B members' shares is "Girault/Wilson" with 20% of the ownership/voting rights. It is worth pointing out that the "Domicile" of "ITGC" appearing in the table is "BVI" (British Virgin Islands) and not Canada. In addition, an internal document prepared by Thunderbird, titled *"NAFTA Claim on behalf of the Shareholders of The Entertainmens de Mexico (EDM) Entities"* contains a table entitled *"EDM-Matamoros Division of Ownership and Cash Flows"* which also establishes that "T-Bird's" ownership is 36.67%. Annex C-86. In the Tribunal's first session held on 29th April, 2003, the claimant delivered to the respondent a copy of the declarations presented by EDM-Mexico to the National Register of Foreign Investments, showing that in January of 2001, the investment or percentage participation of *"International Thunderbird Gaming Corporation"* was 25%" Annex R-035.

287. The Subscription Agreement also anticipates that "the signatory agrees to the signature of a Shareholders' Agreement with the company and all of its members"[254]. Annex 2 of this Agreement contains a table headed *"EDM-Matamoros Division of Ownership and Cash Flow"* which, the same as in Annex A-1 of the Subscription Agreement, indicates that the ownership and voting rights of Thunderbird equal 36.67%[255].

288. As in the Subscription Agreement, the Shareholders' Agreement sets out what needs approval of 60% of the members, including approval or modification of the financial statements, business plan and nomination of managers and external auditors. The rest need a majority of 51%[256]. It also establishes that a quorum of 40% of the shares is required to hold a shareholders' meeting[257].

289. The Shareholders' Agreement anticipates that *"International Thunderbird Gaming Corporation"* will have the right to designate the President and Secretary of the Board, as well as the General Manager[258]. Nevertheless, this conflicts with the bylaws and the subscription agreement.

c. The bylaws

290. The Shareholders' Agreement indicates that "the bylaws of the company will be prepared according to the draft included as Annex B of the agreement. Annex B contains a draft of the minutes of the shareholders' meeting dated 15th September 2001, at which, among other things, the revision of the bylaws was approved[259].

291. As with the Subscription Agreement, the bylaws establish that a quorum for holding a general meeting is 70% of the capital, with a majority of 65% required to pass resolutions on the subjects expressly set out, including the approval or modification of the financial statements, the business plan, and the designation of managers and external auditors[260]. They do not allow Thunderbird to directly appoint the President and Secretary of the Board, nor the General Manager. This right is reserved for the shareholders' meeting.

292. It is for this reason that the claimant alone does not have control of the company, neither is its participation in the capital sufficient to give it control.

293. Consequently Thunderbird cannot bring a claim on behalf of EDM-Mexico under the provisions of Chapter XI of NAFTA.

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254 Annex C-28, article 3 (c) (h)p.14.

255 EDM-Mexico Shareholders Agreement. Annex C-29. One of the tables in the annex identifies the claimant as "ITGC-Canada" while the other identifies him as "ITGC", with domicile in "BVI." The annex also contains a *Membership Certificate* dated 16th December, 2000, which is not signed (annex to the Shareholders Agreement): which indicates that Thunderbird holds 37.18% of all the Class A and Class B interests.

256 This is in conflict with the Subscription Agreement, which establishes that a majority of 65% is required.

257 Annex C-29, article 5.1(a), p.4.

258 Id., articles 5.2 and 5.4, pages 6 and 8.

259 Id., Annex B, Sixth Resolution.

260 See Annex R-037.

3. Ownership and control of other investments

a. Establishments which they opened

294. Thunderbird also presents a claim on behalf of two other companies: EDM-Laredo and EDM-Reynosa. It also argues that it is the owner and has control of these as well. The proof does not support this.

(i) Entertainmens de Mexico Laredo S. de R.L. de C.V.

295. In its Claim the claimant declared:

[I]n November 2000, Thunderbird formed Entertainmens de Mexico Laredo S. de R.L. de C.V. ("EDM-Laredo") [the reference is omitted]. *Thunderbird directly and through its subsidiaries held a significant percentage interest in the entity…EDM-Laredo and various investors executed a "Subscription and Investment Representation Agreement" and a "Members' Quota Agreement" under which the investors held their various percentage interests in EDM-Laredo. Membership certificates were issued to each of the investors indicating their share or quota percentages, Thunderbird maintained its significant ownership interest in EDM-Laredo. Thunderbird retained complete control over EDM-Laredo's operations.*[261]

296. EDM-Laredo was established on 7th November 2000 with Juegos de Mexico and *Thunderbird Brazil* as members[262]. On 31st December 2000, EDM-Laredo held a members meeting[263] at which were approved: (i) an increase in the variable part of the capital by means of contributions in shares and capital by various physical and artificial persons (among whom was Thunderbird) and (ii) the transfer of all or part of the shares of Juegos de Mexico and of *Thunderbird Brazil*, to Thunderbird. The documents provided by the claimant reflect a participation by Thunderbird of 33.3% in the capital of EDM-Laredo[264].

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261 Complaint, page 13, lines 6-8 and 14-8 (our emphasis). The claimant restates its affirmation that the Subscription Agreement for *EDM-Laredo* establishes: *"Thunderbird, through its key executives and management including Messrs. Watson and Girault will manage all aspects of the development and ongoing operation of the company"* Complaint, page 13, lines 20 and 21. Nevertheless these questions relating to the "operation" of the establishments do not confer control of the company in terms of the capacity to make corporate decisions.

262 EDM-Laredo articles of incorporation, Annex C-31.

263 EDM-Laredo minute book Annex R-039.

264 Annex C-35. Shareholders Agreement, page 4. (The claimant presented two agreements with the same date. Both reflect that ITGC owns 33.3% of the capital of EDM-Laredo). An internal Thunderbird document, *"NAFTA Claim on behalf of the Shareholders of The Entertainmens de Mexico (EDM) Entities"* contains a table entitled *"EDM-Matamoros Division of Ownership and Cash Flows"* which establishes that "T-Bird's" ownership is 33.33%. Complaint, Annex C-86. In the Tribunal's first session held on 29th April, 2003, the claimant delivered to the respondent a file of the National Register of Foreign Investments, showing that in December of 2000, the percentage participation of *"International Thunderbird Gaming Corporation"* was 33.3%" Annex R-035. Among the documents provided by Thunderbird in response to the respondent's second request for documents, is a document called "Legal Opinion on Proceeding" of 20th August 2003. This document indicates that *"International Thunderbird Gaming Corporation"* holds 40.13% of the capital of EDM-Laredo. This document contains the heading "Second Proceedings Section", which suggests that it pertains to the National Register of Foreign Investments administered by the General Directorate of Foreign Investment of the Secretary of the Economy. The claimant delivered this document as part of its reply of 22nd September 2003 to the additional request for documents. Annex R-040.

297. It follows from the proof offered by the claimant that he had neither ownership nor control of EDM-Laredo. Nevertheless the bylaws, Subscription Agreements[265] and Shareholders' Agreements[266] offered establish different rules for a voting quorum and the number of managers.

	Bylaws[267]	**Subscription Agreement No. 1**[268]	**Subscription Agreement No. 2**[269]	**Shareholders' Agreement No. 1**[270]	**Shareholders' Agreement No 2**[271]	**Draft Bylaws**[272]
No. of Managers[273]	1 Class A 2 Class B	3 Class A 3 Class B	2 Class A 2 Class B	2 Class A 3 Class B	2 Class A 2 Class B	2 Class A 2 Class B
General Voting[274]	65%	65%	65%	65%	75%	65%
Voting on Listed Subjects[275]	Not covered	Simple majority	Not covered	Simple majority	Not covered	Not covered

298. Even though the bylaws and Shareholders Agreement No. 2 allow appointments to the Board to be made on the majority vote of the Class B shareholders, the claimant alone may not do so.

299. Thunderbird argues that it also had direct control of EDM-Laredo on the basis of a *Management Agreement*, through an administration manager in charge of the development of the operations of the establishment[276]. Nevertheless, the agreement simply indicates that EDM-Laredo will hire an administration manager, who will be approved by Thunderbird, to "coordinate the development, construction, systems implementation and other issues related to the operation" of the establishment. The administration manager was authorized to "hire and train personal, to enter into contracts, prepare budgets and financial reports", among other things. A review of the agreement reveals that the administration manager is essentially an administrator of the

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265 Annex C-35 contains two Subscription Agreements dated 30th November, both signed by Jack Mitchell.

266 Annex C-35 also contains two Shareholders Agreements, one dated 1st February 2000, signed by Wayne Ruydd and the other, undated, signed by Jack Mitchell (Thunderbird), Robert Ruyle (RNST, LLC), Peter Watson, Muffy Bennett, Michael Snow, Mauricio Girault and John Lienert (EDM-Laredo). We must point out that the agreement dated 1st February 2000 is also prior to the date on which Thunderbird allegedly acquired EDM, its main subsidiary (1st August 2000) which casts doubt on its validity.

267 Annex C-31, pages 5 and 10.

268 Annex C-35. Article 3(b)(xv).

269 Id.

270 Id. Annex C of Subscription Agreement No. 1, article 5.1(c) and 5.2(a), page 6 (note that page 5 of this document is missing).

271 Id. Annex C of Subscription Agreement No. 2, article 5.1(c) and 5.2(a), page 6.

272 Id. Annex B to Subscription Agreement No. 2.

273 This refers to the number of managers which the holders of Class A and Class B shares respectively are entitled to appoint.

274 This refers to the majority needed to approve resolutions of members' meetings, other than those relating to subjects expressly identified.

275 This refers to the majority needed to approve resolutions of members' meetings relating to subjects expressly identified.

276 See Complaint page 13, lines 22-24.

establishment who does not have any control over the company[277]. Most revealing is that in the section *"Relationship of the Parties/Indemnification"* the agreement states:

> *It is understood and agreed between the parties hereto that this Agreement does not create a fiduciary relationship between them, that Thunderbird and EDM-Laredo are and will be independent contractors and that nothing in this Agreement is intended to make either party a general or special agent, legal representative, subsidiary, joint venture, partner, employee or servant of the other for any purpose.* [278]

300. Thunderbird therefore had neither ownership nor control of EDM-Laredo.

(ii) Entertainmens de Mexico Reynosa S. de R.L. de C.V.

301. EDM-Reynosa was established on 5th June 2001[279]. The original members are *Thunderbird Brazil* and Juegos de Mexico. On 30th August 2001, EDM-Laredo held a members meeting[280] at which were approved: (i) an increase in the variable part of the capital by means of contributions in shares and capital by various physical and artificial persons and (ii) the transfer of all the shares of Juegos de Mexico and of *Thunderbird Brazil*, to Thunderbird. With effect from this date Thunderbird appeared as a member of EDM-Reynosa with 40.1% participation in the capital, (39.9% in Class B shares and 0.2% in Class A shares). The other members are MRG Entertainments of Reynosa with 39.9% in Class B shares and Messrs. Watson and Girault with 10% each in Class B shares.[281]

302. As with EDM-Laredo, the documents offered as proof do not completely agree. Nevertheless, they also show that the claimant did not own or control EDM-Reynosa.

	Bylaws [282]	**Subscription Agreement** [283]	**Shareholders Agreement** [284]

277 *EDM-Laredo Management Agreement,* Section 2. Complaint. Annex C-37, p. 1.

278 Id., page 3 (our emphasis).

279 See public deed No 45 452 of 5th June 2001, sworn before Roberto Nunez y Bandera, Notary Public No. 1 of the Federal District. Annex C-39.

280 Meeting Book of EDM-Reynosa. Annex R-41.

281 According to a table entitled *"EDM-Laredo, Division of Ownership and Cash Flows"* which forms part of the Shareholders Agreement of EDM-Reynosa, Thunderbird ("ITGC") owns 40% of the voting shares. Annex C-43. Annex C to the Shareholders Agreement.

282 Annex C-42, clauses 15a and 26a.

283 Annex C-42. Article 3(b)(xv).

Number of managers [285]	1 Class A 2 Class B	3 Class A 2 Class B	1 Class A 2 Class B
General Voting [286]	65%	65%	51%
Voting on listed Subjects [287]	Not covered	Not covered	65%

303. In the same manner as EDM-Laredo, the claimant indicates that he "controlled EDM-Laredo and its operations through a Management Agreement"[288]. Nevertheless a review of the agreement reveals that the administration manager is essentially an administrator of the establishment who does not exercise any type of control over the company[289].

304. Neither did Thunderbird exercise ownership or control of EDM-Reynosa.

b. Establishments that were not opened

305. In its Complaint, the claimant incorporated a new claim on behalf of three other companies, through which it claimed to operate other establishments: Entertainmens de Mexico-Juarez S. de R.L. de C.V. (EDM-Juarez), Entertainmens de Mexico-Monterey S. de R.L. de C.V. (EDM-Monterey) and Entertainmens de Mexico Puebla de S de R.L. de C.V. (EDM-Puebla).

306. Mexico considers that the Tribunal must not engage in the study of these claims, in that they are outside its competence because Thunderbird presented waivers for EDM-Puebla, EDM-Monterey and EDM-Juarez on 15th August 2003 and not at the time established according to article 1121 of Chapter XI. Thunderbird has not complied with the formalities set out in Chapter XI regarding the presentation of the complaints of these three companies[290]. Consequently, the Tribunal must reject them in their totality.

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[284] Annex C-43. The Shareholders Agreement of EDM-Laredo states: *"[f]or a quorum to exist at a meeting of members on first and subsequent calls at least forty percent (40%) of the Company's authorized, issued and outstanding quotas shall be in attendance, and a resolution at a meeting shall require the affirmative vote of fifty-one percent (51%) of the Company's authorized, issued and outstanding quotas"* In the same way it states that *"[t]he Company shall have a Board of Managers consisting of three (3) persons, two (2) of whom shall be designated by ITGC, holding the Class "B" Quotas, and one (1) of whom shall be designated by the Members holding the Class "A" Quotas"*. Articles 5.1, 5.2.

[285] This refers to the number of managers which the holders of Class A and Class B shares respectively are entitled to appoint.

[286] This refers to the majority needed to approve resolutions of members' meetings, other than those relating to subjects expressly identified.

[287] This refers to the majority needed to approve resolutions of members' meetings relating to subjects expressly identified.

[288] Complaint page 14, lines 19-20.

[289] Annex C-45, article 2.A, section 3. pages 1 and 2.

