

## **Arbitral Award\***

In the matter of a NAFTA arbitration under the  
UNCITRAL Arbitration Rules  
between:

**International Thunderbird Gaming Corporation**  
Claimant

and

**The United Mexican States**  
Respondent

Before the Arbitral Tribunal constituted under Chapter  
Eleven of  
the North American Free Trade Agreement, and comprised  
of:

Lic. Agustín Portal Ariosa  
Professor Thomas W. Wälde  
Professor Dr. Albert Jan van den Berg (President)

Washington D.C., January 26, 2006

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\* The editors wish to thank the Secretariat of the Canadian Agreement on Internal Trade for its assistance with respect to the reprinting of the panel report in this volume.

**I. THE PARTIES**1. Claimant:

INTERNATIONAL THUNDERBIRD GAMING CORPORATION  
Thunderbird Greeley Inc.  
11545 West Bernardo Court Suite 307  
San Diego, CA 92127  
United States of America

hereinafter: “Thunderbird” or “Claimant.”

2. Thunderbird is a publicly held Canadian Corporation, with its principal offices in San Diego, California, U.S.A.
3. In these proceedings, Thunderbird is represented by its duly authorised attorney James D. Crosby, California, U.S.A, and by Professor Todd Weiler, Ontario, Canada.

4. Respondent:

THE UNITED MEXICAN STATES  
General Directorate of Legal Consulting of Negotiations  
Ministry of Economy  
Mexico, DF, Mexico

hereinafter: “Mexico” or “Respondent.”

5. In these proceedings, the government of Mexico is represented by Mr. Hugo Perezcano Díaz, *Director General de Consultoría Jurídica de Negociaciones, Secretaría de Economía*.

**II. PROCEDURAL HISTORY**

6. On 21 March 2002, Thunderbird submitted a “Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement,” alleging that Mexico had breached its obligations under the North American Free Trade Agreement (“NAFTA”), more specifically under Article 1102 (National Treatment), Article 1103 (Most-Favoured Nation Treatment), Article 1105 (Minimum Standard of Treatment) and Article 1110 (Expropriation and Compensation) of the NAFTA.
7. On 1 August 2002 (and received by Mexico on 22 August 2002), Thunderbird submitted a Notice of Arbitration and Statement of

Claim against Mexico pursuant to the provisions of Chapter Eleven of the NAFTA and under the UNCITRAL Rules of Arbitration (the “Notice of Arbitration”).

8. In the Notice of Arbitration at ¶34, Thunderbird sought the following relief: “i. Damages of not less than USD\$100,000,000; ii. Costs associated with these proceedings, including all professional fees and disbursements; iii. Pre-award and post-award interest at a rate to be fixed by the Tribunal; iv. Tax consequences of the award to maintain the integrity of the award; v. Such other and further relief that counsel may advise and that this Tribunal may deem appropriate.”
9. By letter dated 4 September 2002, Mexico raised objections regarding the language of the proceedings and alleged further that the Notice of Intent did not fully satisfy the NAFTA requirements. Correspondence was subsequently exchanged between the Parties regarding Mexico’s objections.
10. On 14 March 2003, the Arbitral Tribunal was constituted. The Tribunal is composed of Professor Dr. Albert Jan van den Berg (appointed as President of the Tribunal by the Secretary-General of ICSID), of Dutch nationality, residing in Tervuren, Belgium; Professor Thomas W. Wälde (appointed by Thunderbird), of German nationality, residing in Dundee, Scotland, United Kingdom and Mr. Agustin Portal Ariosa (appointed by Mexico), of Mexican nationality, residing in Mexico DF, Mexico. Mr. Gonzalo Flores of ICSID was designated to serve as Secretary of the Tribunal.
11. The first session of the Tribunal was held, with the Parties’ agreement, in Washington D.C. on 29 April 2003. During that session, after having heard the Parties’ arguments, the Tribunal informed the Parties that the arbitration would be conducted in the English and Spanish language; that the place of arbitration in the legal sense would be Washington, D.C.; and that Mexico was invited to inform Thunderbird and the Tribunal whether it pursued objections based on lack of jurisdiction and/or inadmissibility (the “Preliminary Question”), following which the Tribunal would issue a ruling on the question of bifurcation of the proceedings with respect to the Preliminary Question. It was agreed further that the Secretariat of ICSID would render administrative services in relation to the arbitral proceedings similar to those rendered in arbitrations under the ICSID Additional Facility Rules.

12. Order No. 1 (by Consent) was issued by the Arbitral Tribunal on 27 June 2003, in which the sequence of the proceedings and a number of procedural matters were set out.
13. On 29 May 2003, Thunderbird submitted a Request for Production of Documents; Mexico filed objections to said request on 27 June 2003. By Order No. 2 dated 31 July 2003, the Tribunal ruled on the Request for Production of Documents and offered Thunderbird the possibility to submit timely a renewed request that comported with Order No. 2.
14. On 27 June 2003, Thunderbird filed a Motion to Obtain an Interim Measure under Article 1134 of the NAFTA. Mexico filed observations on Thunderbird's motion on 17 July 2003. A telephone conference was held between the Tribunal and the Parties on 15 August 2003 to discuss Thunderbird's motion. During the telephone conference, a number of practical aspects relating to Thunderbird's motion were agreed, and in particular that the Parties would carry out a joint visit of the sites. The joint visit took place on 5-7 November 2003. By letter of 26 November 2003, the Tribunal accordingly informed the Parties that it considered Thunderbird's motion to have become moot.
15. On 15 August 2003, Thunderbird filed a Particularized Statement of Claim.
16. On 27 August 2003, Thunderbird filed a Supplemental Request for Production of Documents, pursuant to Order No. 2; Mexico filed observations in response on 15 October 2003. By letter of 26 November 2003, the Tribunal informed the Parties that, in the absence of any reaction from Thunderbird, it inferred that the matter required no further action from the Tribunal.
17. On 29 August 2003, Mexico filed a Supplementary Request for Production of Documents; Thunderbird responded thereto on 22 September 2003. Subsequent correspondence was exchanged between the Parties. On 11 December 2003, the Tribunal ruled on Mexico's Supplementary Request (*see* Order No. 3).
18. On 18 December 2003, Mexico filed an "*Escrito de Contestación*" (Statement of Defence), including "*Excepciones de Incompetencia y Admisibilidad* [Exceptions of Jurisdiction and Admissibility]."
19. On 22 December 2003, Thunderbird filed a Submission on Whether to Bifurcate the Proceedings.

20. Pursuant to Order No. 4 dated 24 December 2003, the Tribunal ruled that the Preliminary Question was joined to the merits and it invited the Parties to address the Preliminary Question in their forthcoming submissions.
21. On 9 February 2004, Thunderbird filed a Statement of Reply.
22. On 24 February 2004, Mexico submitted a further Request for Production of Documents. Thunderbird filed objections thereto on 3 March 2004. The Tribunal ruled on Mexico's Request in Order No. 5 dated 12 March 2004.
23. On 7 April 2004, Mexico filed a Statement of Rejoinder.
24. On 9 April 2004, Thunderbird filed a Motion to Strike the Witness Statement of Professor Nelson Rose (submitted by Mexico); Mexico objected thereto on 14 April 2004. Thunderbird's Motion to Strike was denied pursuant to Order No. 6 dated 19 April 2004.
25. On 20 April 2004, a pre-hearing telephone conference was held between the Parties and the President of the Tribunal to discuss procedural matters relating to the Hearing; those matters were recorded in Order No. 7 dated 22 April 2004 (which was further supplemented by Order No. 8 dated 25 June 2004).
26. On 26 through 29 April 2004, a hearing for oral argument and witness testimony took place at the offices of ICSID, Washington D.C. (the "Hearing"). For Thunderbird appeared: Mr. James D. Crosby, Professor Todd Weiler, and Mr. Carlos Gomez. For Mexico appeared: Mr. Hugo Perezcano Diaz, Ms. Alejandra Treviño and Mr. Luis Marin of Secretaria de Economía; Mr. Stephan E. Becker, Mr. Sanjay Mullik, Ms. Suzanne Wilkinson and Ms. Zuraya Tapia Alfaro of Pillsbury Winthrop Shaw Pittman LLP; and Mr. Christopher J. Thomas and Mr. J. Cameron Mowatt of Thomas & Partners.
27. At the Hearing, testimony was heard from Mr. Jorge Montaña; Mr. Albert Atallah; Mr. Jack Mitchell; Mr. Peter Watson; Mr. Kevin McDonald; Mr. Luis Ruiz de Velasco; Mr. Steven M. Rittvo; and Mr. Carlos Gomez for Thunderbird. Testimony was heard from Professor I. Nelson Rose; Mr. Alberto Alcántara Martínez; and Mr. Luis Martínez for Mexico.

28. The Government of Canada was represented at the Hearing by Mr. Roland Legault. The Government of the United States of America was represented at the Hearing by Mr. Mark S. McNeill.
29. During the Hearing, the Tribunal circulated a draft tentative list of issues, which was subsequently revised pursuant to the Parties' comments on the draft. The Parties addressed the list of issues in their Post-Hearing Memorials.
30. On 28 April 2004, the Parties filed a *Dramatis Personae*.
31. On 21 May 2004, the Governments of the United States of America and Canada each filed a Submission pursuant to Article 1128 of the NAFTA.
32. On 2 August 2004, the Parties filed Post-Hearing Briefs.
33. On 3 August 2004, the Parties filed a jointly prepared chronology of events.
34. By letter of 3 August 2004, Thunderbird applied to the Tribunal to consider and admit new evidence regarding a complaint filed on 30 November 2001 with the Office of Internal Control of the Secretary of State of Mexico, and the latter's response thereto on 20 July 2004. By letter of 6 August 2004, Mexico objected to Thunderbird's request. By letter of 10 August 2004, Thunderbird applied to the Tribunal to consider and admit new evidence regarding the Bella Vista Entertainment Centre in Monterrey and the Reflejos facilities in Rio Bravo and Reynosa. By letter of 13 August 2004, further to its letter of 3 August 2004, Thunderbird requested the Tribunal to admit into evidence a copy of the Office of Internal Control file pertaining to the complaint. By letter of 17 August 2004, Mexico objected to the requests made by Thunderbird in its letters of 3, 10, and 13 August 2004.
35. Mexico filed a cost submission on 12 August 2004. Thunderbird filed a cost submission on 26 August 2004.
36. Pursuant to Order No. 9 dated 13 September 2004, the evidence submitted by Thunderbird in its letters of 3, 10, and 13 August 2004 was admitted into the record, without prejudice to the relevance, materiality and weight of the evidence in question.

37. On 22 October 2004, Mexico filed further observations regarding the new evidence submitted by Thunderbird. On 5 November 2004, Thunderbird filed reply observations.
38. On 19 November 2004, Mexico submitted a “Dúplica al escrito de réplica de la demandante”; On 22 November 2004, Thunderbird filed a Motion to strike Mexico’s submission. Pursuant to Order No. 10 dated 30 November 2004, Thunderbird’s motion to strike was denied and Thunderbird was afforded the possibility to submit a response to the “Dúplica”; said response was filed by Thunderbird on 8 December 2004.
39. The Tribunal deliberated on various occasions before issuing the Award.
40. In this Award, the Tribunal shall use the following method of citation:
- “Notice of Intent” refers to Thunderbird’s 21 March 2002 Notice of Intent to Submit a Claim to Arbitration;
  - “Notice of Arbitration” refers to Thunderbird’s 1 August 2002 Notice of Arbitration and Statement of Claim;
  - “PSoC” refers to Thunderbird’s 15 August 2003 Particularized Statement of Claim;
  - “SoD” refers to Mexico’s 18 December 2003 Statement of Defence;
  - “SoR” refers to Thunderbird’s 9 February 2004 Statement of Reply;
  - “SoRej” refers to Mexico’s 7 April 2004 Statement of Rejoinder;
  - “Tr.” refers to the Transcript made of the 26-29 April 2004 Hearing;
  - “C-PHB” and “R-PHB” refer to the Post-Hearing Briefs filed by Thunderbird and Mexico on 2 August 2004.

### **III. SUMMARY OF FACTS**

41. Thunderbird is engaged in the business of operating gaming facilities.

42. In the period late 1999 to early 2000, according to Thunderbird, Mr. Jack Mitchell, president and CEO of Thunderbird, with the assistance of Mr. Peter Watson, an American attorney, initiated investigations concerning potential “skill machine” opportunities in Mexico. Meetings were held with Messrs. Doug Oien and Ivy Ong (of A-1 Financial Ltd), both involved in gaming activities, and with Messrs. Julio Aspe and Oscar Arroyo, two Mexican attorneys who had allegedly represented a Mexican national, Mr. Jose Guardia, with respect to his gaming operations in Mexico.
43. In the period April through June 2000, according to Thunderbird, Mr. Luis Ruiz de Velasco of Baker & McKenzie, Mexican counsel of Thunderbird, met with Messrs. Aspe and Arroyo to discuss procedures utilized by Mr. Guardia to defend his gaming operations against actions by the Mexican government, such as “*amparo*” proceedings (temporary injunctive relief), but concluded that such procedures would not provide Thunderbird with the certainty necessary to proceed with its proposed operations in Mexico.
44. On 5 April 2000, Entertainmens de México S.A. de C.V. (“EDM”) was formed by Messrs. Juan Jose Menendez Tlacatelpa and Alejandro Rodriguez Velazquez.
45. On 1 May 2000, EDM entered into a lease for a location in Matamoros (which was revised and extended for 5 years on 20 July 2000).
46. On 26 May 2000, Thunderbird and Messrs. Oien and Ong entered into a “Letter of Intent” regarding the operation of gaming facilities in Mexico.
47. On 22 June 2000, Juegos de México Inc. (“JDMI”) and A-1 Financial Ltd. entered into a “Revenue Share and Consulting Agreement” regarding the operation of gaming facilities in Mexico.
48. In July 2000, according to Thunderbird, following contacts between Messrs. Aspe and Arroyo and the Mexican government, Thunderbird decided to request an official opinion concerning the legality of its proposed gaming operations and if the response were favourable, Thunderbird would proceed with the opening and operation of its “skill machine” facilities in Mexico.
49. On 31 July 2000, EDM imported 50 Bestco Model MTL19U-8L video gaming machines.



50. On 3 August 2000, EDM presented a written request to the Director General de Gobierno de la *Secretaría de Gobernación* (“SEGOB”) concerning its proposed gaming operations in Mexico (the “*Solicitud*”). The full text of the *Solicitud* (English Translation submitted by Thunderbird) provides as follows (numbering between square brackets added):

JÚAN JOSÉ MENÉNDEZ TLACATELPA, legal representative of ENTERTAINMENS DE MÉXICO, S.A DE C.V. which accredits his personality by a certified copy of a notarized document attached hereby, and who has as conventional address, for receiving and hearing any type of communication and documents, Plaza Inverlat piso 12, Blvd. M. Avila Camacho n/ 1, C.P. 1 1009, Mexico D.F., authorizes, for this purpose, Mr. Luis Ruiz de Velasco y P. and with all respects I appear before you to say:

By the means of these writings, I come to request from you that this *Dirección General* give an opinion about the activities that the party I represent is carrying out and which consist in the commercial exploitation of video game machines for games of skills and ability in accordance with the following:

1. - Entertainmens de México, S.A. de C.V., is a legal entity incorporated in accordance with the Laws of the Republic of Mexico with the public deed 38,765, which was issued and granted by the Public Notary Number 53, Mr. Rodrigo Orozco Perez, in Mexico D.F. as in proven by the attached notarial affidavit; and which is also registered in the Federal Registry of Taxpayers under the symbol EME-000405 -LQ7.

2. - The entity which I represent opened a business, at Av. de las Rosas N° 70-A, Colonia Jardin in the city of Matamoros, Tamaulipas, under the commercial name “La Mina de Oro”, which operates video game machines for games of skills and ability, and complies with all Municipal requirements.

3. - The video game machines for games of skills and ability, which the entity I represent commercially exploits, are devices for recreation which have been designed for the enjoyment and

entertainment of its users. In these games, chance and wagering or betting is not involved, but the skills and abilities of the user who has to align different symbols on the machine screen by touching the screen or pushing buttons in order to stop the wanted symbol from several other symbols which spin in a sequential manner in each of the lanes or squares of each video game. The user has to align symbols in an optimum combination to receive a ticket with points which can be traded for goods or services; as this is already done at different locations in the country.

4.- The video game machines for games of skills and ability which we operate, at this present time at the place indicated above on this writings, are trademark Bestco, model MTL19U-8L and S.C.I. model 17"UR; and the entity I represent is trying to place about 2,000 (two thousand) more machines at other locations in the Republic of Mexico and these machines are of the same identical mechanical nature and functioning as those described in point 3, above.

[5] For all I have declared above, I come to this *Dirección General* requesting your opinion about the commercial activities which hereby I have detailed, and, therefore, you can express your opinion about the video game machines for games of skills and ability, which we have referred hereby, in order to determine if these games are regulated by the *Ley Federal de Juegos y Sorteos*.

[6] We are requesting an opinion from this *Dirección General* so the entity I represent has the certainty that the commercial exploitation of video game machines for games of skills and ability is legal; after an analysis of the nature of our machines, and the legal dispositions, we have concluded that our machines are not bound by *Ley Federal de Juegos y Sorteos* and, therefore, are not regulated by *Secretaría de Gobernación* or any other federal authority since the activity which this company is engaged in is not found within the faculties foreseen in Article 73, of Constitution General de la República and which in its Fraction X clearly indicates that the Congress of the Union has exclusive authority to legislate, in the whole of the Republic, about games with bets, wagers and

drawings, and that the Executive Federal has the authority to regulate these activities; but in entertainment where skills and ability is involved, it is logical that these are not under federal authority since *La Constitución General de la República* doesn't indicate that the Congress of the Union can exclusively legislate in such matters. Consequently, the authority to regulate this type of entertainment is not granted exclusively to the Federation, and, therefore, this is excluded from *la Ley Federal de Juegos y Sorteos*.

[7] The nature of video game machines for games of skills and ability is not games of chance or games with bets, wagers or drawings, since, in the operation of these machines, the player seeks entertainment and is playing with our machines assuming an active position where his intelligence, his willpower, his experience and his skills to optimally answer to specific stimulus with the object of finding a combination, effect or boast on the machine, intervene; which can only be possible with ability, experience and control over the machine, and all of this is for the purpose of entertainment and enjoyment, and at the time, the player can receive points that he can trade for a prize as a reward for the skills achieved and in no way as the result of chance.

[8] For this, it is clear to us, that is the skills and ability of the person who produces the effect over the videogame machine, and it is not the chance, the possibility, the fortune, or bet since the determinant to get results is the skills and ability of players; something very different from games of bets and wagers where there is a previous pact or covenant between the company and the user and, therefore, there is an agreement to handle an amount of money or any other thing, and all of this depends on a chance, on the unforeseen, or is not subject to the willpower or control of the user.

[9] For that declared above, we have concluded that our operation is not of the type prohibited by *la Ley Federal de Juegos y Sorteos* since our video game machines do not use chance, bets or wagers, and these video games are only for the purpose of entertainment in which the users can obtain prizes for their skills and abilities, and I'm

requesting from this *Dirección General* your opinion about this.

51. On 4 August 2000, EDM bought 30 SCI model 17" U R "*máquinas de video para juegos de habilidad y destreza,*" which were imported on 14 August 2000.
52. On 10/11 August 2000, JDMI acquired all EDM shares from Messrs. Tlalcaltelipa and Velasquez. Mr. Mitchell was designated president of EDM's board of directors.
53. On 10 August 2000, EDM filed an "Aviso de Apertura," whereby it gave notice to local authorities of its intended operations in its Matamoros facility, called "La Mina de Oro."
54. According to a draft letter dated 10 August 2000, Mr. Watson wrote to Messrs. Aspe and Arroyo to confirm payment of a "success fee" of US\$300,000 upon delivery of a letter from SEGOB "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." Thunderbird confirmed payment of US\$300,000 in a signed letter dated 15 August 2000 to Messrs. Aspe and Arroyo.
55. By letter dated 15 August 2000, SEGOB issued a formal response to Thunderbird's *Solicitud* (the "*Oficio*"). The *Oficio* was signed by Rafael de Antuñano Sandoval, *Director de Juegos y Sorteos*, in the name and on behalf of, Mr. Sergio Orozco Aceves, Director General of Government of SEGOB. The *Oficio* was copied to Messrs. Roberto Pedro Martinez Ortiz, Director General of Legal Affairs of SEGOB, and Sergio Orozco Aceves, Director General of Government of SEGOB. The full text of the *Oficio* (English translation provided by Thunderbird) provides as follows (numbering between square brackets added):

[1] Regarding your letter dated August 3, 2000, received on August 8, 2000 by the Directorate of Games and Sweepstakes, entity that depends from this Directorate, whereby you request this entity to issue a response regarding your representative's exploitation of machines that operate under the concept of ability and skilfulness of its users, please be advised as follows:

[2] As you may be aware, the Federal Law of Games and

Sweepstakes, establishes with precision diverse dispositions that prohibit gambling and luck related games within the Mexican territory. Article I of such law establishes that "... - All gambling and luck related games are prohibited within the Mexican territory, under the disposition of this law."

[3] Likewise, Article 3 of such law establishes that, "The federal executive branch, by means of the Ministry of State, shall supervise the regulation, authorization, control and vigilance of all games when such games contact gambling of any kind; as well as the sweepstakes, with the exception of the National Lottery, which shall be governed by its own law."

[4] In the same light, Article 4 of such law establishes that "in order to establish or operate any open or closed place, in which gambling games or sweepstakes take place, the Ministry of State shall authorize such establishments or operations, specifying the corresponding requirements and conditions to be fulfilled in every case."

[5] According to the above mentioned, the provisions established under the Federal Law of Games and Sweepstakes are enforceable legal dispositions that specifically prohibit gambling and luck related games within the Mexican territory; notwithstanding the above mentioned, according to your statement, the machines that your representative operates are recreational video game devices for purposes of enjoyment and entertainment of its users, with the possibility of obtaining a prize, without the intervention of luck or gambling, but rather the user's ability and skilfulness.

[6] In this light, it is important to clarify that, if the machines that your representative exploits operate in the form and conditions stated by you, this governmental entity is not able to prohibit its use, in the understanding that the use of machines known as "coins-swallowers", "token-swallowers" or "slot machines", in which the principal factor of the operation is luck or gambling and not the user's ability of skilfulness as you stated, could constitute any of the hypothesis described under the Federal Law of Games and Sweepstakes, with the

corresponding legal consequences that may be derived therefrom, under article 8 of such law.

[7] In that view, and based on articles 27, section XXI of the Organic Law of the Federal Government; 1, 2, 3, 4, 5, 7, 8 and other articles related and applicable to the Federal Law of Games and Sweepstakes; as well as articles 8 and 14, Section XVII of the Interior Regulations of the Ministry of State, thus Directorate, in accordance with the faculties previously conferred for such effect; warns you that in the machines that your representative operates there shall be no intervention of luck or gambling; warning that will not be in effect if the machines to be operated are video game devices that operate under the concept of ability and skilfulness.

[8] Please be advised that, even though the machines of your representative operate under the concept of the user's ability and skilfulness, it is necessary that the obligations and requirements set by the laws and regulations of each state and/or municipality be met.

56. On 16 August 2000, Thunderbird Greely, Inc., wired US\$300,000 to an entity called "Consultoria Internacional Casa de Cambio, S.A. de C.V.," a Mexican Currency Exchange entity, for further credit to Rafael Ramos Velasco.
57. On 17 August 2000, Thunderbird announced that it had entered into an agreement with JDMI to operate a business of "*máquinas de destreza*" of games and video in Matamoros.
58. On 18 August 2000, according to Thunderbird, EDM-Matamoros opened "*La Mina de Oro*."
59. On 25 August 2000, Mr. Ruiz de Velasco of Baker & McKenzie addressed a legal opinion to Mr. Mitchell of Thunderbird with respect to the 15 August 2000 *Oficio*, which provides as follows:

As requested, we hereby give you our opinion with respect to the official letter dated August 15, 2000, (the "Official Letter") issued by the Mexican Ministry of Interior ("*Secretaria de Gobernación*") in favour of Entertainmens de México, S.A. de C.V. ("EDM"), and which refers to the operation in Mexico of video game skill machines. Copy if

the Official Letter and the English translation thereof is attached hereto.

Based on the principal terms of the Official Letter, the Ministry of Interior states that it does not have any jurisdiction over the operation of said machines, since in accordance with the representations made by EDM in its application, the video games skill machines to be operated by EDM do not fall into the classification of “slot machines”, which are forbidden in Mexico pursuant to the applicable laws, in view of the fact that they are considered to be gaming and/or betting machines.

Furthermore, under the Official Letter the Ministry of Interior emphasizes that EDM can operate the video games skill machines as long as they do not become, in any manner whatsoever, as gaming or betting machines; provided; however, that EDM complies with the states and/or municipal laws or regulations in Mexico.

Based upon the foregoing, we are of the opinion that EDM is allowed to operate in Mexico the video game skill machines as long as EDM complies with the administrative requirements set forth by the state or municipal laws and regulations in Mexico.

Evenmore, in the event the Ministry of Interior intends to close down EDM’s operations, EDM will be able to appeal; in the understanding, that EDM must comply at all times with each and everyone of the requirements set forth by the competent authorities where the machines are operating.

Should you have any questions, please do not hesitate to contact us.

60. In October 2000, Thunderbird formed Entertainmens de Mexico-Monterrey S. De R.L. de C.V. (“EDM-Monterrey”). Thunderbird’s intended Monterrey gaming facility never opened.
61. In November 2000, JDMI and Thunderbird Brazil formed Entertainmens de Mexico Laredo S. de R. L. de C.V. (“EDM-Laredo”).

62. In December 2000, Mr. Vicente Fox's administration came into office in Mexico. Mr. Jose Guadalupe Vargas Barrera was appointed the new "*Director de Juegos y Sorteos*."
63. On 21 December 2000, Mr. Albert Atallah wrote to Messrs. Oien and Ong "to confirm that A-1 Financial and its principals are no longer authorized to represent International Thunderbird Gaming Corporation, its affiliates and subsidiaries (including Entertainmens de Mexico) with respect to the Mexico Skill Game Operation" and stating, "Thunderbird does not believe that A-1 Financial met its obligations contemplated by the original agreement."
64. On 21 January 2001, EDM-Laredo opened a gaming facility in Nuevo Laredo.
65. On 25 February 2001, SEGOB proceeded to an official closure of the Nuevo Laredo facility.
66. On 16 March 2001, because of administrative irregularities affecting SEGOB's order for official closure of Nuevo Laredo, SEGOB lifted the seals of the Nuevo Laredo facility. Thunderbird reopened the facility on 20 March 2001.
67. On 12 April 2001, Thunderbird, Messrs. Oien, Ong and A-1 Financial entered into a Termination Settlement and Release Agreement.
68. On 5 June 2001, JDMI & Thunderbird Brazil formed Entertainmens de Mexico-Reynosa S. de R. L. de C.V. ("EDM-Reynosa").
69. On 20 June 2001, Thunderbird formed Entertainmens de Mexico-Puebla S. de R.L. de C.V. ("EDM-Puebla"). Thunderbird's intended Puebla gaming facility never opened.
70. On 10 July 2001, an administrative hearing was held at the offices of the *Director de Juegos y Sorteos* in Mexico City (the "Administrative Hearing"). Thunderbird was represented at the Administrative Hearing by Messrs. Watson, Jorge Montaña, Mauricio Girault, Carlos Gomez and Mr. Ruiz de Velasco. Thunderbird submitted documentary evidence and witness testimony, and Mr. Kevin McDonald of SCI appeared and provided a briefcase-sized machine for demonstration. On SEGOB's side, Mr. Guadalupe Vargas and Mr. Alcántara were present.



71. On 13 July 2001, Thunderbird formed Entertainments de Mexico-Juarez S. de R.L. de C.V. ("EDM-Juarez"). Thunderbird's intended Juarez gaming facility never opened.
72. In August 2001, EDM-Reynosa opened a gaming facility in Nuevo Laredo.
73. On 10 October 2001, SEGOB issued a "*Resolución Administrativa*," declaring that the EDM machines were prohibited gambling equipment under the *Ley Federal de Juegos y Sorteos* and ordering the official closure of the EDM-Matamoros and EDM-Laredo facilities (the "Administrative Order"). The Administrative Order was signed by Mr. Humberto Aguilar Coronado, Director General of Government of SEGOB.
74. On 11 October 2001, SEGOB proceeded to an official closure of the EDM-Matamoros and EDM-Laredo facilities.
75. On 15 October 2001, EDM filed a "*juicio de amparo*" before the "Juez de Distrito en Turno" seeking injunctive relief with respect to the official closure of the EDM-Laredo facility, which was denied by the court on 18 October 2001.
76. On 23 October 2001, EDM filed a "*juicio de amparo*" before the Mexican District Court seeking injunctive relief with respect to the official closure of the EDM-Matamoros facility, which was denied on 21 January 2002.
77. On 5 December 2001, EDM filed a "*juicio de nulidad*" for the annulment of the Administrative Order before the "*Tribunal Federal de Justicia Fiscal y Administrativa*."
78. On 21 January 2002, SEGOB proceeded to the official closure of the Reynosa facility. EDM-Reynosa filed a "*juicio de amparo*" for temporary injunctive relief.
79. On 21 March 2002, Thunderbird initiated the present arbitration proceedings.
80. On 10 May 2002, EDM's "*juicio de nulidad*" was denied by the *Tribunal Federal de Justicia Fiscal y Administrativa*.

81. On 30 May 2002, a “*Tribunal Colegiado*” denied EDM’s “*amparo*” with respect to the official closure of the EDM-Laredo facility. EDM-Laredo was subsequently closed down.
82. On 10 June 2002, the judge ratified the decision denying EDM’s “*amparo*” for Matamoros.
83. On 17 July 2002, EDM discontinued the “*juicio de amparo*” with respect to the official closure of the EDM-Reynosa facility.
84. On 21 August 2002, EDM discontinued the “*juicio de amparo*” with respect to the official closure of the EDM-Matamoros facility.

#### **IV. ISSUES TO BE DETERMINED BY THE ARBITRAL TRIBUNAL**

85. In resolving this dispute, the Tribunal shall determine the main issues by reference to the draft Tentative List of Issues referred to in ¶29 above:

##### **A. General**

1. What is the applicable law for resolving each of the Issues mentioned below?
2. Which of the Parties has the burden of proof for each of the Issues mentioned below?

##### **B. Jurisdiction and/or admissibility**

3. Does Thunderbird “own or control directly or indirectly” at the relevant times any of the companies listed below (the “EDM Companies”) that would entitle it to submit to arbitration a claim on behalf of them under Article 1117 NAFTA? If not, what are the consequences thereof?

(a) Entertainmens de Mexico S. de R. L. de C.V.  
 (“EDM-Matamoros”)

(b) Entertainmens de Mexico Laredo S. de R. L. de  
 C.V. (“EDM-Laredo”)

(c) Entertainmens de Mexico Reynosa S. de R. L. de  
 C.V. (“EDM-Reynosa”)

(d) Entertainmens de Mexico Puebla S. de R. L. de

C.V. ("EDM-Puebla")

(e) Entertainmens de Mexico Monterrey S. de R. L. de C.V. ("EDM-Monterrey")

(f) Entertainmens de Mexico Juarez S. de R. L. de C.V. ("EDM-Juarez").

4. Does the filing by Thunderbird of waivers on behalf of EDM-Puebla, EDM-Monterrey and EDM-Juarez on 15 August 2003 comply with the requirements of Article 1121 NAFTA? If not, what are the consequences thereof?

Subject to the answers to Issues 3 and 4, the Issues regarding the merits are:

**C. Merits – General**

5. What is the role, if any, of Chapter Eleven of the NAFTA in the present case? Specifically:

5.1 Does Chapter Eleven of the NAFTA recognize and protect the right of a Contracting Party to regulate a certain conduct that it considers illegal?

5.2 If so, does the *Ley Federal de Juegos y Sorteos* of 31 December 1947 form part of Mexico's law to regulate a certain conduct that it considers illegal, and what are the consequences thereof?

5.3 What is the role and jurisdiction of the Tribunal in relation to the Mexican judicial system regarding the subject matter of Thunderbird's claims in the present case?

5.4 If and to what extent do administrative proceedings of SEGOB form part of Issue 5.3?

6. Is the functionality of the machines, technically or otherwise, operated by the EDM Companies relevant in the present case?

6.1 If so, is that question to be determined under the *Ley*

*Federal de Juegos y Sorteos* of 31 December 1947 and/or on some other basis?

6.2 If so, by whom should that question be determined? In particular, is the Tribunal to defer to the determination by SEGOB? And if so, was that opinion relevant for the dispute?

(a) before 15 August 2000;

(b) between 15 August 2000 and 10 October 2001;  
and/or

(c) after 10 October 2001?

6.3 Assuming that the question is to be determined by the Tribunal, what are the relevant criteria for such a determination?

Specifically:

(a) Were the machines in question skill machines or slot machines?

(b) Is there a “uniqueness for Mexico,” as is contended by Thunderbird, and if so, is it relevant for such determination?

6.4 Assuming that the question is to be determined by the Tribunal and in light of the answer to Issue 6.3, did the machines in question meet the applicable criteria?

