Arbitration — Admissibility of claims — Ancillary and additional claims — NAFTA Article 1102 — NAFTA Article 1120(2) — Article 48 of the Additional Facility Arbitration Rules — Omission to rely on claim in notice of arbitration — Claims pre-dating NAFTA's entry into force — Course of action continuing after NAFTA's entry into force — Interpretation and correction of award — Interpretation and supplementary decision

Claims — Nationality of claims — Standing — Nationality and permanent residence — Definition of nationals — NAFTA Article 201

Claims — Procedure — Time limits — Meaning of "making a claim" — NAFTA Article 1117 — Receipt of claim by ICSID Secretary-General — Suspension of period of limitation — "Discouraging" a claim not a factor in suspension of period of limitation — Extension of time limits by estoppel

Economics, trade and finance — Investment protection — Denial of justice — Access to domestic courts — NAFTA Article 1110 — National treatment — Non-discrimination — NAFTA Article 1102 — Like circumstances — Less favourable treatment of foreign investors

Expropriation — NAFTA Article 1110 — Expropriation through taxation — Tax rebates for export of cigarettes — "Creeping" expropriation — Governmental regulatory activities — Expropriation and regulation

FELDMAN *v.* UNITED MEXICAN STATES[1]

(ICSID Case No ARB(AF)/99/1)

NAFTA Arbitration Tribunal

(Kerameus, *President*; Covarrubias Bravo and Gantz, *Members*)

[1] For related proceedings see p. 536 below. The names of the parties' representatives appear at p. 28 below.

The arbitration was constituted under Chapter 11 of the North American Free Trade Agreement. The Investor elected to submit his claims under the ICSID Arbitration Additional Facility Rules. The seat of the arbitration was Ottawa, Canada.

Interim Decision on Preliminary Jurisdictional Issues. 6 *December* 2000

Award on the Merits. 16 *December* 2002

Decision on the Correction and Interpretation of the Award. 13 *June* 2003

SUMMARY: *The facts*:—Since 1981 Mexico had imposed a special tax on production and sale of cigarettes in the domestic market, under the Impuesto Especial Sobre Producción y Servicios ("IEPS") Law. The IEPS provided for payment of tax for certain activities, including domestic sales, imports and exports of cigarettes. However, the tax rate on exports of cigarettes in the period 1990-7 was set at zero, although as of 1992 only exports to countries that were not considered low income tax jurisdictions were eligible for the zero rate. In most instances, the tax amounts were rebated if cigarettes were purchased domestically and subsequently exported. The claimant, Mr Marvin Roy Feldman Karpa, was a United States citizen by birth, but resided permanently in Mexico where he ran a business, Corporación de Exportaciones Mexicanas SA de CV ("CEMSA"), exporting processed tobacco.

CEMSA first began exporting cigarettes in 1990. The Ministry paid CEMSA the tax rebates for exports in full for 1990-1. However, the respondent alleged that the tax rebates related solely to CEMSA's exports of beer and alcoholic beverages, and not cigarettes. According to the claimant, an authorized producer of cigarettes in Mexico protested regarding the claimant's exports and the respondent passed legislation, as a result of which the claimant became ineligible for rebates. The respondent contested this assertion and claimed that the legislation was designed to provide rebates for exports undertaken by producers of cigarettes and to deny them for exports by resellers of cigarettes. In February 1991 the claimant initiated action before the Mexican courts challenging the constitutional validity of the legislation, alleging that it infringed the constitutional principle of "equity of taxpayers". In August 1993 the Mexican Supreme Court of Justice found that the measures allowing rebates only to producers and their distributors violated constitutional principles of tax equity and non-discrimination but did not rule on other relevant issues, including whether the claimant was entitled to rebates notwithstanding his inability to produce separate tax invoices.