[290] Neither has Thunderbird demonstrated that it owns, has a controlling ownership in, or controls these companies. The members of EDM-Monterey, EDM-Puebla and EDM-Juarez are Juegos de Mexico and *Thunderbird Brazil*. Annex C-48, C53 and C 57. The claimant has not provided any document showing that it is a shareholder or owner of, or exercises control over, *Thunderbird Brazil*. Neither has it offered any proof that Thunderbird acquired the membership shares in EDM-Monterey, EDM-Puebla and EDM-Juarez from them.

307. It must be pointed out that none of these companies opened any type of establishment. Only Thunderbird offered proof that the project had achieved any stage of development. No real "investment" has been demonstrated with respect to these installations. The respondent maintains that the complaints of these three companies do not fall within the competence of the Tribunal in accordance with Chapter XI of NAFTA.

c. Other projects

308. Thunderbird mentions in its complaint that it had planned to establish premises with slot machines in other cities in Mexican territory (Veracruz, Playa del Carmen etc.). In the opinion of the respondent, the Tribunal must take these as they are: just plans.

IX. DEFENSE TO THE CLAIM FOR DAMAGES

A. Introduction

309 The arguments presented on the question of damages are made without prejudice to the respondent's defense in the matter of responsibility. In particular, the respondent maintains its position that: (1) there was no violation of article 1110 of NAFTA given that EDM operated establishments with so called "ability and skill machines" which were illegal according to the Federal Law on Games and Raffles; (2) there is no violation of article 1105 which derives from an effective application of the Federal Law on Games and Raffles, the administrative hearing, the legal proceedings or from any other norm or proceedings; and (3) there was no denial of national treatment.

310. The respondent maintains its objection in the matter of jurisdiction in reference to the fact that the claimant does not own or control the three EDM companies and does not have procedural legitimacy to present a complaint under article 1117 for any damage or loss presumed to have been suffered by them The respondent would only have the right to present a complaint for any loss or damage suffered to its investment in any of the companies referred to.

311. The respondent categorically denies that any of the measures taken by the Interior Secretariat, or any other government entity, could be considered as the immediate cause of any loss or damage suffered by the claimant or any of the EDM companies. The respondent, together with the other shareholders of the EDM companies, proceeded with the development of the "ability and skill machines" establishments in the full knowledge that they had not been authorized by the Interior Secretariat, and that the same secretariat had taken legal action against other similar establishments operated by third parties. Any damage or loss suffered by the EDM companies resulting from criminal action is a consequence of the risk voluntarily taken by the investors. Consequently any loss or damage suffered is due to its own negligence or to information that was not revealed by the claimant.

B. Synopsis

312. The claimant is seeking payment for damages in the amount of 24, 67.9 and 175.4 million dollars respectively, depending on three alternative scenarios:

- loss of income for 10 years from the three existing establishments, taking into account the number of machines that these contained at the time of closure;

- loss of income for 10 years, assuming three times the number of machines that these contained at the time of closure; and

- loss of income for 10 years from the existing establishments as well as three new establishments (although not developed) with three times the number of machines in the existing establishments.

313. The amounts indicated are claimed in United States dollars, but include interest at *Mexican Prime Rate* compounded three monthly[291].

314. According to any reasonable scenario, the amount claimed under the first scenario is excessive. The amounts claimed according to the second and third scenarios are simply exorbitant.

315. To put the amount of the claim in perspective, it is between 6 and 44 times greater than the US$ 3,950,000 which the shareholders in the EDM companies assert that they have invested[292], and between 2.5 and 18 times greater than the market capitalization of *Thunderbird* which amounts to $9,481,557[293], and reflects the value of investments in 11 licensed casinos: six in Panama, two in Venezuela, two in Nicaragua and one in Guatemala[294].

316. The amount claimed is even more extraordinary when it is analyzed in light of the poor financial performance of the three Mexican companies which operated the establishments. The audited financial statements reveal that the three companies operated with significant losses.

317. The are serious problems with the claim for relative damages, both in terms of the facts that the claimant has assumed for the purposes of valuation, and the legal principles that have been applied, or rather, that have not been applied, to various aspects of the claim. The respondent will show that, if the correct legal principles are applied, and even making a generous interpretation of the facts, the three entities would have a negative going concern value using a discounted cash flow method (DCF using English initials), and a very modest value if it were determined according to "appropriate valuation criteria", such as the value of the respondent's investment or the proportion that corresponded to the book value of the assets.

C. Legal principles which are applicable to the claim for damages

318. The claimant's allegations regarding damages offer a long, and mainly irrelevant, discussion on the jurisprudence in accordance with international law. It selectively mentions legal excerpts and principles which are supposedly derived from the cited cases, in an attempt to support its argument that it has a right to "complete restitution" of its investment, calculated on the basis of net present value (NPV) or discounted cash flows.

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291 This is not in accordance with the terms of the treaty. See discussion *infra*.

292 The claimant is alleged to have invested $100,000 in cash, plus net advance payments ($2.24 million dollars less $77,000 which were paid). The amount recognized by the company's auditors is less. See discussion *infra*.

293 Data taken from the page of CNQ at http://www.cnq.ca, relating to *International Thunderbird Gaming Corporation* (ITGC.U), 10th December 2003 (value per share: US$0.39, number of shares: 24,311,687).

294 See "*Gaming Operations*" in http://www.thunderbirdgaming.com/gaming_operations/gamingOps.html

319. The prescribed measure of compensation for violation of article 1110, which is evident even from reading the text, was confirmed by the Tribunal in the *Metalclad Corporation* case:

> With respect to the expropriation, article 1110(2) of NAFTA specifically stipulates that the indemnity will be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. This paragraph also establishes that "the valuation criteria will include the current value, the asset value (including the declared fiscal value of tangible assets), as well as other criteria which are appropriate to determine the fair market value"[295].

320. As far as the valuation criteria which is appropriate to a specific case, the applicable jurisprudence consistently indicates that valuations based on estimated profit (i.e. net present value or discounted cash flows) may be used only when the company in question has had at least two or three years of profitable operation, enabling the estimates to be supported with confidence. The Tribunal in the *Metalclad* case indicated:

> 119. Normally the fair market value of a company that is trading and has had a history of profitable operations may be based on an estimate of future earnings, subject to an analysis of the updating of funds flows. *Benvenuti v. Bonfant Srl v The Government of the Republic of Congo,* 1 ICSID Reports 330; 21 LLM. 758; *AGIP v. the Government of the Republic of Congo*, 1 ICSID Reports 306.
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> 120. Nevertheless when a company has not been trading for a sufficient time to establish its operations or has not produced benefits, future earnings may not be used to determine the current value or the fair market value. In *Solar Tiles, Inc. v. Iran* (1987) (14 Iran-U.S.C.T.R. 224, 240-242; I.L.R. 460, 480-481), the Tribunal dealing with complaints between Iran and the United States, indicated the importance in valuing a company of its business reputation and the relationships established with its suppliers and clients. Similarly, in Asian Agricultural Products v. Sri Lanka (4 ICSID Reports 246 (1990) page 292) another CIADI Tribunal observed, in relation to a similar problem of valuing the basis of a business, that the determination of value requires the company to be present in the market for at least two or three years, being the minimum period necessary to establish lasting business relationships.[296]. [Our emphasis]

321. The claimant cites the *Metalclad* and *Asian Agricultural Products* cases but omits to point out that in both, the use of speculative means to determine damages was specifically disallowed. Both Tribunals concluded that it is an essential requirement to have a long period of profitable operations if said methodology is to be used. None of the three EDM companies had a period of operations which was either profitable or long enough on which to confidently base an estimate of future profitability.

322. The claimant also quotes the case of *Philips Petroleum v. Iran*, but omits to point out an important restriction that the tribunal indicated, in the use of the discounted cash flow method: "*any…analysis of a revenue producing asset…must involve a careful and realistic appraisal of the revenue producing potential of the asset over the duration of its term", and "must also involve an evaluation of the effect on the price of any other risks likely to be perceived by a*

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295 Decision, 30th August, 2000 paragraph 118.

296 Id., ¶¶ 119-120.

reasonable buyer at the date in question…"[297]. It is worth pointing out that any potential buyer of the EDM companies would be very concerned about the dubious legitimacy of the operations of the establishments in question, and of whatever legal action that could be brought against them, including administrative, civil and penal sanctions.

232. As far as the damages caused by the violation of articles other than article 1110, the Tribunal in the Feldman case indicated:

> NAFTA does not provide any other guide as to the correct way of valuing damages or indemnities in situations where these do not fall within the provisions of Article 1110 (expropriation); the only detailed evaluation of damages specifically contemplated in Chapter XI is in Article 110(2-3), when it refers to the "fair market value" which is necessarily only applied in situations where the provisions of Article 1110 apply. From this it follows that in cases of discrimination that constitute a violation of Article 1102, the amount owed by the respondent shall be the amount of loss or damage reasonably associated with such violation. In the absence of a discrimination also constituting an indirect expropriation, in other words, equivalent to an expropriation, the Claimant will not have the right to the whole market value of the investment in accordance with Article 110 of NAFTA. Consequently, if the necessary requisite for submitting a claim to arbitration is the existence of damages, it can possibly be inferred that the Tribunal can order an indemnity in the amount of the losses or damage which actually occurred.[298]

324. The claimant apparently agrees[299] with the tribunal in the case of S.D. Myers which correctly points out:

> "…damages may only be awarded to the extent that there is a sufficient causal link between the breach of a specific NAFTA provision and the loss sustained by the investor. Other ways of expressing the same concept might be that the harm must not be too remote, or that the breach of the specific NAFTA provision must be the proximate cause of the harm"[300].

325. To summarize, from the ordinary meaning of articles 1116, 1117 and 1110, as well as the applicable jurisprudence, the following legal principles can be drawn:

- Articles 1116 and 1117 require that violations that are the subject of complaint be the direct cause of whatever loss or damage recoverable by the claimant;

- Compensation under article 1110 will be equivalent to the fair market value of the expropriated investment immediately before the date of expropriation, and the determination of said value may only be based on future profits when there is a sufficient history of profitable operation; and

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297 *Philips Petroleum Co. vs. The Government of Iran*, et al., Decision No. 425-39-2 (29th June 1898), 21 Iran, U.S.C.I.R. 79, 124, Id., Para 111.

298 Decision, 16th December, 2002 paragraph 194.

299 Complaint, p. 109, lines 16-21.

300 Second Partial Decision, 21st October, 2002, paragraph 140. (Note that this decision is under review because, *inter alia*, the tribunal exceeded its jurisdiction in combining the losses which the claimant incurred as supplier of cross border services, with those that it incurred as investor).

- Compensation under articles 1102 and 1105 must be equivalent to the losses or damages suffered as a consequence of the violation.

D. The claimant's evidence of damages: the *Innovation Group* Opinion

326. The valuation presented by the claimant prepared by *The Innovation Group* of New Orleans, presents at least the following five deficiencies:

- It does not determine the "fair market value" of the investments the object of the claim immediately before the date of expropriation, but tried to be a "determination of the revenues lost due to the premature closure" of the three establishments and another three that were "at various stages of planning and initial development".

- It tries to value the three establishments using the Net Present Value method (NPV) notwithstanding the absence of an appropriate history of profitable operations. It does not offer any other value, based on any other valuation criteria.

- The NPV is based on estimations of costs and income which do not match with the audited financial statements of the three companies in question. *The Innovation Group* carried out these estimates on the basis of information which had not been revealed, in spite of Mexico's repeated requests.

- It does not take into account "any other risk which a buyer could probably foresee as at the date in question", which in similar circumstances to those of this case, must include the risk of closure and other administrative actions, the risk of encountering legal action, potential civil, administrative and criminal responsibility, and the entry of competitors into the market, if the companies were operating according to the Federal Law on Games and raffles.

- It does not offer any alternative means of valuing the damages suffered as a consequence of the presumed violations of articles 1102 and 1105.

1. There was no proof of the "fair market value" of the "investments"

327. The central complaint is based on article 1110. The damages for direct or indirect expropriation of the investment of an investor of the other Party "will be equivalent to the fair market value of the expropriated investment immediately before the expropriation was carried out", and "the valuation criteria shall include the current value, the asset value (including the declared fiscal value of tangible assets), as well as other valuation criteria which are appropriate in determining the fair market value."

328. The term "fair market value" is commonly interpreted as the price that an independent buyer is prepared to pay to an equally independent seller, without either of them being forced to buy or sell, and both having a reasonable knowledge of the relevant facts. [301].

329. The *Innovation Group* stipulates that its mandate "*as set forth by International Thunderbird, was to determine the value of the earnings lost as a result of (the) premature*

[301] See for example, *Black's Law Dictionary, 5th Edition.*

closure"[302] of the three existing establishments and the three planned ones. The term "fair market value" does not appear anywhere in the opinion. Neither does it indicate that it assigns a value to the three existing companies or to the projected companies as at any particular date. It does not consider any other valuation method than the NPV of the supposedly lost earnings. Put simply, the evidence offered does not comply with the requirements established in article 1110(2).

330. The respondent argues that the claimant's investment should be limited to a participation in the three existing companies that operated the establishments, according to Thunderbird's public documents[303]:

- Entertainmens de Mexico-Laredo S. de R.L. de C.V. 33.00%
- Entertainmens de Mexico S. de R.L. de C.V. 37.18%
- Entertainmens de Mexico-Reynosa S. de R.L. de C.V. 40.00%

331. If the claimant had a participation in any of the recently established companies which were created for the purpose of developing new establishments it could argue the existence of an investment. Nevertheless, the value of said investment at the date of the presumed expropriation would be symbolic. The definition of "investment" does not include plans, intentions, hopes or other aspirations. The new companies – not having premises, equipment, personnel or client base – could not have had a value as a business or an asset. It is worth pointing out that Thunderbird did not mention any investment in any Mexican company other than the three EDM companies in its Annual Reports for 2000, 2001 and 2003.

2. The appropriate valuation criteria were not used

332. The determination of net present value of the supposed losses of future profits presented in the *Innovation Group* opinion is purely speculative. The three establishments only operated for a short period of time: Matamoros for 13 months, Nuevo Laredo for 8 months and Reynosa for less than 5 months. None of them generated a profit during the period of operation. Nevertheless *The Innovation Group,* through extrapolating the supposed operating costs and projected income using growth factors, projected the net present value of future income as if it were dealing with companies that were very profitable, and immune to any kind of competitive, financial, regulatory or business contingency throughout a 10 year business life.