7. Was a legitimate expectation created by SEGOB’s letter of 15 August 2000 to the effect that it brings Thunderbird’s claims in the present case under Article 1102, 1105 and/or 1110 NAFTA? Specifically:

7.1 If and to what extent is a legitimate expectation legally relevant under Article 1102, 1105 and/or 1110 NAFTA?

7.2 What are the standards for a legitimate expectation in that respect?

7.3 What is the meaning and legal status of the SEGOB letter of 15 August 2000, and what is the relevance thereof?

7.4 Did EDM fail to disclose relevant facts, in particular in its *solicitud* of 3 August 2000, as it is alleged by Respondent, and if so, what is the relevance thereof?

7.5 What are the consequences of the answers to the foregoing Issues 7.1 -7.4?

**D. Merits – Articles 1102, 1105 and 1110 NAFTA**

8. Did Respondent breach the “National Treatment” standard under Article 1102 NAFTA?

8.1 Which of the following tests as postulated by the disputing parties is the test to be applied under Article 1102 NAFTA?

Specifically:

(a) As it is contended by Thunderbird, is the Tribunal to apply a three-part test, being:

(i) identification of the relevant subjects of the national treatment comparison (the basis being the likeliness of comparators);

(ii) consideration of the relative treatment received by each comparator (the basis being the best level of treatment available to any other domestic investor operating in like circumstances); and

(iii) consideration whether factors exist which could justify any difference in treatment so found (to be construed narrowly and the burden of proof shifting to Respondent)?

(b) Or, as it is contended by Respondent, is the Tribunal to apply Article 1102 in the sense that it is directed only to nationality-based discrimination and proscribes only demonstrable and significant indications of bias and prejudice on the basis on nationality, which are to be proven by Thunderbird, “the like circumstances” of Article 1102 requiring an adequate comparison on the basis of the facts, thereby taking into account, in

particular, compliance with local law relating to illegal conduct?

8.2 On the basis of the test to be applied, did Respondent actually breach Article 1102? Specifically, and to the extent relevant under the test to be applied:

(a) Does the fact that *Guardia* and *de la Torre* are allegedly operating machines essentially identical to the machines operated by the closed EDM Companies mean that Respondent has not accorded to the EDM Companies treatment no less favourable than that it accords, in the like circumstances, to its own investors under Article 1102?

(b) Are other “skill game” operators that have resorted to local remedies and that have obtained injunctive relief pending a final disposition of the legality of *Gobernación’s* closure order against them ‘in like circumstances’ to the EDM companies, as contended by Thunderbird?

(c) Did SEGOB take action against facilities of the kind of the EDM Companies, including those owned by *Guardia* and *de la Torre*, as it is alleged by Respondent, and if so, what is the relevance thereof?

(d) What is the relevance, if any, of the fact that EDM abandoned judicial redress in Mexico against the closure of its facilities?

9. Did Respondent breach the “Minimum Standard of Treatment” under Article 1105 NAFTA?

9.1 What does the “Minimum Standard of Treatment” under Article 1105 NAFTA mean and how is it to be applied by a NAFTA arbitral tribunal?

9.2 Subject to the answer to Issue 7 and 9.1 above, was there a detrimental reliance by Thunderbird on SEGOB’s letter of 15 August 2000, also in light of Thunderbird’s *solicitud* of 3 August 2000, and if so, did it constitute a breach of Article 1105 NAFTA?

9.3 Subject to the answer to Issue 9.1 above, was there a failure to provide due process, constituting an administrative denial of justice, in the proceedings relating to the ruling of 10 October 2001, and if so, did it constitute a breach of Article 1105 NAFTA?

9.4 Subject to the answer to Issue 9.1 above, was there manifest arbitrariness in administration, constituting proof of an abuse of right, in the proceedings before SEGOB, and if so, did it constitute a breach of Article 1105 NAFTA?

10. Did Respondent engage in an expropriation in violation of Article 1110 NAFTA?

10.1 Does the fact that Thunderbird did not submit to arbitration a claim on its own behalf under Article 1116 NAFTA, but rather on behalf of the EDM Companies under Article 1117 NAFTA, preclude it from obtaining compensation under Article 1110?

(a) In this connection, should, as it is requested by Thunderbird at pages 69-70 of its SoR, leave be granted to Thunderbird to amend its PSoC to include, in the further alternative, a claim for 100% of the damages caused to the businesses of each EDM Company as a result of Respondent's alleged breach of Article 1110, using Article 1116 NAFTA?

(b) Does a breach of Article 1110 NAFTA also constitute a breach of Article 1105 NAFTA, as it is contended by Thunderbird?

(i) In this connection, what is the relevance, if any, of Section B.3 of the Notes of Interpretation of Certain Chapter 11 Provisions by the NAFTA Free Trade Commission of 31 July 2001 ("A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)")?

(c) Does Article 1110 NAFTA impose an obligation of Respondent vis-à-vis the EDM Companies?

10.2 Subject to the answer to Issue 10.1 above, and having also regard to Issue 10.3 below, is it relevant to determine which is or are the expropriation standard or standards to be applied under Article 1110 NAFTA? If so, which is that standard or are those standards?

10.3 Subject to the answers to Issues 7, 10.1 and 10.2 above, did any rights legitimately acquired by the EDM Companies exist in the businesses conducted by them? Specifically:

(a) Did the EDM Companies operate on the basis of a business undertaking that is unlawful under Mexican law?

(b) Did the EDM Companies operate on the basis of a legitimate expectation, being similar to the detrimental reliance as alleged by Thunderbird under Article 1105?

(c) Assuming that the answers to Issues (a) and (b) of the present Issue 10 are in the affirmative, do the actions of SEGOB amount to expropriation within the meaning of Article 1110 NAFTA?

#### **E. Merits – Damage**

11. If the answer to Issues 8 and/or 9 and/or 10 above is in the affirmative, is Thunderbird entitled to damages, and if so for what amount?

11.1 What are the compensation principles to be applied to damages in the present case?

(a) Are these principles different with respect to breaches of Articles 1102, 1105 and 1110 NAFTA, and if so, what are the differences?

(b) Does a distinction arise from whether the act complained of is lawful or unlawful?

(c) At which date are the damages to be determined?



11.2 Is there a sufficient causal link between the breach and the damages claimed by Thunderbird?

11.3 Are the damages claimed by Thunderbird a reasonably foreseeable consequence of the act that constituted the breach by Respondent?

11.4 Subject to the answers to Issues 11.1 – 11.3 above, should the damages be valued on the basis of a fair market value of the EDM Companies calculated for anticipated future profits by a discounted cash flow (“DCF”) method, as contended by Thunderbird?

11.5 To the extent that it is not addressed under Issues 11.1 - 11.4 above, has Thunderbird proven the damages as claimed by it?

11.6 Subject to the answers to the foregoing Issues 11.1-11.5, what is the amount of damages?

11.7 As regards interest with respect to the damages:

(a) What is the rate of interest to be applied, and which is the currency to be taken into account in that respect?

(b) Is interest to be compounded?

(c) For which period of time is interest to be applied?

#### **F. Costs**

12. What are the costs of the arbitration and which party shall bear those costs or in which proportion shall those costs be allocated between the parties?

#### **V. ANALYSIS OF ISSUES FOR DECISION**

86. The Tribunal shall now proceed to evaluate the issues *seriatim*. In this regard, the Tribunal has considered all arguments, documents, and testimony that form part of the record in this case, and shall address the contentions made by the Parties to the extent relevant to the Tribunal’s decisions. The Tribunal’s decisions are based on the entire record in this case.

**A. General****Issue 1. What is the applicable law for resolving each of the Issues mentioned below?**(i) Thunderbird's position

87. Thunderbird contends that the applicable law for resolving all issues presented in this arbitration consists of the claimed provisions of Section A of Chapter Eleven of the NAFTA and the applicable rules of international law. Further, according to Thunderbird, the Chapter Eleven of the NAFTA provisions should be interpreted in accordance with the customary international law rules of treaty interpretation and in light of the objectives of the NAFTA and its governing principles specified in Article 102.

(ii) Mexico's position

88. Mexico refers to Article 1131(1) of the NAFTA and contends that the Tribunal must decide the issues in dispute by reference to the relevant provisions of Chapter Eleven of the NAFTA and the applicable rules of international law. MEXICO adds that the jurisdiction of a NAFTA Tribunal is more limited in contrast with other tribunals such as those constituted under ICSID rules since NAFTA tribunals may not decide a dispute by reference to the internal law of a NAFTA Party.

(iii) The Tribunal's findings

89. Pursuant to Article 1131(1) of the NAFTA (captioned "Governing Law"), the Tribunal shall decide the issues in this arbitration "in accordance with this Agreement and applicable rules of international law."

90. In particular, the Tribunal has regard to the sources of law listed in Article 38(1) of the Statute of the International Court of Justice, which provides as follows:

The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

(a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;

(b) international custom, as evidence of a general practice accepted as law;

(c) the general principles of law recognized by civilized nations;

(d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.

91. The Tribunal shall construe the terms of Chapter Eleven of the NAFTA “in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose” (see Article 31 of the Vienna Convention on the Law of Treaties; see also ¶¶ 125-126 below).

**Issue 2. Which of the Parties has the burden of proof for each of the Issues mentioned below?**

(i) Thunderbird’s position

92. Thunderbird contends that it has the legal “burden of proof” upon its claims under the applicable rules of international law and that, conversely, Mexico has the legal burden of proof upon any affirmative defences raised. According to Thunderbird, the “burden of producing evidence” shifts upon a sufficient evidentiary showing. Thunderbird alleges further that it has made its *prima facie* showing of the NAFTA violations and that Mexico has failed to meet its burden of producing evidence to rebut such showing.

(ii) Mexico’s position

93. Mexico refers to Article 24 of the UNCITRAL Rules and international case law, arguing that a party asserting a fact or a claim is responsible for providing proof of all the elements thereof, and that the burden of proof may shift to the other Party on the basis of *prima facie* evidence.

(iii) The Tribunal’s findings

94. The present arbitration is governed by the UNCITRAL Rules. Article 24(1) of the UNCITRAL Rules provides:

Each party shall have the burden of proving the facts relied on to support his claim or defence.

95. The Tribunal notes that the Parties do not seem to diverge on the principles governing the burden of proof. The Tribunal shall apply the well-established principle that the party alleging a violation of international law giving rise to international responsibility has the burden of proving its assertion<sup>1</sup>. If said Party adduces evidence that *prima facie* supports its allegation, the burden of proof may be shifted to the other Party, if the circumstances so justify.<sup>2</sup>

## **B. Jurisdiction and/or Admissibility**

**Issue 3. Does Thunderbird “own or control directly or indirectly” at the relevant times the EDM Companies that would entitle it to submit to arbitration a claim on behalf of them under Article 1117 of the NAFTA? If not, what are the consequences thereof?**

96. Article 1117 of the NAFTA provides:

1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to

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<sup>1</sup> See Bin Cheng, GENERAL PRINCIPLES OF LAW APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS, at p. 302 *et seq.* (1987)

<sup>2</sup> See in this regard *Feldman v. Mexico*, Interim Decision on Preliminary Jurisdictional Issues, 6 December 2000, ICSID Case No. ARB(AF)/99/1, [http://www.worldbank.org/icsid/cases/feldman\\_mexico\\_interim-en.PDF](http://www.worldbank.org/icsid/cases/feldman_mexico_interim-en.PDF), which quotes *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, 23 May 1997, WT/DS33/AB/R p. 14, in which the Appellate Body of the WTO stated:

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

arbitration under this Section a claim that the other Party has breached an obligation under:

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

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

2. An investor may not make a claim on behalf of an enterprise described in paragraph 1 if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage.

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

4. An investment may not make a claim under this Section.

(i) Mexico's position

97. Mexico objects to the jurisdiction of the Tribunal to hear Thunderbird's claim under Chapter Eleven of the NAFTA. According to Mexico, Thunderbird did not own or control any of the EDM companies that would entitle it to present a claim on behalf of them under Article 1117 of the NAFTA, namely, Thunderbird did not demonstrate that it owned Juegos de Mexico and Thunderbird Brazil; that these companies acquired the EDM companies; or that Juegos de Mexico and Thunderbird Brazil were the owners of the EDM companies.

98. As to control, Mexico maintains that the NAFTA requires that legal control be demonstrated, and that Thunderbird did not have legal control of EDM - Matamoros, EDM-Laredo or EDM-Reynosa. Mexico argues further that Thunderbird has also not demonstrated that it had factual control of the companies in question.

(ii) Thunderbird's position

99. Thunderbird contends that it may properly proceed under Article 1117 of the NAFTA because it "owns or controls" the EDM entities. According to Thunderbird, it directly owned, and still owns, at all relevant times all outstanding shares of EDM-Puebla, EDM-Monterrey, and EDM-Juarez.

100. As to EDM-Matamoros, EDM-Laredo, and EDM-Reynosa, Thunderbird argues that, while it at all relevant times owned, and still owns, significant interests in those EDMs, it has never claimed full ownership thereof. Rather, Thunderbird maintains that it has at all times possessed, and still possesses, control of EDM-Matamoros, EDM-Laredo and EDM-Reynosa, directly or indirectly, at all relevant times, thus enabling Thunderbird to proceed under Article 1117 of the NAFTA. Thunderbird refers to case law of the Iran-US Claims Tribunal and to NAFTA case law (such as *S.D. Myers Inc.*) in support of its proposition that factual control may suffice to bring a NAFTA claim, and argues that it has brought a claim supported by substantial evidence that Thunderbird, as a matter of fact, controlled all of the EDM investments involved in its claim.

(iii) The Tribunal's findings

101. Mexico has objected to the jurisdiction of the Tribunal to hear Thunderbird's claim under Chapter Eleven of the NAFTA, because of an alleged lack of ownership or control by Thunderbird over the EDM Entities for the purposes of Article 1117.

102. Article 1117 of the NAFTA requires that the investor bringing a claim on behalf of an enterprise "own or control" the enterprise. Thunderbird must therefore establish that it owned or controlled the EDM entities. The Tribunal is satisfied that Thunderbird has met the requirements of Article 1117 of the NAFTA, for the following reasons.

103. It is not disputed that Thunderbird owned the majority of the shares of EDM-Puebla, EDM-Monterrey, and EDM-Juarez. None of these entities effectively engaged in operations or business activities in Mexico.

104. On the other hand, Thunderbird had acknowledged that it had only a partial ownership of EDM-Matamoros (36.67%), EDM-Laredo (33.3%), and EDMReynosa (40.1%) (jointly the “Minority EDM Entities”).
105. Therefore, the present discussion turns on whether Thunderbird exercised control over the Minority EDM Entities. The question arises whether “control” must be established in the legal sense, or whether *de facto* control can suffice for the purposes of Chapter Eleven of the NAFTA. According to Mexico, to determine what constitutes “control” of a corporation, the Tribunal must turn to the corporate law of the Party under whose laws the enterprise was incorporated, and Article 1117 of the NAFTA therefore requires that legal control be demonstrated under Mexican corporate law.
106. The Tribunal does not follow Mexico’s proposition that Article 1117 of the NAFTA requires a showing of legal control. The term “control” is not defined in the NAFTA. Interpreted in accordance with its ordinary meaning, control can be exercised in various manners. Therefore, a showing of effective or “*de facto*” control is, in the Tribunal’s view, sufficient for the purposes of Article 1117 of the NAFTA<sup>3</sup>. In the absence of legal control however, the Tribunal is of the opinion that *de facto* control must be established beyond any reasonable doubt.
107. Despite Thunderbird having less than 50% ownership of the Minority EDM Entities, the Tribunal has found sufficient evidence on the record establishing an unquestionable pattern of *de facto* control exercised by Thunderbird over the EDM entities.

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<sup>3</sup> See in this regard the definition of control provided in an “Understanding” with respect to Article 1(6) of the Energy Charter Treaty (which is virtually identical in language to Article 1117 NAFTA):

“For greater clarity as to whether an Investment made in the Area of one Contracting Party is controlled, directly or indirectly, by an Investor of any other Contracting Party, control of an Investment means control in fact, determined after such an examination of the actual circumstances in each situation. In any such examination, all relevant factors should be considered, including the Investor’s (a) financial interest, including equity interest, in the Investment; (b) ability to exercise substantial influence over the management and operation of the Investment; and (c) ability to exercise substantial influence over the selection of members of the board of directors or any other managing body. [...]” (emphasis added).

Thunderbird had the ability to exercise a significant influence on the decision-making of EDM and was, through its actions, officers, resources, and expertise, the consistent driving force behind EDM's business endeavour in Mexico.

108. It is quite common in the international corporate world to control a business activity without owning the majority voting rights in shareholders meetings. Control can also be achieved by the power to effectively decide and implement the key decisions of the business activity of an enterprise and, under certain circumstances, control can be achieved by the existence of one or more factors such as technology, access to supplies, access to markets, access to capital, know how, and authoritative reputation. Ownership and legal control may assure that the owner or legally controlling party has the ultimate right to determine key decisions. However, if in practice a person exercises that position with an expectation to receive an economic return for its efforts and eventually be held responsible for improper decisions, one can conceive the existence of a genuine link yielding the control of the enterprise to that person.
109. In the present case, having regard to the record as a whole, the Tribunal finds that without Thunderbird's key involvement and decision-making during the relevant time frame, i.e., during the planning of the business activities in Mexico, the initial expenditures and capital, the hiring of the machine suppliers, the consultations with SEGOB, and the official closure of the EDM facilities, EDM's business affairs in Mexico could not have been pursued. Namely, the key officers of Thunderbird and the Minority EDM Entities were one and the same (*see* *Dramatis Personae* of 26 April 2004: Mr. Jack Mitchell was President and CEO of Thunderbird and the EDM entities; Mr. Peter Watson, counsel to Thunderbird, was shareholder in Thunderbird and the EDM entities). The initial expenditures, the know-how of the machines, the selection of the suppliers, and the expected return on the investment were provided or determined by Thunderbird. Likewise, legal advice regarding the operation of the EDM machines in Mexico was addressed to Thunderbird (*see* Mr. de Ruiz de Velasco's legal opinion of 25 August 2000 at Exh. R-112).
110. In the Tribunal's view, it is clear from the record that without the consistent and significant initiative, driving force and decision-making of Thunderbird, the investment in Mexico could not have materialized. Accordingly, the Tribunal finds that Thunderbird exercised control over the Minority EDM Entities for the purpose of



Article 1117 of the NAFTA, in a manner sufficient to entitle it to bring a claim on behalf of those entities under said provision.

**Issue 4. Does the filing by Thunderbird of waivers on behalf of EDM-Puebla, EDM-Monterrey and EDM-Juarez on 15 August 2003 comply with the requirements of Article 1121 of the NAFTA? If not, what are the consequences thereof?**

111. Article 1121 of the NAFTA, captioned “Conditions Precedent to Submission of a Claim to Arbitration”, provides:

[...]

2. A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise:

(a) consent to arbitration in accordance with the procedures set out in this Agreement; and expectation to receive an economic return for its efforts and eventually be held responsible for improper decisions, one can conceive the existence of a genuine link yielding the control of the enterprise to that person.

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

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

[...]

(i) Mexico’s position

112. Mexico submits that Thunderbird did not file waivers on behalf of EDM-Puebla, EDM-Monterrey, and EDM-Juarez in accordance with

the requirements under the NAFTA. Specifically, Mexico contends that, pursuant to Article 1121 of the NAFTA, Thunderbird should have presented written waivers of the right to initiate or continue any actions in local courts or other fora at the time of submitting the claim to arbitration, i.e., at the time of presenting the Notice of Arbitration. As a result, Mexico argues, the claims of those three EDM entities are not admissible under the NAFTA.

(ii) Thunderbird's position

113. Thunderbird alleges that it satisfied all the requirements of Articles 1121(2) and (3) of the NAFTA with its delivery on 15 August 2003 (concurrent with the PSoC) of waivers for EDM-Puebla, EDM-Monterrey and EDM-Juarez, which had been inadvertently missing from earlier filings. Thunderbird argues in any event that even if it were assumed that the waiver letters were submitted after delivery of the "claim to arbitration," previous NAFTA tribunals have found that such minor procedural defects cannot be used to defeat an otherwise meritorious claim. Thunderbird adds that none of the EDM entities have commenced actions in breach of the Article 1121 waiver.

(iii) The Tribunal's findings

114. Mexico has argued that with respect to EDM-Puebla, EDM-Monterrey, and EDM-Juarez, Thunderbird failed to submit a claim to arbitration in compliance with the requirements of Article 1121 of the NAFTA.

115. Article 1121 of the NAFTA is concerned with conditions precedent to the submission of a claim to arbitration. One cannot therefore treat lightly the failure by a party to comply with those conditions. The Tribunal finds however that the waivers filed for EDM-Puebla, EDM-Monterrey, and EDM-Juarez were valid within the meaning of Article 1121 of the NAFTA, for the following reasons.

116. Thunderbird submitted a claim to arbitration by means of a Notice of Arbitration dated 1 August 2002 (and received by Mexico on 22 August 2002). Pursuant to Article 1121 of the NAFTA, Thunderbird would have been required to file the appropriate waivers under Article 1121 of the NAFTA at the time of the submission of its claim to arbitration, which was, pursuant to Article 1137(1) of the NAFTA, at the time of receipt by Mexico of the Notice of Arbitration under the UNCITRAL Rules. However, Thunderbird only filed written waivers for EDM-Puebla, EDM-Monterrey, and EDM-Juarez with its

Particularised Statement of Claim of 15 August 2003. The issue at hand is therefore not an actual failure to file waivers for EDM-Puebla, EDM-Monterrey, and EDM-Juarez, but rather the (un-)timeliness of the filings in question.

117. Although Thunderbird failed to submit the relevant waivers with the Notice of Arbitration, Thunderbird did proceed to remedy that failure by filing those waivers with the PSoC. The Tribunal does not wish to disregard the subsequent filing of those waivers, as to reason otherwise would amount, in the Tribunal's view, to an over-formalistic reading of Article 1121 of the NAFTA. The Tribunal considers indeed that the requirement to include the waivers in the submission of the claim is purely formal,<sup>4</sup> and that a failure to meet such requirement cannot suffice to invalidate the submission of a claim if the so-called failure is remedied at a later stage of the proceedings. The Tribunal joins the view of other NAFTA Tribunals that have found that Chapter Eleven provisions should not be construed in an excessively technical manner<sup>5</sup>.
118. In construing Article 1121 of the NAFTA, one must also take into account the rationale and purpose of that article. The consent and waiver requirements set forth in Article 1121 serve a specific purpose, namely to prevent a party from pursuing concurrent domestic and international remedies, which could either give rise to conflicting outcomes (and thus legal uncertainty) or lead to double redress for the same conduct or measure. In the present proceedings, the Tribunal notes that the EDM entities did not initiate or continue any remedies in Mexico while taking part in the present arbitral proceedings. Therefore, the Tribunal considers that Thunderbird has effectively complied with the requirements of Article 1121 of the NAFTA.

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<sup>4</sup> See in this regard the distinction made by the majority of the tribunal in *Waste Management, Inc. v. Mexico*, Arbitral Award, 2 June 2000, ICSID Case No. ARB(AF)98/2, [http://www.worldbank.org/icsid/cases/waste\\_award.pdf](http://www.worldbank.org/icsid/cases/waste_award.pdf), between "formal" and "material" requirements under 1121 of the NAFTA.

<sup>5</sup> See *Mondev International Ltd. v. USA*, Award, 11 October 2002, ICSID Case No. ARB(AF)99/2, <http://www.state.gov/documents/organization/14442.pdf>. "Chapter 11 should not be construed in an excessively technical way, so as to require the commencement of multiple proceedings in order to reach a dispute which is in substance within its scope." (¶44)

**C. Merits – General****Issue 5. What is the role, if any, of Chapter Eleven of the NAFTA in the present case?****(i) Thunderbird’s position**

119. Thunderbird accepts that Article 1114 NAFTA allows governments to label and regulate conduct they choose as being “illegal” for domestic purposes. A NAFTA tribunal may determine, Thunderbird contends, whether the NAFTA party has carried out its regulatory activities in a manner that does not violate its Chapter Eleven obligations. Thunderbird considers that the *Ley Federal de Juegos y Sorteos* of 31 December 1947 constitutes a “measure” under Chapter Eleven of the NAFTA, as do the various forms of enforcement activity arising from it.
120. Thunderbird accepts further that the Tribunal has no role in relation to the Mexican judicial system regarding the subject matter of this case – it does not stand as a domestic court of appeal or review – the Tribunal must simply determine whether Mexico has developed and executed the measures in question in a manner consistent with Mexico’s obligations under Chapter Eleven of the NAFTA. In this regard, Thunderbird characterises the SEGOB administrative proceedings as administrative fact-finding or quasi-judicial proceedings, to be adjudged against the standards of due process and procedural fairness applicable to administrative officials, rather than judicial officials.

**(ii) Mexico’s position**

121. Mexico contends that Chapter Eleven of the NAFTA recognises and protects the right of a Contracting Party to regulate certain conduct that it considers illegal, and that the *Ley Federal de Juegos y Sorteos* forms part of Mexico’s law to regulate such conduct that it considers illegal.
122. With respect to the role and jurisdiction of the Tribunal in relation to the Mexican judicial system regarding the subject matter of Thunderbird’s claims, Mexico argues that the Tribunal may not act as a court of appeal with authority to review the decisions of the domestic Mexican courts. According to Mexico, the Tribunal may only assess whether the conduct of the Mexican administration in enforcing domestic law was compatible with the three NAFTA provisions relied upon by Thunderbird. As to the administrative

proceedings of SEGOB, Mexico points out that they were subject, at all stages, to Mexican judicial review, and that the Tribunal may not review those proceedings in the manner of an appellate court.

(iii) The Tribunal's findings

123. The Parties do not dispute that Chapter Eleven of the NAFTA recognizes in principle the right of a Contracting Party to regulate conduct that it considers illegal.
124. The Tribunal notes that under Mexican law, specifically the *Ley Federal de Juegos y Sorteos* of 31 December 1947, gambling is an illegal activity.
125. The Tribunal's role in this arbitration is not to determine whether the EDM machines were prohibited gambling equipment under the *Ley Federal de Juegos y Sorteos*, as acknowledged by both Parties. It is not the Tribunal's function to act as a court of appeal or review in relation to the Mexican judicial system regarding the subject matter of the present claims, or in relation to the SEGOB administrative proceedings for that matter.
126. Rather, the Tribunal shall examine whether the conduct of Mexico and the measures employed by SEGOB in relation to the EDM entities were consistent with Mexico's obligations under Chapter Eleven of the NAFTA.
127. The role of Chapter Eleven in this case is therefore to measure the conduct of Mexico towards Thunderbird against the international law standards set up by Chapter Eleven of the NAFTA. Mexico has in this context a wide regulatory "space" for regulation; in the regulation of the gambling industry, governments have a particularly wide scope of regulation reflecting national views on public morals. Mexico can permit or prohibit any forms of gambling as far as the NAFTA is concerned. It can change its regulatory policy and it has a wide discretion with respect to how it carries out such policies by regulation and administrative conduct. The international law disciplines of Articles 1102, 1105 and 1110 in particular only assess whether Mexican regulatory and administrative conduct breach these specific disciplines. The perspective is of an international law obligation examining national conduct as a "fact."

**Issue 6. Is the functionality of the machines, technically or otherwise, operated by the EDM Companies relevant in the present case?**

(i) Thunderbird's position

128. Thunderbird contends that the functionality of the machines is relevant in assessing Mexico's justification (or lack thereof) for seizing Thunderbird's investment enterprises; to the issue of detrimental reliance under Article 1105 in that use of similar equipment was already familiar to Mexican officials – prior to 15 August 2000 – due to their use in facilities already being regulated by Mexico (e.g. the Guardia facilities); and for Article 1102 to the extent that similar equipment has been, and remains, in use in other facilities while the EDMs remain closed.
129. Thunderbird contends further that the manner in which the functionality of the machines is relevant in the present case does not involve a determination by the Tribunal as to the legality of the EDM machines under Mexican law.
130. Thunderbird also argues that the determination of SEGOB concerning the functionality of the machines, at any given time, is only relevant to the issue of whether any actions taken on the basis of these determinations violates the relevant NAFTA provisions.
131. According to Thunderbird, the only criteria relevant for the Tribunal to determine the functionality of the machines is the standard set forth in the *Oficio* i.e., whether “the principal factor of the operation is luck or gambling and not the user's ability of skilfulness.” Thunderbird contends that the machines in question met the applicable criteria and were as a matter of fact established by the evidence before the Tribunal, to be “skill machines” operated in accordance with the *Oficio*. Thunderbird refers in this regard to the briefcase version demonstration carried out by Mr. McDonald at the Hearing.

(ii) Mexico's position

132. According to Mexico, the functionality of the machines is relevant to the issues of whether SEGOB could be deemed to have acted arbitrarily at international law in finding that such machines were prohibited equipment under Mexican law; and whether Thunderbird could have had a reasonable expectation that SEGOB would agree

that the machines operated by EDM were not illegal gaming machines.

133. Mexico recalls that the Tribunal does not have jurisdiction to determine whether the gaming operations of EDM were legal, or whether the machines in question were prohibited under Mexican law. Mexico disputes however Thunderbird's characterisation of the machines as "skill" machines, arguing instead that the evidence produced by Mexico establishes that the EDM machines are no more than "video poker" or "slot" machines, similar or identical to machines that were held to be gambling equipment in U.S. legal proceedings, and previously described as gambling equipment by Thunderbird itself. Mexico refers in this regard to the expert testimony of Prof. Rose and Mr. McDonald's demonstration at the Hearing.

(iii) The Tribunal's findings

134. Both Parties have argued that the functionality of the EDM machines is relevant to certain issues pending before the Tribunal. Thus, Thunderbird has submitted evidence in support of its contention that the EDM machines are "skill" machines, whereas Mexico has provided evidence establishing, according to Mexico, that the machines in question are "*tragamonedas*" [slot machines] prohibited under Mexican law.
135. The Tribunal agrees that the nature and functionality of the machines may be relevant in considering certain issues in this arbitration. However, the Tribunal does not need to enter into a detailed technical discussion as to the precise nature and functionality of the machines, since both Parties acknowledge that it is not up to the Tribunal to determine the legality of the machines under the *Ley Federal de Juegos y Sorteos*.
136. The Tribunal notes that the machines operated by EDM are equipped with computerised random number generators and that it is possible to set the level of payouts, and thus the odds for winning. For example, the Bestco "Fantasy 5 Game Manual" that was found at the EDM-Laredo Facility provides that the default base pay rate "is set to 75%. This can be changed to a value within the range of 50%-95%." (Ex. R-15, p. 13) The Tribunal notes further that the machine's percentage of payout is not visible or otherwise known to the player (see McDonald at Tr. 498-502). The Tribunal infers that the operation of these video game machines with a built-

in and modifiable random number generator involves a considerable degree of chance, and that by adjusting the payout rate, the machine operator can manipulate the odds for winning regardless of the skill of the player.

**Issue 7. Was a legitimate expectation created by SEGOB's letter of 15 August 2000 to the effect that it brings Thunderbird's claims in the present case under Article 1102, 1105 and/or 1110 of the NAFTA?**

(i) Thunderbird's position

137. Thunderbird contends that this issue is relevant to the application of Articles 1105, 1110, and 1102 of the NAFTA.
138. As to the standard of protection for legitimate expectations, Thunderbird argues that if an investor or investment reasonably relies on the representations of government officials and suffers damages because of such reliance, the responsibility of the State is engaged under international law. Thunderbird cites a number of cases in this regard<sup>6</sup>, arguing that detrimental reliance arises from the general international law principle of good faith and the customary international standard of fair and equitable treatment. Through its ratification of the NAFTA, Thunderbird contends, Mexico authored a set of legitimate expectations upon which an investor or investment could reasonably rely.
139. Thunderbird contends that, seeking certainty as to the legality and propriety of its intended operations in Mexico, Thunderbird and EDM solicited the Mexican government for an official opinion. According to Thunderbird, SEGOB's response to the *Solicitud* provided the EDMs with written assurance or "negative clearance" to operate the specific machines identified in the *Solicitud*; and defined a standard in accordance with which Thunderbird could operate skill machines without regulation by SEGOB, the standard being that the machines had to be ones in which the "principal factor" of operation was the user's skill and ability. Thunderbird

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<sup>6</sup> In particular, *Metalclad Corp. v. Mexico*, Award, 30 August 2000, ICSID Case ARB(AF)/97/1, <http://www.worldbank.org/icsid/cases/mm-award-e.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADF-award.pdf>; *Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467, [http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward\\_001.pdf](http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf).



does not assert that it had thus obtained a government permit or licence to operate. Rather, SEGOB generated, according to Thunderbird, a legitimate expectation upon which the EDMs should have been able to rely reasonably.

140. Thunderbird denies having failed to disclose relevant facts in the *Solicitud*. According to Thunderbird, the SEGOB officials who issued the letter must have been familiar with the skill machines whose operation was proposed by the EDMs, since, amongst others, Mexico had been involved in litigation with Guardia over similar machines and SEGOB did not request any additional information in relation to the EDM machines.