While the proceedings were pending, Mexico amended the IEPS to permit rebates to all cigarette exporters. The legislation remained unchanged until 1997. According to the claimant, CEMSA began exporting cigarettes following the amendment and received rebates thereafter. In January 1993 Mexico shut down CEMSA's business for a second time, because the claimant could not meet other requirements of the IEPS, one of which was to produce invoices separating the IEPS tax. Only producers, not resellers, had access to itemized invoices. During the period 1993-5 Mexico recognized that CEMSA was entitled to the zero tax rate on cigarette exports but continued to demand that the claimant meet the invoice requirements of the IEPS. According to the claimant, an oral "agreement" was reached in June 1995 regarding the payment

of rebates to CEMSA for exports of cigarettes as of June 1996, without the need to present invoices separating the IEPS tax. Mexico denied the existence of such an agreement.

The claimant was paid rebates from June 1996 to September 1997. The rebates were terminated in December 1997 and Mexico refused to pay rebates of US $2.35 million on exports made in October and November 1997. As of 1 December 1997 the IEPS was amended so as to bar rebates to cigarette resellers such as CEMSA. The amendment also required exporters of cigarettes to register in the Sectorial Exporters Registry in order to be entitled to apply for the tax rebate on exports. Subsequently, CEMSA was refused registration as an authorized exporter of cigarettes and alcoholic beverages. On 14 July 1998 the Ministry of Finance and Public Credit began an audit of CEMSA and demanded that CEMSA repay US $25 million for IEPS rebates received in the period January 1996-September 1997, with interest and penalties. CEMSA challenged the decision in Mexican courts, a challenge which was still pending at the time of the Award. According to the claimant, two other Mexican-owned producers were permitted to obtain rebates for taxes on exported cigarettes during periods when such rebates had been denied to the claimant, notwithstanding the inability of those firms to produce separate invoices.

On 30 April 1999 the claimant submitted a notice of arbitration and request for approval of access to the Additional Facility of the Secretary-General of ICSID, pursuant to Article 1120 of the North American Free Trade Agreement (NAFTA). The claimant asserted that Mexico's actions were tantamount to nationalization or expropriation and constituted a denial of justice in violation of the rules and principles of international law and Articles 1110[2] and 1105(1)[3] of NAFTA, as well as discriminatory treatment contrary to Article 1102.[4] Following the establishment of the Tribunal, on 15 February 2000 the claimant requested provisional measures for the preservation of his rights. The Tribunal declined, under Article 1134 of NAFTA, to grant the request.

Interim Decision on Preliminary Jurisdictional Issues: 6 December 2000

Held (unanimously):—The Tribunal had jurisdiction to hear the claim.

(1) The claimant had the requisite standing under NAFTA Article 1117(1).[5] Although a permanent resident of Mexico, the claimant was a United States citizen by birth and was not a citizen of any other State. Under general international law, nationality, rather than residence or any other geographic affiliation, was the main connecting factor between a State and an individual and was determinative of standing in international adjudication or arbitration and with regard to diplomatic protection (paras. 30-2).

[2] See pp. 57-8 below.

[3] Article 1105(1) provided that: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."

[4] See p. 86 below.

[5] See p. 15 below.

(2) NAFTA Article 201[6] defined "national" as "a natural person who is a citizen or permanent resident of a Party". This provision did not make permanent residence tantamount to nationality for all purposes, nor did it mean that the claimant was a dual national for NAFTA purposes. NAFTA Article 1117(1)(a), which concerned the standing of an investor of a State Party, had to be read together with Article 1139,[7] which defined an "investor of a Party" as "a national or an enterprise of such Party, that seeks to make, is making or has made an investment". The reference to a permanent resident in Article 201 had the effect that a permanent resident of one NAFTA State Party who made an investment in another could be treated as a national of the State in which he or she was permanently resident. It did not mean that a citizen of one State who made an investment in another State of which he was a permanent resident was to be treated as if he were a dual national and thus deprived of standing to bring a NAFTA claim. The purpose of NAFTA, as expressed in Article 102(1)(c) and (e), confirmed this interpretation (paras. 24-38).