333. Mexico maintains that net present value or discounted funds flow is not appropriate in this case. The Tribunal is being asked to speculate about companies that were not in fact profitable, and to conclude that they have a value of hundreds of millions of dollars. The fate of most of the claimant's investments indicates that this is not very probable. The following list of Thunderbird's projects that failed[304] is a graphic demonstration of the reason behind the warning in the *Metalclad* case:

302 Valuation opinion of *the Innovation Group*, p. 129.
303 Annex R-026.
304 *Thunderbird's Investments and Dispositions (1996-2002)* Annex R-91.

Initiative behind the investment	Result of the investment
Thunderbird Greeley, Inc. - Assembly and distribution of VGT equipment.	Abandoned due to the expectation of criminal action against Californian Indian tribes and VGT equipment in South Carolina – a loss of $3,375,000 was registered.
Profit sharing agreements for Video Poker machines in South Carolina, United States.	Abandoned due to the risk of criminal proceedings against it – a loss of $1,844,000 was registered.
Profit sharing agreements with Indian tribes in the state of California.	Abandoned due to the risk of criminal proceedings against it – a reduction in assets of $8.8 million was registered.
Thunderbird Eagle. Assembly of electro mechanical slot machines.	Abandoned - A loss of $4,387,000 on account of this project and the projects in China and Brazil was registered.
Peru. Casinos and slot machines.	Abandoned due to changes in applicable legislation - [a breakdown of the amount of the loss has not been located].
Winstreak - Internet Casinos	Withdrew from the investment due to the risk of criminal proceedings against it - [sold for a "nominal consideration"].
Millenium III - China. Joint Venture.	Apparently abandoned - [a breakdown of the amount of the loss has not been located].
Thunderwatch. Program for the administration of VGT machines.	Apparently abandoned - No loss was registered.
Casino in Aruba	Declared bankrupt - a loss of $2,065,000 was registered.
Brazil. Video Lottery Terminals	Abandoned due to concerns about the applicable legislation - a loss of $400,000 was registered.
Brazil. Acquisition of company in the gaming sector.	Abandoned due to concerns about the applicable legislation - a loss of $500,000 was registered.
Calsino. Manufacture of signaling for casinos.	Withdrew because the investment performed poorly - a loss of $163,000 was registered.
Quick Draw. Machine to shuffle cards.	Withdrew because the investment performed poorly - a loss of $728,000 was registered.
FiestaCasinos.com. Internet casinos for the Latin American market.	Withdrew from the investment due to the risk of criminal proceedings against it - a gain of $209,000 was registered.
Costa Rica. Casino	Withdrew from the investment – the recuperation of sales is the subject of legal proceedings.

334. The opinion of *The Innovation Group* does not submit any other valuation criteria for consideration by this Tribunal. That is not surprising: the two most appropriate methods in this case – net asset value and the amount invested- offer much lower results, which agrees with the claimant's investment strategy, set out in its own testimony:

Our strategy of using other people's money is augmented by our strategy of owning as little of the bricks and mortar of our locations as possible. We do not own, at the corporate or project level, the sites that our casinos occupy. Instead, we lease existing space on long-term leases and renovate the space into a casino or skill game facility.[305]

335. The combined value of the activities of the three companies was approximately 1.9 million dollars in 2001. Thunderbird's participation, determined according to its percentage ownership in each of the three companies is approximately 694,000 dollars in total.

336. The amount of money presumably invested by the shareholders of the EDM companies was 3,950,000 dollars, broken down as follows:

EDM Shareholders and their contributions to capital
Amounts in U.S. Dollars

	Matamoros	**Laredo**	**Reynosa**	**Total**
Bennet, Frank	200,000			200,000
Bennet, Martha		50,000		50,000
Berger, Larry	150,000			150,000
De la Guardia, Aquilino	300,000			300,000
Girault & Watson	100,000			100,000
Harari, Joe	250,000			250,000
MRG	200,000		1,000,000	1,200,000
RNST		1,250,000		1,250,000
Rudd, Wayne		50,000		50,000
SCI	100,000			100,000
Snow, Michael	100,000	100,000		200,000
Thunderbird	100,000			100,000
				0
Total contributions in cash	**1,500,000**	**1,450,000**	**1,000,000**	**3,950,000**

Source: Support for EDM Shareholder Contributions. Annex C-35

337. The amount of cash invested by Thunderbird was $100,000 dollars. It made an additional capital contribution – 1.5 million dollars according to Thunderbird, but only 896,000 dollars according to its auditors[306] - in advance to the three companies for "services and/or costs and deposits relating to the development and or costs of operation[307] which were owed as at the date of closure.

338. The claimant has not offered evidence as to the conditions of this advance payment. It is equally likely that this debt has arisen as a consequence of the equipping of the establishments, leasing contracts or other contractual obligations between the EDM companies and Thunderbird.

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305 *Annual Repot for 2000*, International Thunderbird Gaming Corporation, letter to shareholders, p.6. Annex R-56.

306 In Document 5 of Thunderbirds' consolidated financial statements it was reported a loss of US$996,000 for operations in Mexico. This loss includes a cash contribution of US$100,000 and advance payments of US$896,000 attributed to pre-operations expenses. It is also noted that the company has the right to get its funds back. See, Consolidated Financial Statements for the years 2000 and 2001, International Thunderbird Gaming Corporation, Document 5, p. 12. Annex R-064.

307 See Annex L. ¶ 9 of the Complaint

339. Until the claimant presents a properly articulated and documented complaint, in which he explains how amounts owed to him can constitute an investment, the amount of his investment must be considered to be the 100,000 dollars in cash which he contributed.

3. Historic cost and income data were not used

340. The corollary to the need to show a history of profitable operations as a requirement for determining the amount of damages based on future profits is that, if they exist they must be used. The valuation cannot be supported by speculative projections. In other words, the valuation must be based on the company's historic costs and income, not in lower levels of costs which could be obtained in ideal circumstances or levels of income which the investor might one day hope to achieve.

341. The opinion of *The Innovation Group* is based on pure speculation. The costs in the "pro forma operating statements" for each of the establishments are based on "estimated" and "projected" expenses. Nevertheless, the source of these estimates is not offered, neither is the basis on which they were calculated discussed. The projected revenues are inferred from hoped for increases which are not supported by the facts.

342. Among the documents requested of the claimant by Mexico are those to which *The Innovation Group* had access and which they used in estimating the costs and revenues. The respondent's expert was not able to verify or answer *The Innovation Group*'s statements. The respondent observes that it is normally to be hoped that the parties provide the documents used by their experts to support their opinion, as exemplified in the order of the tribunal in the *Methanex* case, to whose consideration the same issue was submitted[308]. The tribunal in the *Methanex* case, upon the petition of the respondent, the United States, and considering the IBA rules of evidence, ordered the claimant to provide the documents used by its expert. Mexico has the right to this same treatment.

343. Nevertheless, the respondent can show the fallacy implicit in the revenue projections prepared by *The Innovation Group*, based on the information available. The Matamoros establishment operated for approximately 13 months; the longest operating period of any of the three establishments. The following graphic illustrates their revenues for the whole period. Gross revenues after Promotional Payments[309].

[Graph on page 102 of the original PDF file].

[308] *Methanex Corporation v United States of America*. Order regarding documents used by the experts of Methanex, October 10, 2003 at http://www.state.gov/documents/organization/25568.pdf

[309] Annex R-092

344. It can be appreciated that the monthly revenues increased constantly over the period following the start of operations in August 2000. Later on, the revenues stabilized at an average of approximately 152,000 dollars per month – gross revenues of 70 dollars per machine – over the following 9 months to the date of the establishment's closure, except for the months of July and August, in which the revenues decreased. After the first 5 months, the operation did not show any tendency to grow.

345. The only conclusion that could be reached by a potential buyer "reasonably informed of the relevant facts" based on the historic data, is that the establishment had reached its full revenue generating potential, and that any future increase would be marginal. Nevertheless *The Innovation Group* has projected monthly growth rates of 2.8% in 2002 and 3.5% in 2003, which translate into annual rates of 32.7% and 33.04% respectively[310]. As a result it is calculated that the company's revenues would pass the 70 dollars per machine per day – the level maintained by the company for the greater part of 2001 – to 120 dollars per machine; an increase of approximately 60% in two years.

346. The projections for Nuevo Laredo and Reynosa are equally excessive. Nuevo Laredo which showed daily revenue per machine of around 90 dollars grew at rates of between 11% and 14% per month, reaching a level of $162 dollars per machine per day, representing an increase of 55% in a period of two years[311]. In Reynosa, the daily revenues per machine grew from 77 dollars to 140, an increase of 82%[312].

347. These projections are no more than an attempt to manipulate the figures so as to present a healthy operating margin that the companies never enjoyed.

348. The previous comments apply to the first scenario (the existing establishments without increasing the number of machines). The following observations apply to the second scenario, which projects profits based on an increase in the number of machines in the three establishments from 290 to 999 (333 machines in each establishment).

349. Matamoros had 75 machines; Nuevo Laredo had 126 and Reynosa, 89, which together total 290. *The Innovation Group* simply state that:

> *In their correspondence with the government of Mexico, skill gaming facility operator International Thunderbird stated its intentions to place 2000 skill gaming devices within the countries borders. Predicated upon that fact, the operator searched to place approximately 333 machines in each of the six locations with the Mexican borders.*

350. It is not clear that the words *"searched to place"* have been intentionally used instead of *"intended to place"*, but in any case, there is no evidence on file that indicates any intention on the part of EDM to increase the number of machines to 333 in each of the establishments, or even more importantly, whether any of the establishments had the physical capacity to incorporate additional machines.

351. Representatives of the litigating parties made an inspection visit to the 3 establishments on 5th, 6th and 7th November, 2003. It was only possible to observe the Reynosa establishment

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310 Valuation Report of *The Innovation Group* , p. 71, Annex C-92 of the Complaint.

311 Id., p. 21.

312 Id., p. 45.

from outside, as the premises was undergoing remodeling. Only in the Nuevo Laredo establishment were the machines in their original dispositions. The majority of the machines from the Matamoros establishment had been attached by the Local Conciliation and Arbitration Board (labor tribunal) as a guarantee in respect of a labor action brought by the employees against the company for overdue wages. All the equipment from the Reynosa establishment had been seized by the Attorney General and was kept in a sealed store room.

352. The testimony of Alejandro Barragan describes the establishment at Nuevo Laredo[313]. The main room has 126 machines and occupies the lower floor of a detached building. It only has space enough to add a small number of machines and apparently there was no additional space that could be used to install more machines. The Matamoros premises were smaller and were also located in a detached building that apparently did not offer the possibility of expansion. The main room in Reynosa was apparently larger, but not much larger than in Nuevo Laredo. Nevertheless the interior of the premises could not be accessed.

353. The absence of evidence supporting the intention or capacity to increase the number of machines in any of the establishments must be decisive. *The Innovation Group* has used conjecture to propose its second and third scenarios.

4. Negative circumstances were not considered

354. *The Innovation Group* assumes that each of the three establishments (or six as the case may be) would operate without interruption for a period of 10 years, and without any obstruction arising out of an administrative or judicial action. At the risk of pointing out the obvious, a potential buyer "reasonably informed as to the facts" would have to consider the possibility that the establishments could be considered illegal or the possibility of law reform to restrict or prohibit the use of so-called "ability and skill machines" which they operate. Thunderbird's public reports warn investors about this type of risks every year:

> *Regulatory: The ability to sell or place VGT's in any country is dependent upon the regulatory authorities of various levels of government. The rulings made by the government continue to fluctuate and are dependent upon a number of political, economic and public oriented factors. The Company is dependent upon the government ruling in the favor of allowing casino gaming and specifically VGT's and slot machines in their jurisdiction. Adverse government rulings may have a significant impact on the Company's ability to generate revenue.*[314]

355. The remaining possibilities are: that the so-called "ability and skill machines" are considered legal by the courts and no other governmental measure is taken to prohibit or restrict their use, and that the government decides to reform the law to allow casinos in certain places within Mexican territory. This leads us to another obvious observation – in any of these cases, there would be no barrier to protect the companies from the effects of competition by other operators. This is another business risk that Thunderbird points out to its shareholders on an annual basis:

> *Competition: The Company's products compete against those of other established companies, some of which have greater financial, marketing and other resources than those of the Company. These competitors may be able to institute and sustain price wars,*

313 R-092.

314 Annex R-017, p. 16.

or initiate the features of the Company's products, resulting in a reduction of the Company's share of the market and reduced price levels and profit margins. In addition, there are no significant barriers to new competitors entering the market place.[315]

356. The Subscription Contract for EDM specifically warns about possible competition to this establishment (Matamoros).

Competition. …… The Company currently faces direct competition from Circa Unidesa and Fanco, both Spanish companies who have established skill game operations in and throughout South American and Central (sic) but not yet in Mexico. The Company anticipates these competitors will establish such skill game operations in and throughout Mexico. These companies have more experience in operating a skill game business, have a greater although different brand name recognition and may have greater financial resources that the Company. The Company may also face competition from casino operators if sanctioned in Matamoros in the future. There is no assurance that the Company can successfully and profitably compete against competitors and there is little chance that the Company will be able to compete against casino operators if either establishes operations in or near Matamoros.[316]

357. The precarious legal situation of the EDM companies is very problematic as far as it relates to postulating their "fair market value". There are serious doubts over whether a potential buyer, acting in good faith, could make an offer to acquire these three companies while their legal situation remained unresolved.

5. Damages under articles 1102 and 1105 were not considered

358. The claimant assumes that the only measure of damages for the supposed violations by Mexico of its obligations under chapter XI of NAFTA is the net present value over 10 years of lost profits, for each of the establishments.

359. As has previously been explained, the valuation offered neither meets the requirements of article 1110 nor offers any way of determining the damages as a consequence of a supposed violation of articles 1102 and 1105, as opposed to anything other than expropriation. In simple terms, the claimant has not complied with its responsibility to prove its claim for damages.

E. The respondent's valuation: the FinBridge Opinion

360. Finbridge Consulting S,C. is a financial consulting company founded in the year 2000, dedicated to credit restructuring, company valuations, mergers and acquisitions and market analysis, among other activities. Since it was established, Finbridge has advised numerous clients in the mining, automotive, telecommunication and pharmaceutical sectors. Luis Martinez senior partner with responsibility for this study is a graduate in International Relations, with a Masters Degree in International Management from the Instituto Tecnologico Autonomo de Mexico. As for his professional experience, he has more than 18 years experience in the banking sector and 4 as a private consultant.