(ii) Mexico's position

141. Mexico denies that the *Oficio* created a legitimate expectation for Thunderbird with respect to its investments in Mexico. According to Mexico, the *Oficio* was an advisory opinion, not an approval or permit, based on the information provided by EDM in the *Solicitud*, stating that if the machines operated by EDM were as described in the *Solicitud*, then they fell outside SEGOB's jurisdiction. Mexico asserts that it clearly and expressly made known to EDM the nature of the machines that were prohibited by law and that the *Oficio* was a clear warning that the operations EDM was conducting could be illegal.
142. However, Mexico argues, EDM did not operate the machines in the form or manner described in the *Solicitud*, neither with respect to the element of "ability and skill" nor with respect to "betting," and EDM did not present any evidence on the operation of the machines. Mexico adds that the *Solicitud* did not allude to the fact that the EDM machines were similar or identical to those operated by Guardia.
143. Further, Mexico contends, EDM did not treat the *Oficio* as a permit or authorisation at the time it was issued by SEGOB, as evidenced by Mr. Ruiz de Velasco's legal opinion, which concurred with the *Oficio* (quoted at ¶ 59 above).
144. Mexico denies in any event that Thunderbird relied on the *Oficio* as the basis for its investments in Mexico, arguing that Thunderbird undertook actions before the *Oficio*'s issuance; that Thunderbird expressly advised investors in EDM that the *Oficio* was no specific entitlement for EDM's operations; that Thunderbird reported to its

shareholders that it relied on private sector advisors in making the investment; and that it asserted in U.S. court proceedings that it was fraudulently induced to enter this business by Messrs. Oien en Ong.

(iii) The Tribunal's findings

145. EDM's *Solicitud* dated 3 August 2000 is quoted at ¶50 above. SEGOB's *Oficio* dated 15 August 2000 is quoted at ¶55 above.
146. Thunderbird has argued that it reasonably relied, to its detriment, upon the assurances provided by SEGOB in the *Oficio*. Mexico, on the other hand, denies that the *Oficio* gave rise to any legitimate expectations for Thunderbird to operate the EDM machines in Mexico.
147. Having considered recent investment case law and the good faith principle of international customary law<sup>7</sup>, the concept of "legitimate expectations" relates, within the context of the NAFTA framework, to a situation where a Contracting Party's conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.
148. The threshold for legitimate expectations may vary depending on the nature of the violation alleged under the NAFTA and the circumstances of the case. Whatever standard is applied in the present case however – be it the broadest or the narrowest – the Tribunal does not find that the *Oficio* generated a legitimate expectation upon which EDM could reasonably rely in operating its machines in Mexico.
149. The Tribunal considers that the point of departure in assessing whether Thunderbird could reasonably rely to its detriment on SEGOB's response to the *Solicitud* is to ascertain what was requested by Thunderbird in the *Solicitud*.

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<sup>7</sup> Bin Cheng, *General Principles of Law applied by International Courts and Tribunals*, at p. 123 *et seq.* (1987); Joerg Mueller, *Vertrauensschutz im Voelkerrecht* (1971); E. Zoller, *La bonne foi en droit international public* (1977); F. Orrego Vicuña, *Regulatory Authority and Legitimate Expectations*, 5 *Intl Law Forum*, 188m 193 (2003); *Nuclear Test Case*, ICJ Reports 1974, 253 at p. 268.

150. Given the lack of contemporaneous evidence on the record regarding the background of the *Solicitud* (such as witness evidence from Messrs. Aspe and Arroyo or from SEGOB officials in office when the *Solicitud* was submitted), the Tribunal cannot rely on presumptions or inferences, let alone speculation concerning that background. For instance, the Tribunal has noted the existence of a “success fee” arrangement between Thunderbird and Messrs. Aspe and Arroyo (who, according to Thunderbird, had numerous contacts with SEGOB officials in relation to Thunderbird’s proposed operations). Thunderbird offered the two Mexican lawyers US\$ 300,000 to secure a letter from SEGOB authorising Thunderbird’s gaming operations in Mexico (see correspondence at Exs. R-106, R-107, and R-121). According to Mr. Watson’s draft letter of 10 August 2000, Thunderbird was prepared to pay Messrs. Aspe and Arroyo an additional US\$ 700,000 if the letter was “granted exclusively for Thunderbird [...] and that no other such permission would be granted to other potential competing parties; otherwise, no additional fees would be owed.” (Ex. R-121) In the absence of any evidence on the record in relation to the “success fee” arrangement and the nature of the dealings between Messrs. Aspe and Arroyo and SEGOB, these facts do not have a bearing on the Tribunal’s analysis below. Under those circumstances, the Tribunal can only interpret the 3 August 2000 *Solicitud* on its face value.
151. In the Tribunal’s view, the information presented by EDM in the *Solicitud* is incomplete and, in particular, inaccurate in two regards.
152. First, it is asserted in the *Solicitud* that the machines operated by EDM do not involve luck or betting (see ¶3: “*In these games, chance and wagering or betting is not involved [...]*”). The Tribunal notes in ¶7 the use of the explicit terms “in no way”: “*The nature of video game machines for games of skills and ability is not games of chance or games with bets, wagers or drawings [...] the player can receive points that he can trade for a prize as a reward for the skills achieved and in no way as the result of chance*” (“*de ninguna manera*” in the original Spanish version). To represent that luck does not affect the outcome of the game in any manner whatsoever contradicts the evidence on the record (see the Tribunal’s findings at ¶136 above).
153. Second, it is asserted in the *Solicitud* that the machines in question are “*devices for recreation which have been designed for the enjoyment and entertainment of its users*” (¶3), “*only for the purpose of entertainment in which the users can obtain prizes for their skills*

and abilities” (*Solicitud* at ¶9; see also ¶8 “[...] the determinant to get results is the skills and ability of players; something very different from games of bets and wagers where there is a previous pact or covenant between the company and the user and, therefore, there is an agreement to handle an amount of money or any other thing.”). It is thus suggested that the machines operated by EDM do not involve any “agreement to handle an amount of money,” attributing instead prizes to the players. Such a representation is not accurate since the player must insert dollar bills to begin the game and any winning ticket is redeemable for cash.

154. In this regard, Mr. Ruiz de Velasco testified that had he known when he rendered his legal opinion on 20 August 2000 that the winning tickets were redeemable for cash, he would have most likely revised his opinion “because it probably could have bid in *[sic]* as gambling or betting.” (Ruiz de Velasco at Tr. 649-650)
155. The Tribunal is therefore of the opinion that the *Solicitud* is not a proper disclosure and that it puts the reader on the wrong track. The *Solicitud* creates the appearance that the machines described are video arcade games, designed solely for entertainment purposes.
156. Thunderbird has argued that SEGOB was well aware of the nature of the EDM machines since it had attempted to proceed with the closure of similar gaming facilities of Mr. Guardia. The Tribunal notes, however, that there is no disclosure in the *Solicitud* that the machines operated by EDM were similar or identical to those of Mr. Guardia.
157. Likewise, Thunderbird’s identification in the *Solicitud* of the trademark and model number of the machines (“Bestco, model MTL19U-8L and S.C.I. model 17"UR”) cannot be deemed sufficient to establish the functionality of the machines. According to the evidence, the model references used in the *Solicitud* were not proper model numbers but rather a description of the size of the computer monitor used to display the video game (see Tr. 125-126 and Exs. C-36 and C-87; see also Tr. 1163-1165). The model numbers did not therefore elucidate the nature of the machines and furthermore appeared to be inaccurate or incomplete. For instance, in the Bestco invoice, the machines sold were identified under the model reference “7100 Fantasy 5” (Ex. C-87; see also operating manual captioned “Fantasy 5 Game Manual” at Ex. R-15), whereas in the *Solicitud* a random combination of abbreviations and numbers was used to identify the same machines (“MTL19U-8L”), without any

reference to the name “Fantasy 5.” In this respect, Mr. McDonald testified that he was not familiar with the Bestco model numbers (Tr. 445-446). Mr. Ruiz de Velasco also testified that he was not familiar with the meaning of the Bestco and SCI model numbers (Tr. 583-585). No operating manuals, catalogues, or photos of the machines were presented with the *Solicitud*.

158. The Tribunal finds no evidence on the record establishing that SEGOB was indeed familiar with the nature and operation of the EDM machines.
159. Thunderbird has also argued that in the event of doubt, SEGOB should have made a request for additional information regarding the operation of the machines, or for an inspection of the machines. Yet Thunderbird was the moving party presenting a “*Solicitud*” to the Mexican administration; one would therefore expect that the moving party supply adequate information and make a proper disclosure. In the Tribunal’s view, the *Solicitud* did not give the full picture, even for an informed reader.
160. The Tribunal turns to the contents of the *Oficio*. Again, in the absence of any contemporaneous evidence surrounding the issuance of the *Oficio* (namely, the lack of witness testimony from SEGOB officials involved in the issuance of the *Oficio*, as well as that of Messrs Aspe and Arroyo; *see also* ¶150 above), the Tribunal cannot rely on presumptions or inferences, let alone speculation, regarding its issuance and can only analyse the letter on its face value. In addition, it is not up to the Tribunal to determine how SEGOB should have interpreted or responded to the *Solicitud*, as by doing so, the Tribunal would interfere with issues of purely domestic law and the manner in which governments should resolve administrative matters (which may vary from country to country). Rather, the Tribunal can only assess whether the contents of the *Solicitud* gave rise to legitimate expectations for Thunderbird within the context of Mexico’s obligations under Chapter Eleven of the NAFTA.
161. SEGOB, in ¶¶ 2-4 of the *Oficio*, recalls the legal provisions applicable in relation to “gambling and luck related games.” In ¶5, SEGOB states: “[...] *notwithstanding the above mentioned, according to your statement, the machines that your representative operates are recreational video game devices for purposes of enjoyment and entertainment of its users, with the possibility of obtaining a prize, without the intervention of luck or gambling, but rather the user’s*

*ability and skilfulness*". In ¶6, SEGOB adds: "if the machines that your representative exploits operate in the form and conditions stated by you, this governmental entity is not able to prohibit its use, in the understanding that the use of machines known as "coins-swallowers", "token-swallowers" or "slot machines," in which the principal factor of the operation is luck or gambling and not the user's ability of skilfulness as you stated, could constitute any of the hypothesis described under the Federal Law of Games and Sweepstake [...]." The Tribunal understands the message conveyed by SEGOB in the *Oficio* to be that if the machines operate in accordance with EDM's representations in the *Solicitud*, SEGOB does not have jurisdiction over said machines.

162. Thunderbird has argued that the *Oficio* defined a standard according to which machines that involved as "principal factor" the user's skill and ability do not fall within SEGOB's jurisdiction. The Tribunal does not follow Thunderbird's interpretation. In ¶ 6, SEGOB refers to slot machines (or "coin-swallowers" or "token-swallowers"). According to SEGOB, such machines are devices in which the "principal factor" ("factor *preponderante*" in the original Spanish text) of the operation is luck or gambling. SEGOB's description of slot machines cannot be interpreted *a contrario* as describing a standard for skill machines, according to which machines in which skill is the "factor preponderante" cannot be treated as gambling equipment. SEGOB's use of the term "preponderante" in reference to luck or gambling is not unusual. Prof. Rose testified, "gambling means that it is predominantly chance. Probably the easiest way to understand that is that if chance determines the outcome at any point, then it's gambling. So skill has to determine the outcome at every point in the game." (Tr. 729) Furthermore, Thunderbird was clearly cautioned in ¶ 7 of the *Oficio*, "in the machines that your representative operates there shall be no intervention of luck or gambling."
163. As to Mr. Ruiz de Velasco's legal opinion of 20 August 2004 (quoted at ¶ 59 above), the contents thereof reinforce the Tribunal's view that Thunderbird could not have reasonably relied to its detriment upon the *Oficio* to operate its gaming facilities in Mexico. In his letter to Thunderbird, Mr. Ruiz de Velasco made clear that (i) the *Oficio* was based upon the EDM's representations in the *Solicitud* ("[...] the Ministry of Interior states that it does not have any jurisdiction over the operation of said machines, since in accordance with the representations made by EDM in its application, the video games skill machines to be operated by EDM do not fall into the

*classification of 'slot machines' [...]*" at R-112); and (ii) that EDM was prohibited from operating gaming or betting machines ("[...] EDM can operate the video games skill machines as long as they do not become, in any manner whatsoever, as gaming or betting machines" at R-112 (emphasis added)).

164. It cannot be disputed that Thunderbird knew when it chose to invest in gaming activities in Mexico that gambling was an illegal activity under Mexican law. By Thunderbird's own admission, it also knew that operators of similar machines (Guardia) had encountered legal resistance from SEGOB. Hence, Thunderbird must be deemed to have been aware of the potential risk of closure of its own gaming facilities and it should have exercised particular caution in pursuing its business venture in Mexico. At the time EDM requested an official opinion from SEGOB on the legality of its machines, EDM must also be deemed to have been aware that its machines involved some degree of luck, and that dollar bill acceptors coupled with winning tickets redeemable for cash could be reasonably viewed as elements of betting. Yet EDM chose not to disclose those critical aspects in the *Solicitud*.
165. Further, the fact that SEGOB took action against Thunderbird's gaming facilities in February 2001, i.e., approximately six months after the issuance of the *Oficio*, is insufficient to establish that prior to that date, SEGOB had authorised (or was intentionally tolerating) Thunderbird's operations. Six months under the circumstances is by any standard a reasonable period for a government to seek enforcement of local gambling legislation.
166. Considering the foregoing, the Tribunal finds that there was no legitimate expectation created by the *Oficio* to the effect of bringing Thunderbird's claims in the present case under Article 1102, 1105 and/or 1110 of the NAFTA.
167. Finally, the Tribunal questions to what extent Thunderbird invested in Mexico in reliance on the *Oficio*, considering the non-negligible steps that Thunderbird had completed for the operation of its gaming machines prior to the issuance of the *Oficio* on 15 August 2000. The record shows that before 15 August 2000: EDM had been incorporated; JDMI had entered into a detailed Revenue Sharing Agreement with Messrs. Ong and Oien regarding the operation of the gaming facilities in Mexico (Exh. R-98); EDM had opened bank accounts (C-6); EDM had obtained land use permits (Ex. C-7); EDM had entered into a lease for a gaming facility location in Matamoros

(Exs. C-3 to C-5); EDM had imported 50 Bestco machines and 30 SCI machines (Exs. C-9, C-87 and C-15); EDM had filed an “Aviso de Apertura” for the establishment of “La Mina de Oro” (Ex. C-10); and by Thunderbird’s own admission in ¶2 of the *Solicitud*, EDM had already “opened a business [...] in the city of Matamoros, Tamaulipas, under the commercial name ‘La Mina de Oro’, which operates video game machines for games of skills and ability, and complies with all Municipal requirements.” (see also the *Solicitud* at ¶4)

**D. Merits – Articles 1102, 1105 and 1110 of the NAFTA**

**Issue 8. Did Respondent breach the “National Treatment” standard under Article 1102 of the NAFTA?**

168. Articles 1102 (1) and (2) of the NAFTA provide as follows:

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

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

(i) Thunderbird’s position

169. Thunderbird contends that Mexico has breached Article 1102 of the NAFTA by according different treatment to EDM and its investments than that what has been provided to domestic investors and investments operating in like circumstances.

170. According to Thunderbird, the Tribunal is to apply a three-part test under Article 1102 of the NAFTA, being identification of the relevant subjects of the national treatment comparison (the basis being the likeliness of comparators); consideration of the relative treatment received by each comparator (the basis being the best level of treatment available to any other domestic investor operating in like circumstances); and consideration whether factors exist which



could justify any difference in treatment so found (to be construed narrowly and the burden of proof shifting to Mexico). Thunderbird cites NAFTA and BIT case law in support of this three-part test<sup>8</sup>.

171. Thunderbird's EDM enterprises were seized and closed by Mexico because the skill machines operated at those facilities were deemed illegal, Thunderbird argues, whereas domestic investors, operating skill machines under essentially identical circumstances, remain open and operating. Thunderbird cites Guardia's "Club 21," de la Torres's Reflejos facility, and the Bella Vista Entertainment centre in Monterrey as appropriate comparators. Thunderbird disputes Mexico's argument that the EDM entities were not in "like circumstances," arguing instead that Mexico has not provided a sufficient evidentiary basis upon which to make the argument.
172. Finally, Thunderbird maintains that its decision to abandon recourse to judicial proceedings for relief in Mexico is irrelevant to the issue of whether Mexico breached its NAFTA obligations under Chapter Eleven of the NAFTA.

(ii) Mexico's position

173. Mexico denies having accorded less favourable treatment to EDM than that accorded to Mexican companies in like circumstances. SEGOB has acted consistently, Mexico argues, in enforcing the law against all operators (including Mexican nationals) who have attempted to operate facilities with so-called "skill" machines, and it has proceeded with the closure of every similar facility of which it became aware of and defended its actions in every court of appeal initiated by the operators of machines similar or identical to those of EDM.

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<sup>8</sup> *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2, 10 April 2001, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/PopeandTalbot-Merit.pdf>; *S.D. Myers Inc. v. Canada*, First Partial Award, 13 November 2000, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/SDMeyers-1stPartialAward.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case No. ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADFaward.pdf>; *Feldman v. Mexico*, Award, 16 December 2002, ICSID Case No. ARB(AF)/99/1, [http://www.worldbank.org/icsid/cases/feldman\\_mexico-award-en.PDF](http://www.worldbank.org/icsid/cases/feldman_mexico-award-en.PDF); *Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467, [http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward\\_001.pdf](http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf).

174. Mexico contends that Thunderbird has not succeeded in proving any discrimination against EDM, whether based on nationality or otherwise. In this regard, Mexico disputes Thunderbird's three-part test Article 1102. According to Mexico, Article 1102 is directed only to nationality-based discrimination and proscribes only demonstrable and significant indications of bias and prejudice on the basis on nationality, which are to be proven by Thunderbird, "the like circumstances" of Article 1102 requiring an adequate comparison on the basis of the facts, thereby taking into account, in particular, compliance with local law relating to illegal conduct. Mexico adds that EDM is not "in like circumstances" with the operators of facilities that have been able to continue operating under temporary injunctive relief while their legal challenges were pending, as even if EDM filed "*juicio de amparo*" proceedings, it was not granted injunctive relief and moreover withdrew its appeals.

(iii) The Tribunal's findings

175. In construing Article 1102 of the NAFTA, the Tribunal gives effect to the plain wording of the text. The obligation of the host NAFTA Party under Article 1102 of the NAFTA is to accord non-discriminatory treatment towards the investment or investor of other NAFTA Parties. It must therefore be established that discriminatory treatment was accorded to the foreign investment or investor.

176. The burden of proof lies with Thunderbird, pursuant to Article 24(1) of the UNCITRAL Rules. In this respect, Thunderbird must show that its investment received treatment less favourable than Mexico has accorded, in like circumstances, to investments of Mexican nationals.

177. It is not expected from Thunderbird that it show separately that the less favourable treatment was motivated because of nationality. The text of Article 1102 of the NAFTA does not require such showing. Rather, the text contemplates the case where a foreign investor is treated less favourably than a national investor. That case is to be proven by a foreign investor, and, additionally, the reason why there was a less favourable treatment.<sup>9</sup>

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<sup>9</sup> See *S.D. Myers Inc. v. Canada*, First Partial Award, 13 November 2000, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/SDMeyers-1stPartialAward.pdf>; *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2, 10 April 2001, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/PopeandTalbot-Merit.pdf>; *Feldman v. Mexico*, Award, 16 December 2002, ICSID Case No. ARB(AF)/99/1,

178. In the Tribunal's view, Thunderbird has not sufficiently established – not even on a *prima facie* basis – that the EDM investments were treated, in like circumstances, worse than those of Mexican nationals (or any other nationals for that matter).
179. The record shows that SEGOB has sought to enforce Mexican legislation on gambling by pursuing the closure of numerous gambling facilities (most of which have been closed definitely), and that the official closure of Mexican gambling facilities was in fact pursued at the very same time SEGOB proceeded to the official closure of the EDM facilities in Nuevo Laredo and Matamoros (see Exh. R-9). The Tribunal notes that SEGOB met resistance from the gaming facilities in question, including those of EDM, before the Mexican courts. As a result, it appears that some of the facilities closed by SEGOB were able to continue to operate under temporary injunctive relief, but the record also shows that SEGOB legally challenged the court decisions granting injunctive relief in connection with SEGOB's official closure orders and that appeals are pending.
180. As to the gambling facilities that apparently continue to operate without having obtained temporary injunctive relief, the Tribunal finds insufficient evidence on the record establishing that Mexico had knowledge of the existence of those facilities and deliberately allowed them to remain open. In this regard, it should be noted that some of the gambling facilities appeared to operate in a clandestine manner (see the videos submitted by Thunderbird).
181. With respect to the Guardia facilities, the Tribunal notes that this is a particular case where SEGOB has experienced long-standing legal altercations with Mr. Guardia. The Tribunal infers that even if any of the facilities operated by Mr. Guardia remain open today, one cannot talk of discrimination towards EDM since the record shows that SEGOB has repeatedly taken action to close Mr. Guardia's facilities, but has met fierce legal and other resistance in the process (see Exs. R-97; R-114; R-31, R-32).

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[http://www.worldbank.org/icsid/cases/feldman\\_mexico-awarden.PDF](http://www.worldbank.org/icsid/cases/feldman_mexico-awarden.PDF),  
*Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467, [http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward\\_001.pdf](http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf).

182. It thus appears from the facts of the case that SEGOB's policy and actions in enforcing the *Ley Federal de Juegos y Sorteos* were directed at both Mexican and non-Mexican gambling operations and that they were overall consistent. Accordingly, the Tribunal finds that Thunderbird has not established a breach the "National Treatment" standard under Article 1102 of the NAFTA.
183. In any event, even if Thunderbird had established without doubt that Mexico's line of conduct with respect to gambling operations was not uniform and consistent, one cannot overlook the fact that gambling is illegal in Mexico. In the Tribunal's view, it would be inappropriate for a NAFTA tribunal to allow a party to rely on Article 1102 of the NAFTA to vindicate equality of nonenforcement within the sphere of an activity that a Contracting Party deems illicit.

**Issue 9. Did Respondent breach the "Minimum Standard of Treatment" under Article 1105 of the NAFTA?**

184. Article 1105(1) of the NAFTA provides as follows:

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.

(i) Thunderbird's position

185. With respect to the meaning of the "Minimum Standard of Treatment" under Article 1105 of the NAFTA and its application by a NAFTA tribunal, Thunderbird cites various NAFTA awards, alleging that the conduct of SEGOB officials in this case reflects exactly the kind and level of arbitrariness that the *Waste Management II* tribunal would conclude violates the minimum standard under Article 1105.
186. According to Thunderbird, three international law doctrines – detrimental reliance, denial of justice, and abuse of rights – can be used to inform the Tribunal's interpretation of how "fair and equitable treatment" was not provided to Thunderbird or its investments. Hence, Thunderbird contends that the detrimental reliance by Thunderbird and the EDMs on the *Oficio* in pursuing their investments in Mexico and Mexico's subsequent actions against Thunderbird and its EDM entities, in contravention to the content of the *Oficio*, establish a breach of Article 1105 of the

NAFTA, adding that the EDMs were not only entitled to rely upon the SEGOB letter because of its contents, but also because of the expectations generated by Mexico's ratification of the NAFTA. Thunderbird alleges further a failure by Mexico to provide due process, constituting an administrative denial of justice, in the proceedings relating to the ruling of 10 October 2001, which constituted a breach of Article 1105 of the NAFTA; and manifest arbitrariness in administration, constituting proof of an abuse of right, in the proceedings before SEGOB, in breach of Article 1105 of the NAFTA.

(ii) Mexico's position

187. Mexico denies having violated the "Minimum Standard of Treatment" of Article 1105 of the NAFTA.
188. According to Mexico, Thunderbird's complaints about the SEGOB administrative proceedings are factually incorrect and in any event pertain to issues of pure domestic law; and Thunderbird has not presented any evidence of failures of the Mexican judicial system that it argues prejudiced it and constituted the principal reason why it withdrew its judicial appeals.
189. Mexico contends that it has adopted a uniform and consistent line of conduct with respect to illegal gaming operations. In particular, Mexico argues that it has, to its knowledge, closed down all facilities where so-called slot machines were operating and has legally challenged all court decisions granting injunctive relief regarding SEGOB official closure orders.
190. With respect to any alleged detrimental reliance on the *Oficio*, Mexico contends that SEGOB's determination that it would consider the machines to be prohibited games cannot be considered arbitrary, given that Thunderbird itself knew the nature of the machines and knew of the existing risk that they would be inspected by SEGOB and it would reach that conclusion.
191. As to the SEGOB administrative proceedings, Mexico denies that they were illegal, arbitrary or unfair, arguing that the decision itself indicates that EDM's evidence was taken into account even when not in strict accordance with the applicable domestic legal requirements and the decision set out a reasoned basis for its conclusions; that the procedure was transparent and in compliance with Mexican laws, validated by EDM's lawyers who were experts in

Mexican law; and that if there had been a violation during the proceedings, there were appropriate judicial remedies available to challenge it.

(iii) The Tribunal's findings

192. The Tribunal shall interpret Article 1105(1) of the NAFTA in accordance with the NAFTA Free Trade Commission's Notes of Interpretation of certain Chapter Eleven Provisions ("Minimum Standard of Treatment in Accordance with International Law") dated 31 July 2001<sup>10</sup>, which provides as follows:

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

193. The Tribunal shall accordingly measure the Article 1105(1) of the NAFTA minimum standard of treatment against the customary international law minimum standard, according to which foreign investors are entitled to a certain level of treatment, failing which the host State's international responsibility may be engaged.

194. The content of the minimum standard should not be rigidly interpreted and it should reflect evolving international customary law.<sup>11</sup> Notwithstanding the evolution of customary law since

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<sup>10</sup> <http://www.dfait-maeci.gc.ca/tna-nac/Nafta-interpr-en.asp>.

<sup>11</sup> See in particular *Mondev International Ltd. v. USA*, Award, 11 October 2002, ICSID Case No. ARB(AF)/99/2, <http://www.state.gov/documents/organization/14442.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case No. ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADF-award.pdf>; *Waste Management Inc. v. Mexico*, Arbitral Award, 2 June 2002, ICSID Case No. ARB(AF)/98/2,

decisions such as *Neer Claim* in 1926<sup>12</sup>, the threshold for finding a violation of the minimum standard of treatment still remains high, as illustrated by recent international jurisprudence<sup>13</sup>. For the purposes of the present case, the Tribunal views acts that would give rise to a breach of the minimum standard of treatment prescribed by the NAFTA and customary international law as those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards<sup>14</sup>.

195. In the present case, the Tribunal is not convinced that Thunderbird has demonstrated that Mexico's conduct violated the minimum standard of treatment, for the following reasons.
196. The Tribunal has already found that Thunderbird could not reasonably rely the *Oficio* to its detriment (see the Tribunal's findings under Issue 7 above).
197. As to the alleged failure to provide due process (constituting an administrative denial of justice) and the alleged manifest arbitrariness in administration (constituting proof of an abuse of right) in the SEGOB proceedings, the Tribunal cannot find sufficient evidence on the record establishing that the SEGOB proceedings

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[http://www.worldbank.org/icsid/cases/waste\\_award.pdf](http://www.worldbank.org/icsid/cases/waste_award.pdf); Final Award, 30 April 2004, ICSID Case No. ARB(AF)/00/3, [http://ita.law.uvic.ca/documents/laudo\\_ingles.pdf](http://ita.law.uvic.ca/documents/laudo_ingles.pdf).

<sup>12</sup> *USA (L.F. Neer) v. Mexico* (1926), 4 R.I.A.A. 60 (Gen. Cl. Comm'n 1926).

<sup>13</sup> See in this regard *Alex Genin et al. v. Estonia*, Award, 25 June 2001, ICSID Case No. ARB/99/2), <http://www.worldbank.org/icsid/cases/genin.pdf>; *Waste Management Inc. v. Mexico*, Final Award, 30 April 2004, ICSID Case No. ARB(AF)/00/3, [http://ita.law.uvic.ca/documents/laudo\\_ingles.pdf](http://ita.law.uvic.ca/documents/laudo_ingles.pdf).

<sup>14</sup> See in this regard *Alex Genin et al. v. Estonia*, Award, 25 June 2001, ICSID Case No. ARB/99/2, <http://www.worldbank.org/icsid/cases/genin.pdf>; *S.D. Myers Inc. v. Canada*, First Partial Award, 13 November 2000, UNCITRAL (NAFTA), <http://ita.law.uvic.ca/documents/SDMyers-1stPartialAward.pdf>; *Mondev International Ltd. v. USA*, Award, 11 October 2002, ICSID Case No. ARB(AF)/99/2, <http://www.state.gov/documents/organization/14442.pdf>; *ADF Group Inc. v. USA*, Award, 9 January 2003, ICSID Case No. ARB(AF)/00/1, <http://www.worldbank.org/icsid/cases/ADF-award.pdf>; *Azinian v. Mexico*, Arbitral Award, 1 November 1999, ICSID Case No. ARB(AF)/97/2, [http://www.worldbank.org/icsid/cases/robert\\_award.pdf](http://www.worldbank.org/icsid/cases/robert_award.pdf); *Loewen v. USA*, Award, 26 June 2003, ICSID Case No. ARB(AF)/98/3, <http://ita.law.uvic.ca/documents/Loewen-Award-2.pdf>; *Case concerning Elettronica Sicula SpA (ELSI) (United States v. Italy)*, 20 July 1989, 1989 I.C.J. 15.

were arbitrary or unfair, let alone so manifestly arbitrary or unfair as to violate the minimum standard of treatment.

198. In particular, the Tribunal notes that Thunderbird was given a full opportunity to be heard and to present evidence at the Administrative Hearing, and that it made use of this opportunity. The Tribunal does not find anything reproachable about the Administrative Order. The 31-page document appears, in the Tribunal's view, to be adequately detailed and reasoned; it reviews the evidence presented by Thunderbird at the hearing; and discusses at length the legal grounds on which SEGOB based its determination that the EDM machines were prohibited gambling equipment (*see* Exh. R-93).
199. As to the official closures of the EDM facilities, the Tribunal does not find that the manner in which SEGOB proceeded for the official closure was arbitrary. In fact, the record shows that on one occasion, SEGOB itself recognized that the official closure order for Nuevo Laredo was irregular and accordingly rectified its error by lifting the seals of the Nuevo Laredo facility.
200. The Tribunal does not exclude that the SEGOB proceedings may have been affected by certain irregularities. Rather, the Tribunal cannot find on the record any administrative irregularities that were grave enough to shock a sense of judicial propriety and thus give rise to a breach of the minimum standard of treatment. As acknowledged by Thunderbird, the SEGOB proceedings should be tested against the standards of due process and procedural fairness applicable to administrative officials. The administrative due process requirement is lower than that of a judicial process. Hence, for instance, even if one views the absence of Lic. Aguilar Coronado (who signed the Administrative Order) at the 10 July hearing as an administrative irregularity, it does not attain the minimum level of gravity required under Article 1105 of the NAFTA under the circumstances.
201. Finally, the SEGOB proceedings (including the Administrative Resolution) were subject to judicial review before the Mexican courts. The Tribunal notes in this regard that EDM filed a nullification (*juicio de nulidad*) of the 10 October Ruling before the federal tax and administrative court (in which it did not raise any complaint about Lic. Aguilar Coronado's absence at the Administrative Hearing). EDM went on to appeal the court's decision on the nullification (*juicio de amparo*), but subsequently



withdrew from the proceedings, which decision cannot be attributed to Mexico.

**Issue 10. Did Respondent engage in an expropriation in violation of Article 1110 of the NAFTA?**

202. Article 1110 (1) of the NAFTA provides as follows:

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of law and Article 1105(1);  
and
- (d) on payment of compensation in accordance with paragraphs 2 through 6.

(i) Thunderbird's position

203. With respect to Mexico's jurisdictional objections, Thunderbird contends that the purposes of the NAFTA would be completely frustrated if investors were not entitled to bring claims under Article 1110, on behalf of their investment enterprises established in the territory of another NAFTA Party. Thunderbird requests that leave be granted to Thunderbird to amend its PSoC to include, in the further alternative, a claim for 100% of the damages caused to the businesses of each EDM Company as a result of Respondent's alleged breach of Article 1110, using Article 1116 of the NAFTA.

204. Thunderbird contends that Article 1110 of the NAFTA, which requires the payment of full, prompt, and effective compensation for the taking of an "investment," imposes an obligation upon Mexico vis-à-vis the EDMs. The standard for determining whether a taking has occurred is whether government action has resulted in substantial interference with the investment.

205. According to Thunderbird, the EDM Companies had legitimately acquired rights in the businesses they conducted. The actions of SEGOB amounted to expropriation within the meaning of Article 1110 of the NAFTA, Thunderbird argues, because the EDMs established their investments in Mexico on the general promise of fair and equitable treatment and with the added security of the “negative clearance” contained within the *Oficio*, and the official closure of these facilities destroyed the EDMs’ businesses, requiring the payment of fair market value for these investments so taken.

(ii) Mexico’s position

206. Mexico raises a jurisdictional objection to the effect that Thunderbird cannot succeed in its claim of expropriation because it failed to bring a claim on its own behalf as an investor of a Party under Article 1116 of the NAFTA. Thunderbird’s request in the SoR to amend its claim should be denied according to Mexico.

207. Mexico contends that SEGOB determined that EDM was operating prohibited gambling equipment and that, therefore, bona fide law enforcement actions by SEGOB, such as the closure of illegal gambling operations, do not amount to an expropriation. Further, Mexico argues, EDM filed appeals in the national courts that it subsequently withdrew.