(3) NAFTA Article 1117(2), which required that claims be brought within three years, had to be interpreted in the light of other NAFTA provisions in Chapter 11, Section B. In the present case, the notice of intent to submit the claim to arbitration was delivered on 16 February 1998, while the notice of arbitration was received by the Secretary-General on 30 April 1999. The measures complained of extended over the whole period, starting in the year 1990 or 1991. Although Article 1117(3) distinguished between "making a claim" and "submitting a claim to arbitration", Article 1117 used the expression "making a claim" to denote the definitive activation of an arbitration procedure, rather than to localize the commencement of arbitration in terms of time. Therefore, the time at which the notice of arbitration was received, rather than the time of delivery of the notice of intent to submit a claim to arbitration, was the critical date for the limitation period under Article 1117(2). Accordingly, the Tribunal would normally have had no jurisdiction with regard to events occurring before 30 April 1996. In the present case, however, it was argued that the oral agreement between the parties had the effect of suspending the limitation period for some 32.5 months. That was an issue for determination on the merits (paras. 41-7).

(4) In his notice of intent to submit a claim to arbitration under NAFTA Article 1119, the claimant announced a claim based on an alleged violation of, among others, Article 1102 concerning national treatment. In his subsequent notice of arbitration the claimant omitted to rely again on an alleged violation of Article 1102. The respondent relied on NAFTA Article 1120(2), under which "[t]he applicable arbitration rules shall govern the arbitration except to the extent modified by this Section". NAFTA Chapter 11 had not modified Article 48 of the Additional Facility Arbitration Rules concerning ancillary claims. The claim concerning an alleged denial of national treatment or violation of

[6] See p. 15 below. [7] See p. 15 below.

NAFTA Article 1102 was properly before the Tribunal, because it had been in substance included in the notice of arbitration (paras. 50-9).

(5) The Tribunal lacked jurisdiction to decide claims arising before NAFTA came into force on 1 January 1994. However, if there had been a continuing course of action by the respondent, which started before 1 January 1994 and went on after that date, the latter part of the respondent's activity was subject to the Tribunal's jurisdiction (paras. 61-2).

Award: 16 December 2002

Held (Mr Covarrubias Bravo dissenting in part):—The respondent had not violated the claimant's rights under NAFTA Article 1110. The respondent had, however, acted inconsistently with the claimant's rights under NAFTA Article 1102.

(1) *Jurisdiction* The Tribunal in its Interim Decision of 6 December 2000 decided most of the jurisdictional issues. Additional jurisdictional issues, not addressed in the Interim Decision, included estoppel with regard to the period of limitation and the basis of the claim, and exhaustion of local remedies (para. 47).

(2) The claimant alleged that in June 1995 he had been given oral assurances amounting to an agreement between the parties concerning CEMSA's right to export cigarettes, which discouraged the claimant from initiating a lawsuit. This did not suspend the three-year limitation period under NAFTA Article 1117(2). Article 1117(2) did not provide for any suspension of the limitation period. Under general principles of law applied by international tribunals, such suspension was provided only in the final part of the limitation period and only in cases of act of God or if the debtor maliciously prevented the institution of a suit. "Discouraging" an action did not amount to preventing it. Accordingly, the Tribunal lacked jurisdiction with respect to events before 30 April 1996 (para. 58).

(3) The respondent was not estopped from relying on the limitation period. While an acknowledgement of the claim under dispute by the competent organ of the respondent State would probably interrupt the running of the period of limitation, behaviour short of such formal and authorized recognition would only do so under exceptional circumstances. Such exceptional circumstances might include a long, uniform, consistent and effective behaviour of the competent State organs which would recognize the existence, and possibly the amount, of the claim. No such circumstances were presented to the Tribunal in this case. Moreover, in any State governed by the rule of law there is no way to impose, to reduce, to claim, to recuperate or to transfer any tax burdens by agreements with some tax officials not provided by law. Such agreements would necessarily have a quasi-private character and could neither bind the State nor be enforced against it (paras. 63-4).