361. The Government of Mexico requested FinBridge Consulting S,C. to estimate the fair market value of the three existing EDM companies, as well as of the companies that Thunderbird

315 Id. P. 15 and following.

316 Representation Agreement, p. 10. Annex C-28 of the Complaint.

was considering opening in Mexico. It was also asked to issue an opinion on the valuation opinion presented by *The Innovation Group*.

362. At the request of the Government of Mexico, Finbridge used three different methods to determine the fair market value of the three exiting EDM companies in this case: Replacement Book Value, Liquidation Value and discounted cash flow. All of these meet the requirements established in article 1110(2) of NAFTA.

363. The results obtained were as follows:

a) less than 14.19 million pesos (less than $1.48 million dollars [sic])[317] based on DCF method;
b) 17.67 million pesos (1.84 million dollars) based on book value; and
c) 13.25 million pesos (1.38 million dollars) based on liquidation value.

364. The above figures reflect the value of the three companies existing prior to the date of closure in October 2001.

F. Conclusions

365. The valuation criteria which could be considered appropriate in this case are: (i) amount invested by the claimant, (2) book value of the assets, and (3) liquidation value.

Claimant's participation in the amount invested

366. The tribunal in the *Metalclad* case, in the absence of a sufficient history of profitable operations, determined the fair market value on the base of the amount invested by the claimant, less some deductions. In this case, the presumed capital contribution of the EDM companies' shareholders was US$3,950,000 in cash. There was an additional amount – US$896,000 according to Thunderbird's auditors – on account of advance payments to the three companies, relating to *"services and/or other expenses and deposits related to the development and/or operating costs"*- although owing at the moment of closure of the establishments. The claimant has not established that this debt has in fact been used to acquire a participation in the EDM companies, or that it can qualify as an "investment" under article 1139.

367. The claimant's participation in the total amount of capital invested will be as follows:

	Participation %	Amount invested USD	Attributable to Thunderbird USD
Matamoros	37.20%	1,500,000	558,000
Nuevo Laredo	33.30%	1,450,000	482,850
Reynosa	40.00%	1,000,000	400,000
Total		3,950,000	1,440,850

[317] Rate of exchange for settling obligations denominated in foreign exchange (FIX) as 10th October, 2001 ($9.566 pesos/dollar) Source: Banxico.

Claimant's participation in the Book Value

368. To determine the value of the claimant's participation in the EDM companies, based on the book value of the assets, is a matter of pure arithmetic:

	Participation %	Book Value of Assets	Attributable to Pesos	Thunderbird USD*
Matamoros Nuevo	37.20%	5,228,317	1,944,934	203,305
Laredo	33.30%	8,420,054	2,803,878	293,090
Reynosa	40.00%	4,031,290	1,612,516	168,557
Total		17,679,661	6,361,328	664,952

* Exchange rate FIX on 10th October, 2001 ($9.566/dollar). Banxico

Claimant's participation in Liquidation Value

369. The value of the claimant's participation in the EDM companies, based on the asset liquidation value, is also a matter of simple arithmetic:

	Participation %	Liquidation Value of Assets	Attributable to Thunderbird Pesos	USD*
Matamoros Nuevo	37.20%	3,921,238	1,458,701	152,478
Laredo	33.30%	6,315,041	2,102,909	219,818
Reynosa	40.00%	3,023,468	1,209,387	126,418
Total		13,259,747	4,770,996	498,714

* Exchange rate FIX on 10th October, 2001 ($9.566/dollar). Banxico

Interest

370. The claimant makes his claim for payment in United States dollars, but requests that the interest be calculated on the basis of "*Mexican Prime Rate"*, compounded quarterly. Article 1110 of NAFTA views the payment of interest as follows:

> 4. If the indemnity is paid in the currency of a member country of the Group of Seven, the indemnity will include interest at a reasonable commercial rate for the currency in which said payment is made, from the expropriation date to the date of payment.
>
> 5. If one Party chooses to pay in a currency other than one from the Group of Seven, the amount paid will not be less than the equivalent of the indemnity if it were paid in the currency of one of the Group of Seven countries on the date of expropriation, and this currency had been converted at the ruling market rate on the date of expropriation, plus interest that would have accrued at a reasonable commercial rate for said currency up to the date of payment.

371. The respondent observes that the payment should be made according to the criteria established in NAFTA, with interest at a reasonable rate for this currency, or pesos, from the date of expropriation to the date of payment. The respondent considers that the simple one year United States Treasury Bill rate is a reasonable rate for the United States dollar.

X. PETITION

372. On the basis of all that has been set out above, the respondent requests that the Tribunal dismiss the complaint presented by International Thunderbird Gaming Corporation in its entirety, with a corresponding award of costs.

All of which is respectfully submitted for your consideration:

[signed in the original]

_____

Hugo Perezcano Diaz
Legal Advisor and Legal Representative
of the respondent party
the United States of Mexico

18th December, 2003

APPENDIX
Admissions and Denials

373. Below the respondent provides its Admissions and Denials of the facts asserted by the claimant. Mexico has reproduced the relevant paragraphs of the Complaint (omitting the footnotes, unless otherwise indicated) and providing its response, when required, immediately afterwards. The respondent follows the order and structure of the Complaint. For ease of reference, the respondent reproduces in this section all the titles and subtitles of the corresponding section of the Complaint.

I. STATEMENT OF FACTS

A International Thunderbird Gaming Corporation

Complaint page 3, lines 3-8

Complaint	Admissions and Denials
Claimant International Thunderbird Gaming Corporation (hereinafter "Thunderbird") is a publicly held Canadian corporation. Thunderbird has approximately twenty-four million outstanding shares; approximately eight million of which are held each by Canadian residents, United States residents, and European residents. Thunderbird's Chief Executive officer and President of its board is Jack Mitchell. Its general counsel is Albert Atallah [Atallah, paras. 5,6 and 7; Ex 1; Mitchell, para. 1] [footnote omitted]	Admitted.

Complaint page 3, lines 9-12

Complaint	Admissions and Denials
Thunderbird is an owner and operator of international gaming facilities. In the early 1990's Thunderbird was involved in Indian gaming activities. In the late 1990's Thunderbird shifted its activities to exclusive involvement in Latin American gaming and entertainment operations. [Atallah, para. 9; Mitchell, [paras. 4-7]	Admitted.

Response:

374. As already explained, Thunderbird had to abandon its operations in the United States Indian reservations for questions related to the legality of its machines.

Complaint page 3, lines 13-16

Complaint	Admissions and Denials
Thunderbird presently owns and operates gaming facilities in Guatemala, Panama, Nicaragua and Venezuela. From 2000 to 2001, it owned, controlled and operated "skill machine" facilities	First sentence: admitted. Second sentence: denied that

in the Mexico cities of Matamoros, Nuevo Laredo and Reynosa. The wrongful seizure of those facilities by Mexico is the subject of this claim. [Atallah, paras. 10, 11; Mitchell, para. 7]	it owned or controlled the installations and that they concern "machines of ability and skill". Third sentence: admitted with the exception of the qualification "wrongful".

B. Initiation of Thunderbird's Investments in Mexico

Complaint page 3, lines 18.24

Complaint	Admissions and Denials
Beginning in late 1999 and early 2000, Peter Watson, a lawyer from Minnesota, USA, initiated discussions with Jack Mitchell, President and CEO of Thunderbird. Those discussions concerned potential gaming opportunities in Mexico. Watson had previously represented a U.S. investor in a Mexican gaming operation. Through that effort he had gained considerable expertise and experience with respect to investments in Mexico and with respect to its gaming laws. Mitchell had significant knowledge concerning gaming activities throughout Latin America. [Watson para 3;Mitchell paras. 4-7]	Neither admitted nor denied, on the basis that they are not facts.

Response:

375. In its response to the respondent's first request for documents, Thunderbird provided a letter dated 8th December 1999 from Peter Watson to Jack Mitchell[318]. In this letter Mr. Watson confirms his proposal for services in preparation for the opening of "minor or major casinos" in Mexico[319]. From the letter it follows that Thunderbird had initially planned to start operations in Monterrey.

376. Thus document describes the plan of an establishment in Monterrey, in which "*slot machines*" would be operated. Mr. Watson recognized that gambling is illegal in Mexico: *"…winning money is still illegal…"*.

Complaint page 4, lines 1-6

Complaint	Admissions and Denials
Mitchell and Watson looked at a number of investment possibilities, partnership arrangements and prospects for Thunderbird to establish gaming operations in Mexico. Thunderbird initially considered acquisition of a horse track facility and sports book operation in Nuevo Laredo.	Neither admitted nor denied, on the basis that they are not facts.

318 Annex R-043.

319 The letter read "*[i]f the goals are ultimately met of establishing major or minor casino venues in Mexico"* See Annex R-043.

Complaint page 3, lines 3-8

Complaint	Admissions and Denials
Thunderbird's lawyer in Mexico, Luis Ruiz de Velasco of Baker & McKenzie in Mexico City, reviewed proposed acquisition documents. Thunderbird ultimately decided not to pursue that investment. [Watson para 5, Mitchell, paras 8, 9 and 10; Velasco, paras 1, 2, 3]	

Complaint page 4 lines 7-10

Complaint	Admissions and Denials
Mitchell and Watson were contacted by Doug Oien and Ivy Ong ("Oien/Ong"). Oien/Ong were involved in various gaming activities inside and outside Mexico. They represented to Watson and Mitchell that they had made an investment in a sports book and skill game facility operated by Jose Guardia in Juarez, Mexico. [Watson para 6; Mitchell, para 8, 9, 10]	Neither admitted nor denied, on the basis that they are not facts.

Complaint page 4, lines 11-17

Complaint	Admissions and Denials
"Skill games" or "skill machines" are commonly understood in the international gaming industry as differing from slot machines in that the skill machine player is able to start and stop the activity at play, to make decisions about which symbols to hold, and to effect, through his skill and dexterity, the outcome of the game. None of these elements are present in a "slot machine". There, the player simply pulls the handle and waits to see if he has won anything. Further, in the international arena of gaming activities, there is a clear distinction between traditional "casinos" and video gaming parlors. [Atallah, para 14; McDonald, para 10, 11; Ex 69, Maida Dec.]	Denied.

Complaint page 4, lines 18-25, and 5 line 1

Complaint	Admissions and Denials
Mitchell and Watson met with Oien/Ong in the Nuevo Laredo to discuss potential skill machine operations in Mexico. Present at that meeting were two Mexican lawyers, Jose Aspe and Oscar Arroyo. Aspe and Arroyo had represented Jose Guardia with respect to his skill machine operations in Mexico. Aspe and Arroyo stated that Guardia had a significant legal altercation with Gobernacion concerning his skill machine operations. Gobernacion is Mexico's Department of the Interior. It regulates and controls all gaming activities. Aspe and Arroyo stated that Gobernacion had entered Guardia's facility and sealed off the skill machines. Aspe and Arroyo representing Guardia, had obtained and "Amparo" (judicial injunctive relief) allowing use of the machines, and had recently won the underlying court case establishing the legality of skill machine operations in Mexico. [Watson, para 7; Mitchell, para 11]*	The fifth and sixth sentences are admitted. The rest are neither admitted nor denied, on the basis that they are not facts.

** In the footnote o page 3, is added:* *Guardia subsequently obtained a favorable higher court ruling establishing the legality of his skill machine operations. Guardia's skill machine facilities are open and operating in Mexico today. [Watson, para 57; Velasco, para 25]*	

Response:

377. The respondent is not in a position to admit or deny whether the meeting happened, who was present and what was discussed. Nevertheless, it makes the following observations:

378. The respondent does not have any evidence that Messrs. Aspe and Arroyo represented Mr. Guardia in the petitions for protection brought by him[320].

379. As explained in section VI.D.3.a of this document, the definitive suspension was granted to CPD in one case, but the judgments issued in the first instance reverse them (the judgment of the Collegial Court in the case of the establishment located in the State of Mexico is not resolved on the basis of the protection requested, but ordered that the procedure be reinstated). CPD has appealed these judgments. The proceedings are sill in process.

380. The Mexican courts have not established "the legality of the operation of machines of ability and skill in Mexico."

381. It is well known that Thunderbird admitted that Messrs. Aspe and Arroyo advised of a "significant legal altercation" which Mr. Guardia had with SEGOB about the legality of the machines he operated. The Tribunal also warned that the judgments in the petitions for protection brought by CPD all date from 2001, and not from 1999 and 2000 as suggested by the claimant.

Complaint page 5, lines 2-7

Complaint	Admissions and Denials
Oien/Ong were looking for investors to open and operate a skill machine facility similar to Guardia's. They proposed a revenue sharing arrangement under which Thunderbird would back financially and operate one or more skill machine parlors in Mexico. Aspe and Arroyo would be utilized to obtain necessary local permits and deal with Gobernacion. During these meetings, Watson and Mitchell developed the idea that Thunderbird would raise capital to create, own and control a Mexican entity or a series of entities to operate skill machine parlors in Mexico. [Watson, para 8]	Neither admitted nor denied, on the basis that they are not facts.

C. Gaming Activities in Mexico

[320] According to the judgment handed down by the District Judge in the petition for protection in respect of the establishment in Huixquilucan, Mexico State, it was Jesus Quintana Lopez, the Sole Administrator of the company, who appeared for CPD. Annex R-31/2.

Complaint page 5, lines 9-16

Complaint	Admissions and Denials
When Watson and Mitchell commenced their discussions concerning the operation of skill machines in Mexico, they understood that even though Mexican law prohibited games of chance, it did not, and still does not, prohibit other related activities. In Mexico there are bingo parlors, sports book operations where customers wager on sporting events and horse and dog racing operations with betting on race outcomes, jai lai and wagering, and various other gaming related activities. There are skill machine operations at various locations in Mexico City and Juarez. [Watson, para 4,5,57; Velasco, para 25; Montano, para 19; Lic. A. Armas Sawin, para 4,5,6,7; Sawin, para 8; Dec. of Cepeda y Torres; Gomez, paras. 27-29; Exs. 82-85]	First sentence; neither admitted nor denied. The respondent cannot admit to or deny what was the understanding of Messrs. Watson and Mitchell of the Federal Law on Games and Raffles. Second sentence: admitted as set out below. Third sentence: admits that CPD maintains an establishment in operation.