(iii) The Tribunal’s findings

208. The Tribunal does not need to decide on Mexico’s jurisdictional objection regarding Thunderbird’s failure to present its claim under Article 1116 of the NAFTA, since the Tribunal has already found that the EDM Companies could not have operated based on a legitimate expectation in Mexico. Accordingly, as acknowledged by Thunderbird, compensation is not owed for regulatory takings where it can be established that the investor or investment never enjoyed a vested right in the business activity that was subsequently prohibited.

**E. Merits – Damages**

209. The Tribunal has found that Mexico did not violate any of the NAFTA provisions relied upon by Thunderbird (*see* the Tribunal’s findings on Issues 8, 9 and 10 above). Accordingly, Thunderbird is not entitled to damages and the Tribunal does not need to address Issue 11.

**VI. COSTS**

210. In Thunderbird's Cost Submission of 26 August 2004, Thunderbird claimed US\$ 995,934.50 for its legal fees and expenses. In Thunderbird's Supplementary Statement of Costs of 31 March 2005, Thunderbird claims US\$ 1,163,375.20 (including previous sums claimed).
211. In Mexico's Cost Submission of 12 August 2004, Mexico claimed US\$ 1,310,943.78 for its legal fees and expenses. In Mexico's Supplementary Statement of Costs of 31 March 2005, Mexico claimed an additional US\$ 191,122.06.
212. Pursuant to Article 1135 of the NAFTA, a tribunal may "award costs in accordance with the applicable Arbitral Rules," i.e., the UNCITRAL Rules. Pursuant to Article 38 of the UNCITRAL Rules, the "arbitral tribunal shall fix the costs of arbitration in its award." Article 38 (e) includes within the scope of the definition of the "costs of arbitration" the "costs for legal representation and assistance of the successful party if such costs were claimed during the arbitral proceedings, and only to the extent that the arbitral tribunal determines that the amount of such costs is reasonable". Articles 40 (1) and (2) of the UNCITRAL Rules provide as follows:
1. Except as provided in paragraph 2, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the arbitral tribunal may apportion each of such costs between the parties if it determines that apportionment is reasonable, taking into account the circumstances of the case.
  2. With respect to the costs of legal representation and assistance referred to in article 38, paragraph (e), the arbitral tribunal, taking into account the circumstances of the case, shall be free to determine which party shall bear such costs or may apportion such costs between the parties if it determines that apportionment is reasonable.
213. The majority view in *S.D. Myers v. Canada* believed that there is a "subtle distinction" between these two paragraphs, the first emphasizing "success," and the second "the circumstances of the case."<sup>15</sup> The present Arbitral Tribunal does not see the distinction

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<sup>15</sup> *S.D. Myers v. Canada*, Final Award, 30 December 2002, UNCITRAL (NAFTA),

between the two paragraphs in that way. The first paragraph too refers to “the circumstances of the case” whilst the second, as conceded by the majority view in *S.D. Myers*, also implies success. Rather, the difference between the two paragraphs is that the first paragraph sets forth a rule with an exception to that rule, whereas the second paragraph gives an arbitral tribunal unfettered discretion. According to the first paragraph, the costs of the arbitration “shall in principle be borne by the unsuccessful party,” whilst according to the second paragraph, an arbitral tribunal “shall be free” to determine which party bears the costs of legal representation (or may apportion such costs). In the present case, the Arbitral Tribunal does not see a reason to rely on that distinction, as the more objective benchmark for both types of costs is the rate of success of a party.

214. It is also debated whether “the loser pays” (or “costs follow the event”) rule should be applied in international investment arbitration. It is indeed true that in many cases, notwithstanding the fact that the investor is not the prevailing party, the investor is not condemned to pay the costs of the government. The Tribunal fails to grasp the rationale of this view, except in the case of an investor with limited financial resources where considerations of access to justice may play a role. Barring that, it appears to the Tribunal that the same rules should apply to international investment arbitration as apply in other international arbitration proceedings.
215. It may be added that Article 1135 of the NAFTA explicitly contemplates the possibility for a tribunal to award costs: “[a] tribunal may also award costs in accordance with the applicable arbitration rules.” The treaty does not contain any limitation in regard of the award of costs.
216. The parties to the present case have themselves each claimed an award of costs (see Notice of Arbitration at ¶34 and SoD at ¶372). Although Thunderbird has contended that it is rarely appropriate for costs to be awarded to an unsuccessful NAFTA claimant, it has at the same time recognized: “[n]o Nafta provisions exist which would modify the application of [Articles 38 and 40 of the UNCITRAL] arbitration rules. Accordingly, it lies within the discretion of this Tribunal to award costs in the manner it

determines to be the most appropriate and reasonable in the circumstances.” (see PSoC at p.121)

217. The Tribunal is mindful of other NAFTA awards such as the decision in *Azinian v. Mexico*,<sup>16</sup> in which the tribunal considered four factors for deciding that the losing investor need not pay the costs of the respondent (state party):

The claim has failed in its entirety. The Respondent has been put to considerable inconvenience. In ordinary circumstances it is common in international arbitral proceedings that a losing claimant is ordered to bear the costs of the arbitration, as well as to contribute to the prevailing respondent’s reasonable costs of representation. This practice serves the dual function of reparation and dissuasion.

In this case, however, four factors militate against an award of costs. First, this is a new and novel mechanism for the resolution of international investment disputes. Although the Claimants have failed to make their case under the NAFTA, the Arbitral Tribunal accepts, by way of limitation, that the legal constraints on such causes of action were unfamiliar. Secondly, the Claimants presented their case in an efficient and professional manner. Thirdly, the Arbitral Tribunal considers that by raising issues of defective performance (as opposed to voidness *ab initio*) without regard to the notice provisions of the Concession Contract, the Naucalpan Ayuntamiento may be said to some extent to have invited litigation. Fourthly, it appears that the persons most accountable for the Claimants’ wrongful behaviour would be the least likely to be affected by an award of costs; Mr. Goldenstein is beyond this Arbitral Tribunal’s jurisdiction, while Ms. Baca – who might as a practical matter be the most solvent of the Claimants – had no active role at any stage.

218. With respect to the first factor, investment arbitration in general and NAFTA arbitration in particular have become so well known and established as to diminish their novelty as dispute resolution

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<sup>16</sup> *Azinian v. Mexico*, Arbitral Award, 1 November 1999; ICSID Case No. ARB(AF)/97/2, [http://www.worldbank.org/icsid/cases/robert\\_award.pdf](http://www.worldbank.org/icsid/cases/robert_award.pdf)

mechanisms. Thus, this factor is no longer applicable when considering apportionment of costs in international investment disputes. As for the second factor, although it may be said that the Parties here presented their case in an efficient and professional manner, the Tribunal does not find it a decisive factor for awarding costs in deviation of the general principle. Finally, the third and fourth *Azinian* factors are not applicable in the present case.

219. In the present case, the Tribunal has found that Mexico is the successful party, except on issues of jurisdiction and/or admissibility.

220. Accordingly, the Tribunal finds that Mexico may in principle recover an appropriate portion of the costs of its legal representation and assistance. In this regard, the amount of US\$ 1,502,065.84 claimed by Mexico appears to be reasonable in light of the scope and length of the present arbitral proceedings. Mexico did not however prevail on all issues. In consideration of this fact, the Tribunal shall exercise its discretion and allocate the costs on a  $\frac{3}{4}$ - $\frac{1}{4}$  basis. Accordingly, the Tribunal hereby determines that Thunderbird shall reimburse Mexico in the amount of US\$ 1,126,549.38 in respect of the costs of legal representation for this arbitration.

221. As regards the fees of the arbitrators, the Arbitral Tribunal has determined the fees of the Arbitrators to be US\$405,620. The disbursements of the arbitration, including rent of hearing rooms, travel, hotel accommodation and court reporters amount to US\$99,632.08. Consequently, the costs of the arbitration amount to US\$505,252.08 and will be paid out of the deposits made by the Parties. For the same reasons as expressed in the preceding paragraph, the costs referred to in this paragraph shall be allocated between Thunderbird and Mexico on a  $\frac{3}{4}$ - $\frac{1}{4}$  basis. Accordingly, the Arbitral Tribunal hereby determines that Thunderbird shall reimburse Mexico in the amount of US\$126,313.02 in respect of the aforementioned deposits made by Mexico.

## VII. DECISIONS

222. FOR THE FOREGOING REASONS, the Arbitral Tribunal renders the following decisions:

- 1) FINDS that Mexico did not breach Articles 1102, 1105 or 1110 of the NAFTA or otherwise;
- 2) DISMISSES Thunderbird's claims in their entirety;

- 3) DETERMINES the costs of the arbitration referred to in ¶ 221 above at US\$505,252.08, and further DETERMINES that these costs are to be shared by the Thunderbird and Mexico on a 3/4-1/4 basis, and are to be paid out of the deposits made by the Parties;
- 4) DETERMINES that Thunderbird shall reimburse Mexico in the amount of US\$ 1,126,549.38 in respect of the costs of legal representation and US\$126,313.02 in respect of the deposits made by Mexico for the fees and disbursements of the Arbitral Tribunal.

Made in Washington D.C., U.S.A., being the place of arbitration, on  
January 26, 2006,

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Lic. Agustin Portal Ariosa,  
Arbitrator

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Professor Thomas W. Wälde,  
Arbitrator  
(see separate opinion)

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Professor Dr. Albert Jan van den Berg,  
President



## Separate Opinion

### In the Arbitration under Chapter XI of the NAFTA and the UNCITRAL Arbitration Rules: Thunderbird ./ Mexico

#### 1) Summary

1. I concur with my colleagues on several significant issues of the case:

- The questions of jurisdiction, admissibility, control and waivers;
- the rejection of the expropriation (NAFTA Art. 1110) claim;
- the rejection of the “denial of administrative justice” claim;
- the rejection of the NAFTA governments’ position that pursuant to Article 1102 Claimant needs to prove that the government had a direct intention to harm the foreign investor because it is foreign is required for Art. 1102 and needs to be proven by claimant;
- the general view that the principle of legitimate expectation forms part, i.e. a subcategory, of the duty to afford fair and equitable treatment under Art. 1105 of the NAFTA. We also seem to concur on the general conditions for this claim – an expectation of the investor to be caused by and attributed to the government, backed-up by investment relying on such expectation, requiring the legitimacy of the expectation in terms of the competency of the officials responsible for it and the procedure for issuing it and the reasonableness of the investor in relying on the expectation. I do, however, not concur with the application of this standard to the specific factual situation in light of the purpose, specific content and precedents of the legitimate expectations standard as it should be applied under investment protection treaties based on recent relevant jurisprudence.

2. I have found the rejection of the national treatment (non-discrimination) under Art. 1102 more difficult. Guardia, Thunderbird’s competitor with comparable operations, continued to operate through success with procedural appeals (“amparos”) before Mexican courts and through the lesser success of SEGOB in enforcing against him as compared to its – most effective – enforcement against Thunderbird. He was the domestic investor that was the “most comparable” and “best treated” by the integral Mexican (administrative and judicial) system. That creates a presumption of discrimination which Mexico has to rebut by showing and proving “legitimate reasons” for such distinct, but more favourable treatment. But I have in the end accepted the view of my colleagues denying a breach of Art. 1102. However, I have been able to identify “discriminatory elements” in the greater energy, focus and

effectiveness of the enforcement activities by the SEGOB against Thunderbird – which had arranged (or at least tried to arrange) a clearance of its activities as compared to the main and most successful Mexican competitor, Mr Guardia (who had always taken a non-cooperative approach. But I have not come in the particular circumstances to the conclusion that the much more favourable position enjoyed by Guardia in terms of de-facto practice and effectiveness of enforcement created a corresponding right for Thunderbird under Art. 1102 to continue its gam(bl)ing operations or to receive an equivalent amount of damages. I have been able to solve this dilemma by taking into account such “discriminatory elements” in the enforcement of the Mexican gambling law in the context of the balancing that is, in my view, required between legitimate expectations of a foreign investor and an equally legitimate public interest in preserving a large “regulatory space” in particular in the field of gambling regulation under Art. 1105 of the NAFTA.

3. I will discuss in this separate opinion both the normative scope and contours of the legitimate expectation concept as it should be construed under Art. 1105 of the NAFTA and their significance in the particular factual context. The facts that emerged in this arbitration and on its record provide, as always, not a complete picture of the events. But what has emerged can only be assessed, including through presumptions and other rules of evidence, on the basis of the particular features of the legitimate expectations concept<sup>1</sup> Since the arbitration has, as often or always, not elucidated all relevant facts, one needs to rely on standard practice of rules of evidence, burden of proof and presumptions to determine when the claimant and when the respondent has to bear the respective burden. In addition, as recently explained again by the *Methanex v US* award, what is unknown but relevant has to be dealt with by inference, i.e. by taking the “dots” that are available, drawing explanatory lines between them<sup>2</sup> and then determine what explanation can be inferred by relying on burden of proof allocation, prima facie evidence and arbitral determination of the evidence. They need to be assessed not only from the lofty spheres of commercial arbitration law, but also with a real-life understanding of the “coal-face” of foreign investment practices.

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<sup>1</sup> On the burden of proof and persuasion by respondent government for factual allegations and their legal implications that weaken the investor’s claim see *Biloune v. Ghana*, 95 ILR 183 (1994), para. 29

<sup>2</sup> *Methanex v US*, Final Award, at pp. 211, 212

4. My disagreement is based on a different weight which needs to be accorded to this principle in the particular context of an investment promotion and protection treaty which protects interests different from those involved in an ordinary commercial relationship involving two equal private parties. Commercial arbitration is a suitable mechanism for resolving the disputes of equal parties on equal footing and without need for the purpose of taking into account the position of the weaker party; nor is there any policy purpose underlying commercial arbitration – such as to protect and promote investment, enhance transparency and the “rule of law”, create employment or enhance trade opportunities. In commercial arbitration, rules including the caveat emptor and due diligence principle are deeply ingrained in the culture, approaches and principles applied consciously or subconsciously by the tribunals. By contrast, international investment law is aimed at promoting foreign investment by providing effective protection to foreign investors exposed to the political and regulatory risk of a foreign country in a situation of relative weakness<sup>3</sup>. The main principles underlying the NAFTA (preamble, Art. 102) as developed in the most recent and authoritative jurisprudence by arbitral tribunals require that in case of doubt, the risk of ambiguity of a governmental assurance is allocated rather to the government than to a foreign investor and that the government is held to high standards of transparency and responsibility for the clarity and consistency in its interaction with foreign investors. If official communications cause, visibly and clearly, confusion or misunderstanding with the foreign investor, then the government is responsible for pro-actively clarifying its position. The government can not rely on its own ambiguous communications, which the foreign investor could and did justifiably rely on, in order to later retract and reverse them– in particular in change of government situations
  
5. Investors need to rely on the stability, clarity and predictability of the government’s regulatory and administrative messages as they appear

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<sup>3</sup> All multilateral and most bilateral treaties expressly mention this objective; the 2005 World Bank Development Report provides an authoritative explanation of the role of investment protection in terms of signaling good-governance standards in the host state. See also *Tecmed v Mexico*, at para 122 citing the European Court of Human Rights (in the case of *James and others*, February 21, 1986, pp. 19-20; <http://hudoc.echr.coe.int>: “...non-nationals are more vulnerable to domestic legislation: unlike nationals, they will generally have played no part in the election or designation of its authors nor have been consulted on its adoption.”

to the investor when conveyed – and without escape from such commitments by ambiguity and obfuscation inserted into the commitment identified subsequently and with hindsight. This applies not less, but more with respect to smaller, entrepreneurial investors who tend to be inexperienced but provide the entrepreneurial impetus for increased trade in services and investment which NAFTA aims to encourage. Taking into account the nature of the investor is not formulation of a different standard, but of adjusting the application of the standard to the particular facts of a specific situation.

6. It is with these principles in mind that I have come to assess the – never absolutely clear and straightforward – factual background of the case and the presumptions and burden of legal justification and proof differently from my colleagues. They rather see the glass of the investor half empty, I rather see it half full. They imply a very high level of due diligence, of knowledge of local conditions and of government risk to be taken by the investor. I rather see the government as responsible for providing a clear message and of sticking to the message once given and as reasonably understood by the investor. They view the investor as having a duty to be close to perfect in its dealings with the government, I consider the government to have a duty to be transparent and consistent, and as responsible for the message conveyed: i.e. how such conduct was reasonably understood by the investor. They interpret the “Oficio” on its face value; I suggest it should be construed in light of its context, history and the objectively identifiable common intentions of both parties and as it was – reasonably – understood by the recipient, i.e. Thunderbird. They attach no importance to the combination of an official comfort letter followed by acceptance by the chief regulator of the investor’s operation to the end of the term of the government’s term; I view the governments accepting conduct subsequent to the comfort letter as reinforcing and clarifying the investor’s understanding of the key message conveyed by the comfort letter. My colleagues see no discrimination whatsoever in the fact that the chief Mexican competitor goes on providing the same type of services the claimant offered while claimant loses all appeals and gets shut down; I see here by way of inference, presumption and burden of proof on the government discriminatory elements of enforcement which reinforce the government’s obligation to respect the messages the comfort letter and the subsequent accepting conduct have reasonably conveyed to the investor.
7. I would have come to a quite modest obligation of the government of Mexico to pay a part of those investment expenditures assumed by

Thunderbird to the extent such costs can be reasonably and directly related to reliance of Thunderbird on positive assurances and accepting conduct by the competent Mexican authorities. I therefore find the claimant's argument and evidence on detrimental reliance more persuasive, but I then find the respondent's argument on compensation more convincing; in effect, my compensation assessment would have been at less than 0.5 % of the compensation claimed.

8. I also do not concur with the tribunal's decision to deviate from established practice not to allocate attorney costs to the losing investor claimant. In my view, such a deviation would have required an in-depth and extensively reasoned justification.

**2.) Main Principles underlying the Application of the "Investment Disciplines" in Chapter XI of the NAFTA to the Thunderbird - Mexico dispute**

9. It is likely to lead to highly divergent outcomes if the key NAFTA disciplines at issue here – 1102, 1105 and 1110 – are not applied with a common understanding of the pertinent principles of legal interpretation and application to a specific factual situation. Let me therefore highlight the key principles and methodological approaches I consider most relevant to define for the interpretation and application to the factual situation, the relevant "context" and "purpose" of these principles:
10. First, the applicable law is – Art. 1131 – "this Agreement" (i.e. the whole NAFTA, not just Chapter XI) and "applicable rules of international law", guided by the authoritative article 31 of the Vienna Convention on the Law of Treaties ("Vienna Convention") where the elements of "good faith", "ordinary meaning", "context" and "object and purpose" are the main principles of treaty interpretation. These principles – plus the Vienna Convention's reference to "subsequent conduct" – should also guide the interpretation of the crucial "Oficio" of August 2000.
11. The Preamble of NAFTA emphasises as authoritative interpretation guidelines, namely the need for "**clear rules**", "**predictable commercial framework for business planning and investment**", "**promotion of trade in.. services**" and "**creation of new employment opportunities**".

Art. 102 NAFTA: Highlights the purpose to “**facilitate cross-border movement of ..services**”, **transparency, promotion of fair competition, increasing substantially investment opportunities**<sup>4</sup>;

Art. 1115: To assure “**equal treatment** among investors of the parties”

12. While the forms and procedures of international commercial arbitration are relied upon<sup>5</sup>, one needs, for the application of such rules, to bear in mind that their purpose is to govern the procedure, but not to inject substantive principles, rules and legal concepts used in international commercial arbitration into the qualitatively different investment disputes between a foreign investor and a host state. International commercial arbitration assumes roughly equal parties engaging in sophisticated transnational commercial transactions. Investment arbitration is fundamentally different from international commercial arbitration. It governs the situation of a foreign investor exposed to the sovereignty, the regulatory, administrative and other governmental powers of a state. The investor is frequently if not mostly in a position of structural weakness, exacerbated often by inexperience (in particular in the case of smaller, entrepreneurial investors). Investment arbitration therefore does not set up a system of resolving disputes between presumed equals as in commercial arbitration, but a system of protection of foreign investors that are by exposure to political risk, lack of familiarity with and integration into, an alien political, social, cultural, commercial, institutional and legal system, at a disadvantage. Legal principles for and methodological approaches to examining the factual situation, habits, natural instincts and styles from commercial arbitration are therefore no suitable guideposts for investment arbitration. The relevant legal texts and the factual situation at issue have therefore to be seen in the light of the close link between **investment promotion** – to get foreign businessmen to come with their capital and efforts into a new, alien and inherently difficult and high-risk situation – and **investment protection**, i.e. the protection against governmental risk offered by investment treaties to increase the attractiveness of the host state economy<sup>6</sup>.

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<sup>4</sup> This interpretation method has been properly applied in the *Metalclad v Mexico* award; the contrary view of an enforcement court in Vancouver (suggesting that principles of the NAFTA outside Chapter XI should be ignored) has, rightly, not found any support.

<sup>5</sup> See the references in Art. 1120 ff to the various arbitration rules to be used.

<sup>6</sup> World Bank, Development Report 2005, 175-185; see also *infra* the citation to Elihu Root.

13. Secondly, while public international law still provides the main principles (in particular Art. 31 of the Vienna Convention, which moreover is an expression of an international consensus on interpretative principles), one needs to bear in mind that investment treaties such as the NAFTA, deals with a significantly different context from the one envisaged by traditional public international law: At its heart lies the right of a private actor to engage in an arbitral litigation against a (foreign) government over governmental conduct affecting the investor. That is fundamentally different from traditional international public law, which is based on solving disputes between sovereign states and where private parties have no standing. Analogies from such inter-state international law have therefore to be treated with caution; more appropriate for investor-state arbitration are analogies with judicial review relating to governmental conduct – be it international judicial review (as carried out by the WTO dispute panels and Appellate Body, by the European- or Inter-American Human Rights Courts or the European Court of Justice) or national administrative courts judging the disputes of individual citizens’ over alleged abuse by public bodies of their governmental powers<sup>7</sup>. In all those situations, at issue is the abuse of governmental power towards a private party that did and could legitimately trust in governmental assurances it received; in commercial arbitration on the other hand it is rather a good-faith interpretation of contractual provisions that is at stake. Abuse of governmental powers is not an issue in commercial arbitration, but it is at the core of the good-governance standards embodied in investment protection treaties. The issue is to keep a government from abusing its role as sovereign and regulator after having made commitments of a more formal character (contracts and licenses) or of a less formal character (i.e. the assurances by explicit communication or by meaningful conduct that form the basis of the legitimate expectations principle under Art. 1105 of the NAFTA).
14. The disappointment of legitimate expectations must be sufficiently serious and material. Otherwise, any minor misconduct by a public official could go to the jurisdiction of a treaty tribunal. Their function is not to act as a general-recourse administrative law tribunal. The introduction of direct investor-state arbitration (“arbitration without privity; “transnational arbitration”) since the late 1980, resulted in a “discontinuity” which is not as yet fully appreciated and requires

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<sup>7</sup> Also: Gaillard, *Jurisprudence du CIRDI*, 2004, at p. 7

attention in cases such as this one. In former times, investment treaties provided for an intergovernmental arbitration process only; governments therefore had to “sponsor” private claims. Such governmental sponsorship provided an important “filter” for screening claims and for avoiding that investment treaties were used for a multitude of claims that did not justify the machinery of an international treaty to come into play: The risk of opened “floodgates” and the spectre of treaty-based procedures for a single instance of misconduct<sup>8</sup> of an individual official. Modern treaties with direct investor-state arbitration rights no longer have such in-built “filters”. The construction of key legal terms must therefore provide sufficient filtering so that the treaty is only available to material, substantive and serious breaches and not for the every-day grievances arising from an individual’s interaction with the machinery of government. Cases of administrative misconduct which are not serious enough, in terms of materiality of a breach, amount of damage or lack of instant remedy,<sup>9</sup> do not justify triggering the operation of the heavy and costly treaty machinery under Chapter XI.

15. Finally, I wish to highlight the need to pay attention and respect to the consolidating jurisprudence coalescing out of pertinent decisions of other authoritative arbitral tribunals, in particularly the more recent decisions applying the NAFTA and international investment treaties which have a similar methodology, procedure and substantive content to NAFTA Chapter XI. While there is no formal rule of precedent in international law, such awards and their reasoning form part of an emerging international investment law jurisprudence<sup>10</sup>. This is again a significant difference from

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<sup>8</sup> In the hearing this was referred to as a “bad hair day”

<sup>9</sup> J. Paulsson, *Denial of Justice in International Law*, 2005, at p. 109 citing *Generation Ukraine v Ukraine* at para 20.30 requiring a “reasonable, not necessarily exhaustive effort” by the investor to obtain correction”.

<sup>10</sup> Brower-Brueschke, *The Iran-US Claims Tribunal*, 1998, 651-654; E. Gaillard, *Use of General Principles of International Law in International Long-term contracts*, *Intl Bus. Lawyer*, May 1999 at p. 217: “arbitral tribunals have a strong tendency to use precedents established by arbitral awards rendered in similar circumstances”. This approach has to be a fortiori much stronger in public, transparent and public-policy involving investment arbitration than in commercial arbitration; Gaillard, *La Jurisprudence du CIRDI*, 2004, p. 8, 153; this does not prevent one tribunal disagreeing from another one, but it should preclude a tribunal from departing, without in-depth reasoning if at all, from an established jurisprudence (“jurisprudence constante”), see *SGS v Philippines*, at para. 97 (footnotes omitted) :

“In the Tribunal’s view, although different tribunals constituted under the ICSID system should in general seek to act consistently



commercial arbitration where there is little authoritative and persuasive precedent, largely because the awards are exclusively formulated for the private parties and because they are generally not publicly available. Investment treaty tribunals should therefore place themselves in the centre of emerging international investment law rather than at or beyond the margin:

“To place one decision in a long tradition of similar decisions give the entire tradition of consistency, an “integrity” that is a central feature of law as such”<sup>11</sup>.

16. While individual arbitral awards by themselves do not as yet constitute a binding precedent<sup>12</sup>, a consistent line of reasoning developing a principle and a particular interpretation of specific treaty obligations should be respected; if an authoritative jurisprudence evolves, it will acquire the character of customary international law and must be respected. A deviation from well and firmly established jurisprudence requires an extensively reasoned justification. This approach will help to avoid the wide divergences that characterise some investment arbitral awards – not subject to a common and unifying appeals’ authority. Otherwise, there is the risk of discrediting the health of the system of international investment arbitration which has been set up as one of the major new tools in improving good governance in the global economy<sup>13</sup>. But it also is also mandated by the reference to applicable rules of international Law (Art. 1131 NAFTA) and thereby Art. 38 of the Statute of the International Court of Justice: An increasingly continuous, uncontested and consistent modern arbitral jurisprudence is part of the authoritative source of international law embodied in “judicial

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with each other, in the end it must be for each tribunal to exercise its competence in accordance with the applicable law, which will by definition be different for each BIT and each Respondent State. Moreover there is no doctrine of precedent in international law, if by precedent is meant a rule of the binding effect of a single decision..... It must be initially for the control mechanisms provided for under the BIT and the ICSID Convention, and in the longer term for the development of a common legal opinion or jurisprudence constante, to resolve the difficult legal questions..”.

<sup>11</sup> P. Norton, *Modern tribunals and the international law of expropriation*, 85 *AJIL* 474 (1991), p. 497 ff.

<sup>12</sup> See also Art. 59 of the Statute of the International Court of Justice

<sup>13</sup> World Bank Development Report, 2005, “A Better Investment Climate for Everyone”, pp. 175 – 180.

decisions” (Art. 38 (1) (d)) and will develop, with an even greater legally binding effect, into “international custom (Art. 38 (1) (b)), in particular as an arbitral jurisprudence defines in a contemporary treaty and factual context the “general principles of law” (Art. 38 (1)(d).

3.) Specific Approaches to the Factual Situation of the Thunderbird – Mexico Dispute

17. This case presents neither solely a legal or solely a factual issue, but a situation where the factual situation has to be closely scrutinised, but always with the view of the legal rules and principles that are applicable. The application of a legal rule to a factual situation always involves a certain feed-back between the way the legal rule is defined and the way the factual situation is viewed. The adjudicator’s personal and cultural pre-understanding will inevitably play a role as much as competent professionals will try to minimise and make transparent such a pre-disposition.
18. At issue here is a foreign investment in gambling or, as industry advocates would now call it, “gaming”. This industry has a bad press in many cultures and is not accepted in several religions, including as I understand Canon law, fundamentalist Protestant attitudes and Islamic law. The negative view towards gambling businesses may be the reason underlying the change in attitude that took place between the outgoing Mexican PRI and the incoming PAN government in 2001. It has also been relied upon by respondent in order to colour the case<sup>14</sup>. The former PRI government considered more extensive legalisation of gambling to create employment and re-attract Mexican demand for such services in Las Vegas; the latter seems to have been, to some extent, more closely attached to an attitude negative towards gambling. As far as this dispute is concerned, I have advocated a fully neutral and professional approach, without inherent bias for or against this particular industry. There has been no evidence in this dispute about any of the negative effects of gambling often alleged to accompany such entertainment services – crime, prostitution, money-laundering or similar undesirable by-products justifying an extra-rigorous approach. That liberalisation was in the relevant period under consideration in Mexico is also indicated by a study commissioned by the Mexican Congress on the implications of liberalisation<sup>15</sup> Under the WTO/GATS Schedules of

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<sup>14</sup> Reference: Transcripts of Hearing in April 2004, 92 ff; 1165 ff.

<sup>15</sup> Los casinos en México y sus principales efectos Servicio de Investigación y Análisis sociales: Un análisis de opinión pública División de Política Social SIID

Specific Commitments, certain countries have made specific commitments to liberalize gambling services, namely by offering non-discriminatory treatment to foreign gambling services establishing themselves on the domestic market; recent WTO panel and Appeals Body cases have treated gambling as any normal entertainment services industry as has the European Court of Justice<sup>16</sup>. This indicates that gambling services, in particular if not typically accompanied by criminal by-products, have to be treated as a fully legitimate investment.

19. There is therefore no general or compelling reason to approach gambling investment with a negative attitude compared to other types of investment. All evidence in this particular case points towards operations of computer-programmed slot machines with a “skill” stop button; they have a certain attraction and entertainment value for many people. But from the record of this case and from personal observation of such facilities one now finds throughout the world, it seems not possible to either win or lose large amounts of money in a normal period of time spent. Such video-arcades with gambling machines can not be compared to the high-stakes traditional casinos. None of the criticism of “high gambling” applies here: There is no suggestion of children left destitute because of fathers’ gambling, of family assets dispersed, but a rather mundane activity of putting coins repeatedly into multi-coloured slot machines. As a result, Thunderbird’s operation should be viewed and treated as a normal operation of entertainment services, without any in-built bias against them and in favour of governmental closure.

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Dr. (c) Juan Martín Sandoval De Escurdia DPS, 55 noviembre 2002; available from the internet. Mexico was, as the report for the Mexican Congress shows, under competitive pressure from the US which pulled in a large amount of Mexican gambling business. While “Gambling was illegal in 49 of 50 American states 30 years ago,. Today, all but two of them allow gambling in some form” – C. Caldwell, *Financial Times* 27/8/2005.

<sup>16</sup> See most recently the WTO Appeals Body decision in *Antigua/Barbuda v US* case of 7 April 2005 ; WT/DS285/AB/R following on the earlier panel decision; The ECJ, in established jurisprudence (*Schindler, Laara and Gambelli* case) accepted that gambling is an economic activity and a service that falls under the Treaty’s guarantees of freedom to provide services, most recently: ECJ Case C-243/01 (*Gambelli and Others*, 2003) at paras 44-46; for an overview of WTO and ECJ jurisprudence: Sofie M.F. Geeroms, *Cross-Border Gambling on the Internet under the WTO/GATS and EC Rules Compared: A Justified Restriction on the Freedom to Provide Services?* in: *Cross-Border Gambling on the Internet, Challenging National and International Law*, Research conducted by the Swiss Institute of Comparative Law, Vol. 47 / 2004.

20. The same applies to the corruption hint insinuated by respondent in its submission on the “success fee” paid to Aspe & Arroyo, two of Thunderbird’s lawyer-lobbyists, for negotiating the “oficio” of August 15, 2000. Such insinuations are now frequently employed by both claimant investors and respondent governments. They should be disregarded – explicitly and implicitly, except if properly and explicitly submitted to the tribunal, substantiated with a specific allegation of corruption and subject to proper legal and factual debate for the tribunal. That is simply the implication of the “fair hearing” principle. In contrast to, for example, the WTO dispute system and other international adjudicatory bodies, there is in current investment arbitration only one level of fact-finding. If a tribunal should be influenced by insinuations, there is no appeal instance (at present) in the NAFTA arbitral system which can correct a factual finding or assumption that has a bearing on the ultimate award. It is therefore particularly important for a tribunal not to get influenced, directly or indirectly, by “insinuations” meant to colour and influence the arbitrators’ perception and activate a conscious or subconscious bias, but to make the decision purely on grounds that have been subject to a full and fair hearing by both parties. Cards should be placed, “face up”, on the table rather than be waved around, with hints and suggestions. If the Mexican government had wanted to prove bribery it had the opportunity both to raise it and to try to prove it by providing its officials involved in the transaction for cross-examination; but it chose not to produce them.