(4) The local remedies rule could be derogated from, qualified, or varied by treaty. NAFTA Article 1121 and Annex 1120.1 qualified the effect of the

rule. Article 1121(2)(b) and (3) envisaged a situation where domestic proceedings with respect to the same alleged breach referred to in Article 1117 were available or even pending in a court or tribunal operating under the law of any Party. In such case, Article 1121(2)(b) required that the disputing investor waive his right to initiate or continue the domestic proceedings. In contrast to the local remedies rule, it gave preference to international arbitration rather than domestic judicial proceedings. That was limited, however, to a claim for damages, explicitly leaving available to a claimant "proceedings for injunctive, declaratory or other extraordinary relief" before the national courts. Thus, Article 1121(2)(b) and (3) substituted a special rule on the relationship between domestic and international judicial proceedings for the general rule on the exhaustion of local remedies. Annex 1120.1 of NAFTA restricted resort to arbitration, in particular with respect to Mexico as respondent. It gave a statutory preference to domestic proceedings in Mexico vis-à-vis possible international arbitration by preventing the investor from instituting, then waiving, domestic proceedings. Since the respondent accepted that the claimant had not sought to submit an alleged breach of NAFTA to the Mexican courts, there was no conflict with Annex 1120.1. The Mexican courts were the appropriate forum for determining the claimant's rights under the IEPS law. However, questions as to whether Mexican law as determined by administrative authorities or Mexican courts was consistent with the requirements of NAFTA and international law were to be determined by the Tribunal, which was not barred from making that determination by the fact that not all of the issues had yet been resolved by Mexican courts. Otherwise, any arbitral tribunal could be prevented from making a decision simply by delay in local court proceedings. Nor was an action determined to be legal under Mexican law by Mexican courts necessarily legal under NAFTA or international law (paras. 71-8).

(5) *Tribunal's authority to grant declaratory relief* The claimant had requested the Tribunal to declare the validity or legality of the 1998 audit of CEMSA by Mexican authorities and the corresponding tax assessment. Proceedings regarding those decisions were pending before the competent Mexican federal courts and it was premature to consider whether the respondent would comply with a decision of the Mexican court. The declaratory character of the relief sought was not necessarily inconsistent with NAFTA Chapter 11, Section B; the question was whether it was admissible in the particular case. NAFTA Article 1136(1) provided that an award had binding force between the parties. Any decision by the Tribunal regarding CEMSA's entitlement to tax rebates was bound to have a direct bearing upon any domestic litigation on the entitlement to tax rebates. Therefore the validity or legality of the tax assessment did not constitute an independent or unrelated count in the arbitration but rather concerned whether a "creeping" expropriation had taken place and whether there had been a violation of the principle of equal treatment in Article 1102. Thus there was no reason for the Tribunal to make a separate declaratory ruling (paras. 84-8).

(6) *Expropriation* CEMSA was an "enterprise" and therefore an "investment" within the meaning of NAFTA Article 1139. The actions of Mexico

did not, however, amount to an expropriation of that investment. Drawing the line between expropriation and legitimate governmental action in the field of regulation and taxation was not straightforward and taxation measures were capable in principle of amounting to indirect expropriation or measures tantamount to expropriation. At the same time, governments had to be free to act in the public interest and reasonable governmental regulation could not be achieved if any business that was adversely affected could seek compensation. In the present case, the effect of the respondent's actions was that the claimant was no longer able to engage in his business of purchasing Mexican cigarettes and exporting them and had thus been deprived, completely and permanently, of any potential economic benefits from that activity. The respondent's actions did not, however amount to an expropriation:

(a) not every business problem experienced by a foreign investor constituted expropriation under Article 1110;
(b) NAFTA and principles of customary international law did not require a State to permit "grey market" exports of cigarettes;
(c) at no time had the IEPS Law afforded Mexican cigarette resellers such as CEMSA a "right" to export cigarettes; the alleged assurances relied on by the claimant were at best ambiguous and largely informal and conflicted with the IEPS Law; and
(d) the claimant had not been deprived of complete control over CEMSA by the respondent's regulatory actions; CEMSA still had the right to engage in the export of any product that could be purchased upon receipt of invoices stating the tax amounts and to receive rebates of any applicable taxes under the IEPS Law.