Response:

382. The Federal Law on Games and Raffles prohibits games of chance and gambling games, although it allows limited exceptions which are expressly foreseen, and which require a permit issued by SEGOB (see section III.A.2 of this document).

383. SEGOB closed down CPD's establishments for the same reasons that those of EDM were closed down. CPD challenged SEGOB's actions through legal channels. In one case a definitive suspension was granted. These proceedings are still in progress.

384. In addition, the Tribunal must appreciate that one of the claimant's witnesses, Mr. Sawin, states that the machines which Mr. Guardia operated are not "of ability and skill", but *"slot machines."*

D. Initiation of Government Contacts Concerning Thunderbird's Proposed Skill Machine Operations

Complaint page 5, lines 19-23, and page 6, lines 1 to 6

Complaint	Admissions and Denials
Thunderbird, through Watson and Mitchell, sought assistance from Thunderbird's Baker & McKenzie attorneys in Mexico. In April and May 2000, Baker & McKenzie lawyer Luis Ruiz de Velasco, Mitchell, Watson and Mauricio Girault met several times with Aspe and Arroyo. Girault was a long time friend of Watson. He became an investor in Thunderbird's skill machine enterprises, and a director of Thunderbird. Aspe and Arroyo generally explained the process used by Guardia to fend off Gobernacion with respect to his skill machine operation in Juarez and Mexico City. De Velasco analyzed the procedures utilized by Aspe and Arroyo; i.e. to simply open a skill machine facility and,	First sentence: admitted. The remainder are neither admitted nor denied as they are not facts.

if Gobernacion took action as it had with Guardia, defend by Amparo proceedings. Velasco concluded that while this procedure had been effective for Guardia, it would not provide Thunderbird with the certainty necessary to proceed with the significant investment. [Watson, paras 9, 10, 11, 12; Mitchell, para 12; Velasco, paras. 3,4]	

Response:

385. The Tribunal must appreciate that the claimant admits once again that he was warned about the actions of SEGOB against the establishments that operated "ability and skill machines" and apparently, Messrs. Aspe and Arroyo recommended the strategy of simply opening the establishments and suing SEGOB if they were closed down.

Complaint page 6, lines 7-14

Complaint	Admissions and Denials
In July 2000, Velasco, Girault, Aspe and Watson met in Mexico City. Aspe advised that he had several conversations with the Director of Juegos and Sorteos within Gobernacion. He stated that he had described to the Director what Thunderbird intended to do. Aspe indicated that he felt it might be possible to obtain an opinion letter from Gobernacion attesting to the legality of the skill machines. Thunderbird decided to request the official opinion from Gobernacion concerning the legality of its skill machines and proposed operations. If the response was favorable, Thunderbird would proceed with the opening and operation of its skill machine facilities in Mexico. [Watson, paras. 11, 12; Mitchell, para. 12; Velasco, para. 5]	The fifth and sixth sentences are denied. The remainder are neither admitted nor denied as they are not facts.

Response:

386. The claimant affirms that Messrs. Aspe and Arroyo held meetings with the then Director of Games and Raffles; nevertheless there is no record in SEGOB's files of any such meetings. In the respondent's request for additional documents, the respondent required Thunderbird to provide a copy of the minutes, jottings and notes of the meetings held by Messrs. Aspe and Arroyo with SEGOB officials, relating to the authorization of the machines of "ability and skill"[321]. Thunderbird declined to provide them.

387. Thunderbird did not request an opinion from SEGOB. Mr. Menendez Tlacaltepa, then partner and Sole Administrator of the company, sent the document of 3rd August 2000 to SEGOB. This document preceded the contract for the sale of shares in EDM to Juegos de Mexico[322].

388. EDM had already proceeded to open the Matamoros establishment before requesting the opinion of SEGOB on 3rd August, 2000

321 See letter No. DGCJN.511.13.949.03 of 29th August, 2003.

322 See paragraph 275 of this document.

Complaint page 6, lines 15-21

Complaint	Admissions and Denials
Over the next few weeks, Aspe and Arroyo continued to speak with their contacts in Gobernacion. There were numerous contacts between the Thunderbird group and Gobernacion by and through Aspe and Arroyo. These contacts concerned the nature and operation of the skill machines, Thunderbird's proposed operation and the text of a formal application to be presented to Gobernacion for consideration. Drafts of the proposed application were exchanged and discussed. Ultimately, Aspe indicated that Gobernacion was willing to consider and issue the opinion letter attesting to the legality of the skill machines. [Watson, para. 11, 12, 13, 14; Mitchell, para. 12; Velasco, para.5]	Sentences 2 to 4 are denied. The fifth sentence is neither admitted nor denied as they are not facts.

Response:

389. SEGOB has confirmed that there is no record of these meetings, or of the drafts that the claimant indicates were exchanged. In the respondent's request for additional documents, the respondent required Thunderbird to provide copies of the drafts prepared[323]. Thunderbird declined to provide them.

Complaint page 6, lines 23-24

Complaint	Admissions and Denials
During this same period, and in anticipation of Gobernacion's approval of its intended operations, Thunderbird proceeded with preparations to open its first skill machine facility.	Denied.

Response:

390. As already mentioned, EDM had commenced operations in Matamoros before requesting SEGOB's opinion.

391. As regards the "approval" of SEGOB, see section VI.D.1 of this document, relating to section II.E of the Complaint, p. 7, lines 1-6.

Complaint	Admissions and Denials
In April, the Oien/Ong had incorporated an entity known as Entertainmens de Mexico S. de R.L. de C.V. (hereinafter "EDM"). In May, EDM had entered into a lease for a location in Matamoros. In June, 2000, discussions began for acquisition of EDM by subsidiaries of Thunderbird. On June 20, 2000, EDM executed a modification of the Matamoros lease. Under that modification, EDM secured a voluntary five year extension of the lease through 2006. [Watson, para. 18; Atallah, para. 15, 25; Gomez, para. 47; Exs. 2, 3, 4, 5]	Denied, except that EDM entered into a lease contract which was later modified[324].

323 Id.

324 The date of the modifying instrument is 20th July, 2000.

Response:

392. EDM was formed by Messrs. Juan Jose Menendez Tlacaltepa and Alejandro Rodriguez Velasquez, not by Messrs Oien/Ong who were never partners[325].

Complaint page 7, lines 7-10.

Complaint	Admissions and Denials
On June 27, 2000, EDM opened bank accounts for both U.S. dollars and pesos. On June 30, 2000, EDM secured a license for land use which specifically referred to the intended use as "video games of skill and dexterity". On June 29, 2000, EDM noticed its intended business operations to local authorities. [Gomez, paras. 48-50; Exs. 6, 7, 8]	Admitted with the following clarifications.

Response:

393. EDM described its business to the local authorities as "machines of ability and skill". The local authorities replied on the basis of EDM's declaration, did not carry out any analysis of the type of machine involved or any investigation as to the truthfulness of EDM's assertions. Their jurisdiction is limited to questions of zoning, consumption of alcoholic drinks, etc.

394. Authorizations issued by local authorities are normally framed in the terms requested by the individual applicants, if they meet the legal requirements relating to the application concerned[326]. The fact that the permit was issued in the conditions of use contained in the application, does not imply that the authority gave any certification of the type of activity or the nature of the machines, and much less does it confer legality on them pursuant to the Federal Law on Games and Raffles, which is under the exclusive nationwide jurisdiction of SEGOB.

Complaint page 7, lines 11-12

Complaint	Admissions and Denials
On July 27, 2000, EDM imported 50 Bestco Model MTL19U-8L video gaming machines. [Gomez, para. 51; McDonald, paras 4, 7, 9, 10, 12; Exs. 9. 36]	Admitted[327]

Response:

395. It should be pointed out that these were the same machines that Thunderbird had previously operated in California.

Complaint page 7, lines 13-15

Complaint	Admissions and Denials
On August 10, 2000, EDM provided notice of its intended operations to local authorities. That notice specified the following activities: "restaurant, bar and video games were skill and abilities [sic]. *[Gomez, para. 52; Ex 10]*	Admitted with the following clarification.

325 Annex C-2. Articles of Incorporation of Entertainmens de Mexico S. de R.L. de C.V.

326 See formats from the Tamaulipas State Government. Annex R-044.

327 The date of the import permit offered in Annex C-9 is 31st July, 2000.

Response:

396. EDM presented to the Regulatory and Health Promotion Coordination Department of the Matamoros Municipal Council the notice of opening that any commercial establishment dispensing food is required to present. The health authorities only have jurisdiction over the dispensing of food.

Complaint page 7, lines 16-18

Complaint	Admissions and Denials
On August 10, 2000, Thunderbird through two wholly owned subsidiaries, Juegos de Mexico, Inc. and International Thunderbird Brazil, acquired all the outstanding shares of EDM. Mitchell, Watson, and Atallah were designated as the board of directors of EDM. [Atallah, para. 26; Exs. 11, 12, 13].	Denied.

Response:

397: See section VIII.C of this document.

Complaint page 7, lines 19-22

Complaint	Admissions and Denials
On August 11, 2000, Thunderbird acquired the EDM shares of International Thunderbird Brazil. Thunderbird, through its direct ownership and that of its subsidiaries, Juegos de Mexico, Inc. held the majority of EDM shares. Mitchell, Thunderbird's president and CEO, was designated president of EDM's board of directors.	Denied.

Response:

398. See section VIII.C of this document.

Complaint page. 7, lines 23-24

Complaint	Admissions and Denials
On August 14, 2000, EDM imported 30 SCI model 17" UR video game machines.	Admitted.

Complaint page 7, lines 25-28

Complaint	Admissions and Denials
Thunderbird obtained NOMS (Mexican consumer protection registration required for all imported products) for the imported machines. The machine had to be tested, analyzed and verified in order to obtain the NOMs. The NOMs specifically identified the imported machines as skill machines.	Denied.

Response:

399. An official Mexican standard (NOM) is a general administrative order, issued by the competent authority that establishes the characteristics that specified goods must satisfy[328]. The NOMs are not "obtained" for an individual product.

400. All electronic apparatus supplied by electricity must comply with the safety requirements established in NOM-001-SCFI-1993 "Electronic apparatus. Apparatus for domestic use, supplied from various sources of electrical energy. Safety requirements and tests for type approval[329]. Certification agencies exist that test the apparatus to certify its compliance with the NOM, before it can be imported or traded.

401. EDM (not Thunderbird) obtained from Normalización y Certificación Electrónica, A.C. (NYCE), a private organization for standardization and evaluation of the conformity of products with certain official Mexican standards[330], a "Certificate of New Equipment pursuant to the Official Mexican Standard [331] [NOM]. NYCE only certified that the machines met the requirements of NOM-001-SCFI-1993, as regards electronic apparatus supplied by electric current.

Complaint page 8, lines 1-2

Complaint	Admissions and Denials
Thunderbird and EDM were prepared to open the Matamoros "skill machine" facility upon expected issuance of formal Mexican Government approval.	Neither admitted nor denied as it is not fact.

F. Mexico's Approval of Thunderbird's Proposed Skill Machine Operations

Complaint page 8, lines 4-13

Complaint	Admissions and Denials
On August 3, 2000, and after extensive discussions between the Thunderbird representatives and Gobernacion, EDM presented a formal request, or "solicitud" to Gobernacion concerning the proposed skill machine operation. The application notified Gobernacion of EDM's intention to operate 2,000 machines at various locations in Mexico. The application contained a detailed description of the machines, their method of operation, and the manner by which prizes were obtained by the players. The application identified the precise make and model number of the	First sentence: admitted that EDM presented a request to SEGOB for the operation of machines which it described as of ability and skill. Second sentence: admitted. Third sentence: denied. Fourth sentence: admitted. Fifth sentence: denied.

328 The Federal Law of Measurement and Standards Defines an "official Mexican standard" as the mandatory technical regulation issued by competent agencies according to the objectives set out in article 40, which establishes the rules, specifications, attributes, directives, characteristics or prescriptions applicable to a product, process, installation, system, activity, service or method of production or operation, as well as those relating to terminology, use of symbols, packing, marking or labeling and those referring to their compliance or application. Article 915 of NAFTA, for its part, defines "technical regulations" as "a document establishing the characteristics of goods or processes and related production methods or the characteristics of services and their related methods of operation, including the applicable administrative orders, and whose observance is obligatory. It may also include requirements relating to terminology, use of symbols, packing, marking or labeling, applicable to an object, process, or production method or operation, or relating exclusively to them."

329 NOM-001-SCFI-1993. Annex R-045.

330 See www.nyce.org.mx

331 See Annex C-16.

machines to be used. The application clearly states its purpose. [Extracts from the request are omitted]	

Response:

402. See section VI.D.I of this document.

Complaint pages 8, lines 14-18 to 10, line 7

Complaint	Admissions and Denials
The application was a direct request to the Director General of Gobernacion for an official opinion that the identified machines were not prohibited by Mexican law. [Extracts from the request are omitted]	Admitted.

Complaint pages 10, lines 8 – 15 to 11, line 25

Complaint	Admissions and Denials
On August 15, 2000, Gobernacion issued the official letter. The letter was signed by Rafael de Antunano Sandoval, Director de Juegos y Sorteos in the name of and on behalf of, Mr. Sergio Orozco Arceves, Director General de Gobernacion. These are the officials in charge at the highest levels of the Mexican government with direct authority over all games in which betting is involved, including games of chance. Gobernacion's official letter stated that the machines identified in EDM's August 3, 2000 solicitud are: [Extracts from the request are omitted]	The first, second and third sentences are admitted with the following clarifications. The fourth sentence is denied.

Response:

403. SEGOB does not establish the nature of the machines referred to in the application. The letter from SEGOB dated 15th August, 2000 simply refers to the description offered by EDM.

404. According to the applicable regulations, the then Director General of the Interior and the Director of Games and Raffles are the responsible officials for matters relating to games and raffles. The qualification that Thunderbird uses to describe their responsibilities comes from a purely subjective view, for which reason the respondent expresses no view about it.