Legitimate Expectations (Detrimental Reliance) under Art. 1105 of the NAFTA

21. At issue in dispute – and the main area where I disagree with my colleagues – is whether the conduct of the Government, i.e. SEGOB, the federal gambling directorate, has individually or in its aggregate, created a legitimate expectation for Thunderbird that it could carry out legally its business of computer-driven slot machines involving some measure of skill and human intervention. In this context, the government’s duty to avoid ambiguity towards foreign investors, to send clear messages and to pro-actively correct any misperception manifestly created, to take into account the investor’s need for predictability of government conduct and key attitudes is engaged, also its obligation to take its prior assurances into account when “closing” the facilities. It is not sufficient that Thunderbird had an “expectation”, and that this expectation contributed in a significant way to its readiness to commit risk capital and effort, but the expectation must also have been “legitimate”, i.e. it must have been

created by government officials in an official way (i.e. attributable to the government of Mexico), they must have been competent (or at least appeared, credibly, to be competent) for the trust-inspiring action. The procedure for issuing the assurance (“comfort”) letter must have been legitimate and it must have been “reasonable” for Thunderbird to rely on that letter<sup>17</sup>.

22. The following are the key distinct factors on which the determination of “legitimate expectation” under Art. 1105 of the NAFTA must rest:

- First: The letter “oficio” or “criterio” of August 2000, to be read in conjunction with the following: (i) the request (“solicitud”) by claimant; (ii) the prior, prolonged, informal and preparatory discussions with the competent government officials who later commended the investor’s “cooperative” approach in contrast to the Mexican competitors’ confrontational approach and who encouraged Thunderbird to pursue this cooperative approach; and (iii) the subsequent legal advice by its legal adviser in September 2000 (I do not concur with the majority’s reasoning: paras. 158-163);
- Second: The accepting conduct of SEGOB subsequent to the issuance of the “oficio” in August 2000 which did not raise any questions, did not require any further information, did not inspect or review the operations and which tolerated and did not interfere in Thunderbird’s operation until a new (more anti-gambling minded) government and a new SEGOB director (on the uncontested facts available in the record more anti-Thunderbird-minded) came into office about six months later;
- Third: The conduct of SEGOB under its new director which targeted less the long-established slot machine operations at various locations of Mr Guardia, and certainly had no success (if there was a serious effort) in factually preventing them from operating but which targeted with priority and soonest after taking office Thunderbird’s operation, though (or perhaps

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<sup>17</sup> An excellent overview, with particular emphasis on civil law systems in Spanish speaking countries such as Mexico, is Hector Mairal, *La Doctrina de los propios actos y la administracion publica*, Buenos Aires, 1994; on the requirement that the expectation must be reasonable, Mairal, p. 90, 91. On the requirement that the reliance be reasonable: D.Anderson, *Compensation for interference with property*, 6 EHLR (1999) 543-558, text at note 80

because) Thunderbird had gone the legal way and obtained an “interpretative assurance” which did give green light to Thunderbird, or at least seemed to them to give such green light. (The majority award – paras 174-179 – has no problem with both the relative enforcement intensity and its ultimate success against claimant but not against the Mexican competitor and does not deal with the question if the issuing of the “oficio” has anything to do with the later enforcement and closure)<sup>18</sup>.

23. It is in the combination of these three inter-related and consecutive measures of SEGOB – solicitud, oficio and subsequent conduct - that I find a breach of legitimate expectations under NAFTA Art. 1105 in contrast to the tribunal which finds the “Oficio” of August 2000 not clear enough and tainted by insufficient disclosure, attaches no significance to either the preparatory discussions of Thunderbird with SEGOB where a cooperative approach was encouraged, nor to the subsequent accepting toleration of Thunderbird’s slot machine operations for over six months and which finds no elements of discriminatory treatment in the enforcement intensity, focus and effectiveness of SEGOB as between Thunderbird (rapidly closed after the new government and then the new SEGOB director took office) and Guardia – who continues, it seems, to this day, winning injunctive relief (“amparo”) and maintaining at least several of his long-standing slot machine operations.
24. To understand my different application of the principle of “legitimate expectation” under Art. 1105 of the NAFTA to the factual situation it is necessary to understand its background and scope which is far from simple or un-ambiguous.
25. First the doctrinal structure: “Legitimate expectation” is not explicitly mentioned in Art. 1105 nor in other similar investment treaties. It is, however, considered to be part of the “good faith” principle which is a guiding principle (also a general principle of international law)<sup>19</sup> for applying the “fair and equitable treatment” standard in Art. 1105, a

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<sup>18</sup> The tribunal majority here follows SEGOB in considering the Oficio as meaningless as obtained with insufficient disclosure and as not clearly approving the type of operations carried out. In consequence, the Oficio is for the tribunal of no consequence for the later enforcement actions of the – new government-controlled – SEGOB.

<sup>19</sup> See Bin Cheng, 120 ff. who considers that one of the applications of the principle of good faith is crystallised in the doctrine of “estoppel”, the common law term for “legitimate expectations” (venire contra factum proprium).

standard that is repeated, more or less identically, in most of the other over 2500 investment treaties in force at present<sup>20</sup>. In the current dispute both parties (and the tribunal) assume the existence of such a standard under Art. 1105<sup>21</sup>. They can, correctly, rely on the recognition of “good faith” principle – either as a separate obligation or, arguably mainly, as a major interpretative principle that is applied ancillary to a principal obligation (such as “fair and equitable treatment”)<sup>22</sup>. “Good faith” is explicitly mentioned in Art. 31 of the Vienna Convention<sup>23</sup>. This principle has been applied in intergovernmental relations to reinforce an obligation, to prevent a state to invoke formal law against a claim when it has caused the other state to rely on the way it would exercise rights, and to deny a legal argument to a state when its previous conduct indicated it would not rely on such argument<sup>24</sup>. To cite Derek Bowett in an authoritative statement <sup>25</sup>:

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<sup>20</sup> A recent OECD study on the “fair and equitable standard” mentions “good faith” as a combination of elements: respect of basic expectations, transparency and lack of arbitrariness and quotes the Tecmed v Mexico case to illustrate this link, p. 37-39., - Working papers on international investment number: Fair and equitable treatment standard in international investment law September 2004. Older precedent and modern arbitral jurisprudence (*Metalclad v Mexico*; *Tecmed v Mexico*; *MTD v Chile*; *Occidental v Ecuador*) have not as yet been examined in this study. Legitimate Expectation has been employed as early as the *Aminoil v Kuwait* award; *Amoco v. Iran* – see I. Seidl-Hohenveldern *L’Evaluation des dommages dans les arbitrages transnationaux*, *Annuaire Francais de Droit International*, 1987 at p. 28 mainly, it appears, to correct an otherwise too formal legal approach; similar, in the *Shufeldt* award, a similar approach was used to hold the government to a commitment when the formal contract was not legally valid, but the government had tolerated the operations based on such commitment and had benefited from them by way of taxes and otherwise – as in this case.

<sup>21</sup> *Generation Ukraine v Ukraine*: Para.20.37;

<sup>22</sup> There is a discussion if “good faith” is a separate obligation under international law or rather a guiding principle for interpretation of distinct obligation – so the US government in its Rejoinder in the *Methanex v US* case ([www.state.gov/s/1/c5822.htm](http://www.state.gov/s/1/c5822.htm) at pp. 25-26. But this controversy is not material here. At issue is the application of the good faith principle to support the existence of a legitimate expectation standard as subcategory of the “fair and equitable treatment” obligation.

<sup>23</sup> Bin Cheng, *General Principles of Law*, Grotius, Cambridge, 123 et seq

<sup>24</sup> ICJ *Nuclear Tests Case*, ICJ Reports 1974, 253 at p. 268

<sup>25</sup> Estoppel before international tribunals and its relation to acquiescence, 33 BYIL 176 (1957) cited as authority in *Reisman/Arsanjani*, *ICSID Journal* 2004 at p. 340

“Representations .. may be made expressly or impliedly where, upon a reasonable construction of a party’s conduct, the conduct presupposed a certain state of act to exist. Assuming that another party to whom the statement is made acts to its detriment in reliance upon that statement or from that statement the party making the statement secures some advantage, the principle of good faith requires that the party adhere to its statement whether it be true or not. It is possible to construe the estoppel as resting upon a responsibility incurred by the party making the statement for having created an appearance of act, or as a necessary assumption of the risk of another party acting upon the statement”

26. But such international inter-state rules are difficult to apply in the context of a foreign investor’s reliance on host state assurances as to its law (i.e. a specific interpretation) or as to the way its authorities would proceed<sup>26</sup>. But what can be used from international, inter-state law is the concept that “good faith” and “legitimate expectation” under Art. 1105 of the NAFTA trump the application of domestic law – such as Mexican gambling law as interpreted by the – then – new Mexican government<sup>27</sup>. The good-faith and legitimate expectations principle control, for the relationship between the parties (e.g. Mexico and Thunderbird), the way the Mexican gambling law has to be

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<sup>26</sup> Different from inter-state relations , also within the WTO, with NAFTA investor-state disputes, the parties are on an unequal footing as to conditions of competition, because the host State even if bound by the fair and equitable treatment standard is less vulnerable than the investor to the application of that standard in the specific case at hand, because the investor lacks the retaliatory power of a trading partner. Therefore it is important to interpret more broadly under NAFTA Chapter XI than under the WTO Agreements the legitimate expectations an investor may have with respect to a host state’s assurances..

<sup>27</sup> In international law, as Brownlie has said, “references to the ‘principles of good faith’ are, first, and foremost, indications that the national law of the respective parties is not to apply.” The assumption, so Brownlie is that “the applicable law should be applied in a manner which is compatible with the shared expectations of the parties. I. Brownlie, Ian, Some Questions Concerning the Applicable Law in International Tribunals, in: *Theory of International Law at the Treshold of the 21st Century, Essays in Honour of Krzysztof Skubiszewski, Jerzy Makarczyk (ed.), The Hague, Kluwer Law International, 1996; Reisman/Arsanjani, ICSID Review 2004, at p. 339: “If the investor has relied on that statement, as in public international law, it is difficult to see how domestic law can then be used by the state to avoid responsibility.”*



interpreted<sup>28</sup>. Governments can not, against a determination that under the international law-based “fair and equitable treatment” principle a legitimate expectation of a specific interpretation has emerged, invoke a dominant contrary interpretation under domestic law<sup>29</sup>. The implication of this analysis is that the principle of “legitimate expectation” under Art. 1105 of the NAFTA overrides any dominant interpretation of applicable Mexican law on the legality of the operation at issue if SEGOB can be considered to have given – reasonably and legitimately – such an assurance. Mexico is not compelled by the treaty to change its law or the dominant interpretation of the law at a certain point of time; it is simply obliged to provide financial compensation if its officials have created an investment-backed legitimate expectation with a specific investor that another, or earlier, interpretation would prevail.

27. The principle of protection of “legitimate expectation<sup>30</sup>” or, in common law, estoppel<sup>31</sup>, has also been applied in comparative contract law, mainly to deny formal rights invoked by a party if such invocation contradicts previous statements and conduct that made the other party trust in the particular expectation so created<sup>32</sup>. But contract

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<sup>28</sup> The Government of Kuwait v. Aminoil award, 1982 (66 International Law Reports (1982) at 518) says: Thus, to the extent that Article III, 2 of the Arbitration Agreement calls for interpretation, such an interpretation ought to be based on that provision which not only was freely chosen by the Parties in 1973, but also reflects the spirit which has underlain the carrying on of the oil concession in Kuwait.”

<sup>29</sup> That has also been the conclusion of the MTD v Chile tribunal where a protected legitimate expectation was found to exist, though the building project contravened national planning law.

<sup>30</sup> “Venire contra factum proprium”, “Vertrauensschutz”

<sup>31</sup> Cave v Mills (1962) Court of Exchequer, 7 Hurlstone & Norman, p. 193 at p. 927 (cited from F. de Trazegnies, LA VERDAD CONSTRUIDA: Algunas reflexiones heterodoxas sobre la interpretación legal, TDM 2005 ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com)))

<sup>32</sup> See references in Hector Mairal, Actos Proprios, Buenos Aires, 1994; this use of the concept of “estoppel” seems related to “laches” (“acquiescence”) where prolonged and informed acquiescence will lead to a barring of a claim or an implied waiver, Corpus Juris Secundum, June 2005, 30 A CJS Equity at para. 136. also Fernando de Trazegnies, La Verdad construida, algunas reflexiones heterodoxas sobre la interpretacion legal, in: TDM 2005 ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com)). Trazegnies examines the principle in light of its Roman (and mediaeval) law antecedents and in particular Latin American, Argentine and Peruvian practice: “no es admisible que un contratante o parte en general actue unas veces en un sentido y otras en otro, afirme ciertos hechos en una situacion y los niegue en otra, reconozca y acepte ciertas interpretaciones ..

law – presuming the existence of two equal parties in a commercial contract – is less relevant than comparative public law with respect to the judicial review of governmental conduct. For example, in its well-established jurisprudence, the European Court of Justice held “legitimate expectations” to be a key principle of the relation between state and individuals<sup>33</sup>. The principle requires public authorities (including the European Commission) to respect legitimate expectations it has created with individuals, in particular if such expectations have become the basis for investment<sup>34</sup>. In ECJ jurisprudence, the public authority can not lightly reverse course once it has created such investment-backed legitimate expectations, but has to take its prior conduct into account when planning to reverse its course with a detrimental effect on individuals/ investors. The principle has also been recognised in the jurisprudence of the European Court of Human Rights, here in particular to define the existence of legally protected “acquired rights”<sup>35</sup>. European law does not prevent a public authority from reversing its course, but requires a balancing process where the strength of the individual’s interest is balanced against the need for flexibility in public policy: <sup>36</sup>

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y las desconozca en otra similar, simplemente porque en una le conviene y en otra no le conviene” (at p. 10/11

<sup>33</sup> The principle of “legitimate expectation” is independent from the “fundamental rights” underlying EU law, Case 120/86 *Mulder* (1988) ECR 2321, paras. 23-26; Case 170/86 *von Deetzen* (1988) ECR 2355, paras. 12-15.

<sup>34</sup> See case C-17/03 of June 2005 at para 73 : “The principle of the protection of legitimate expectations is unquestionably one of the fundamental principles of the Community (see, inter alia, Case C-104/97 *P Atlanta v European Community* [1999] ECR I-6983, paragraph 52, and Joined Cases C-37/02 and C-38/02 *Di Lenardo and Dilexport* [2004] ECR I-6945, paragraph 70” . in *Marks & Spencer v Commissioners of Customs and Excise*, 2002, ECR I-6235 the ECJ held that the protection of legitimate expectations applies so as to preclude a national legislative amendment which retroactively deprives a taxable person of the right enjoyed prior to that amendment”; that principle should equally apply to a fundamental re-interpretation of national law that was specifically and formally conveyed to that person who relied on it for making a substantial investment.

<sup>35</sup> *Kopecký v. Slovakia*, at para. 35, 28 September 2004 *Djidrovski v. the former Yugoslav Republic of Macedonia* at para .68 , 24 February 2005 ; case of *s.a. Dangeville v. France* , 16 April 2002.

<sup>36</sup> S. Schonberg, *Legitimate Expectations in Administrative Law*, OUP, 2001; J. Schwarze, *European Administrative Law*, 1992, 880 ff. ; Advocate General Jacobs opinion in ECJ case *RAcke v Hauptzollamt Mainz*, Case C 162/96, at para 95: “Moreover, under Community law, the protection of legitimate expectations may be limited by some overriding public interest”.

“An expectation is then legitimate and ought to be protected if “taking a new and different course will amount to an abuse of power” – “Once the legitimacy of the expectation is established, the courts will balance the requirements of fairness against any overriding interest relied upon for the change of policy”.<sup>37</sup>

28. The principle of legitimate expectation is also recognised in several developed systems of administrative law<sup>38</sup>. The common principles of the principal administrative law systems are in my view an important point of reference for the interpretation of investment treaties to the extent investment treaty jurisprudence is not as yet firmly established. But its exact scope and implication are not well established<sup>39</sup>. There are contradictions between the principle that public administrations have to be utterly clear in their dealing with individuals and to respect any legitimate expectations they have been responsible for and the concept that only confidence in unambiguous assurances by public authorities are protected<sup>40</sup>. Legitimate expectations in EU law can be created by informal statements, including sufficiently precise oral representations and by

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<sup>37</sup> R v North and East Devon Health Authority, 2000, 3 ALL ER 850, para. 57

<sup>38</sup> Schonberg, 2001; De Smit, Woolf & Jowell, *Judicial Review of Administrative Action*, fifth Ed, London 1995, 867 ff; P. Craig, *Administrative Law*, 1994, 611-650; for Latin American countries: Ana I. Piaggi: *Reflections on the basic principles of the Law*, in Marcos A. Córdoba (Director): *Treatise on good faith in the Law*. La Ley. Buenos Aires, 2004. T. I, p. 118.; also: Concurrent vote of Dr. Cançado Trindade in Consultative Opinion 16/99. Inter-American Justice Court, 1 Oct. 1999 – “allegans contraria non audiendus est” . French Law (see Schonberg, op.cit. p. 116 ff.) solves the issue by a extensive recognition of rights acquired by administrative act and protected against retroactive revocation. German law recognizes the principle of Vertrauensschutz as a general principle of administrative law, flowing from the guarantees contended in constitutional law, Hartmut Maurer, § 2 Nr. 17, 15th ed, Munich 2004.

<sup>39</sup> This method of interpretation is also anchored in the explanation of the fair and equitable standard in the new US BIT model (2004) with its reference to the “principle of due process embodied in the principal legal systems of the world”, Art. 5 (2) (a); see also the reference to state practice and the jurisprudence of arbitral tribunals in *Mondev v US*, 42 ILM 85, at para. 119.

<sup>40</sup> Case T-123/89 (*Chomel v Commission* (1990), para 26.; Schonberg, op. cit. p. 120 ff; as noted in para. 28 of this opinion, Schonberg suggests that the principle of legitimate expectation has to be applied with due regard to the particular circumstances – with smaller and less experienced companies deserving greater protection as large companies with the ability to mobilise substantial legal expertise.

government conduct, either by itself or in combination with written assurances<sup>41</sup>. Noteworthy is a reference in Schonberg's comprehensive study to the need for a more subjective approach that takes into account the experience and size of investors – with greater protection for smaller and less experienced investors<sup>42</sup>. The principle is recognised in the Spanish and Latin American civil law systems<sup>43</sup> and presumably forms – as part of the overall principle of “good faith” – part of Mexican civil and administrative law<sup>44</sup>.

29. Legitimate expectation has also been recognised as an important principle guiding the interpretation of other obligations in international economic law. A certain measure of recognition of this principle can be inferred from several WTO panel decisions:<sup>45</sup> “The protection of legitimate expectations of Members regarding the conditions of competition is a well-established GATT principle, which derives in part from Article XXIII, the basic dispute settlement provisions of GATT (and the WTO).”<sup>46</sup> In the main, the principle is here used to protect negotiated concessions from being undermined

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<sup>41</sup> P.Craig, *Substantive Legitimate Expectations in Domestic and Community Law*, CLJ 289 (1996) with a review of relevant ECJ case law.

<sup>42</sup> Schonberg, *op. cit.* at p. 128

<sup>43</sup> Hector Mairal, *La doctrina de los propios actos y la Administracion Publica*, Depalma, Buenos Aires, 1994; Piaggi, *supra*; Trazegnies (2005) *supra*; Cancado Trindade in the *Opinión Consultiva 16/99*, Inter-American Court, 1 October 1999, cited *alter Trazegnies*, 2005: “el que elga lo contrario (de un alegato o un hecho propio anterior) no debe ser escuchado.

<sup>44</sup> S. Zamora *et.al.* 2004, *Mexican Law*, Chapter 17 discusses the concept of “bad faith” – conduct contrary to what was conveyed (“dolo”); I understand from Pedro Coviello, *La Proteccion de la Confianza del Administrado*, Buenos Aires 2004, p. 446 that Mexican author Alvaro Carlos Estrado, *Responsabilidad patrimonial del estado*, 1997, pp. 124-125 discusses the application of the principle of legitimate expectation and good faith in Mexican law, but I have been unable to trace this book.

<sup>45</sup> *India-Patents*, Panel Report para 7.20; *India-Patents*, AB Report 43-45; *EC-Lan* Panel report para 8.25; *US-Section 301*, panel report para 7.67 *Italy-Agricultural Machinery*, GATT 1947 Panel report paras. 5, 12, “provide equal conditions of competition”; *Canada-Autos*, GATT 1947 panel report paras. 10.76, 10.77, 10.80, “less Favourable as Formally Different or Formally Identical Treatment which Modifies the Conditions of Competition,”; *EEC-Oilseeds I*, GATT 1947 panel report, paras. 147-148, 152. See: Marion Panizzon, “Good Faith in the Jurisprudence of the WTO, A Study on the Protection of Legitimate Expectations, Good Faith Interpretation of the WTO Agreements and Fundamental Fairness in Dispute Settlement”, Manuscript submitted to publication April 2005,.

<sup>46</sup> *India-Patents*, Panel Report, para. 7.20.

by conduct of member states contrary to the purpose and spirit of such concessions.<sup>47</sup>

30. While this brief survey of general international, international economic (including EU), comparative contract and comparative administrative law does not specify exactly the contours of this principle, it suggests that under developed systems of administrative law, a citizen – even more so an investor – should be protected against unexpected and detrimental changes of policy if the investor has carried out significant investment with a reasonable, public-authority initiated assurance in the stability of such policy. Assurance on a particular interpretation of often open-ended statute against an unexpected detrimental change of such interpretation is in this context particularly relevant<sup>48</sup>. Such protection is, however, not un-conditional and ever-lasting. It leads to a balancing process between the needs for flexible public policy and the legitimate reliance on in particular investment-backed expectations. The consulted authorities are indicative of contemporary state practice and the minimum standards of comparative national and international law. The “fair and equitable standard” can not be derived from subjective personal or cultural sentiments; it must be anchored in objective rules and principles reflecting, in an authoritative and universal or at least widespread way, the contemporary attitude of modern national and international economic law. The wide acceptance of the “legitimate expectations” principle therefore supports the concept that it is indeed part of “fair and equitable treatment” as owed by governments to foreign investors under modern investment treaties and under Art. 1105 of the NAFTA. It is before this international and comparative law background that

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<sup>47</sup> The WTO AB has associated what it calls the “GATT-specific” principle of protection of legitimate expectations with the general principle of law of good faith to prohibit the US from abusing the injury-test in anti-dumping law, by distributing the funds collected from anti-dumping duties to those of the US businesses, which had voted in favour of introducing and sustaining US anti-dumping duties against EU imports of steel. The US thereby created an incentive to apply trade remedies, which the WTO Anti-Dumping Agreement’s “threat of injury” clause does not foresee, and which the Panel implied, was contrary to good faith. See US-Offset Act («Byrd Amendment»), Panel Report, paras. 7.63-7.64, US-Offset Act («Byrd Amendment»), Appellate Body Report, paras.

<sup>48</sup> Mairal, *op. cit.* 140, 150 ff. ; Schonberg, *op. cit.* p. 109 with reference to HTV v Price Commission, 1976 ICR 1970, 1985: “a public authority which had led traders to rely on one interpretation of a statutory provision could only adopt another interpretation if there was an overriding public interest in doing so”.

one needs to make sense out of several recent investment treaty awards which have applied the legitimate expectations principle, both under Art. 1105 of the NAFTA and the equivalent provisions of applicable bilateral investment treaties. These awards – *Metalclad v Mexico*, *Tecmed v. Mexico*, *Occidental v. Ecuador*, *Waste Management v Mexico II*<sup>49</sup> and *MTD v. Chile*<sup>50</sup> – may not have explained the doctrinal background of the principle, its scope and contours specifically, but these authoritative precedents have contributed towards establishing the “legitimate expectation” as a sub-category of “fair and equitable treatment” in the for this dispute here most pertinent investment treaties (including NAFTA Chapter XI’s Art. 1105)<sup>51</sup>.

31. While these cases for the first time appear to consider “legitimate expectation” as a definite subcategory of the “fair and equitable treatment” obligation, there are precursors. In most of them, legitimate expectation is used as a principle to specify the scope and content of primary legal obligations. In *Revere Copper and Brass v OPIC*, the tribunal identified the “assurances given in good faith to such aliens as an inducement to their making the investments” as contributing to the creation of a protected right<sup>52</sup>. In *ME Cement v Egypt*, legitimate expectation was used to delineate future profitability of a license, for the purpose of calculating compensation<sup>53</sup>. In *Nagel v. Czech Republic* (p. 33), the concept of a legitimate expectation was used to distinguish the existence of a protected acquired right from a mere hope or legally irrelevant personal expectation<sup>54</sup>. The tribunal’s reasoning suggests that the less formal “personal communications”, the less likely is the

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<sup>49</sup> Award published in 43 ILM 967 (2004)

<sup>50</sup> I understand there is an annulment request with respect to the *MTD v Chile* award.

<sup>51</sup> F Orrego Vicuna, *Regulatory authority and legitimate expectations*, Intl Law Forum, Vol. 5, 2003, 188-197; C Schreuer, *Fair and equitable treatment in arbitral practice*, in: J. World Investment, 2005, at p. 374; B. Sabahi, *Protections of Legitimate Expectations*, TDM 2005 ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com) – forthcoming).

<sup>52</sup> Award of August 24, 1978, 17 ILM 1321 (1978) at p. 1331.

<sup>53</sup> *ME Cement v Egypt*, ICSID website, paras 127-129

<sup>54</sup> SCC Case 49/2002; The lack of formality of representations in informal personal contacts with government officials was seen by the tribunal as a reason to deny the existence of an acquired right and legitimate expectation, p. 156: “[Mr X] may, in good faith, have been over-optimistic in interpreting the informal signals he received from his influential personal friends and contacts within the ...Government.”

emergence of a legitimate expectation; this means that the greater the formality of an assurance, the greater its ability to trigger a legitimate expectation. That criterium is pertinent to the highly formalised “Oficio” issues in this case by SEGOB. In *ADF v US*, the tribunal discussed the claimant’s expectation allegedly created by existing case law; but it denied the existence of a “legitimate expectation” because the expectation was not created by “any misleading representations made by authorised officials of the US federal government but rather, it appears probable, by legal advice received.. from private counsel”<sup>55</sup>. That case suggests, e contrario, that it is representations from authorised officials that provide the foundation for legitimate expectations if these representations become reasonably the basis for the investor’s commitment of capital<sup>56</sup>. In *Mobil Oil v Iran*, legitimate expectation was used to calculate compensation for the break-down of negotiations for a termination agreement<sup>57</sup>; it functions in this context as the protection of an interest that has not yet grown into a full-fledged legally binding contract, but is still worthy of protection – similarly to the *Shufeldt*-case<sup>58</sup>. The key feature of these cases is that a proto-contractual interest is protected, albeit, in terms of compensation, at a significantly different and lower level than would be available to a full-fledged, contractually validated legal interest. In *SPP v Egypt*, the tribunal held that “certain acts of Egyptian officials”... were “cloaked with the mantle of government authority and communicated as such to foreign investors who relied on them in making their investment.

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<sup>55</sup> *ADF v US*, Award of January 9, 2003, para 189;

<sup>56</sup> So also B. Choudhury, *Defining fair and equitable treatment in international investment law*, 6 *J World Investment & Trade*, 296 at p. 309; the European Court of Justice in established jurisprudence holds that “comfort letters” bind the Commission unless new facts emerge, see: V. Korah, *Comfort letters – 1981* 6 *ELRev* 14;

<sup>57</sup> *Mobil Oil v Iran*, 16 *Iran-US CTR* 3, 43-44 (1987)

<sup>58</sup> *Shufeldt* case, *Claim USA v Guatemala UNRIAA* 2 (1949) 1081; the case dealt with concession activities carried out without a legally valid concession instrument; nevertheless, the award considered the government to be bound as it had tolerated the activities for a prolonged period and had been quite ready to benefit from it – by way of taxes and related benefits. Similarly, in the ICSID case of *Biloune v. Ghana* (95 *ILR* 183 (1994) at pp. 207, 210) conduct – in the form of an about 12 months’ toleration of the process of setting up and constructing a restaurant was seen as sufficient to create not only a legitimate expectation (a formal assurance was alleged but contested), but justify a farther-reaching claim of “constructive expropriation”.

Whether legal ... or not these acts.. created expectations protected by established principles of international law”<sup>59</sup>.

32. A review of these cases suggests that conduct, informal, oral or general assurances can give rise to or support the existence of a legitimate expectation. But the threshold for such informal and general representations is quite high. On the other hand, a legitimate expectation is assumed more readily if an individual investor receives specifically formal assurances that display visibly an official character and if the official(s) perceive or should perceive that the investor intends, reasonably, to rely on such representation (the element of “investment-backed expectation”). The strongest way to build a legitimate expectation is if both formal and official elements are followed and reinforced by conduct that carries the same message as the investor reads – and can reasonably read – into an interpretative assurance or “comfort letter”. That is as well the implication of both the relevance of subsequent conduct for interpreting a formal declaration of treaty under Art. 31 (3) (b)<sup>60</sup> and the method of interpretation for contracts and unilateral legally relevant declarations in comparative contract law of civil-law countries (such as Mexico).<sup>61</sup> A most recent analysis suggests that specific “expectations that have been created by the acts, statements or omissions of the relevant public authorities” are “close parallels” to the requirement to accord “treatment that is fair and equitable”<sup>62</sup>.

33. As mentioned, the essential difference for the application of the “legitimate expectation” concept under Art. 1105 of the NAFTA and

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<sup>59</sup> SPP v Egypt, 3 ICSID Reports 189, paras. 82-83, of 20 May 1992

<sup>60</sup> “There shall be taken into account, together with the context:

(b) any **subsequent practice** in the application of the treaty which establishes the agreement of the parties regarding its interpretation”;

<sup>61</sup> Zweigert/Koetz An Introduction into Comparative Law, Vol. II, 1977, pp. 71-76 which highlights that in civil law it is not the exclusive focus on the literal face value of a written document, but rather “what the other contractor must in the circumstances have understood him to mean” – “in accordance with good faith with reference to normal commercial usage” (p. 75). The tribunal’s emphasis on reading the “Solicitud” and “Oficio” merely on its “face value” is application of the traditional legal formalism which even in its “home”, English common law, is no longer practised with this sort of context-excluding rigidity, Zweigert-Koetz, p. 80, 81.

<sup>62</sup> S. Fietta, Expropriation and the fair and equitable standard, BIICL Fifth Investment Treaty Conference, 9 September 2005, forthcoming on TDM ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com)). The CMS v Argentina tribunal emphasised the “specific commitment” by government as the basis for a claim (at para. 277, award on the merits).



comparable investment treaties from commercial contract law as applied in international commercial arbitration is that the two parties in investment disputes are not in an equal position<sup>63</sup>. If the parties are in an equal position, a much higher degree of due diligence is justified, as for example in inter-state relations under conventional international law, in WTO law or in transnational commercial relations, as usually adjudicated in international commercial arbitration. Strong parties in an equal position can be expected to deploy more expertise and due diligence to minimise ambiguity in their dealings with each other. Nor can the same requirements as in national judicial review of administrative actions be applied as the foreign investor is in a much more vulnerable, exposed position than a national citizen confronting his administration before national courts. Investment treaties throughout – witness the Preamble and Art. 102 of the NAFTA – are meant to compensate for this weaknesses of foreign investors by a regime of intensified protection. Such special protection for foreign investors is required in order to encourage investment, to compensate for the foreign investors’ structural handicap when entering a foreign society and to help governments enhance the quality of their governance systems. As Elihu Root said, in 1910, about the foreign investor:

“He will naturally be at a disadvantage in litigation against citizens of the country. He is less familiar than they with the laws, the ways of doing business, the habits of thought and action, the method of procedure, the local customs and prejudices.”<sup>64</sup>

And recently Jan Paulsson:

“Whatever the rosy rhetoric about the equality of treatment of nationals and foreigners, the very fact of being foreign creates an inequality. The foreigner’s obvious handicap – his lack of citizenship – is usually compounded

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<sup>63</sup> This feature also distinguishes investment arbitration from the WTO – thus justifying a higher-level of protection; the observation by Schonberg (*supra*, at p. 128) about the need to take into account the specific background of in particular inexperienced investors) suggests that the subjective perception of the assurance by the particular addressee needs to be taken into account – rather than how an ultra-competent and perfect large corporation would have and should have understood the assurance addressed to it by the public authority.

<sup>64</sup> Cited from Jan Paulsson, *Denial of Justice in International Law*, 2005 at p. 23

by vulnerabilities with respect to many types of influence: political, social, cultural.”<sup>65</sup>

34. All international investment treaties aim at attracting foreign capital in a situation where the domestic investor is in a much better position: It is as a rule more expert in dealing formally and informally with the government apparatus; there are often hidden forms of collusion between administrators and local businessmen. What happens in such government-business relationships is usually not visible – it is a “black box” into which foreign investors – and arbitral tribunals – have great difficulties in penetrating<sup>66</sup>. So if “**fair competition**” aimed at (Art. 101 (1)(b) NAFTA) and an “**increase of substantial investment opportunities**” (Art. 101 (1)(c) NAFTA) is to be achieved, there must be an extra attention to “**clarity**” and “**predictability**” for “**business planning and investment**” (NAFTA preamble). The protection of legitimate expectations standard thus says that such competitive opportunities as are protected under Art. 101(1) (b) NAFTA shall not be offset by measures which are in effect detrimental to the “business planning and investment” of the investor. NAFTA Chapter XI is to attract foreign investors to the host state in spite of their greater exposure to the political risk, including the risk of camouflaged domestic competitor-government alliances; the special protections of Chapter XI NAFTA serve as the principal instrument for such an investment promotion policy. As the World Bank Development Report for 2005, the authoritative policy instrument on foreign investment and economic development, formulates the relevant standard for government promises and administrative conduct<sup>67</sup>:

“Can firms rely on them, with confidence, when making their investment decisions?”