While none of these factors alone was necessarily conclusive, taken together they tipped the expropriation/regulation balance away from a finding of expropriation (paras. 96-137).

(7) *Due process/fair and equitable treatment/denial of justice* NAFTA Article 1110 had to be interpreted in accordance with international law. Not every denial of due process or of fair and equitable treatment constituted a violation of international law. Mexican courts and administrative procedures at all relevant times had been open to the claimant, who had been successful in some of the proceedings. There had been no denial of due process or denial of justice such as would rise to the level of a violation of international law. While it was arguable that Mexico's behaviour fell short of the standards in NAFTA Article 1105, the Tribunal had no jurisdiction to decide that issue since Article 1105 was not available in tax cases, although it might be relevant in the cross-reference of Article 1110(1)(c). The Tribunal did not need to decide whether this cross-reference made a full Article 1105 consideration appropriate in a tax matter (paras. 138-41).

(8) *National treatment* The claimant alleged that Mexico discriminated against CEMSA in 1998-2000 in violation of NAFTA Article 1102 by permitting at least three resellers of cigarettes to export cigarettes and to receive

rebates, notwithstanding the fact that, like the claimant, they had purchased their goods from retailers, were not formally taxpayers and thus could not have invoices stating the IEPS tax amounts separately. In addition, he claimed that CEMSA was denied registration as an export trading company while no similar denial occurred with regard to the other resellers. The national treatment/non-discrimination provision was a fundamental obligation of Chapter 11. What mattered was not whether the respondent's law was discriminatory on its face but whether there had been discrimination in fact, since a de facto difference in treatment was sufficient to establish a denial of national treatment under Article 1102. CEMSA had been treated in a less favourable manner than domestically owned resellers/exporters of cigarettes. This difference in treatment was inconsistent with Mexico's obligations under Article 1102 (paras. 169-88).

(9) *Damages* Chapter 11 tribunals had exercised considerable discretion in fashioning what they believed to be reasonable approaches to damages, consistent with the requirements of NAFTA. The claimant was awarded the equivalent in Mexican pesos of US $9,464,627.50, plus simple interest at the rate calculated in conformity with the Mexican Government Federal Treasury Certificates interest rates at maturity of twenty-eight days (paras. 197-206).

(10) *Costs and fees* Each party was to bear half the costs of the arbitration. In addition, each party was to bear its own legal fees and costs (para. 213).

Per Mr Covarrubias Bravo (dissenting in part): There had been no violation of NAFTA Article 1102.

(1) *Tax rebates* CEMSA had never been entitled to claim tax rebates from Mexico, due to its inability to show invoices issued by the supplier stating separately and expressly the amount of the tax. CEMSA's cigarette export business had been based on premises that clearly violated Mexican laws: to obtain tax rebates from the Government without being entitled to them. The granting of tax rebates did not necessarily mean that CEMSA had a right to such rebates (p. 111).

(2) *National treatment* The claimant had failed to prove violation of the national treatment principle. Like the claimant, the other export companies, which were presumably in like circumstances and owned by Mexican investors, had received rebates for some periods and not for others. It would have been different had the claimant shown that these companies had always been given the rebates sought (pp. 113-20).

(3) Even if CEMSA had been treated less favourably than the other exporters, that did not in itself amount to a violation of the national treatment standard under NAFTA, which was breached only if there were composite acts involving a set of conducts of a State evincing a systematic practice (pp. 120-3).

Decision on the Correction and Interpretation of the Award: 13 June 2003

The respondent applied for correction and interpretation of the award.