Complaint page.11, lines 26-28

Complaint	Admissions and Denials
Based upon Gobernacion's official opinion letter, Thunderbird and its counsel concluded that Thunderbird could proceed with the skill machine operations in Mexico.	*Neither admitted nor denied. The respondent does not have the means to evaluate the conclusions reached by Thunderbird and its lawyers.*

Complaint page 12, lines 1-2

Complaint	Admissions and Denials
In reliance upon Gobernacion's official opinion, Thunderbird moved forward with its plans to operate skill machine facilities in	Denied.

Mexico. Two days after Gobernacion issued its opinion, EDM opened in Matamoros.	

Response:

405. EDM has started operations in Matamoros before requesting an opinion from SEGOB. As explained in V., Thunderbird proceeded on the basis of the opinions of its partners and lawyers.

G. Thunderbird's EDM Skill Operation

1. EDM-Matamoros

Complaint page.12, lines 5-11

Complaint	Admissions and Denials
The Matamoros facility ("La Mina de Oro") opened with approximately 80 machines. It was an immediate success. Thunderbird and EDM quickly brought the facility up to full operation. On August 21, 2000, EDM provided notice to the municipality of added facilities, specifying "video game machines for skills and dexterity". On September 8, 2000, EDM registered with the Federal Registry of Tax Payers. EDM paid local municipality machine fees. On September 19, 2000, EDM filed employer registration documents. On September 19, 2000 EDM applied for workers' insurance.	Neither admitted nor denied as they are not facts.

Response:

406. The annexes sent by the claimant do not contain documents related to these facts:

- Annex 20 contains a series of forms presented by EDM to the Local Collection Administration of North DF. The respondent has not been able to identify among these the transaction of 8th September 2000 to which the claimant refers.

- Annex 21 contains a copy of receipts numbered 292 and 293 from the Matamoros Municipal Treasury for twenty pesos for municipal cooperation. Nevertheless these receipts do not have any cashier's stamp.

- Annexes 22 and 23 contain formats of transactions on the part of the company Servicios de Destreza SA. De C.V., to which the claimant has not made any reference.

Complaint page 12, lines 12-14

Complaint	Admissions and Denials
In January 2000, "La Mina de Oro" underwent inspections by the health department. In February, 2001 it received compliance certifications from the fire and hazard department. In March, 2001, EDM secured a liquor license.	Admitted[332].

[332] The inspection by the health authorities was in January 2001 and not in January 2000.

Complaint page 12 lines 15-18

Complaint	Admissions and Denials
On December 14, 2000, EDM was renamed "Entertainmens de Mexico S. de R.L. de C.V." and converted into an "SRL". Thunderbird, through its direct ownership and that of its subsidiary, maintained majority ownership. Mitchell maintained his position as President of the Board of Directors of EDM.	Denied.

Response:

407. See the footnote on page 239 of this document.

Complaint page 12, lines 19-28

Complaint	Admissions and Denials
Thunderbird secured new investors into EDM. Those investors were uniformly advised of and relied upon Gobernacion's August 15 official opinion. In June 2001, EDM and investors executed a "Subscription and Investment Representation Agreement" and a "Members Quota Agreement" under which the investors secured various percentage interests in EDM. Membership certificates were issued to each of the investors indicating their share or quota percentages. Thunderbird maintained its significant ownership interest in EDM. Further, pursuant to the agreements, Thunderbird retained complete control over EDM's operations. The subscription agreement reflected and acknowledged Thunderbird's control of the investment: *"Thunderbird, through its key executives and management including Messrs. Wilson and Girault will manage all aspects of the development and ongoing operation of the company.*	The first, third and fourth sentences are admitted. The second sentence: is neither admitted nor denied as it is not fact. Fifth and sixth sentences: denied.

Response:

408. See section VIII.C.2 of this document.

409. As regards the certainty of the shareholders, the Tribunal will be able to appreciate that the Subscription Agreements and Members Participation Agreements contain statements about the letter of 15th August 2000 from SEGOB. They apparently proceeded on the basis of these rather than on the letter itself.

Complaint page 13, lines 1-4

Complaint	Admissions and Denials
The non-Thunderbird investors in EDM were "passive". They exercised no control whatsoever over EDM or its operations. Thunderbird secured additional investors and acted to open new skill machine facilities. Those investors were uniformly advised of and relied upon Gobernacion's August 15 official opinion.	Denied.

Response:

410. See section VIII.C.2 of this document.

2. EDM-Laredo

Complaint page 13, lines 6-12

Complaint	Admissions and Denials
In November, 2000, Thunderbird formed Entertainmens de Mexico-Laredo S. de R.L. de C.V. ("EDM-Laredo"). Thunderbird directly and through subsidiaries held a significant percentage interest in the entity. On November 17, 2000, EDM Nuevo Laredo entered into a lease for a location in the city of Nuevo Laredo, Mexico. That one year lease granted EDM-Laredo voluntary extensions for a total lease term of nine years. On November 17, 2000, EDM-Laredo registered with the Federal Register of Taxpayers. EDM-Laredo secure necessary permits and licenses.	The first and second sentences are denied. The third, fourth and sixth sentences can neither be admitted to or denied with as the respondent does not have the means to do so. The fifth sentence is admitted.

Response:

411. See section VIII.C.3.a(i) of this document.

Complaint page 13, lines 14-19

Complaint	Admissions and Denials
EDM-Laredo and various investors executed a "Subscription and Investment Representation Agreement" and a "Members Quota Agreement" under which the investors held their various percentage interests in EDM-Laredo. Membership certificates were issued to each of the investors indicating their share or quota percentages. Thunderbird maintained its significant ownership interest in EDM-Laredo. Thunderbird retained complete control over EDM-Laredo's operations. The "Subscription and Investment Representation Agreement" acknowledged Thunderbird's control of the investment (the reference is omitted).	First sentence: admitted. The second sentence is neither admitted nor denied, as the respondent does not have the elements to make a judgment. The rest is denied.

Response:

412. See section VIII.C.3.a(i) of this document.

Complaint page 13, lines 22-35

Complaint	Admissions and Denials
Further, Thunderbird maintained control over EDM-Laredo and its operations through a "Management Agreement". Under that agreement, Thunderbird had direct control, through a managing director, of the development and operations of EDM-Laredo. The non-Thunderbird investors in EDM-Laredo were "passive". They exercised no control whatsoever over EDM-Laredo or its operations.	Denied.

Response:

413. See section VIII.C.3.a(i) of this document.

Complaint page 14, lines 2-3

Complaint	Admissions and Denials
On February 9, 2001, EDM-Laredo opened its skill game facility in Nuevo Laredo.	There is a contradiction in that, further on, the claimant indicates that the establishment opened on 21st January, 2001.

3. EDM-Reynosa

Complaint page 14, lines 5-10

Complaint	Admissions and Denials
In June 5, 2001, Thunderbird formed Entertainmens Reynosa S. de R.L. de C.V. ("EDM-Reynosa"). Thunderbird directly and through subsidiaries held a significant percentage interest in the entity. EDM-Reynosa secured a location with a two year lease, The lease had two voluntary extensions for a total lease term of fifteen years. EDM-Reynosa secured various permits and licenses.	First, second and third sentences: denied. The fourth sentence: admitted. Fifth sentence is neither admitted nor denied as it is not fact.

Response:

414. See VIII.C.3.(a)(ii) of this document.

Complaint page 14, lines 11-18

Complaint	Admissions and Denials
EDM-Reynosa and various investors executed a "Subscription and Investment Representation Agreement" and a "Members Quota Agreement" under which the investors held their various percentage interests in EDM-Reynosa. Membership certificates were issued to each of the investors indicating their share or quota percentages. Thunderbird maintained its significant ownership interest in EDM-Reynosa Thunderbird retained complete control over EDM-Reynosa's operations. The "Subscription and Investment Representation Agreement" acknowledged Thunderbird's control of the investment: "Thunderbird, through its key executives and management including Messrs. Wilson and Girault will manage all aspects of the development and ongoing operation of the company."	First sentence: admitted. The rest is neither admitted nor denied, as the respondent does not have the elements to make a judgment. The rest is denied.

Response:

415. See section VIII.C.3.a(ii) of this document.

Complaint page 14, lines 19-23

Complaint	Admissions and Denials

Further, Thunderbird maintained control cover EDM-Reynosa and its operations through a "Management Agreement". Under that agreement, Thunderbird had direct control, through a managing director, of the development and operations of EDM-Reynosa. The non-Thunderbird investors in EDM-Reynosa were "passive". They exercised no control whatsoever over EDM-Reynosa or its operations.	Denied.

Response:

416. See section VIII.C.3.a(ii) of this document.

Complaint page 14, lines 24-25

Complaint	Admissions and Denials
In August 2001, EDM-Reynosa opened its skill game facility in Nuevo Laredo.	Denied.

Response:

417. EDM-Reynosa operated the establishment of Reynosa.

The respondent will not raise the facts set out in pages 15, 16 and 17 of the Complaint, referring to the establishments of EDM-Puebla, EDM-Monterey, EDM-Juarez and the description of the potential projects, because, as already mentioned in section VIII.C.3.b of this document, the Tribunal should not consider them. In this context these are denied.

H. Mexico's Destruction of Thunderbird's EDM Investment in Mexico

Complaint page 17, lines 6-11

Complaint	Admissions and Denials
Mexico held general elections in July, 2000. Vicente Fox's administration came into office in December, 2000. J. Guadalupe Vargas Barrera ("Guadalupe Vargas") was appointed the new Director de Juegos y Sorteos. That position had been held by Antunano Sandoval. He had signed, on behalf of Juegos y Sorteos and Gobernacion the August 15 official letter approving EDM'S operation of skill machines. Through Guadalupe Vargas, Mexico began aggressive efforts to disrupt Thunderbird's skill machine operations.	The first, second, third and fourth sentences are admitted. The fifth and sixth sentences are denied.

Response:

418. The 15th August 2000 letter, signed by Mr. Antunano Sandoval, Director of Games and Raffles, in the absence of Sergio Orozco Aceves, Director General of the Interior, does not approve EDM's operations. See section VI.D.1 of this document.

Complaint page 17, lines 12-14

Complaint	Admissions and Denials
Nuevo Laredo opened on January 21, 2001. Two weeks later, on	Admitted with the

February 9, 2001, Guadalupe Vargas closed the facility. He did so after conducting a personal "visual inspection" of the operation.	following clarifications.

Response:

419. The closure of the Nuevo Laredo establishment took place on 25th February, 2001[333].

420. Mr. Guadalupe Vargas was commissioned by the then Director General of the Interior to attend the Nuevo Laredo establishment, and proceed with the closure if prohibited games were taking place[334] (as indicated, SEGOB had not issued permits for this type of operation; they were not permitted by law.

Complaint page 17, lines 15-26

Complaint	Admissions and Denials
Peter Watson was at home in Minnesota when Nuevo Laredo was closed. Watson received a telephone call from Steve Sawin, a manager at the facility. Sawin advised Watson that the new Director de Juegos y Sorteos, Guadalupe Vargas, had arrived at Nuevo Laredo with local police and was closing down the facility. Watson spoke directly with Guadalupe Vargas over the pone. Guadalupe Vargas stated that he was closing down the facility because "lo que veo aqui son tragamonedas" ("What I see before me are slot machines"). Watson described the August 15 official letter from Gobernacion. He explained the difference between skill machines and slot machines. Finally, Guadalupe Vargas simply said. "Look, I would like to help you but I am just following orders from my boss and I have an order here to close you down and that is that. "[Watson, para.26] Another employee of the Nuevo Laredo facility specifically advised Guadalupe Vargas and the local authorities that Director General de Gobernacion, Sergio Orozco Eschevez had granted permission for operation of the skill machine facility. That statement is expressed in the closure documents.	Neither admitted nor denied, with the exception of the last two sentences, which are admitted with the following clarifications.

Response:

421. The act of closure shows that the person in charge of the establishment, Francisco Javier Ortiz Arroyo, indicated the following: "We are against what is contained in this act as our machines are not games of chance and gambling, but are machines of ability and skill, which interact with those who operate them. We are therefore against the confiscation of the property which is mentioned here. We operate under the protection [the note is omitted] and under the criteria issued by the General Directorate of the Interior, Directorate of Games and Raffles, according to Letter Number DGG/SP/1057/2000 of 15th August, 2000…"

Complaint page 18, lines 1-11

Complaint	Admissions and Denials
Thunderbird's representative flew to Mexico City the next day	First sentence: neither

333 See Annex C-72.

334 Commissioning letter which forms part of Annex C-72. See also Annex R-042.

and with their lawyers from Baker & Mackenzie. The lawyers filed for an amparo. Thunderbird they secured a meeting with Orozco Aceves. He was now the outgoing Director General of Gobernacion. At that meeting for Thunderbird and the EDM entities were Girault, de Velasco, Mitchell and Jorge Montano. Orozco Aceves stated that he was aware of the August 15 letter granting permission to operate the skill machines. He agreed with Thunderbird representatives that Guadalupe Vargas had not followed proper procedure. He stated that he had given Guadalupe Vargas complete freedom to operate as the new director. Orozco Aceves said it was clear the order of closure had been signed prior to any inspection. He conceded there were many irregularities in the closure of the Nuevo Laredo facility. Orozco Aceves arranged an immediate meeting with a Mr. Alcantaro, head of the Amparo Division of Gobernacion. Alcantaro and Orozco Aceves both expressed great concern about the closing and about the procedures used. They agreed to review the matter on an expedited basis.	admitted nor denied because these are not facts. Second and ninth sentences: admitted. Third, fourth, fifth, tenth, eleventh and twelfth sentences: neither admitted nor denied. Sixth, seventh, eighth sentences: denied.

Response:

422. Mr. Guadalupe Vargas did not act "with complete freedom". His functions are established in the Internal Regulations of SEGOB. The Director General of the Interior commissioned him by means of letter on 20th February 2001, to carry out an inspection visit to the Nuevo Laredo establishment, with orders to close it down if games prohibited by the Federal Law on Games and Raffles were being carried out inside. Mr. Vargas carried out the inspection based on this letter.

423. EDM petitioned for protection against the act of closure of the property. Subsequently EDM withdrew the petition. SEGOB revoked the closure order. It stated that the closure was the result of the doubt generated by the operation of the machines which were found in the establishment, but that it did not have the legal and technical elements to determine the legality or illegality of the machines with precision. He therefore revoked the closure order and initiated an administrative procedure to previously analyze the formal questions and materials that would permit the question to be resolved[335].