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<sup>65</sup> Op.cit. at p. 149

<sup>66</sup> Note here the observations by the Feldman v. Mexico tribunal, para 180, and its efforts to develop a method of presumptions to deal with the “black box” of domestic investor/ competitor with officials collusion.

<sup>67</sup> The World Bank Development Report (2005), at p. 176, highlights the importance of government promises and administrative conduct to be “credible” – in order to support investment – “ (p. 179). It views the use of investment treaties and their “disciplines” as a “potentially powerful tool to enhance the credibility of their contractual and policy commitments”

35. Enforcing rules making such promises effective is both in the long-term and comprehensive interest of the host state and of the investor (at p. 179 ff). The use of the disciplines of investment treaties – here the legitimate expectation principle under fair and equitable treatment – is a “potentially powerful tool to enhance the credibility of (governments’) contract and policy commitments”. As the World Bank Development Report puts it:

“Governments and firms can both benefit. Governments benefit from a commitment device that can address concerns from investors, and thus help them attract more investment at lower cost, and also reduce the risk of any later dispute becoming politicized. Firms benefit from reduced risks and a more reliable mechanism for protecting their rights if the relationship with the host government deteriorates.”

36. These objectives of the NAFTA – both the general objective of enhancing the attractiveness of the host state for foreign investors and the instrumental tool of using greater transparency, clarity and predictability to enable better investment planning– have therefore to guide the process of both defining the conditions of the “legitimate expectations” principle under Art. 1105 and of applying it to the particular facts of a specific situation<sup>68</sup>. They are essentially different from the approach to the “legitimate expectations” concept in commercial and contract law adjudicated through international commercial arbitration. The UNCTAD survey on the “Fair and Equitable Treatment” for investment treaties<sup>69</sup> therefore highlights that the “concept of transparency overlaps with fair and equitable treatment in at least two significant ways”, one being that “the investor will need to ascertain the pertinent rules concerning the state action; the degree of transparency in the regulatory environment will therefore affect the ability of the investor to assess whether or not fair and equitable treatment has been made available..”.

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<sup>68</sup> On the significance of the investment promotion-by-protection objectives of the NAFTA to govern the interpretation: *Metalclad v. Mexico*, para. 75: “ensure the successful implementation of investment initiatives” and “promote .. cross-border investment opportunities”; *Pope-Talbot, Award on Merits I*, para. 77: “The legal context includes the trade and investment liberalizing objectives of the NAFTA”, i.e. the investment liberalizing objectives are the main “purpose” of the Treaty as relevant for interpretation under Art. 31 (1) of the Vienna Convention.

<sup>69</sup> 1999, at p. 51

37. The most relevant NAFTA (and ICSID) awards have translated these authoritative objectives and instruments provided by the NAFTA and similar investment treaties into an emphasis on “transparency” and a concept of “legitimate expectation” that takes up, but further develops the meaning of this concept in conventional international, comparative contract, administrative and European and WTO law jurisprudence. One can observe over the last years a significant growth in the role and scope of the legitimate expectation principle, from an earlier function as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the “fair and equitable standard” as under Art. 1105 of the NAFTA. This is possibly related to the fact that it provides a more supple way of providing a remedy appropriate to the particular situation as compared to the more drastic determination and remedy inherent in concept of regulatory expropriation. It is probably partly for these reasons that “legitimate expectation” has become for tribunals a preferred way of providing protection to claimants in situations where the tests for a “regulatory taking” appear too difficult, complex and too easily assailable for reliance on a measure of subjective judgment.
38. In **Maffezini v Spain**, the tribunal linked the fair and equitable treatment obligation with transparency. The lack of transparency with a financial transaction carried out on government orders and detrimental to the investor was considered the core of the breach of this obligation<sup>70</sup>.

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<sup>70</sup> Award on the merits, para 83; November 13, 2000. ICSID website: “The lack of transparency with which this loan transaction was conducted is incompatible with Spain’s commitment to ensure the investor a fair and equitable treatment”.

39. In **CME<sup>71</sup> v. Czech Republic<sup>72</sup>**, the tribunal found a breach of the fair and equitable treatment discipline in the reversal of its previous position on the legal situation of CME. CME had, held the tribunal, a legitimate expectation that its legal position recognised by the Czech regulator would be maintained and not be changed, without bona fide purpose, to undermine its business, in particular favouring domestic investors. Such a change of the regulator's position on statutory interpretation created an opportunity for the squeeze-out of the investor by its local partner (and competitor). It is the "evisceration of arrangements in reliance upon which the foreign investor was induced to invest" by the new or subsequent government authorities which was at the core of the determination that there was a breach of the investment treaty. As in the current case, the change of legal interpretation by the regulatory agency on which the foreign investor relied allowed a domestic competitor, favoured de-facto, to flourish.
40. The **Metalclad v. Mexico** tribunal interpreted "transparency" to mean:

"that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors.. There should be no room for doubt or uncertainty on such matters. Once the authorities of the central government.. become aware of any scope of misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident

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<sup>71</sup> The tribunal relied here on Detlev Vagts, *Coercion and Foreign Investment Rearrangements*, 72 AJIL 17 (1978) where he suggests that "cancellation .. of the authorisation to do business in which the investor relies... " to establish expropriation. One should probably see the breach of legitimate expectation as a former of less intensive breach than expropriation; investment-backed legitimate expectation is one of the standards to define expropriation, particularly in the form of "regulatory taking" (action tantamount to expropriation), but it requires also a very severe interference in the property right and its economic value. The difference between the lesser-intensity breach and the more intensive breach in the form of expropriation should lie primarily in the compensation – full value in expropriation, reliance damage in the case of a non-expropriatory breach of the fair and equitable treatment obligation.

<sup>72</sup> CME v Czech Republic, partial award of 13 September 2001 paras 133, 611

belief that they are acting in accordance with all relevant laws”.

The tribunal held that the investor was entitled to rely on the representations of the federal officials (para 89) and the The Respondent “failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment. The totality of these circumstances demonstrate a lack of orderly process.. in relation to an investor.. acting in the expectation that it would be treated fairly and justly”. The duty in Metalclad (as in the later MTD v Chile case) is not just a passive duty to ambiguous messages, but to pro-actively take clarificatory action when the government agency knows or should know that the investor has misunderstood the relevant signalling from the government.

41. In **Tecnicas Medioambientales (TecMed) v. Mexico** (para 154), the tribunal held:

“Part of these expectations is the foreign investor’s assumption that the state receiving the investment will act consistently, without any ambiguities, and transparently with the foreign investor so that the investor may know in advance (and thus plan its activities..) not only the rules or regulations.. but also the policies pursued by such rules... and the administrative practices or guidelines that are relevant. “The foreign investor also expects the host state not to act in a contradictory manner; this means .. that the state will not arbitrarily reverse prior or pre-existing state-made decisions or approvals upon which the investor relied and on the strength of which it took on its commitments and planned and set in motion its .. operation”. And it referred to the standard of a “reasonable and impartial man”.

42. In **Occidental (OEPC) v. Ecuador**, the tribunal examined the government’s responses to queries by the investor and found that the official response to such queries was a:

“wholly unsatisfactory and thoroughly vague answer”

and it considered that the “legal and business framework” did not meet the “requirement of stability and predictability” (paras 190-191).

43. In **Waste Management v. Mexico II** (para 98) the tribunal considered that Art. 1105 was breached by:

“a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host state which were reasonably relied on by the claimant”.<sup>73</sup>

44. The recent **CMS v Argentina** (Merits) award confirms the principles developed in *Metalclad* and *Tecmed v. Mexico*. It draws a close link between the fair and equitable treatment standard, the government duty to provide clear and un-ambiguous signals to the investor and the treaty objectives to promote investment<sup>74</sup>. It concurs with my explanation of established jurisprudence according to which the breach of legitimate expectations created by specific assurances now constitutes a self-standing subcategory of the “fair and equitable treatment” standard under Art. 1105 of the NAFTA<sup>75</sup>.
45. This is further confirmed in **Eureko v Poland** (2005); the award quotes (at para 235) with approval the *Tecmed v Mexico* (para 154) statement that:

“This provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment”

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<sup>73</sup> This explanation of the legitimate expectations standard was subsequently relied upon in *MTD v Chile*, para 114.

<sup>74</sup> *CMS v Argentina*, 2005, at paras. 273-280; that a failure to implement a regulatory programme could constitute a breach of a legitimate expectation was also confirmed in *GAMI v Mexico*, paras 97, 108, but only provided in the case (not found to exist here) that, first, the investor was made to trust that such regulatory action would be taken, that it relied on such assurances, that the government was solely responsible for the lack of implementation of promised regulatory action and that a minimum threshold was reached. In *Gami*, the government conduct was too unspecific to be able to create a legitimate expectation.

<sup>75</sup> So also Stephen Fietta, 9 September 2005 BIICL conference presentation, at p. 7; R. Dolzer *Fair and Equitable Treatment: A Key standard in investment treaties*, *International Lawyer* 39 (2005), 87 at p. 105 with a reference suggesting that in analogy to the legal effect of unilateral statements in state-to-state international law assurances given to foreign investors may create legal significance and, at p. 106, that one of the two pillars of foreign investment law is the “protection of the investor’s legitimate expectation”.

and determines that the “discriminatory conduct by the Polish Government is blunt violation of the expectations of the Parties in concluding the SPA..” (at para. 242)<sup>76</sup>

46. These statements on the required clarity mirror established jurisprudence of the European Court of Justice. For example, in **Opel Austria v Commission** (1997, at para 124):

“According to the case-law, moreover, Community legislation must be certain and its application foreseeable by individuals. The principle of legal certainty requires that every measure of the institutions having legal effects must be clear and precise and must be brought to the notice of the person concerned in such a way that he can ascertain exactly the time at which the measure comes into being and starts to have legal effects. That requirement of legal certainty must be observed all the more strictly in the case of a measure liable to have financial consequences in order that those concerned may know precisely the extent of the obligations which it imposes on them”<sup>77</sup>

47. The implications of the obligation to be clear and avoid ambiguity is that the government agency has to bear the risk of its own ambiguity. This allocation of the risk of ambiguity requires that the investor did and could reasonably have confidence in the assurance, not as an ultra-perfect lawyer equipped with a hindsight vision facility, but as a reasonable businessman in the position of the investor would do in

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<sup>76</sup> An not identified recent award in an East European investment dispute relating to oilfield development reported by K. Hober, , OGEL 5-2003, p. 37, 28 ([www.gasandoil.com/ogel](http://www.gasandoil.com/ogel)) also relies on the legitimate expectation of the investor in connection with a joint venture that the state would not subsequently interfere and hamper the on-going operation and implementation of the investment project.

<sup>77</sup> With further references to ECJ decisions upholding the principle of legitimate expectations, paras. 78, 90 and 93: “ The principle of good faith is the corollary in public international law of the principle of protection of legitimate expectations..”. See also *CNTA v Commission*, Case 74/74 (1975) ECR 533 paras. 42-4: on the protection by legitimate expectations by traders relying on the continuation of specified regulatory conduct, without an “overriding matter of public interest” and without “adopting transitional measures which would at least permit traders either to avoid the loss..”. On the need for transitional arrangements in case of the existence of a protected legitimate expectation see also ECJ in the *Marks & Spencer v. Customs and Excise* case, *supra*, at para 34 ff, 38.



the particular circumstances. “Hindsight, of course, is notoriously lucid”<sup>78</sup>; but foresight lacks the sharpness of hindsight. Investors’ lack clairvoyance and need to make rapid decisions on the basis of the way facts are and can reasonably be perceived at the time they become known – not the way they appear after years of litigation. Lord Mansfield, in 1761 said:

“The daily negotiations and property of merchants ought not to depend upon subtleties and niceties, but upon rules easily learned”<sup>79</sup>”

48. Lord Denning, in *HTV v Price Commission*, said that “a public authority which had led traders to rely on one interpretation of a statutory provision could only adopt another interpretation if there was an overriding public interest to do so.”<sup>80</sup>
49. The European Court of Justice has recently confirmed its jurisprudence on “legitimate expectation” and “legal certainty”<sup>81</sup>:

“With regard to the principle of legal certainty, this requires in particular that rules involving negative consequences for individuals should be clear and precise and their application predictable for those subject to them (see, to this effect, *Case 325/85 Ireland v Commission* [1987] ECR 5041, *Case C-143/93 Van Es Douane Agenten* [1996] ECR I-431, paragraph 27; and *Case C-63/93 Duff and Others* [1996] ECR I-569, paragraph 20)”

50. The conclusion that the risk of ambiguity falls square on the shoulders of the assurance-issuing public authority, is reinforced by the traditional international law principle that the construction of a legal instrument in need of interpretation and with elements of ambiguity should be “in dubio contra proferentem”, i.e. that the drafter and the authority issuing a legally relevant statement has to

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<sup>78</sup> Reisman/Sloane, *Indirect Expropriation and its valuation in the BIT Generation*, 74 *BYIL* (2003-2004) 126, 132

<sup>79</sup> *Hamilton v Mendez* (1761) 2 *Bur.* 1214

<sup>80</sup> 1976 *ICR* 170, 185; quoted from Schonberg, *Legitimate Expectations in Administrative Law*, OUP at p. 109, note 14 – with further references. Dissappointment of legitimate expectations would be seen as an abuse of power and an element of procedural fairness.

<sup>81</sup> *Case C-17/03, VEMW v Directeur DUTE*, June 2005

bear the risks of ambiguity<sup>82</sup>. This rule is primarily concerned with interpretation of unilateral legal acts – such as the “interpretative assurance” given by SEGOB to Thunderbird. Related to the “contra proferentem rule” is the legal principle “Nemo audiatur propriam turpitudinem allegans<sup>83</sup>”: It implies in the context of the transparency and clarity obligation on governments under NAFTA that a public authority which has evaded – as bureaucratic behaviour often does – the clarity of expression required by investors, then it can later not rely on the obfuscation it intentionally or negligently deployed to avoid the legal consequences of the legitimate expectation thus created and protected by Art. 1105 of the NAFTA. A change of interpretation of the law has to be reckoned with, but it becomes suspicious and “must be viewed with the greatest scepticism if their effect is to disadvantage a foreigner”<sup>84</sup>.

51. The most relevant Unctad reports – authoritative UN surveys that can not be accused of investor sympathy – tie transparency explicitly to the “fair and equitable treatment” discipline<sup>85</sup>:

“This interpretation suggests that where an investment treaty does not expressly provide for transparency, but does for fair and equitable treatment, then transparency is implicitly included in the treaty (UNCTAD, 1999a, p. 34). Secondly, where a foreign investor wishes to establish whether or not a particular State action is fair and equitable, as a practical matter, the investor will need to ascertain the pertinent rules concerning the State action; the degree of transparency in the regulatory environment will therefore affect the ability of the investor to assess

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<sup>82</sup> Ignaz Seidl-Hohenveldern, *German Yearbook of International Law*, 23 (1980), 412 – identifying not only the allocation of such risk to the “drafting” authority, but also to the party which holds, in the relationship, the “superior” position – as held SEGOB in its relation with the applicant for the “oficio”, Thunderbird. Oppenheim’s *International Law*, 9th Edition, Vol. I, - 1279: “If two meanings are admissible, the provision should be interpreted contra proferentem, i.e. which is least to the advantage of the party which prepared and proposed the provision...”. Also C. Schreuer, *The interpretation of Treaties by Domestic Courts*, 45 *BYIL* 298 (1971)

<sup>83</sup> Reisman/Sloane, 2004, 146

<sup>84</sup> Paulsson, 2005, at p. 200; similarly on comparative law of judicial review of administrative conduct Mairal, p. 140, 150, 152; Schonberg, *op. cit.* at p. 109

<sup>85</sup> UNCTAD, *Fair and Equitable Treatment*, 1999, at p. 59-60; also: Unctad, *Transparency*, 2004 at p. 71

whether or not fair and equitable treatment has been made available in any given case.”

52. Hector Mairal, in his authoritative study of “legitimate expectation” (Actos propios) for Latin American civil law systems, emphasises that ambiguity in an official representation can not free the public administration from the “legitimate expectations” effect if such ambiguity appears intentional and contrived in order to leave to the administration two options while appearing to provide predictability to the individual; if the administration is in a relationship with the individual which obliges it to be clear that imposes an extra duty of transparency and clarity upon it<sup>86</sup>. Schonberg, in his study on comparative law on legitimate expectation has in this context pointed out correctly that smaller and less experienced investors deserve greater protection than large and experienced companies<sup>87</sup>.
53. Similarly, in two recent arbitral awards, an interpretation of ambiguous treaty language in light of the treaty’s investment promotion objective was preferred over a restrictive interpretation that would have allocated the risk of ambiguity to the investor<sup>88</sup>. While these statements have been made in the context of treaty interpretation, they express a principle that is equally relevant to interpretation of official communications between government and

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<sup>86</sup> Mairal, -. 73 : “Cuando el declarante es negligente al incurrir en la ambigüedad y existe entre las partes una relación (.. ) que obliga a ser explícito”. Mairal on the same page also recognises a frequent government practice : “ que la Administración recurre con gran frecuencia a la ambigüedad or sencillamente a la oscuridad en sus relaciones con los particulares”.

<sup>87</sup> Schonberg, op. cit. supra

<sup>88</sup> CSOB v Slovak Republic, para 57, decision on jurisdiction, May 24, 1999 on ICSID website; SGS v v Philippines, decision on jurisdiction, 2004, para 116: “The BIT is a treaty for the promotion and reciprocal protection of investments. According to the preamble it is intended “to create and maintain favorable conditions for investments by investors of one Contracting Party in the territory of the other”. It is legitimate to resolve uncertainties in its interpretation so as to favour the protection of covered investment”; also Loewen v. US (5 January 2001, para 40 ff): “The text, context and purpose of Chapter Element combine to support a liberal rather than a restricted interpretation... and: citing Ethyl v Canada, award of 1998, 38 ILM 708 –“ that is an interpretation which provides protection and security for the foreign investor and its investment and to “increase substantially investment opportunities”. MTD v Chile holding that the treaty standards had to be interpreted “in the manner most conducive to fulfil the objective of the BIT to protect investments and create conditions favourable to investments”, para 104.

investor, arguably even more so as different from a bilateral treaty, an official communication from government to a foreign investor is not a bilateral agreement, but a unilateral communication solely under the responsibility of the issuing government agency.

54. These observations describe the legal contours of the principle of “legitimate expectations” under Art. 1105 NAFTA. But it is helpful to take an even closer look at the decision and underlying rationale of the arbitral tribunal in the very recent MTD v Chile case which should be considered the most relevant authoritative precedent:
55. In MTD, a Malaysian investor planned an investment in housing in Chile. The government made at a high political and administrative level positive noises; it assured the investor of its welcome. It signed a formal investment contract which, however, did not include any specific approvals for the investment project at issue, but rather formalised the grant of foreign exchange and tax-stability related investment guarantees; this investment contract also clarified that it was not a substitute for specific zoning permits and other applicable authorisation requirements. The investor was thus made to believe in the positive attitude of the government. Chile issued, at a senior governmental level, a formal endorsement of the project though the project could not be done under the regulatory framework as it stood at the time of such endorsement. The investor was unaware of this, was not made aware of this and the minister responsible for the sector was not even invited to the relevant meetings. Without the investor’s knowledge, other government authorities that were opposed to the project, took active steps to counter local support of the project and in the end ensured the project could not go ahead due to the lack of required zoning permits. The difference to Thunderbird is that the contradiction was there not simultaneous, but in the consecutive actions of government. The MTD tribunal did recognise that a “rigorous due diligence” by the investor – inexperienced and new to Chile – would probably have identified the crucial obstacles to his investment plan (para 117):

“A wise investor would not have paid full price up-front for land valued on the assumption of the realization of the project” (para 242),  
but:

“Chile has an obligation to act coherently and apply its policies consistently independent of how diligent an investor is” (paras 165-166)

56. The tribunal considered such contradictory conduct by the competent government authorities to constitute a breach of the “legitimate expectation” principle – as sub-category of the duty to fair and equitable treatment. It found that the “investment promotion” obligation was not just a prescription for passive behaviour or avoidance of prejudicial conduct, but had a “pro-active” meaning. Relying on *Tecmed v. Mexico and Waste Management II*, the tribunal found a breach of the legitimate expectations of the investor in the governments failure to “act consistently”, to be “free from ambiguity and totally transparent with the foreign investor so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant practices and directives” (para 114). The tribunal took account (also in terms of mitigating the compensation claim) of the “unwise business decisions or .. lack of diligence of the investor” though “counsel for Chile in effect argued for the notion that the claimant was foolish to have relied upon representation of the government”<sup>89</sup>. In MTD, the formal approval of the financial arrangements for the project and official signals about its desirability were in contradiction to urban policy and regulation; the fact that this contradiction was not conveyed to MTD before it committed its investment, constituted the breach of the fair and equitable obligation; this situation is not that different from the positive “Oficio” of August 2000, confirmed by continuing acceptance of the operations by SEGOB, but then, and in contradiction to the earlier actions and positions taken by the former government, followed by the targeted and prioritised enforcement of the Mexican gambling law against Thunderbird by another, new, set of officials and political forces acquiring powers under the new government.

57. The MTD award supports the view that even if government assurances were ambiguous and an extra-careful investor could have found this out, the government still owes a duty of consistency and protection of legitimate expectations to the foreign investor. This is not a passive duty, but a pro-active duty (as in *Metalclad v. Mexico*) to ensure investors are not misled and are made to realise where the “true” directions of government policy for the issue at stake lie. This approach is in contrast with the “caveat emptor” and “due diligence” approach in commercial arbitration, but also, to a lesser extent though, to some statements in for example comparative

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<sup>89</sup> See a case comment by Ian Laird on the MTD v Chile case, [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com), 2004

administrative law where the risk of ambiguity in the governmental assurance is either assumed by the citizen, or at least balanced against a duty on the public agency to provide un-ambiguous statements. The MTD v Chile award thus reinforces a reading of the legitimate expectation principle that is distinct for investment disputes. It acknowledges the structural weakness of the investor – in MTD as in Thunderbird we have entrepreneurial investors without extensive country experience – when confronted with a foreign country that wishes to attract such investment. Such a pro-active duty to ensure the foreign investor does not succumb to a visible misunderstanding is even more acute in cases where there are substantial indicators of “black box” collusion between administrative agencies and powerful domestic competitors. This conclusion has a bearing in particular on my point No. 2 – subsequent accepting conduct by SEGOB – for assuming the existence of a “legitimate expectation” by Thunderbird protected by Art. 1105 of the NAFTA.

58. It is with these interpretative guidelines that I will now examine the factual situation.

5.) Did Thunderbird have a “legitimate expectation” that it could operate its “skill” slot machines in Mexico?

59. The issues are essentially if the “Oficio” (“official response” or “criterio” (translatable as “legal opinion” in this context) of 15 August 2000 and the subsequent conduct by SEGOB can be qualified as creating a “legitimate expectation” with Thunderbird that it could legally operate its slot machine facilities. The majority of the tribunal rejects this interpretation; I respectfully disagree. The relevant meaning of investor and government conduct and communications with each other can not only be determined from within the “four corners” of the legal documents, but must be appreciated with an approach that recognises realistically the practicalities of the foreign investment process. The legal documentation has to be understood before the context in which the investor-government interaction takes place. The interpretation of the key document – the official, authoritative, unilateral assurance in the format of the “Oficio” – needs to rely on international and comparative (civil law) methodology applicable to contractual, and where distinct, unilateral, documentation. That means that the text has to be assessed as it represents a “meeting of the minds” of both parties and in particular as it was, reasonably and for both parties manifestly, understood by the investor to whom the “comfort letter” was addressed, taking into

account the history of their interaction, the context, the purpose and the subsequent conduct of the parties<sup>90</sup>.

60. In light of the differing opinions on the legal value and meaning of the “Oficio”, one needs to bear in mind the burden of proof situation: Thunderbird has to prove that the Oficio conveyed to it, from the perspective of a reasonable foreign businessman in the gambling industry and in the specific context of the interaction between Thunderbird and SEGOB, the message that it could operate the software-driven video poker machines it imported. Mexico, on the other hand, has to prove that the Oficio was tainted by insufficient, but mandatory disclosure by Thunderbird. This is a high threshold because, first, Mexico has to counter the presumption of the validity of official acts of government which respect for government requires; secondly, it has total control over all the documentation and witnesses – its own past and present SEGOB officials who alone can testify about what they knew and did not know. We therefore have to measure the evidence to see if Thunderbird has met this burden of proof, and, if so, Mexico has met its burden of proof.

The “Solicitud”: Request for negative clearance

61. It is not contested that Thunderbird was very keen to get a “negative clearance”, “green light” or an in its sense, positive interpretative assurance from the government that its “skill” machines were not covered by the Mexican gambling law. It rejected the strategy of Mr Guardia who kept his profitable slot machine operations alive by using a sequence of mostly successful, mainly injunctive appeals, and seems in whatever way have managed to defeat any attempt at effective enforcement. This is characteristic of the way a foreign investor approaches a business the legality of which is not certain: A domestic investor, often with tacit allies in the administrative and

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<sup>90</sup> Art. 31 of the Vienna Convention on Treaties; on civil law contract interpretation: Zweigert/Koetz, *An Introduction to Comparative Law*, Vol. II, 1977, at page 73 “..one should seek out the common intention of the parties rather than adhere to the meaning of their words; in case of doubt, a contract should be construed so as to have validity.” And “what matters is not what real intention lay behind what one contractor said but what the other contractor must in the circumstances have understood him to mean” (p.75). “The judges must use the principle of commercial good faith and the guidelines of the intention expressed in the contract for the relationship” and (p.80): “ the evidence of witnesses is held to be admissible whenever the contract clause in question is obscure or ambiguous”

judicial institutions, can afford more easily a blatantly illegal conduct. A foreign investor will want more legal certainty – and in Thunderbird’s case that seems also to have been urged by its venture investors. It thus took the most “legal” course by asking SEGOB, and trying to persuade it, to assure it that its “skill” machines – in effect combining chance and skill – were not covered by the law.

62. Thunderbird’s proposed interpretation - that machines involving a substantial amount of skill (in addition to chance) could be considered legal - was not implausible<sup>91</sup>. As all other players in the industry, it used the label of “skill machines” to highlight the involvement of skill in order to make the point for the interpretation of the Mexican Gambling Act it advocated. Witness Watson reports that former Gobernacion Secretary Labastida, had informally supported the approach to get a comfort letter (Oficio) from the government that confirmed and repeated the “skill” argument already, reportedly, raised in a litigation in “northern Mexico”<sup>92</sup>. SEGOB does seem to have a certain administrative and interpretative discretion, both with respect to interpreting the law and with respect to directing enforcement efforts<sup>93</sup>. The older and the more obsolete a law, as the 1940’s Mexican Gambling Law, the more grows the need and the space for interpretation. Thunderbird had – this is not contested – received encouragement from a very senior Mexican politician – formerly the Minister in charge of Gobernacion (Labastida) -to go forward. Liberalisation of the 1943 gambling law was considered in Mexico during the end of the PRI government in

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<sup>91</sup> See the testimony by Mexico’s expert Prof Rose, p. 791 “clearly require some skill”; “certainly skilful players will do better “ (p. 793); referring to a court that said: “this is a game of skill if you have the time to sit and play it” (794) and referring (p. 795) to the “learning curve whether the more you play it the better you do and a learning curve should be fairly steep at the beginning” and (p. 796) “the more you play those games, the better you’re going to do”.

<sup>92</sup> Watson, p. 404: “ Mr La Bastida stated in general terms that he was aware of the skill game litigation that had taken place in northern Mexico; that in light of the outcome of that he felt that the letter (i.e. the Oficio) which Gobernacion had issued to us was appropriate .. because of some precedent”

<sup>93</sup> Prof Rose testified for Mexico about the role of the regulatory agency’s powers and the widely interpreted concept of “predominantly” skill or chance – pages 766, 768, 769, 773, 774, 775; Alcantara (pp. 880, 881) testified that action would – if it were to depend on him (“believe me”) be taken “right away”, but that he acted merely as a subordinated officer to higher authorities in Gobernacion that decided on how to focus and prioritise enforcement – namely the “government unit of Gobernacion” (p. 881. p. 922: “I follow instructions. I don’t decide things on my own” (p. 922). Respondent has not made available any testimony from Lic Alcantara’s superiors who “called the shots” on enforcement matters.



order to bring it in line with modern developments outside Mexico and to re-attract gambling income and employment that had moved to the Caribbean, Las Vegas and US Indian reservations<sup>94</sup>. As Mexico's expert testified on the potential to liberalise the gambling regulation in Mexico:

"There was a great movement right before President Fox was elected" (i.e. in 2000, the year the "Oficio" was issued).

63. There were no particular public order concerns with the type of coin-operated, computer-programmed video-slot machines. The then Mexican PRI government had the choice of either changing the law in a formal, time-consuming and politically costly process or to try out a more low-profile liberalisation by introducing and then testing a re-interpretation of the law to relax its margins. Thunderbird's description of its machines as "not involving chance" was factually – with the hindsight of this tribunal's expertise – incorrect, but it was a qualification for interpretative purposes that was also used by other operators (including Guardia), possibly suggested by Mexican experts. The issue of skill versus chance was well known to SEGOB from its confrontational interaction with Guardia and in several other litigations since 1998<sup>95</sup> as a suggestion to stretch the prohibition of the 1943 Gambling Law. As the report of the discussion with former Gobernacion Secretary Labastida indicated, the concept of liberalisation by "stealth" through re-interpretation of the "skill concept" is likely to have been common currency among senior officials and politicians with some knowledge of gambling regulation in Mexico. It was also the standard criterium operators and

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<sup>94</sup> Mexico's expert Prof Rose testified (p 776) on the prospect for liberalisation of Mexico's gambling law in the end days of the PRI government: "There was a great movement right before President Fox was elected and then some sort of scandal or political issue hit, and the government had to back away". This is consistent with the study for the Mexican Congress, op.cit. of 2002 and the testimony of Thunderbird expert Watson on his discussion with former Gobernacion Secretary Labastida (p. 404, 423-424) which indicates a positive attitude towards the relaxation of the gambling prohibitions by using the issue of "implication of skill" as an opening. That testimony – consistent with Mexico's expert Rose's comment – also suggests that the "Oficio" was using a re-interpretation of the skill concept in "skill game litigation.. in northern Mexico" appropriately (p. 404, bottom).

<sup>95</sup> Cross-Examination of Lic Alcantara at p. 852, testifying that the "skill" issue arose since 1998, in particular (page 874) with Guardia, then accelerated in several litigations.

regulators used when desiring to relax more prohibitive gambling regulation<sup>96</sup>.

64. It is in this light that we have to see the August 3, 2000 request (“solicitud”) by Thunderbird for an authoritative opinion (“criterio”). Thunderbird’s “solicitud” makes it clear that such a “comfort letter” by SEGOB is desired to provide legal certainty for the investment envisaged – and it is not contested that Thunderbird had such an intention and that SEGOB officials understood this perfectly well<sup>97</sup>. In interpreting a unilateral declaration under international law, the relevant ICJ jurisprudence has emphasised the “significance of the intention behind the unilateral declaration made by a state”<sup>98</sup>. It is therefore not a free-standing abstracted from its context text as it appears to a tribunal years after the event, but the intention as it was conveyed and, moreover, as it was – reasonably - understood by the specific investor in that specific situation that counts. Literal interpretation purely on an isolated text is a traditional common law method (itself not applied strictly any longer and least in situations of ambiguous declarations); but it is not appropriate to our situation where, next to the NAFTA, Mexican law, and thereby also interpretation method, is applicable. The relevant ICJ jurisprudence deals mainly with unilateral declarations “erga omnes”. Here we do not have a declaration erga omnes, but a governmental representation made in the context of a specific relationship. In that specific relationship, the reading of the interpretative assurance letter needs to be guided by what both parties involved understood the purpose and factual background of the letter<sup>99</sup>. The “face” of the letter is largely gibberish if not read before the context, the parties’ common intention and the meaning that was intended to be conveyed and that was reasonably so understood by the addressee of the

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<sup>96</sup> Testimony Prof Rose, p. 766

<sup>97</sup> Testimony, among others, by CEO Mitchell and Watson all confirm that getting an interpretative and official assurance and support letter was crucial for Thunderbird, see only (among several other indications) Watson, p. 417 “so we cautioned him and told him that it would probably be far better if he sought some type of clarification from SEGOB in order to go forward” and (418) “ I understood ... we needed to look carefully and work with Gobernacion”.

<sup>98</sup> Reisman/Arsanjani, The question of unilateral governmental statements as applicable law in investment disputes, ICSID Review 328, at p. 331 with reference to the ICJ case of the Temple of Preah Vihear.

<sup>99</sup> So the International Court of Justice in the Nuclear Tests Case (Australia v France) 1974 ICJ 253, 269 which held that to determine the legal value and meaning of a unilateral declaration: “it is from the actual substance of these statements, and from the circumstances attending their making, that the legal implications of the unilateral act must be deduced, at para. 269.