Held (unanimously):—(1) The request for correction of the award submitted by the respondent, substituting in paragraph 211 of the award the word "CEMSA" for the word "Claimant", was granted (pp. 124-5).

(2) The request to include the mandatory language in NAFTA Article 1135(2)(c) and add paragraph 214 which should read as follows: "the Award is made without prejudice to any right that any person may have in the relief under applicable domestic law" was granted (p. 125).

(3) All other requests for the interpretation of the award, or for a supplementary decision, were rejected (p. 125).

(4) The respondent should bear three quarters, and the Claimant one quarter, of the expenses and charges of ICSID for this phase of the proceedings. Each party should bear its own costs (p. 126).

The texts of the decisions and award are set out as follows:

The following is the text of the decision on jurisdictional issues:

INTERIM DECISION ON PRELIMINARY JURISDICTIONAL ISSUES

[**327**] I. PROCEDURAL BACKGROUND

1. On April 30, 1999, Mr Marvin Roy Feldman Karpa (the Claimant) filed, with the Secretary-General of the International Centre for Settlement of Investment Disputes (ICSID or the Centre), a Notice of Arbitration against the United Mexican States (the Respondent or Mexico) under Chapter 11 of the North American Free Trade Agreement (NAFTA), and, simultaneously, sought approval of access to the Additional Facility of ICSID as foreseen under NAFTA Article 1120.

2. By such Notice of Arbitration, the Claimant, as a national of the United States of America, submitted a claim to arbitration under NAFTA Article 1117 on behalf of Corporación de Exportaciones Mexicanas SA de CV (CEMSA), a company constituted and organized under the law of the United Mexican States which the Claimant owns and controls.

3. On May 27, 1999, the Secretary-General of ICSID notified the parties that he had on that same day approved access to the Additional Facility and registered the Notice of Arbitration.

4. Under NAFTA Article 1123, the Tribunal was to be constituted by three arbitrators, one arbitrator appointed by each party and the third, who was to be the presiding arbitrator, appointed by agreement of the parties. In due course, the Claimant appointed Professor David A. Gantz, a national of the United States, and the Respondent appointed Mr Jorge Covarrubias Bravo, a national of the United Mexican States. The parties not having agreed on the appointment of the third, presiding, arbitrator, the Claimant requested the Secretary-General of ICSID, under NAFTA Article 1124, to make that appointment. Following full consultations with **[328]** the parties, the Secretary-General appointed Professor Konstantinos D. Kerameus, a national of Greece and a member of the ICSID Panel of Arbitrators, as the arbitrator to be President of the Tribunal.

5. On January 18, 2000, the ICSID Secretary-General announced that, each arbitrator having accepted his appointment, the Tribunal was deemed to be constituted, and the proceeding to have begun, on that date. Mr Alejandro A. Escobar, Senior Counsel, ICSID, was designated to serve as Secretary of the Tribunal. In accordance with Article 22 of the Additional Facility Arbitration Rules, the Tribunal held its first session, with the parties, in Washington DC on March 10, 2000. At that first session, the parties confirmed that the Tribunal had been properly constituted in accordance with the Additional Facility Arbitration Rules and NAFTA Chapter 11.

6. Following such first session, at which the Tribunal consulted the parties fully on questions of procedure, the Tribunal issued its Procedural Order No 1, of April 3, 2000, on the place of arbitration, and its Procedural Order No 2, of May 3, 2000, on a request for provisional measures and the schedule of the proceeding.

7. In its Procedural Order No 2, the Tribunal invited the parties to exchange requests for the production of documents, and envisaged that documents would be produced by each party by July 15, 2000. The Claimant's memorial would then be filed by September 1, 2000, and the Respondent's counter-memorial would be filed by November 1, 2000.

8. By communications of May 23 and June 20, 2000, the Claimant informed the Tribunal of certain issues which had arisen in connection with the Claimant's request for the production of documents from the Respondent. Those communications were followed by a communication of June 30, 2000 from the Respondent and a communication of