Complaint page 18, lines 12-19

Complaint	Admissions and Denials
As a result of these meetings and other contacts, an agreement was reached. EDM would dismiss the Amparo proceeding. Gobernacion would lift the seals and allow operation of the Nuevo Laredo facility provided Thunderbird would enter into an administrative review proceeding to determine whether the machines did in fact comply with or violate Mexican law. In reaching that agreement, Thunderbird believed it would get fair treatment from the government. The Nuevo Laredo and Matamoros skill machines were being operated exactly as represented to Gobernacion in the August 3 solicitud. Gobernacion had	First, second and third sentences: admitted to in the terms expressed in paragraph 423. Fourth sentence: neither admitted nor denied. The respondent cannot speculate as to what Thunderbird thought. Fifth and sixth sentences: denied.

335 Annex C-68.

approved operation of the skill machines in response to that solicitud.	

Response:

424. See sections IV and VI.D of this document.

Complaint page, 18 lines 20-21

Complaint	Admissions and Denials
Thunderbird withdrew the amparo claim. Gobernacion lifted the seals. Laredo reopened on March 20, 2001.	Admitted with the following clarification.

Response:

425. According to the EDM-Laredo State of Results for the month of March, 2001, the establishment re-started operations from 17th March, 2001[336].

Complaint page, 18 lines 22-25

Complaint	Admissions and Denials
Evidence indicates outright misrepresentation the part of Guadalupe Vargas as to the closure of Nuevo Laredo. In a March 9, 2001 letter to Daniel F. Cabeza de Vaca, Director General of Legal Affairs, the legal department of Gobernacion, Guadalupe Vargas explained his reasons for closing Nuevo Laredo.	Denied.

Response:

426. Document DJS/NC/1306/2001 of 9th March, 2001 is a report to the head of the legal area of SEGOB on the closure. It indicates that EDM had instigated a petition for protection and sent a copy of the respective file.

Complaint page 19, lines 1-11

Complaint	Admissions and Denials
In doing so, he misrepresented the August 15 official letter. He explained that the Nuevo Laredo facility because he had found 120 "slot machines" operating without authorization or permit. He identified the August 2 solicitud and the August 15 official letter as the origin of the matter. But, in describing the August 15 letter to his superior, Guadalupe Vargas misrepresented it as denying authorization to Thunderbird's EDM entity to operate skill machines. He stated as follows:	First sentence denied. Second and third sentences: admitted. Fourth sentence: denied.

Response:

427. Mr. Vargas explained that he proceeded to close down the establishment as he had found 120 gaming machines "as those known as 'slot machines', which operated without the authorization of SEGOB. He indicated that the problem had originated with EDM's request to

336 Annex R-046. See also Annex C-90.

SEGOB dated 3rd August 2000, which had given rise to the reply of 15th August of the same year, which did not authorize the operation of machines of games of chance or gambling. As already explained, SEGOB neither issued an authorization nor gave its approval for EDM's activities.

428. Following the conclusion of the administrative procedure, SEGOB once again closed down the establishment at Nuevo Laredo, as well as those at Matamoros and Reynosa. EDM went to the Mexican courts but was not successful in its claim.

Complaint page 19, lines 12-14

Complaint	Admissions and Denials
This is an outright misrepresentation. In fact, the August 15 letter specifically stated that the identified machines were not games of chance and were not prohibited by Mexican law.	Denied.

Response:

429. See section VI.D.I and paragraph 403 of this document.

Complaint page 19, lines 15-21

Complaint	Admissions and Denials
Gobernacion, by means of an official letter, requested the presence of EDM'S legal representatives at a hearing on July 10, 2001. The official notice, executed by Aguilar Coronado, the new Director General of Gobernacion, requested the company's legal representative to present all necessary proof and evidence concerning the machines installed in the facilities at Matamoros and Nuevo Laredo. The notice specifically stated that Guadalupe Vargas would be present at the meeting assisting Gobernacion in the process. In fact, he presided over the meeting.	First and second sentences: admitted. Third sentence: admitted with the following clarification. Fourth sentence: denied.

Response:

430. Mr. Vargas played a very limited part. He closed the EDM Nuevo Laredo establishments on 25th February2001, on the instructions of the then Director General of the Interior. After the closure, he sent the file to SEGOB's legal area. He attended the audience held on 10th July of the same year, but did not play any part. The hearing was presided over by Mr. Aguilar Coronado[337].

Complaint page 20, lines 1-11

Complaint	Admissions and Denials
At about the same time, representatives of Thunderbird and its EDM entity were noticed by the Attorney General ("PRG") in Matamoros to appear and address a pending criminal investigation resulting from an earlier inspection of the Matamoros site. Carlos Gomez, a lawyer retained by Thunderbird, together with a Baker & Mckenzie lawyer, met with the prosecutors. The prosecutors proposed to select an expert who would inspect the Matamoros machines and	First sentence: admitted. The rest is neither admitted nor denied, as they are not facts.

337 Annex R-047.

determine if there was an element of skill in their operation. The prosecutors selected an expert who analyzed the machines in Matamoros. That expert made a sworn report to the PGR that the Matamoros machines were indeed skill machines and not games of chance. The criminal investigation was concluded. Thunderbird felt the expert report and the investigation would have precedential effect in the upcoming administrative proceeding. Thunderbird and EDM prepared for the July 10 administrative hearing.	

Response:

431. Thunderbird had argued that this expert testimony was procured at the request of PGR, and was presented at the hearing on 10th July as official expert testimony[338].

Complaint page 20, lines 12-20

Complaint	Admissions and Denials
Shortly before that hearing, Thunderbird representatives met with the new Director General Gobernacion, Umberto Aguilar Coronado. He had replaced Orozco Aceves. Aguilar Coronado received the Thunderbird representatives in the same office where they had previously met with Orozco Aceves. The Thunderbird representatives explained who they were and the nature of their operations. Aguilar Coronado stated that Thunderbird and its Mexican entities were "the good guys", the only ones who had sought permission for their skill machine activities. Aguilar Coronado promised to set up a procedure to get the problems out in the open and resolved. After that meeting, the Thunderbird representatives felt confident that somebody was in charge who clearly understood the situation.	Denied with the following clarification.

Response:

432. Such meetings as may have taken place between Thunderbird and SEGOB, took place at the respondent's request. SEGOB did not take on any obligation in this respect.

Complaint page 20, lines 21-22

Complaint	Admissions and Denials
Thunderbird prepared for the administrative hearing. It obtained and prepared the following evidence in booklet form for presentation to Gobernacion. [references are omitted] *[continues until PSOC Page 24, line 24]*	Neither admitted nor denied, as they are not facts.

338 Note that the classification of the Commission's (the *National Indian Gaming Commission)* opinions concentrated heavily on these factors, as well as on the question as to whether there was a discernible pattern in the movement of the reels, to give the player a chance to learn this pattern. In some cases, the Commission found that the pattern changed. In other cases the Commission found that the longer the player waited before pressing the buttons, the more quickly the reels revolved. The NetComm report does not analyze any of these factors.

Complaint page 24, lines 25-28

Complaint	Admissions and Denials
In addition to these materials, Kevin McDonald, agreed to appear and provide a laptop-sized machine for demonstration. Francisco Ortiz, the manager of Nuevo Laredo, agreed to appear and demonstrate the machine.	Neither admitted nor denied, as they are not facts.

Complaint page 25, lines 1-8

Complaint	Admissions and Denials
The hearing took place on July 10, 2001 at the offices of Director de Juegos y Sorteos in Mexico City. Gobernacion was represented by Guadalupe Vargas and Mr. Alcantara , one of the general counsels of Gobernacion in charge of the Amparo proceedings. No other representatives of Gobernacion were present. A stenographer was present. Thunderbird was represented by Peter Watson, Jorge Montoyo, Mauricio Gauralt, Carlos Gomez and Luis de Ruiz Velasco of Baker & Mackenzie. The meeting was presided over by Guadalupe Vargas, the same individual who had previously closed down the Nuevo Laredo.	First and fifth sentence admitted. Second sentence admitted with the following clarification. Third, fourth and sixth sentences denied.

Response:

433. Mr. Humberto Aguilar Coronado chaired the hearing[339].

Complaint page 25, lines 9-21

Complaint	Admissions and Denials
Guadalupe Vargas looked at the materials for a matter of seconds. He threw the booklet off to the corner of the desk and said "this is just a thesis, and means nothing". Throughout the hearing Guadalupe Vargas exhibited a prejudice towards the foreign investment. He was "nasty and disrespectful" of the Thunderbird representatives. Although the Thunderbird representatives explained and demonstrated everything possible to Guadalupe Vargas, he, from the beginning of the hearing until the end. Steadfastly represented that the machines were "slot machines" and nothing else. Guadalupe Vargas had clearly made up his mind long before the hearing and nothing Thunderbird could say would change his personal opinion regarding the operation of the machines. Gobernacion presented no evidence at the hearing relating to the operation of the machines, no evidence that the machines were being operated in a manner different than as represented in the August 3 solicitud, and no evidence establishing in any respect that the machines were anything other than legally-operating skill machines. More simply stated, Gobernacion presented no evidence.	Denied.

339 See Annex R-047.

Response:

434. As already stated, Mr. Vargas had a very limited role. He did not take any active part in the hearing.

435. The Federal Law of Administrative Procedure and the Federal Code of Civil Procedure establish the rules for appraising evidence presented by an individual in any administrative proceeding. An administrative authority which is conducting an administrative procedure is not competent to present arguments and evidence, but has the right to receive, evaluate, study and give its opinion on the arguments and evidence offered by the individual.

Complaint page 25, lines 22-26

Complaint	Admissions and Denials
Sometime after the hearing, Thunderbird representatives sought and obtained another meeting with Aguilar Coronado. Aguilar Coronado stated that he felt the administrative hearing would turn out well. But he did imply that Guadalupe Vargas had direct connections to the highest levels of the Mexican government and to President Fox himself. Otherwise, Aguilar Coronado said little about the way that the matters were being handled by Guadalupe Vargas.	Denied.

Complaint page 26, lines 1-4

Complaint	Admissions and Denials
Thunderbird representatives also had a meeting with Mr. Cabeza de Vaca, head of the legal department for Gobernacion. De Vaca said that Thunderbird and its entities had done things right, that they were working through the system, that the administrative decision was his and not that of the Director de Juegos y Sorteos. De Vaca assured them the decision would be made on a strictly legal basis, but it was also clear that de Vaca had very limited understanding of the situation.	Neither admitted nor denied as it is not on the respondent's files.

Complaint page 26, lines 5-9

Complaint	Admissions and Denials
The summer of 2001 ended with Thunderbird and its entities not knowing exactly where they stood. They did not know when they would hear anything from the government or whether it would be favorable. Thunderbird pushed slowly ahead with its plan. He opened Reynosa in August 2001 and moved forward with the Puebla and Monterey sites, but slowed down with the other projects.	The first part of the fourth sentence is admitted. The rest is neither admitted nor denied, as they are not facts.

Complaint page 26, lines 10-20

Complaint	Admissions and Denials
On October 11, 2001, without prior notice, the Mexican government closed down and seized the Thunderbird/EDM skill machine operations at Matamoros and Nuevo Laredo.	Admitted with the following clarifications.

Mr. Alcantaro on behalf of Gobernacion, appeared at Luis de Ruiz Velasco's office in Mexico City and personally served him with administrative findings and an order for the closure at Matamoros and Nuevo Laredo. While the administrative findings and order specifically represented that an appeal could be taken. Gobernacion acted immediately to shut down and seize the facilities. Within an hour of service of the administrative findings and order in Mexico City, Guadalupe Vargas, with the assistance of federal and local police, seized and sealed the Matamoros and Nuevo Laredo facilities. The event was carefully designed for high publicity. Members of the press were present. The federal and local police who closed the facilities were armed. Employees of the facilities were arrested and taken away.	

Response:

436. SEGOB completed the review of the file, and issued a resolution which concluded that the operation of EDM's machines contravened the provisions of the Federal Law on Games and Raffles, as they involved prohibited games. SEGOB gave notice of the resolution to EDM's legal representative personally according to the provisions of the Federal Law of Administrative Procedure, and proceeded immediately to close down the sites as required by the Federal Law on Games and Raffles[340].

437. Mr. Vargas took part in the closures. The names of the inspectors who carried out the procedures appear in the respective minutes of the closures[341].

438. The Federal Law on Games and Raffles establishes that SEGOB may secure the help of the police force in the exercise of its powers (article 10). The law also classifies as crimes the violation of some of its provisions, for which reason it invokes the participation of the Federal Attorney General's department to deal with the people who are found in the establishments according to the requirements of the law.

Complaint page 26, lines 21-27

Complaint	Admissions and Denials
Thunderbird closed the Reynosa facility for a period of time but then reopened because the October 10, 2001 administrative order only affected Matamoros and Nuevo Laredo. On January 21, 2002, the Mexican government seized and sealed the Reynosa facility. A video taken at the time of the close indicates the public fashion in which the Mexican government acted against the Reynosa facility and Thunderbird's investments. More than 100 state and local law police appeared at Reynosa. At gun point, they closed the facility and arrested many employees.	First and second sentences partially admitted. Third, fourth and fifth sentences: neither admitted nor denied, as they are not facts.

Response:

340 Judicial study. Annex R-054.

341 Acts of closure of the Nuevo Laredo and Matamoros establishments. Annexes C-72 and 73.

439 The Reynosa establishment started operations in August of 2001, before SEGOB resolved to conclude the administrative procedure.

440. SEGOB is not responsible for the publicity that was given to the closures. SEGOB does not control the communications media.

Complaint page 27, lines 1-10

Complaint	Admissions and Denials
The Matamoros, Nuevo Laredo and Reynosa have remained closed. As of the date of these closures, Mexico had not sought obtained or provided a single expert or other evidence to establish that the machines were not, in fact, skill machines. In fact, the only expert evidence obtained on that point by Mexico was the analysis obtained by the PGR attesting that the machines were in fact skill machines and not games of change. Further, Mexico had not and, to date, has not provided any evidence that the machines were operating in any manner different than that described in the August 3, 2002 solicitud. All of the actions taken by Gobernacion resulting in seizure of the three facilities were the result of Guadalupe Vargas "visual inspection" and subjective opinion. There is no evidence that Guadalupe Vargas had or has any experience with, or clear understanding of the operation of skill machines.	First sentence: admitted. The rest is denied.