“Oficio”. Even if there was a divergence – i.e. if SEGOB had a more modest intention with the assurance letter, then the – reasonable – perception of the investor as the relevant specific addressee of the letter has to prevail. The reason is that it is the investor that is to be encouraged by the assurance letter, the investor that comes with capital and exposes its capital to government risk. It is therefore the investor’s confidence that is to be reinforced by the Oficio. To quote Reisman & Arsanjani:

“.. the inclination of an international tribunal to infer that a unilateral act has given rise to a binding obligation will probably be reinforced if the state making the declaration expects to receive clear benefits on the basis of the declaration”<sup>100</sup>.

65. Different from the majority (see para 157), I see no lack of required disclosure: Thunderbird disclosed clearly that at issue were video slot machines and identified them in a way that for a knowledgeable Regulator it was clear that these were video-gaming devices. I accept Mexico’s suggestion that these were most likely refurbished gaming devices used by Thunderbird in the US. But this does not detract from the fact that for somebody with experience in the gambling industry it was clear that these were video-gaming devices. The reference to BESTCO should have alerted the most sleepy gambling regulator that these were video gambling machines produced by one of the largest US producers of such devices. One can not assume, again, that the Mexican gambling regulator who according to its own statements had fought for years with Mexican businessman Guardia over video-gaming machines labelled as “skill” machines would not have been aware both of BESTCO as a major supplier of such machines. A short look at BESTCO’s website and a google search confirm this<sup>101</sup>. The same applies to the reference to “SCI-Support

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<sup>100</sup> Op. cit., at p. 336; Mexico has – as in the relevant much earlier Shufeldt case – continued to benefit from the investment made in terms of employment, taxes and levies.

<sup>101</sup> Top two listings in a Google search for BESTCO and gaming (August 2005):

[The Best Games are from BestCo Electronics](#)

BestCo Electronics offers new and refurbished redemption games including 8-line games, video poker, cherry master and more. Game accessories, parts and ... [www.bestcoelectronics.com/](#) - 15k - [Cached](#) - [Similar pages BestCo Electronics](#)  
BestCo is one of the largest manufacturers and developers of video gaming ...  
Manufacturing, Sales & Service of games and accessories including boards, DBA, ... [www.casinovendors.com/VendorPage.cfm/81151.html](#) - 10k - [Cached](#) -

Consultants” as an identifiable manufacturer of video slot gambling machines, class III, deployed on US Indian reservations. The reference to BESTCO and SCI is therefore not misleading; it is a clearly identifiable reference to video slot machines. It is consistent with the result of the cross-examination, namely that SCI (K. McDonald) probably refurbished Thunderbird and other operators’ video slot machines previously used in US Indian reservations<sup>102</sup>.

66. Its letter otherwise needs to be seen not as a detailed factual description of the functioning of the machines (which it was not asked to provide), but as development of the legal argument as it had emerged in earlier litigation and already indicated in the discussions with ex-Gobernacion Minister Labastida. It made the legal argument that the machines were either only skill-based (para 3, which was overshooting reality), but it then referred in order to suggest as reason for legalisation, that “**skills and ability is involved**” (para 6). This qualification for legal purposes is correct and it advances from the earlier reference that the machines were “only” skill-based. The issue was here to propose to SEGOB a legal qualification to help the liberalisation by “stealth” through a cautious interpretative strategy – that the machines were “skill” machines because they were used “in entertainment where skills and ability is involved”.<sup>103</sup> Thunderbird’s “Solicitud” described the character of these machines in a light so as to make it easy to subsume them under the label “skill” machines<sup>104</sup> -

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SCI: <http://www.cniga.com/members/associate.php>: Support Consultants – can be identified via Google associated with Thunderbird, witness Kevin Mc Donald: Its listing indicates: “SCI manufactures, distributes, refurbishes and services standard and custom video slot machines for the Native American gaming market. SCI specializes in parts repair and combination Class III/ Bingo products.

<sup>102</sup> I accept the point brought out in the presentation and cross-examinations conducted by respondent that the “model qualifiers” for the BESTCO and SCI machines were ad-hoc identifiers rather than normal trade names, but that would also be consistent with the idea that it was machines refurbished ad-hoc for Thunderbird’s use in Mexico.

<sup>103</sup> That key statement is contained in paragraph 6 of the Solicitud; it does not follow any factual description, but refers to the investor’s need for “certainty” that the operation is “legal” under the Ley de Juegos y Sorteos”.

<sup>104</sup> Technically, the machines combined chance and skill – at the beginning of a player’s competence, chance presumably prevails, while then – so Mexico’s expert Professor Rose (see supra) – there is a “steep learning” curve so that the role of skill increases significantly. The skill component consists mainly of probability calculation, possibly also of some element of physical alertness. The abundance of technical manuals for playing poker and their emphasis on understanding probability analysis suggests that skill plays a role and can be greatly enhanced by learning. Otherwise, there would be no point in using these manuals to

a term that was used, for reasons of suggesting compatibility with the law, throughout the industry in Mexico<sup>105</sup>. Its statement – that “chance and wagering is not involved” was involved, is technically not correct. However, it should be seen not as a scientific analysis but as rather a legal-interpretative term suggesting (or repeating a suggestion informally made by SEGOB as can be inferred from Waton’s testimony on the discussion with Labastida) how the law could be interpreted to allow such machines.

67. Virtually all games, indeed all human activity, involve some element of skill and chance (including say chess or football);<sup>106</sup> only some games – presumably the more mechanically and machine-based chance-oriented games – have in practice been prohibited in Mexico. As Mexico’s principal expert Prof Rose put it:

“The second, element (sc. in gambling law), chance has caused the most problems in the courts. Part of the problem is that if every human activity is mixed skill and chance, the question is simply where you draw the line”<sup>107</sup>. And: “In England, any skill at all takes a game out of the prohibited lottery category. California outlaws slot machines if any chance enters into the payoff, but then states that devices that are predominantly skill are legal”.

68. So the legal-interpretative view that is put forward does not amount in my view to a lack of disclosure, but rather reflects the particular interpretative strategy, a strategy that Professor Rose describes in detail as the interpretation normally put forward to justify liberalisation<sup>108</sup>. In his extensive study on gambling law – and I have to take this as authoritative as he has been put forward by Mexico as the principal authority on gambling law – he describes courts that recognised video poker as a game of skill and other courts which did not do so. But putting forward a legal view based on several respected

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enhance skill and thereby the probabilities of winning. To rely on the Supreme Court of California – after N. Rose, *Gambling and the Law*, p. 81: It “pointed to the large body of books and periodicals discussing strategy for playing the game. “The existence of such a large amount of literature designed to increase the player’s skill is a persuasive indication that bridge is not predominantly a game of chance”.

<sup>105</sup> Confirmed by the witnesses from both sides, Alcantara and Watson, see *supra*.

<sup>106</sup> Also testimony of Mexico’s expert Prof Rose, 793 ff

<sup>107</sup> I. Nelson Rose, *Gambling and the Law*, , p. 79, 80

<sup>108</sup> *Ibidem*, p. 79-82, 90-95.

US courts in Illinois and Pennsylvania – that video-poker is a game of skill or a game predominantly of skill<sup>109</sup> – can not constitute a deception. Thunderbird was not asked or expected to provide a dispassionate academic study on comparative regulatory approaches on video poker machines to the Mexican Regulator, but did suggest, and was expected to do so, its view on how the machines could and should be legally qualified. It naturally advocated an interpretation that was in its favour rather than develop the reasoning for an opposing view. Nothing else is expected of professional advocacy, including in interaction with an industry Regulator.

69. The tribunal thus views as factual statements – and in this respect incorrect and lacking in required disclosure – what I consider is not a factual and technical statement, but a legal qualification of the machines made with the very intention to suggest an interpretation that would extend the boundaries of the 1943 law. I should add that I do not consider the “Solicitud” as the most technically perfected document. Thunderbird did not highlight the fact that “chance” was inevitably involved in playing such machines (but as Prof Rose testified and we all know, chance is involved in any activity), but it did reduce its original claim that “no chance was involved “ to, later in the Solicitud, that “skill” was involved (i.e. that it was not exclusively a skills game). That some level of “skill” is involved has not been disputed in the case; the tribunal has come so far as to suggest that a “considerable degree of chance” was involved, without, however, being willing and feeling competent to quantify specifically the “degree of chance” (See para 136).
70. Thunderbird did not say these were refurbished Thunderbird videopoker machines; it did not say that Guardia was using the same type of machines. It did not invite SEGOB to inspect the machines nor did it provide manuals. But SEGOB did request further information when it wanted to – such as later in 2000 when a request for a similar “Oficio” was launched by Mr Gomez. That Thunderbird did not provide the information Mexico now thinks they should have provided is, in my view not material. They were under no duty to do so. If SEGOB had felt in summer 2000 there was a need for more, it

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<sup>109</sup> N. Rose, *Gambling and the Law*, p. 94: “Is video poker a game of skill? The Illinois court thought so, but other courts have not been so charitable. Trial courts have given mixed results...” “Pennsylvania is typical of the confusion over these machines. Various trial courts in the state came to various decisions; some finding video draw poker machines were gambling devices per se, other courts holding that they were games of skill”.

should have requested Thunderbird to provide whatever it considered relevant. If Mexico now raises them in arbitration, but did not raise them during the informal and formal process of *Solicitud* and *Oficio*, this suggests that it changed its mind on information requirements under the impact of a new government and the arbitration. Relevant non-disclosure – deception – would only then have been material if SEGOB had requested such information and Thunderbird had in response provided false information.

71. The signs were there – it must have been clear to anybody involved – that Thunderbird was testing the waters with a cooperative approach to government for video-slot machines issuing prizes (or US Dollars, as a prize that eschewed offering Mexican pesos – legal tender – as prizes). From the prolonged period of informal consultations – the claimant’s factual assertion is not contested<sup>110</sup> – the presumption arises that SEGOB officials knew what was at issue – and most probably suggested or at least approved of the very low-profile and discreet description. I can not agree that the tribunal “cannot rely on presumptions or inferences, let alone speculation concerning that background” and interpret the 3 August 2000 *Solicitud* on its “face value” (para 150). The significance and the meaning of the *Solicitud* and the *Oficio* can only be understood when the itself undisputedly convoluted and ambiguous text is read before the background of the parties’ interactions, their level of knowledge, their role and relationship (regulator vis-à-vis clearance seeking investor) and interests. That is standard interpretation of contracts and related instruments, and in particular in civil-law countries such as Mexico<sup>111</sup>. Not only does *Oficio* have to be interpreted on the basis of the parties common intentions and the context of their interaction, but also with the principle of good-faith which emphasises transparency, clarity and discourages the abuse of intentional ambiguity to allow a government to first make the recipient and investor believe one message and then turn around and claim it really had sent the opposite message. In addition, as we have – as mostly in litigation – a not completely verified factual situation, it is

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<sup>110</sup> Crosby, p. 26; Mitchell, p. 290; Crosby, p. 37: “and the fact they came back with a refining of the standard indicates knowledge on their part of that they were intending to do..” Mitchell’s testimony – so far never contested – was that informal consultations had gone on for a prolonged period, and then intensified through lawyers Aspe and Arroyo (with a more technical role for Ruiz Velasco, their formal legal adviser on Mexican law) throughout summer 2000.

<sup>111</sup> F. De Trazegnies, *La verdad construida, Algunas reflexiones heterodoxas sobre la interpretación legal*, in TDM 2005 ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com))

normal and necessary to use inference and presumptions to derive from the evidence that is available what was most likely to have happened.

72. The “solicitud” did not come out of the blue; the normal way to go about such matters is to informally sound out, negotiate and prepare in such an evidently very sensitive matter both the “solicitud” and the “oficio”. This has to be the common-sense assessment of the situation. That would make eminent sense in terms of the “stealth liberalisation by interpretation at the law’s margins” strategy that can be easily identified. If the unlikely course of action had been that SEGOB was surprised by a request coming out of nowhere and then reacted a little bit confusedly, as must be Mexico’s and the tribunal’s understanding, then it was up to Mexico, using its control over SEGOB officials, to prove a course of event that would be strikingly different from the way interaction between an investor and a regulating agency normally proceed.
73. Whatever the defects of the letter (and with hindsight and professional perfectionism a technically perfect “solicitud” separating a technical description from suggested legal qualification could have been written), I do not concur that by not providing manuals, complete technical specifications and not forcing SEGOB to inspect and test the machines physically,<sup>112</sup> Thunderbird failed with its disclosure duties in a way that any response would be invalidated. SEGOB was not a group of widows and orphans to whom shoddy goods are deceptively sold at the door and which requires the special protection of the law: It was the chief gambling regulator in Mexico; it had battled with Mr Guardia about precisely this type of machines since at least 1998<sup>113</sup>; its legal battles with Guardia had been at the centre of SEGOB activities. According to the chief witness on this issue put forward by Mexico, the issue of the “skill versus chance machines” had been at the forefront of its litigation activity –

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<sup>112</sup> Mexico’s counsel suggested proper disclosure should have included the “slot that you can put US \$”, “manuals and operating instructions”; a “machine to show how these machines worked or even photographs of these machines”, p. 99-100. But that seems to be second-guessing ex-post the Mexican gambling regulator’s role. They had to know, and presumably did know, what information they needed and wanted. They could have easily obtained any information they wanted from Thunderbird as they controlled the process of the for Thunderbird vital “green light clearance”.

<sup>113</sup> Alcantara, 874, 917 (“there have been a number of decisions by the Supreme Court, one in 1998, and four other ones in 2000”)



including five Supreme Court decisions. It is therefore not conceivable that when SEGOB received the *Solicitud* it did not think of the issue of using the “skill involvement” for relaxing the Mexican gambling law prohibition. The machines itself – and that is essential – were identified in a way that allowed SEGOB to know they were video-slot machines used in the US for class 3 gambling.

74. If SEGOB had had the slightest doubts about the nature of the operations, it had the duty to investigate. The preparation of an administrative decision is not the responsibility of the applicant, who does what the government requires of him, but of the Regulator. It is not – as implicit in the majority’s award – the obligation of private applicants to tell the national chief regulator how to run its business, but the public authority has to advise applicants what information it requires. This is even more so as SEGOB had enough time; the time between the receipt by SEGOB of the *Solicitud* and the delivery of the *Oficio* is quite short; the claimant’s narrative of several weeks (if not months) of informal discussions between SEGOB and its lawyer-lobbyists Aspe & Arroyo has not been contested. It is also the way such business is conducted practically and in reality. One does not write out of the blue a request to a government agency, but the rules of the art of interaction with the regulator normally involve an informal period (“sounding-out”) with the formal inputs and outputs (*Solicitud* and *Oficio*) only as the ultimate official documentation of an informal process of consultation. Again, with full sensitivity of the controversial skill-chance issue created by years of litigation, with clear indicators of a wish to liberalise gambling policy by interpretation rather than full-fledged legislative change, one has to expect the Regulator knew exactly what the issues were. It must have considered a physical inspection superfluous – much as later Mexico felt a physical inspection of the machines was not necessary for its principal expert, Prof Rose to develop his views later presented to the tribunal. Respondent can not now argue that its federal Gambling Regulator needed more information which should have been provided by Thunderbird without being asked to do so when its NAFTA defense unit considered such information for a foreign gambling law expert not necessary.
75. The consequence is that Mexico has not met the incumbent burden of proof that there was deception of SEGOB by insufficient disclosure. It should have brought the SEGOB officials involved to the tribunal. Since it did not do so, the inference must be allowed that it considered that production of these key witnesses to the

events would not have supported its argument of deception – nor its argument about the meaning conveyed with the *Oficio*.

76. SEGOB therefore knew full well what these machines were like and what issues they raised; the over two years of litigation occupying SEGOB's core attention focused on one issue: The question if slot machines with stop-functions (video-poker) could be exempted from the Gambling Law because of the publicly and in litigation alleged "skill" character<sup>114</sup>. I suggest that SEGOB therefore understood the issue at stake quite possibly much better than Thunderbird itself. The uncontested evidence on the interaction between Thunderbird and SEGOB officials suggests that the officials had encouraged Thunderbird to seek a clearance – rather than the confrontational strategy with Guardia which must have cost SEGOB a large amount of resources and loss of face. If SEGOB had had any doubts about the machines, they could have easily asked Thunderbird to provide more information and inspect the machines – which were available in the offices of Baker McKenzie in Mexico City. The fact that they did not suggests that SEGOB had not the slightest problem in terms of awareness. The confrontation with Guardia and other Mexican operators must have provided to SEGOB all relevant technical understanding and legal sensitivity. They must have known how such machines functioned and how skill and chance played a role, both from a technical and legal/ regulatory perspective. It is not proper to consider a large country such as Mexico with a fully developed legal and administrative system, a 60+ years old gambling law and an experienced regulatory agency as acting, on the highest level of this specialised regulator, as un-informed, naïve, inexperienced and not aware of the key issues relevant at the time in their line of business. We have to consider SEGOB as a competent regulator of its industry which knew what it was doing. The respect for government owed by international tribunals requires also respect for its officials and regulatory agencies – and with this respect, naturally, comes responsibility.

77. Nor did SEGOB have any doubts – or could have any doubts – that the investor was asking for an assurance in the light of its interest to invest under conditions of greater legal certainty in a "grey area" of the law where the competent government agency's authoritative

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<sup>114</sup> Alcantara, p. 893; p. 852: Question: When does this skill phenomenon arise for skill machines? Answer: There was a first event, isolated event around 1998-1999. Then from 2000 onwards, we saw a number of litigations take place.; p. 874, referring to the 1998 case: "That was the first site where the Gobernacion detected the operation of these type of machine"

interpretation would make the decisive difference<sup>115</sup>. If SEGOB had had any doubts about either what machines were being envisaged, their technical character and the way they functioned, or the interpretative challenges they raised, they could have easily – and should have under the transparency and avoidance of ambiguity rule – requested Thunderbird to amend and back-up its “solicitud”. That they did not do this indicates that SEGOB saw the letter – as Thunderbird intended – not as a technical description of the machines, but as a request to confirm the legal qualifications that Thunderbird, after informal consultations, proposed or was recommended to propose. The same approach was practised by Mexico in the arbitration. Not only did SEGOB never feel it was necessary to inspect and test the machines, but respondent, in its defense, did exactly the same: It let its principal (but foreign) expert, Professor Rose, opine on the machines, their functionality and the legal implications under Mexican law in great detail, but never felt it necessary to let him see, inspect, review and test the machines (which were in Mexico’s hands)<sup>116</sup>:

Question: “Did counsel for Mexico indicate that they had it in their ability to provide a machine for your review if you could work out the logistics? Answer Rose: “I don’t think we ever really got to that stage”.

The Mexican approach throughout this case - be it SEGOB at the Oficio-stage, newly directed SEGOB in the prohibition phase or Mexico in the defense stage - has been that the functionality of the machine was self-evident, and no need for in-depth inspection and examination was necessary<sup>117</sup>. If, after all the controversy on skill

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<sup>115</sup> See testimony Watson, *supra*; the same was expressed by CEO Mitchell, never seriously contested by Mexico. Plus, it is in the very logic of foreign investment that serious commitment of capital in a grey area of the law needs to be risk-managed, and such risk management is best done by getting a comfort letter/interpretative assurance from the competent regulatory agency. This is indeed common practice in other areas of high-value foreign investment in areas of substantial political risk, as e.g. in the Sakhalin oil-gas investment process in Russia where a similar “comfort/interpretative” letter was informally negotiated and in the end issued by the Russian Prime Minister (direct information).

<sup>116</sup> Testimony Rose, 747, 748:

<sup>117</sup> This attitude about the self-evident nature of the machines is also reflected by the remark attributed to the new SEGOB Director Guadalupe Vargas in 2001 when he reportedly said: “What I see are slot machines” (“lo que veo son tragamonedas”), Particularised statement of Claim, p. 90; statement by P. Watson, 15 August 2003, p. 5, para 26, p. 45 (not as far as I can see contested).

and chance, Mexico still felt it was not necessary to let their principal expert examine the machines physically and directly, then the conclusion to be drawn is that at no time was there any doubt with SEGOB about how the machines functioned and what legal issues they raised. The “lack of disclosure” by Thunderbird argument hence can go nowhere: Re-examining the machines in August 2000 – as during the subsequent NAFTA arbitration from 2002 to 2005 – would have been to “bring coal to Newcastle” or “owls to Athens”. SEGOB and Mexico’s counsel never thought it was necessary to examine the machines in detail – and the tribunal, I suggest, should not theorise on SEGOB’s ignorance as SEGOB and Mexico’s counsel, then and now, act in a way that indicates that they have a perfect understanding of the machines at issue.

To sum up: Since I view the Solicitud as a proposal for a legal qualification of the machines as not being covered by the Mexican gambling law, I can not view the claimant’s Solicitud as lacking in required disclosure of the technical nature of the machines. There can be no deception of SEGOB if SEGOB was or must have been aware of the nature of the machines, the legal issues raised, the precedential litigation and if the Solicitud in essence was conceived as and understood as a legal advocacy. The facts were evident and knowledge of them was shared by both parties; what was at issue was the legal qualification. Even Mexico’s chief expert describes the moment in time when the Oficio was issued as “a great movement right before President Fox was elected” for liberalisation of the gambling law. And he equally provided the explanation for the subsequent reversal of SEGOB’s position under the new PAN government:

“then some sort of scandal or political issue hit, and the government had to back away”.

78. Nothing can be more persuasive for explaining Mexico’s attempt to liberalise by stealth, through the “oficio” interpretation and its subsequent reversal (at the cost of the investor) than Professor Rose, Mexico’s own chief expert and authority on comparative gambling law.
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“Oficio” (or “Criterio”) of August 15, 2000 – the Interpretative Assurance or Comfort letter

79. The formal letter that emerged is an extreme case of bureaucratic obfuscation: While protecting the “back” of the officials that signed and authorised that letter by ambiguous references, sometimes to machines where chance does not “intervene” (there is hardly any game where chance does not at least have a minor role – so Mexico’s principal gambling law expert Rose<sup>118</sup>), sometimes to machines which “predominantly” (“preponderante”) involve chance<sup>119</sup>, the main “operative” message of the letter is: Yes – go ahead with the machines if they are as you qualified them, but bear in mind that machines which involve “predominantly” chance are not allowed. A very rigorous analysis, done with hindsight of 4 years of national and international litigation and with the sophisticated expertise of my respected colleagues examining closely the Oficio word for word (paras. 159, 160), can plausibly come to the conclusion that the literal text of the letter did not give unambiguous clearance if chance was involved in the operation of the “skill” machines<sup>120</sup>. Chance is evidently involved to a substantial extent, as it is in every respect of human activity, so my colleagues have some justification in suggesting this letter was not the un-ambiguous and clear assurance to Thunderbird that it could go ahead.
80. On the other hand, if the letter is read from the perspective of the addressee and a “reasonable businessman” of the relevant trade without the benefit of 4 years of litigation, and over twenty lawyers and experts poring over every word in the letter, a different message emerges. The letter does not say: Your machines (which SEGOB knew perfectly well) are not allowed nor did it say: We think your machines

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<sup>118</sup> P.774: questioning the assumption that for example in chess chance plays no role;

<sup>119</sup> Rose – though never very clearly – suggests that it is never easy to draw the line between “predominantly skill” and “predominantly chance” and that the skill of the player (which improves by application and learning) has a lot to do with it: “The line is drawn fairly hard in terms of you have to have a lot of skill” and on video poker (“does clearly require some skill” (791); “certainly skilful players will do better” (793) and on using the “learning curve” to identify skill (p. 795) while recognising that videopoker (as used here) has a undeniable skill component and that the more players learn and play, the better they get (796).

<sup>120</sup> Mexico’s chief counsel, p. 1150: “maybe when you get to a very fine level of detail, it might be possible to establish a certain or view a certain contradiction in the letter from Gobernacion”.

are the same as Guardia's machines (which SEGOB knew or should have known) and as you know they can not be operated in Mexico. It did give a positive signal – you can go ahead; its qualification (“as you described the machines”) refers back to “legal” interpretation given by Thunderbird in its “solicitud” to the machines. Possibly, it plays intentionally with ambiguity in the “solicitud” which was meant to convey the legal qualification but could also be read as meaning the “factual” or “technical” description. Most importantly, and at first sight out of the blue, comes the reference that machines that are “predominantly” involving chance are forbidden. The use of the “predominant” criterium inevitably leads to the conclusion that if an operation that is “predominantly chance” is forbidden, then an operation that is “predominantly skill” is allowed. Predominant means “more than 50%”. There is a zero-sum relationship between skill and chance. Something that is more skill, is less chance and vice versa. The “predominant” criterium is – as Professor Rose testified and wrote – the key issue around which legalisation and liberalisation of gambling regulation turns:

“There is the difference between whether it is a game of skill or a game of chance, so if it's predominantly skill, it is not gambling. If it is predominantly chance, then it is gambling”.<sup>121</sup>

81. Using the “predominant” criterium is referring to a crucial gambling regulatory standard. A reference to “predominantly chance” as an indicator of prohibition is therefore automatically a reference to “predominantly skill” as an indicator of legality. I have therefore trouble with the tribunal's rejection of the “e contrario” argument (para 160), in particular as Mexico's chief counsel (same as counsel for Mexico later, in the hearing, accepted quite explicitly the e contrario argument as inevitable logic<sup>122</sup>:

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<sup>121</sup> P. 751; Rose, *Gambling and the Law*, p. 80: On California: “devices that are predominantly skill are legal”

<sup>122</sup> Question of president to Mexico's chief counsel and answer, p. 1161 ; also: Cross-Examination of A. Attallah, p. 207: Question by Mexico's counsel: “Again, the obverse of this, of course, would be to be a skill machine, the skill machine, the skill would have to be the predominant factor in operation, would'n't it” and p. 209: “ and what I am suggesting to you and trying to see if you agree , is basically what this is saying that to be lawful, a game would have to require – the principal factor in the game would have to be skill in order to meet this test: do you agree?”

Question by President: “But does it address also the question predominantly, now the **reverse**, predominantly skilled? .. It says one thing, but does it also say the other thing.

Answer: You might interpret it as predominantly ability and skill and not betting

Question: So, you would say you can interpret this?

Answer: Yes, sir

82. It is virtually impossible to determine if the machines involve chance under or over 50%; at best, it depends on the level of player skill which, so respondent expert Prof Rose, increases in a “steep learning” curve, i.e. with a rapid increase once a serious effort at learning is made<sup>123</sup>.

83. With the introduction of the criterium of “predominantly skill or chance”, SEGOB shows the way how the boundaries of the Mexican gambling law’s prohibition on games of “chance” can be relaxed. That is fully consistent with the report of witness Watson’s conversation with ex-Gobernacion Secretary Labastida supporting the “appropriateness” of using the “skill issue” from a “northern Mexican litigation” to relax the gambling prohibition. The “Oficio” can therefore be read as suggesting to Thunderbird that it should not qualify its machines as “only skill” (reflecting the label of “skill machines” used for presentational purposes), but as “predominantly skill”. While “no chance at all” is a criterium that can not be met (by any game), with “**predominantly skill**” the door is open to discretionary assessment. A gambling industry person can only hear when the term “predominantly skill” emerges the message: “Yes – allowed” – as Mexico’s chief expert Prof Rose said in describing the Californian approach<sup>124</sup>:

”devices that are predominantly skill are legal”

A dispassionate expert or a tribunal careful weighing up facts ex-post and after intensive litigation may come to a more nuanced conclusion. That what is relevant for interpreting the conveyed

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<sup>123</sup> Prof Rose’s testimony is lengthy and never unequivocal; but in sum he concedes that in video-poker and related games skill plays a role; that the more players play and learn, the better they get, that the skill consists mainly in the ability to make rapid probability calculations taking into account prior experience and that the predominant criterium is fuzzy and can not easily be pinned down and that it is and can be used to introduce liberalisation – pages 773-791.

<sup>124</sup> Rose, *Gambling and the Law*, p. 80

meaning and message by SEGOB to Thunderbird is not what a dispassionate expert or a meticulous tribunal would or should understand, but what the addressee of the message – the Thunderbird gambling industry investors and promoters – could reasonably understand at the time the message was conveyed.

84. SEGOB's and Thunderbird's interaction can not be construed on the sole basis of the text of the "Oficio" as would be read in isolation by sophisticated international lawyers, but they need to be read as the "people in the business" – the gambling regulator and gambling professionals – would read them. In proper methodology for construing contractual text and text of unilateral declarations addressed to investors as we have here, it is the "horizon" and perception of a reasonable person in the trade that counts. And here "predominantly skill" means – let us simply trust Mexico's chief expert in this matter: "Yes".
85. With this criterium, a large leeway of discretionary interpretation is opened: Do video-slot machines running on software involve skill at 10%, at 51%? There is no fully objective determination possible; player skill and experience determine the relative proportions of chance and skill. In capturing the main message conveyed by the text in its particular context, we need to acknowledge the desire by Thunderbird to get legal clarification for its investment. That was perfectly known to SEGOB. We need also to appreciate that SEGOB knew and must have known all about the technical nature of the machines and the legal sensitivity, tested in many litigations and administrative procedures. The August 15, 2000 "criterio" ("oficio") has then to be seen as SEGOB giving a green light (at the end of a long tunnel darkened by ambiguity and obfuscation). The numerous reservations can be explained by the usual self-defensive strategies of bureaucracies<sup>125</sup>. Some of the reservations – i.e. "predominantly" skill-involving versus "involving no chance at all" – are contradictory. But the ultimate message for a reasonable businessman in that situation was the answer to his question: Can we operate these machines which you know?: Yes, you can, just be careful and note that you – we – have to present this as something that can be qualified as "predominantly" – but not exclusively – skill-involving. That explanation fits perfectly with Mexico's expert Rose's reference to the window of opportunity for relaxation of the rules that existed just in 2000 (before President Fox was elected) and closed rapidly

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<sup>125</sup> See on the strategy of intentional bureaucratic ambiguity Mairal, *op.cit.* *supra*.



thereafter. What counts for the legal assessment of the letter is not the text per se, but the way it could be and was likely to be understood by Thunderbird to whom the message was conveyed. It was how Thunderbird could, reasonably, have understood the response of SEGOB to its request – the reasonable perception of the addressee of the message.

86. Thunderbird was no “Fortune 100” multinational company with hundreds of lawyers and country analysts at its disposal. It is a small entrepreneurial company where entrepreneurial activism was not matched with commensurate expertise and caution. But NAFTA would lose its objective of mobilising investment opportunities if its requirements were only suited to very large, expert, well resourced and suitably super-cautious companies. The vigour and dynamics of entrepreneurial drive would be lost; this is not compatible with the cited objectives both from Art. 102 and the Preamble of the NAFTA. If SEGOB had wanted to keep Thunderbird from operating its – clearly identified – machines, it should have said so and it could have said so easily, clearly and unequivocally.
87. This conclusion, I suggest, is the one most consistent with real-life practices and expectations. It takes into account that a private investor will rarely look at what looks like and is intended to be a positive response with the “rigorous due diligence” and the fine comb of an ultra-cautious litigation lawyer based on hindsight, but will look towards the essential message. It was: “You can go ahead – bear in mind: Such types of games in Mexico need to be presented as “predominantly skill-involving””. While a text-book approach would always require that official opinions be very clear, the messy reality of business life in most places and most times is that bureaucrats tend to use obfuscation for self-protective purposes in sensitive situations even if they want to be supportive. Disputes would not go to arbitration and investment treaties were not necessary if every investor would at any stage in its business manage to execute a legal transaction so that there were no doubts whatsoever over a government’s intention. To the contrary, ambiguity is the name of the game in dealing with governments and the task of international investment protection comes into play not in the case of the perfectly executed and documented transaction, but in the imperfect one of real life.

88. It is here that the legal criteria identified earlier for “legitimate expectations” need to be applied: The tribunal’s majority relies on the ambiguity<sup>126</sup> and lack of clear, unconditional and un-reserved text of the letter. But if we apply the principle that the risk of ambiguity has to be allocated to the drafting government, that a government agency can not rely on intentionally inserted obfuscation to extract itself from the key message the investor relied upon and that the drafter and the public authority in a position of superiority over the foreign investor has to be clear, unambiguous and consistent – then the positive message that a reasonable businessman could have taken from the “Criterio” of August 10, 2000 must prevail over the manifold reservations and contradictions my esteemed colleagues rely on. Similarly, based on the rules developed in particular in the *Metalclad v Mexico* and *MTD v Chile* cases, but also reflected in other precedents on the duty of governments’ to provide pro-actively legal certainty to investors, one can conclude that if SEGOB did not want to accept Thunderbird’s type of operation, it should have said so, clearly, and if it saw that Thunderbird did not get the message properly, it should have repeated the message and ensured it was clearly conveyed and understood<sup>127</sup>.
89. The “Oficio” or “Criterio” is not private legal advice – the claimant did not need any more legal advice having contracted several respected lawyers and law firms already. It comes, as respondent concedes<sup>128</sup>, with the presumption of being an official and authoritative act by the competent government agency. It comes with the full authority of government – on SEGOB letterhead, multiple official seals or stamps of the “Secretaria de Gobernacion” – the Mexican Interior Ministry. It is not a furtive note handed out secretly to Thunderbird to avoid the light of day, but it is formally copied to at least two senior Gobernacion officials; it presents itself as an official unilateral statement intended to have legal implications. It is signed, every page is initialled and it has reference to an official case identification

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<sup>126</sup> Ambiguity was conceded by Mexico in the hearing, see *supra*.