Response:

441. SEGOB is the legal authority empowered in matters of games and raffles, and it falls to SEGOB alone to determine whether the operations of this type of machines are legal or not. In this case, it determined that they were not. The Tribunal will also appreciate that Thunderbird is focused on the fact that these machines were "of ability and skill". They omit to inform the Tribunal that SEGOB also closed the establishments because bets were being placed.

442. The administrative procedure is not held as if there were a dispute between two parties in which they each bring evidence to support their respective arguments. It is held before the competent authority and it is the individual who has to prove to this authority that the law is on his side. The authority is obliged to hear evidence, evaluate it and reach a decision[342]. This is what SEGOB did. If the individual is not in agreement with the outcome, there are judicial methods available to him to challenge it. EDM made use of them, but without success.

Complaint page 27, lines 12-17

Complaint	Admissions and Denials
The administrative findings and order issued on October 10, 2001 under which Mexico seized the Thunderbird/EDM operations was issued and signed by Umberto Aguilar Coronado, Director General Secretary of Gobernacion. While Aguilar Coronado signed findings and order, he was not present at the hearing. The findings and order were based entirely on the personal subjective beliefs and	First sentence: admitted. Second sentence: admitted partially. Third sentence: denied.

342 See Annex R-054.

misunderstandings of Guadalupe Vargas.	

Response:

443. Mr. Umberto Aguilar Coronado was present at the hearing and, in fact chaired it[343]. The respondent has already referred to the limited role played by Mr. Vargas[344].

Complaint page 27, lines 18-21

Complaint	Admissions and Denials
A significant portion of the administrative findings dealt with exclusion of all of the evidence provided by Thunderbird/EDM at the July 10 administrative hearing. At the outset of the findings, all of the evidence was excluded because it was allegedly provided in photostatic copy form as opposed to original documents.	Admitted.

Response:

444. The resolution of 10th October establishes in detail SEGOB's reasoning and its conclusions[345]. EDM subsequently challenged it unsuccessfully.

Complaint page 27, lines22-26

Complaint	Admissions and Denials
Declarations provided by Thunderbird/EDM were rejected and excluded because they were offered in English and because they were offered by employees of Thunderbird. Thunderbird representatives had supplied the report obtained by the Attorney General of Mexico, attesting that the machines operated at Matamoros were skill machines. The administrative findings addressed this report by stating it was not exactly the expert testimony of the Attorney General of the Republic but rather an expert opinion requested by the Attorney General. It was therefore a private document and not a public document. The findings concluded that because it was a private document and not a public document, it had no value as evidence.	Partially admitted.

Response:

445. The Federal Civil Procedure Code is of supplementary application to matters relating to the evaluation of evidence in administrative procedures. This law gives the judge broad powers to appraise evidence. If the norm does not give a certain piece of evidence the weight of complete proof, its value depends on the prudent discretion of the judge. The Code establishes the distinction between public and private documents, and requires the latter to be presented as originals, leaving the evidentiary value as a matter of prudent discretion.

Complaint page 28, lines 4-13

Complaint	Admissions and Denials

343 See Annex R-047.
344 See Annex R-042.
345 See Annex C-70.

As to the declaration testimony of experts, James Maida and Carlos Lozano, the findings and order simply noted that their expert opinions contained subjective personal evaluation and therefore had no value.	Admitted.

Response:

446. The resolution of 10th October establishes in detail SEGOB's reasoning and its conclusions. EDM subsequently challenged it unsuccessfully.

Complaint page 29, lines 19-21

Complaint	Admissions and Denials
Further, there is no evidence cited in the administrative findings and order that the machines were any different than those specifically identified in, or operated in any manner different from that described in, the original August 3 solicitud, in response to which the August 15 official opinion letter was issued.	

Response:

447. See section VI.D.1 of this document.

Complaint page 29, lines 23-28

Complaint	Admissions and Denials
Thunderbird through its Mexican EDM entities, appealed the closure of the facilities as well as the order issued by Gobernacion through "amparos" in the courts of Reynosa and Matamoros and an appeal before the tax courts in Mexico City. The amparos were successful at the courts of first instance, but were denied at the "Colegiado" level. During the amparo process in Matamoros and Reynosa, government lawyers had lengthy ex-parte sessions with judges in charge of the cases without the presence of Thunderbird lawyers. The tax court appeal of the administrative order was unsuccessful.	Denied except for the first sentence.

Response:

448. See section VI.C of this document.

Complaint page 30, lines 2-9

Complaint	Admissions and Denials
While the various legal claims were in process, Thunderbird's representatives had several meetings with Cabeza de Vaca, the head of the legal department of Gobernacion. Umberto Aguilar the new Director General of Gobernacion and Augusto Chavez Chavez - the Internal Controller of Gobernacion. In those meetings, Thunderbird representatives were advised that Gobernacion would reconsider its position with respect to the closures but nothing ever occurred. Thunderbird	Denied.

representatives were repeatedly told that Mexico would agree to submit the machines to independent analysis and that if they were determined to be skill machines, the facilities could be re-opened. That analysis never took place.	

Complaint page 30, lines 10-17

Complaint	Admissions and Denials
Thunderbird representatives met with Guillermo Flores, the individual in charge of creating a new gaming law in Mexico. He was a private citizen but they understood that he was a good friend and the former campaign manager of Marin Huerta the second in command at Gobernacion (Aguilar is third). Flores acknowledged Gobernacion's opinion letter. He proposed that he would act as liaison, or conciliator, between Thunderbird and Gobernacion. He said he didn't see a reason why it could not be worked out amicably. Thunderbird/EDM were not, after all, "fly by night money launderers". Thunderbird as a "public company and very transparent". Nothing happened.	Neither admitted nor denied as they are not facts.

Complaint page 30, lines 18-23

Complaint	Admissions and Denials
Simultaneously with these proceedings, Guardia obtained a federal decision upholding his right to operate skill machines. Thunderbird/EDM representatives met again with de Vaca to obtain an explanation of the disparate, discriminatory treatment received by the Thunderbird/EDM operations. De Vaca's response was tat Gobernacion believed the legal resolutions in favor of Guardia were wrong and that he would take a closer look at the matter. Nothing happened. Guardia's skill machine facilities remain open and in operation.	Denied.

Response:

449. See section VI.D.3 of this document.

Complaint page 30, lines 24-27

Complaint	Admissions and Denials
In one meeting, de Vaca also stated that Gobernacion had interviewed Antunano, the former director of Juegos y Sorteos, who had signed the opinion letter on behalf of Gobernacion. De Vaca stated that Antunano had provided them with a written statement indicating that what he had intended by the letter was not what Thunderbird had "inferred" from it. Thunderbird representatives were not allowed to see the claimed statement. It has never been produced.	Denied.

Response:

450. The terms of the 15th August 2000 letter are clear. See section VI.D.1 of this document.

Complaint page 31, lines2-6

Complaint	Admissions and Denials
Jorge Montano, a career diplomat, served as Mexico's Ambassador to both the United Nations and the United States. In both capacities, he served on Mexico's NAFTA negotiation team. Concerning Mexico's treatment of Thunderbird's investment enterprises, Mr. Montano states that Mexico government acted "in bad faith", clearly discriminating against foreign investment" and "completely disregarded NAFTA obligations".	First sentence: admitted. Second sentence: denied. Third sentence neither admitted nor denied as these are not facts.

Complaint page 31, lines 7-9

Complaint	Admissions and Denials
On March 21, 2002, Thunderbird initiated the present proceedings by serving Mexico with its "Notice of Intent to Submit Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement".	Admitted with the following clarification.

Response:

451. The respondent objected to the presentation of the notice of intention, as it did not comply with NAFTA requirements. Up to now it has not been proved that [Thunderbird] is the owner of, or controls, EDM. See section VIII of this document.

Complaint page 31, lines 11-15

Complaint	Admissions and Denials
At the time of seizure and closure on October 11, 2001, Matamoros was operating 80 video skill gaming machines. Those machines had been generating significant revenues. Net wins (drops into the machines less prizes paid in U.S. dollars) for its initial months of operation were as follows: [table omitted]	Denied.

Response:

452. According to the act of closure, there were 75 slot machines operating in the Matamoros establishment. According to the audited financial statements of 31st December 2001, the three establishments suffered losses. The Matamoros establishment in particular suffered an operating loss of 2,241,057 pesos (approximately 244,403 dollars) in 2001.

453. The claimant has not made available any reliable source of information to verify the revenue figures reported in the Complaint. There is also an important difference between the 2001 audited statements of account, and the daily operating records. For example, according to the statement of account in the audited financial statements, the Matamoros establishment had net sales of 31.3 million pesos (approximately 3.4 million dollars) in 2001, while the earnings shown in the operating records for this year total 13.4 million pesos (approximately 1.4 million dollars), a difference of approximately 2 million dollars.

454. According to the daily operating record and the act of closure, the Nuevo Laredo establishment had 126 machines in operation at that time.

455. The 2001 audited financial statements show that the Nuevo Laredo establishment had operating losses of 7,636,625 (approximately 832,828 dollars).

456. In fact the monthly statements at 30th November 2001 show that gaming income was 1,497,448 dollars less that the initial projections.

Complaint page 32, lines 9-12

Complaint	Admissions and Denials
Matamoros has been closed and purportedly sealed since October 11, 2001 with Thunderbird/EDM's 80 machines skill machines inside. Thunderbird has sought and been denied access to the facilities. Mexico divulged in these proceedings that Matamoros has apparently been looked. The facility now sits "without seals of closure and largely empty."	Denied.

Response:

457. At the time of the establishment's closure 75 machines were found. The respondent informed the Tribunal about the action of the Matamoros Local Conciliation and Arbitration Board[346]. In fact the establishment was found practically empty as the parties could verify in the joint visit of 6th November, 2003[347].

Complaint page 33, lines 4-8

Complaint	Admissions and Denials
Nuevo Laredo has been closed and purportedly sealed since October 11, 2001 with Thunderbird/EDM's 120 machines skill machines inside. Thunderbird has sought and been denied access to the facilities. Mexico divulged in these proceedings that Nuevo Laredo has also been looked. The facility now also sits "without seals of closure and largely empty."	First sentence: admitted. Second sentence: denied. Third sentence: denied.

Response:

458. In its Letter No. DGCJN.511.13.886.03 of 8th August, 2003, the respondent clarified to the Tribunal the state in which the Nuevo Laredo establishment had been found. The parties were able to verify in their visit of 5th November 2003 that the establishment was found in the same condition as it was at the time of closure. In this establishment there are 125 slot machines subject to closure.

Complaint page 33, lines 10-13

Complaint	Admissions and Denials
At the time of seizure and closure on January 28, 2002, Nuevo Laredo was operating 80 video skill gaming machines.	First sentence: not admitted. Second sentence: denied.

346 See Letter No. DGCJN.511.13.756.03 of 17th July, 2003. See also Letter No. DGCJN.511.13.886.03 of 8th August, 2003.

347 See Annex R-033

[Atallah para: Copeland para. 12; Ex. 88 (Section 11)]. Those machines had been generating significant revenues. Net wins (drop into the machines less prizes paid in U.S. dollars) for its months of operation were as follows:	Third sentence: denied.

Response:

459. According to the daily operational record and the act of closure, the Reynosa establishment had 89 machines in operation. Nevertheless on the date indicated, 125 machines were subject to closure.

460. According to the audited financial statements for 2001, Reynosa had operating losses of 6,447,381 pesos (approximately 703,133 dollars).

Complaint page 33, lines 21-24

Complaint	Admissions and Denials
Reynosa has been closed and purportedly sealed since January 28, 2002 with Thunderbird/EDM's 80 machines skill machines inside. Thunderbird has sought and been denied access to the facilities. The Reynosa apparently remains closed with seals intact.	First and second sentences: denied. Third sentence admitted.

Response:

461. The closure was carried out on 18th January 2002. As advised to the Tribunal at the appropriate time, the Reynosa establishment was handed over to its owner, and other equipment was transferred to a warehouse under the custody of the PGR[348]. The parties were able to confirm the above in their joint visit on 7th November, 2003[349].

Complaint page 33, lines 26-28

Complaint	Admissions and Denials
Thunderbird had formed EDM entities for proposed facilities in each of these locations and had made considerable progress toward opening operations. Due to Mexico's seizure and closure of three operating facilities, Puebla, Monterrey and Juarez never opened.	First sentence: admitted in part. Second sentence: denied.

Response:

462. As already explained, these concern operations prohibited under Mexican law.

Complaint page 34, lines 2-7

Complaint	Admissions and Denials
Guardia and Other Skill Machine Operations Present Operating in Mexico. Thunderbird was originally attracted to skill game operations in Mexico due to the success of Guardia's skill machine facilities. Guardia was operating	First and second sentences: neither admitted nor denied as these are not facts. Third sentence: denied.

348 See Letter No. DGCJN.511.113.1168.03 of 21st October 2003.

349 See Annex R-033.

skill machine facilities at several locations in Mexico. These operations had withheld legal challenge by Gobernacion and were legally operating under existing Mexican law.	

Response:

463. See section VI.D.3 of this document.

Complaint page 34, lines 8-16

Complaint	Admissions and Denials
Throughout Thunderbird's initial development and operation of its EDM Enterprises, throughout the period of seizures and legal challenges' throughout the present NAFTA proceedings, and up to the present, Guardia continued, and still continues, to operate his skill machine facilities in Mexico. He has done so in a very public fashion. Thunderbird witnesses played skill machines that Guardia facilities several years ago, several months ago, and several weeks ago. Several weeks before this filing, a Thunderbird witness also observed the operation of skill machines at a facility operated by another Mexican national in Rio Bravo, Tamaulipas, Mexico.	Denied.

Response:

464. See section VI.D.3 of this document.

Complaint page 34, lines 17-33

Complaint	Admissions and Denials
In post-seizure discussions with Cabeza de Vaca, Thunderbird's representatives pointed out that Guardia had obtained a favorable court decision allowing the operation of skill machines. A demand and an explanation as to the discriminatory treatment being accorded to Thunderbird's investment enterprises in light of Guardia's open and legally operating skill machine facilities. De Vaca stated Gobernacion felt the legal resolutions in favor of Guardia were against the law and that they would take "a closer look at this matter". Guardia's skill machine facilities remain open and operating to date.	Denied.

Response:

465. See section VI.D.3 of this document.