<sup>127</sup> Trazegnies, 2005, at p. 10, discussing the application of good faith principle by way of the legitimate expectations rule suggests that the good faith principle requires “claridad y transparencia de la expresion y del comportamiento. Sin ella, los agentes juridico-economicos no puedan calcular las consecuencias de sus actos porque el co-contratante de mala fe puede desajustar el acuerdo con cualquier pretexto”. Trazegnies quotes later (at p. 14) a formal determination by the Peruvian Telecommunications regulator upholding, in the regulatory context, a previous understanding of the regulator with a regulated company

<sup>128</sup> Response”, para 64, of October 2004,

code<sup>129</sup>. There is also a formal act of notarisation of the document. The more formal a communication by an administrative agency to an individual in a specific case, the more likely it is to create a legitimate expectation; the threshold for informal or general communications is much higher.

90. Formal acts of government have to be treated with full respect<sup>130</sup>; it would not be respectful to treat a government's formal declaration as if it were the un-informed utterings of an ignorant minor in need of protection against shady dealings. Thunderbird did not want or need a restatement of the letter of the law – it wanted, as was clear to the government, a statement if its “skill machines”, identified properly, could be operated in Mexico. It wanted an interpretation – and with the “predominant criterium”, it received one. We have to assume that SEGOB did mean what it said and was ready to provide “green light” to the investor. The presumption is that such a formal legal advice, sought by an investor, is valid, has an effective meaning, responds properly to the request and in its operative conclusion gives to the investor a clear response. Respondent bears the burden of proving that the “oficio/criterio” was emitted in an improper procedure by officials acting manifestly outside their powers and that it did not convey the main message which was the reply to the main question of the investor: Can we operate our machines – the BESTCO and SCI machines which we (as the other operators) call “skill machines”, in Mexico?
91. We also have to assume that it was intended to say something substantial on the request for “green light” by Thunderbird – rather than just a re-copying of the text of the law. A view that reduces the conveyed meaning of the letter to something close to zero, lacking a true substantive response to the “solicitud”, does not do justice to accepted interpretation methodology for legal instruments which include a legally significant unilateral statement such as contained in the Oficio. Legal instruments formally emitted are in doubt to be interpreted for an “effet util”. If they serve as a formal and official reply to a request for clarification of the law by a foreign investor,

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<sup>129</sup> Alcantara, p. 926: Question: So this would be a document issued with the full authority under the applicable laws of Mexico; Answer: Yes, issued with full authority”.

<sup>130</sup> Mairal, p. 50, 51 emphasises that the more formal an official representation, the more it is effective in creating a legitimate expectation. The reason is that formality enhances the confidence while informal representations are less confidence inspiring.

then they have to be an effective response to the request. If it did so with so many reservations and ambiguity, then the government has to bear the risk for such ambiguity. There is a presumption – both in international and in comparative administrative law – of the legitimacy of official acts<sup>131</sup>. That is the risk that the government, as price for the due respect to official acts, has to bear.

92. That the “Oficio” gave green light was also the opinion of Thunderbird’s Legal Adviser Mr Ruiz de Velasco of Baker McKenzie. While he re-iterated the reservations of the “Oficio” – which lawyer does not equally try to protect his back when giving legal opinions, the operative conclusions, and this is what counts, he confirmed that Thunderbird could go ahead and operate its video skill machines. He may not have understood nor Mexican gambling law nor the functionalities of the machines; possibly, he did not appreciate the implication that the introduction of the criterium of “predominantly skill-involving” machines in the Oficio opened the interpretative door of the Mexican gambling law. But his opinion must be weighed primarily by its clear conclusion rather than by its lawyerly and self-protective reservations. While other sophisticated lawyers are competent to appreciate the self-protective legalese in legal opinions, in particular with hindsight ex-post, our impression from the hearing was not that this applied to Thunderbird. Mr Ruiz Velasco got in cross-examination increasingly confused about disclosure as it should have been, as it was done, about the functionality of the machines and their legal implication in Mexico, but that was because he had little if any understanding or interest in the technical and legal issues of the Mexican gambling law. Had he understood the implication of the “predominantly skill or chance” criterium introduced by the Oficio properly, then he would have been able to give a clearer legal opinion and represent this accordingly before the tribunal.

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<sup>131</sup> Mairal, p. 81: “En efecto si la Administracion impugna el caracter de factum proprium, jugara un rol importante la presuncion de legitimidad del acto administrativo, en este case en favor del particular”.

93. The “Oficio” was also within the competence of the government officials who signed it<sup>132</sup>. Interpretative and similar official assurances and representations must be “legitimate”, i.e. they must be issued by competent officials and not, at least from the due-diligence horizon of the recipient, be against the law<sup>133</sup>. SEGOB is the highest federal authority in Mexico for regulating the gambling business. Such authority involves a competence to determine, for the purpose of the administration of SEGOB, the boundaries of the law. That inevitably implies interpretation of the terms – even if such interpretation was not legally binding in the way courts act and subject to judicial action. Since virtually all games involve some elements of chance and skill, it is a normal and legitimate activity for the principal national regulatory authority to determine (and to convey to an investor) its own view of the precise line constituting that boundary, even more so as the underlying law, of the 1940s, was quite old and had not kept up with modern commercial and technological developments. International regulatory practices – on which Prof Rose testified for Mexico – had developed the “predominantly skill or chance” distinction; accordingly, it was perfectly appropriate for SEGOB to interpret the 1940s’ Mexican Gambling Law in the light of such practices, in particular as there was a political idea of liberalising the Gambling law around at the time. Liberalising it at the margin – rather than seeking a wholesale legislative change – is often if not mostly used to introduce policy changes in a way that is faster, more efficient and more politically palatable. Ex-Gobernacion Minister Labastida, Mexico’s chief expert Professor Rose and Thunderbird witness Watson all in effect concur that there was, in 2000, a window of opportunity for “stealth liberalisation” using the openness of the “skill” condition and SEGOB and Thunderbird exploited this window. The SEGOB officials therefore issued their “Oficio” well within their real and apparent competence and within the then emerging (but later reversed) official policy<sup>134</sup>.

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<sup>132</sup> Alcantara p. 926 and cited supra; Mairal, p. 48, 49 on the requirement that officials making representations leading to legitimate expectations must act within their sphere of bureaucratic competence.

<sup>133</sup> So, for example, the (then) European Commission of Human Rights in the Pine Valley case, para. 84 (ECHR, Pine Valley Developments Ltd. and Others judgment of 29 November 1991, Series A No. 222)

<sup>134</sup> Mairal, p. 152 emphasises the ability of interpretative assurance to create for the thereon relying individual a legitimate expectation – except if the response given by the official is “clearly contrary to law”, p. 150-152

94. Thunderbird's view that the "Oficio" was giving formally (even if cautiously worded in bureaucratic language) green light to their operations was also reasonable. First, the machines and their mode of operation were well known to both parties. Second, Thunderbird had made clear to SEGOB that it considered the issuance of a comfort letter as significant to their operation, and also engaged on the path of cooperation with the government rather than the confrontational strategy applied by Mexican competitor Guardia. They might have been more cautious; they might have seen that the "Oficio" left many escape routes to SEGOB and was not an absolutely clear and un-ambiguous assurance. But they were not unreasonable in drawing comfort from what appeared in the context of their communication the positive attitude of the Oficio towards Thunderbird's machines and the confirmation of this positive message in the operative paragraph of their legal adviser's subsequent legal opinion letter.
95. To sum up: The expectation was created, by the competent officials in their normal conduct of affairs, with Thunderbird and it was also reasonable by Thunderbird under the circumstances to draw confidence from the Oficio. We do therefore have a "legitimate expectation" protected by Art. 1105 of the NAFTA. Thunderbird evidently understood the "Oficio" to give green light, but my analysis also suggests that it could reasonably and in the context of the regulator-gambling business interaction understand the operative message and the "predominant" criterium to mean that green light was given, and for the machines it had named, envisaged for its operations and ultimately deployed for operations. Mexico's case in the main rests on the "deception of SEGOB" argument, but as I have determined earlier, it did not meet the incumbent burden of proof for deception.

Post-Oficio Acceptance of Thunderbird Operations by Outgoing Mexican Government

96. In spite of my different view attributing effectiveness to the "Oficio", I might have become swayed by the eloquent arguments of my colleagues dissecting the Oficio in a painstaking way that the "Oficio" was just not enough to create a legitimate expectation that Mexico's SEGOB was ready to use its powers to tolerate Thunderbird's operations. But the "comforting" messages coming from SEGOB to Thunderbird did neither start nor stop with the "Oficio" of August 15,

2000. As is recognised in “legitimate expectations” jurisprudence,<sup>135</sup> conduct, as the “consistent and prolonged treatment of a person in a particular way, can create a reasonable expectation that the treatment will be continued until further notice”. Given the difficulty of enforcing Mexican anti-gambling laws throughout the country swiftly, I would not have been willing to qualify the about six months of toleration of Thunderbird’s operations alone, without preceding Oficio, by the then outgoing Mexican government as sufficient for creating a legitimate expectation under Art. 1105 of the NAFTA. But even if one considers the “Oficio” as not sufficiently strong and the post-Oficio toleration as not sufficiently prolonged, the combination of the two creates a much stronger case for a protected legitimate expectation<sup>136</sup>. This is also in line with the interpretation guideline of Art. 31 (2) of the Vienna Convention where subsequent conduct of the parties is taken as a significant indicator of their common intention. In comparative administrative law – in particular in legal systems of the Latin tradition – subsequent conduct by the administration is generally relied upon to interpret earlier, ambiguous, administrative acts and contracts<sup>137</sup>.

97. If SEGOB had been effectively deceived by dressing up a video-poker operation as an innocent video arcade game, as the majority suggests, then it had sufficient time to inspect the operations, realise that they were not what was submitted and for which SEGOB had given green light, but something else that was against Mexican law as then interpreted by SEGOB. Given the sensitivity of the issue and the long legal battles of SEGOB with Guardia starting in 1998, it would have been natural for SEGOB to check on the facilities soon after the

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<sup>135</sup> R v IRC, ex p Unilever, 1996 STC 681, cited from Schonberg, *Legitimate Expectations in Administrative Law*, OUP 2001 121, 122; note the emphasis on “reasonable construction of a party’s conduct” in Professor Bowett’s statement cited by Reisman/Arsanjani, op. cit. at p. 340

<sup>136</sup> That would also be the consequence of construing “legitimate expectation” in accordance with the common law equity doctrine of “laches” or, in civil law, acquiescence. The six-months by itself may not have been a very long period, but it is the full period from the grant of the “oficio” to the end of the PRI government. The fact that it took a new government with its own politics to rescind the acceptance embodied in the combination of Oficio and subsequent informed toleration suggests rather that the “Oficio” can be legitimately interpreted with the post-Oficio informed toleration by the outgoing PRI government.

<sup>137</sup> Mairal, 129: “La Suprema Corte de la provincia de Buenos Aires ha considerado a los hechos subsiguientes de las partes como “elementos decisivos” para la interpretacion de un contrato de obra publica”. “Analogia regla cabe proponer respeto de los actos administrativos de objeto dudoso o ambiguo”.

“Oficio” of August 15, 2000. Lic. Alcantara testified to his ever present will to pursue vigorously and consistently any perpetrators<sup>138</sup>. Nothing would be more normal after a so carefully drafted Oficio than to inspect Thunderbird facilities to see that the “warnings” were observed and the machines were as what they were presented to SEGOB. But there was no action by SEGOB throughout 2000 and beyond – until a new government and thereafter a new Director of SEGOB – Guadalupe Vargas – took office. The first actions against Thunderbird, reflecting the change of interpretation and enforcement attitude, started in February 2001, i.e. only after a new government and a new SEGOB Director had taken office. I do therefore not share the tribunal’s view (para 165) that “approximately six months” is “insufficient to establish that prior to that date SEGOB had authorised (or was intentionally tolerating) Thunderbird’s operations. It was not just the mere passage of time from August 2000 to February 2001 that is relevant, but the fact that toleration and an absence of any action of monitoring, inspection, request for information or enforcement lasted throughout the whole period remaining for the outgoing PRI government. It only ended when a new, PAN-appointed SEGOB director, took office. As we have to read the “Oficio” in a way that is most likely to reflect the true intention and common understanding of the parties in the context of their interaction, it is only that period – of the same group of players motivated by the same type of approach and attitude to gambling regulation – that we have to look at. We do not have simply a period of six months’ toleration – short some might say for many government agencies to get their acts together, but the full remaining period of the tenure of the government which negotiated and later issued the “Oficio”. I note that in *Biloune v. Ghana*<sup>139</sup> the tribunal identified the about 12-months’ long toleration of a visible construction as a key factor for a finding of expropriation, i.e. a sanction that reaches much further than the Art. 1105 NAFTA breach at issue here. But 12 months of toleration of a construction process indicates much less than the combination of a formal, though ambiguous, interpretative assurance combined with toleration not only of the prior process of establishing the gambling facilities, but also of their operation subsequent to the Oficio to the very end of the government’s tenure. On the *Biloune* principles, Thunderbird had therefore a much better case for the lesser Art. 1105 NAFTA claim. Different from *Biloune* where a positive signal

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<sup>138</sup> P. 880: Question: “How soon will that action be taken? Answer: “Were it to depend on myself, believe me, it would be right away”. Later on the same question: “As soon as those actions and strategies allow”.

<sup>139</sup> 95 ILR 183 (1994) at pp. 207, 210



from the regulating agency was alleged, but contested, Thunderbird had a very formal assurance letter following its formal request plus a subsequent toleration of the very operations for which the Oficio had been requested.<sup>140</sup>

98. In *Thunderbird*, the assurance letter was given in light of a well known interpretative dispute, where the facilities were not only established, but up and running and where the government had a specialised agency charged with monitoring and enforcing the regulation-intensive gambling law and where the government prided itself on rapid and energetic enforcement. The comparison with the *Biloune* case thus reinforces the view that SEGOB's conduct subsequent to the Oficio letter, throughout the outgoing PRI government, not only expressed toleration, but allows us to read the preceding Oficio in light of the subsequent toleration.
99. The combination of the "Oficio" with the continuous tolerating acceptance of *Thunderbird's* operation by SEGOB to the end of the term of the government – which had been responsible for issuing the Oficio – suggests that SEGOB knew exactly what it gave a green light for and was content with it. The conduct of both parties subsequent to the key "Oficio" – *Thunderbird's* continued investment and SEGOB's tolerance – confirms that the "Oficio" was meant to give green light to the installation and operation of exactly the type of software-programmed slot machines *Thunderbird* operated and that SEGOB was perfectly aware and accepting of this fact – regardless of circuitous and convoluted way it formulated the Oficio.
100. In interpreting legal acts, what counts in the end is what the parties intended and what the recipient of a legally relevant communication did and could reasonably understand the main message to be. The fact that it took a new government and a new director – with his own sets of attitudes, affiliations and alliances<sup>141</sup> – to reverse the course that the Oficio of August 15, 2000 had most cautiously taken, suggests that the earlier Mexican government had indeed given green light to *Thunderbird*, had been fully conscious of it and accepted the consequences of *Thunderbird* now backing its expectation with

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<sup>140</sup> In *Biloune*, the claimant also raised an assurance from government authorities for his construction without permit, but such an assurance was contested and in the tribunal's view not necessary for its determination of a "constructive expropriation".

<sup>141</sup> This has been the in my view credible – and never contested – interpretation by witness Montano, para 151.

substantial follow-up investment. The fact that it took a new government and a new SEGOB director to suddenly reverse the course – and the fact that “the first closure order was issued” against Thunderbird in early 2001 – and not against the confrontational Mexican competitor Guardia – is unlikely to be coincidental: Thunderbird was penalised for having collaborated with the (earlier) government and for having been part of the earlier government’s attempt to gradually relax the gambling prohibition.

101. If this is not enough to explain what SEGOB meant and the investor understood with the Oficio, then the “pro-active” duty of government to avoid contradiction and confusion of the investor – developed in the MTD v Chile, Tecmed v. Mexico and Metalclad v Mexico cases – would come into play. Given the close interaction between SEGOB and Thunderbird, one has to assume that SEGOB was aware that Thunderbird started to operate with its video-poker and related machines (identified as BESTCO and SCI machines) after the Oficio. If this was not covered by the Oficio – as the majority of the tribunal believes – then SEGOB had a duty to advise the investor accordingly and to ensure no legitimate expectation would arise. That they did not so, both confirms the meaning SEGOB and Thunderbird assigned to their Oficio, but also that SEGOB would have breached the duty of transparency and fair dealing with the investor by letting him run blindly into an open knife.

Disappointment of Legitimate Expectation with Discriminatory Elements in the Enforcement Process

102. The element of breach in the case of legitimate expectations under Art. 1105 of the NAFTA does not consist in the act of creating them, but in the disappointment of such expectations i.e. when a government changes course after the investor made its investment. We need therefore to examine not only how the expectations were created, but also how they were breached. Legitimate expectations – under Art. 1105 of the NAFTA or equivalent investment protection treaties - is never to be seen as an iron-clad guarantee – comparable to a long-term concession contract with a stabilisation guarantee – that policies will not change. Throughout the extensive jurisprudence surveyed, we find that if governments reverse their previously communicated and relied upon course, a balancing process takes place between the strength of legitimate expectations (stronger if an investment for the future has been committed) and the very legitimate goal of retaining “policy space” and governmental flexibility. Equality between individuals and absence of favouritism – i.e. non-discrimination – plays a role in the assessment of legitimate

expectation<sup>142</sup>. That is even more relevant in investment treaties where the prohibition on discrimination in favour of domestic competitors is formally enshrined, as in Art. 1102 of the NAFTA. Courts have made reference to transitional measures<sup>143</sup> to smooth a reversal of policy. But this is not what occurred here. With the change of government and SEGOB director, enforcement started with priority and focus on the weakest player: the foreign investor<sup>144</sup>. As Licenciado Alcantara confirmed: The first closure order, under the new director, was issued against Thunderbird's Nuevo Laredo facility<sup>145</sup>. The new SEGOB director did not go first, as one would have expected, against Guardia who had never sought or obtained a comfort letter from government, but against the foreign investor who had engaged with the (previous) government and obtained an assurance, as disputed as such assurance later became. Enforcement attempts against Guardia followed, but they were ultimately not effective. It is hard to tell and the evidence is not conclusive if Guardia was simply more skilful with his "amparos" before Mexican courts or if SEGOB was pursuing Guardia with less intensity than Thunderbird, a much easier and politically less protected target. Lic Alcantara's, SEGOB's enforcement lawyer, cross-examination indicates that the direction of enforcement was not in his discretion but ordered from above by senior authorities ("Unidad de Gobierno")<sup>146</sup> in the "Secretaria de Gobernacion". Lic Alcantara –

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<sup>142</sup> Mairal, p. 104. That "discriminatory elements" can play a role in the examination of Art. 1105 of the NAFTA does not mean that a breach of Art. 1102 may automatically lead to a breach of other NAFTA obligations such as Art. 1105 or Art. 1110. That is also confirmed by the interpretation by the NAFTA Commission quoted in the award.

<sup>143</sup> E.g. among many others: *Findlay v Secretary of State*, 1985, AC 318 discussed in De Smith, Woolf & Jowell, *Judicial Review of Administrative Action*, 428-430; Schonberg, 118-119.

<sup>144</sup> Mexico has not explained why the outgoing PRI government went on accepting Thunderbird's conduct and why then the incoming PAN government changed tack"; in this situation, the explanation offered by Ambassador Montano, p. 150, 151: "there was a difference in viewpoints on the part of the new officials" is relevant, including his reference to the possibility of collusion between Guardia – the competitor – and Guadalupe Vargas, the new Regulator even if he could not provide proof (who can?) but offered this as a plausible explanation not contested or better explained by respondent.

<sup>145</sup> P. 990

<sup>146</sup> From the records (confirmed by an internet review) the Unidad de Gobierno appears to be the (or one of the) central administrative departments of the Secretaria de Gobernacion; it is responsible for gambling regulation: [http://www.gobernacion.gob.mx/compilacion\\_juridica/webpub/Reg-Int-SEGOB-2005.pdf](http://www.gobernacion.gob.mx/compilacion_juridica/webpub/Reg-Int-SEGOB-2005.pdf).

keen as he said he was to enforce vigorously - was excluded from such deliberations and acted simply as a lawyer executing enforcement directions given from above. His cross-examination indicated quite clearly that when he was given an enforcement job, he went about energetically, but the targets were given to him from above. Nothing has come to light or been produced by Mexico on who these officials were, how they went about their business and if they directed enforcement actions with equal energy against both Thunderbird and Guardia. This is another “black box” in Gobernacion overseeing SEGOB. But the results speak against such equality. Since the prima facie results indicate that Thunderbird was singled out without good reason (Guardia’s confrontation should in normal circumstances made him the first target), and since access to these people and their conduct controlling enforcement is under Mexico’s exclusive control, the prima facie presumption is that they favoured Guardia or at least had a particular reason to go after Thunderbird first rather than after Guardia.<sup>147</sup> That leads to another – rebuttable but not rebutted or explained and proved – presumption that there was an intention to discriminate against Thunderbird and quite plausibly to thereby favour the chief and most potent and visible Mexican competitor. Support comes here again from the method of the Feldman v Mexico tribunal<sup>148</sup> which inferred from a number of factors – including the willingness of the foreign investor to raise a NAFTA claim and the better-treatment of a well-connected Mexican investor – that there was a good case for an intention to single out Feldman because he was a foreign investor; with the unwillingness or inability of the government of Mexico to rebut that plausible conclusion based on available factual “dots” which the tribunal was able to connect with an explanatory “line”, the tribunal

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<sup>147</sup> It is well established that control over evidence and non-production of relevant evidence necessary for rebutting a presumption leads to a burden of proof on the evidence-controlling and not submitting party, e.g. Kalkosch US-Mexican Claims Commission case cited in D Sandifer, *Evidence before International Tribunals*, 1939; M Polkinghorne, *The Withholding of Documentary Evidence in International Arbitration*, 2004, at p. 13-16, forthcoming in *Fordham Law Review*. Most recently: *Methanex v. US*, p. 154, para 56: “the burden of proof. shifted to Methanex, yet Methanex elected not to call the relevant partners of the unnamed law firm whose testimony might have clarified the issue. The Tribunal is unable to see why these partners could not have testified before it”. Similar at p. 155 (para 58), the tribunal again draws an inference from the fact that the relevant person “was not called by Methanex as a witness... was made aware of these proceedings and could have testified, Methanex provided no satisfactory explanation for his absence as a witness”.

<sup>148</sup> Paras 181, 182 in particular

rightly inferred from the available “dots” that they were connected by the “line”<sup>149</sup> of discriminatory intention.

103. While I have come to an agreement with my respected colleagues that such conduct may not have amounted to a full breach of the national treatment duty of Art. 1102, I find more than enough “discriminatory elements” that have to be taken into account when judging the disappointment of legitimate expectation inherent in the rapid priority enforcement of closure against Thunderbird. “Discriminatory elements” may per se not amount to a breach of Art. 1102 of the NAFTA (and I concur that breach of one NAFTA Chapter XI duty does not necessarily indicate the breach of another one), but in particular in the context of fair and equitable treatment (Art. 1105 of the NAFTA) discriminatory elements have to play a role in the process of determining if problematic conduct has risen to the required threshold of intensity required under Art. 1105. I am comforted here by the similar (or identical) approach of the prestigious *Eureko v. Poland* (2005) tribunal; it has also linked “discriminatory conduct” with a finding of a breach of the fair and equitable standard<sup>150</sup>.
104. It is clear from the uncontested evidence and my assessment of the witnesses, in particular Lic Alcantara, that the reversal of government attitudes towards Thunderbird started right after the new PAN government and its new director of SEGOB, Guadalupe Vargas, took office and that it developed a special vigour in enforcing the law against Thunderbird. That is evidenced by the not contested fact that the first closure order was against Thunderbird. Under normal circumstances, one would expect that the first target of a more vigorous anti-gambling policy should have been Guardia who had pioneered the “skill” machine operation since 1999 and openly defied SEGOB, going as far to brag in public about his success of running such operations “with or without the law”<sup>151</sup> – rather than Thunderbird who had chosen the approach of not confronting, but

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<sup>149</sup> This is the language of the *Methanex v US* tribunal, *supra*

<sup>150</sup> Para. 242: “that discriminatory conduct by the Polish Government is blunt violation of the expectations of the parties..”.

<sup>151</sup> This is even more so as Guardia had publicly taunted SEGOB and had claimed political and religious (“Santa Rita”) protection to explain his success in running gambling operation – in dramatic contrast to Thunderbird which had taken the route of the “Oficio” assurance; Exhibit C-97, article from *Millenio*, August 18 of 2003 on Jose Maria Guardia, entitled: “Abrire mi casino con o sin ley” (I will open my casino with the law or without the law”. Guardia is described in this article as “Amigo de políticos PANISTAS” – i.e. as friend of “PAN” (the new government party) politicians.

cooperating with the Regulator. Guardia is described in the most illustrative article as “friend of PAN politicians”. I therefore find the justification for a presumption of discriminatory enforcement energy and direction in the result. We do not know and hardly are able to know what happens exactly in the “black box” of government administration, in particular in sensitive matters and where domestic competitors are linked with government services against foreign competitors. That is why a distinct treatment by result raises the presumption of a discriminatory strategy and intention. SEGOB was, with respect to Thunderbird, successful before the Mexican courts. But such combination of exceptional enforcement energy and success did not occur against the competing operations of Mr Guardia. What happens within the Mexican courts is not separate from the measures SEGOB took nor does it provide immunity for SEGOB action: Mexico is before the NAFTA responsible for its courts as it is for the conduct of SEGOB<sup>152</sup>.

105. Without an extensive analysis of the national treatment obligation – Art. 1102 – I read the relevant jurisprudence – Pope-Talbot v. Canada, Myers v Canada, Feldman v Mexico and Occidental v Ecuador – as requiring the claimant to prove “likeness” and different treatment at least de-facto, with the burden of proof that such difference in treatment is either linked to legitimate policy objectives or unrelated to the foreign nationality of the claimant going to defendant. I also read these persuasive precedents as suggesting that the best-placed major domestic competitor<sup>153</sup> has to be compared

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<sup>152</sup> I concur with my colleagues that the allegations by Thunderbird do not rise, in their aggregate, to the serious and material due process breach that would qualify as a “denial of administrative justice”. But I remain troubled over the fact that it is not contested that the chief government lawyer, Alcantara, had an over 13 hours private discussion with one of the “Colegiado courts”, Witness Watson, 421, 422: “Mr Alcantara had arrived the day before the tribunal was to consider this matter, and had spent over 13 hours in locked, closed door session with the Colegiado of the Tribunal”. That may be acceptable practice in Mexico as I am advised, but it weakens the argument that discriminatory elements are not significant as the Mexican courts had cleared SEGOB’s conduct.

<sup>153</sup> Note Loewen v. US, Final Award para. 14o: “What article 1102 (3) requires is a comparison between the standard of treatment accorded to a claimant and the most favourable treatment to a person in like situation to that claimants.”; OECD, MID-TERM REPORT ON THE 1976 DECLARATION AND DECISIONS Annex V (1982) AT P. 50; Unctad, National Treatment, 1999, p. 33; Myers v Canada , Partial Award, November 13, 2000, paras. 93, 112, 256; particularly in Pope & Talbot v. Canada, Interim Award, June 26, 2000, paras. 11, 24, 36, 38. The idea that one could use the example of badly treated domestic companies to justify discrimination between the best-treated domestic company and a foreign

with the foreign investor. The fact that there may be other domestic competitors who are also not treated as favourably as the best domestic competitor does not detract from this approach. The reference to “most favourable treatment” in Art. 1102 (3) suggests that it is “the most favourable treatment” accorded to a domestic competitor, and not an “average treatment” or the “worst treatment afforded to a domestic competitor” that is the required benchmark. There is no defense of equally bad treatment for some, politically not favoured, domestic companies.

106. Treatment means the consolidated conduct by national authorities (including courts). I accept that discrimination requires a certain materiality and weight; it also requires that it can not be remedied rapidly and practically by an administrative or judicial appeal readily available<sup>154</sup>. It also does not involve a duty of “affirmative action” by the state to equalise all the informal handicaps which are inherent in the foreign origin of the investor nor does it require that bad luck and lack of litigation skill of the investor in judicial processes be automatically seen as a breach of national treatment. Nor do I see the Art. 1102 obligation to require a government to afford the same toleration to illegal operations just because it is foreign owned – such as supporting a foreign Mafia group just because a local police chief is in cahoots with a domestic Mafia group.
107. But we are not faced here with a criminal conduct, but rather an often legitimate gam(bl)ing service the legality of which depends on legal interpretations of the boundaries of the law; these boundaries are neither a thin line nor a bright line, but rather a fuzzy grey area. One can therefore identify government conduct (reinforced by court conduct) – by SEGOB in its enforcement intensity and focus – that leads to the result that the foreign investor who committed its investment after a reasonable comfort letter by the previous government suffers first, while the domestic investor who always played the card of legal confrontation continues to thrive. The most legitimate way to test the margins of a about 60 years old law bypassed by technology is surely to ask the government for an interpretation that takes into account emerging technologies and

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competitor is questionable; it could lead to a situation were some local companies are badly treated to avoid application of the NT standard. See: J. Kurtz, NATIONAL TREATMENT, FOREIGN INVESTMENT AND REGULATORY AUTONOMY, CONTRIBUTION TO HAGUE ACADEMY OF INTERNATIONAL LAW 2004 RESEARCH SEMINAR, FORTHCOMING IN 2006, P. 19/20.

<sup>154</sup> Paulsson, 2005, op. cit. supra

comparative regulatory practices. Why Thunderbird seems to have been penalised for this approach while the confrontational approach of the major domestic competitor is – 4 years later – still reaping rewards, has not been explained, neither by the government nor by the tribunal in its majority award. The reasons for this difference in result are hard to ascertain. It has to do with what happens within the “black box” of interface between government and domestic business people. But my conclusion is that we have at least a presumption of discriminatory and arbitrary elements in the SEGOB enforcement activity. That presumption has not been rebutted by a satisfactory explanation. Mexico has kept studiously silent on Guardia’s relationship with the government and the reason for his relative success with the courts. That such difference only emerges after a new government and a new SEGOB director have taken office reinforces the idea that SEGOB went after Thunderbird because it was seen to have reached a deal with the prior government.

108. The Mexican government could have cleared up such a presumption by producing the key players on its side: The Gobernacion Director General under whose authority the Oficio was executed; the SEGOB official who prepared and signed it; the SEGOB officials to whom the “oficio” was copied to, Guadalupe Vargas who was the instrument of the reversal of policy with energetic targeting of Thunderbird. Nor did the respondent produce any member of the “Unidad de Gobierno” which, though left faceless and un-identified, ordered Lic Alcantara to focus on and go first after Thunderbird and which must bear responsibility for the relative ineffectiveness of enforcement against Guardia. Alcantara’s testimony on the first target of enforcement – Thunderbird – and on the location of the “command and control center” within Gobernacion indicates only one thing: That the unnamed powers in the “Unidad de Gobierno” had earmarked Thunderbird as the first and prioritised target. That the government did not produce any of these key players – both in the PRI and the subsequent PAN period - supports a not rebutted presumption that Thunderbird was singled out in enforcement. This is the same legal operation as was carried out by the *Feldman v Mexico* tribunal which found evidence, though never fully explained by Mexico, that the foreign investor was targeted by effective audit-based enforcement procedures, while the politically well connected and economically more powerful competitor was left alone<sup>155</sup>.

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<sup>155</sup> The lack of enforcement resources was also considered not to excuse discrimination in *Gami v. Mexico*, para. 94; the issue here is not the relative weakness of enforcement in general, but the prioritising of the resources and



109. Accordingly, I find that a breach of the duty to respect investment-backed legitimate expectation under Art. 1105 of the NAFTA has taken place at the time when enforcement began against Thunderbird in 2001 without a similar enforcement effort displayed (on the evidence available and as determined by the operation of the presumption of discriminatory elements) against Guardia. The presumption that at least some discriminatory elements were present in the enforcement against Thunderbird strengthens the position of Thunderbird in the necessary balancing process between its investment-backed legitimate expectation and the equally legitimate acknowledgement of the need for governmental flexibility. Since it is in the end the de-facto situation of different treatment that is compared – Guardia continues to operate from 2000 throughout 2004 at least – the presumption is that there is discrimination. Perhaps it is mere difference of relative luck and litigation skill (though that is not very probable),<sup>156</sup> perhaps Guardia was protected

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energy that were available against the foreign – cooperative – rather than the domestic – confrontational – competitor.

<sup>156</sup> Note Ambassador Montano's reference to Guardia's very good informal relationship with government offices which squares with Prof Rose's finding that a strong informal link is normally present when a local operator is tolerated and a foreign one closed down, see *supra*. It also squares with Lic Alcantara's statement that he was "very keen" to close down anybody contravening the law, but needed directions from higher authorities ("Unidad de Gobierno") – from which nobody was presented by Mexico. These witness and expert statements are consistent with the references to Guardia's close relationship with the Catholic Church (supporter of the ruling PAN party) and with PAN politicians in exhibit C 97 (Exhibit C-97's journalistic information squares with references available by google search on Jose Maria Guardia (e.g. <http://www.revistavertigo.com/historico/27-9-2003/reportaje.html>; [http://raultrejo.tripod.com/SyPblogs02y03/2003\\_06\\_01\\_raultrejo\\_archive.html](http://raultrejo.tripod.com/SyPblogs02y03/2003_06_01_raultrejo_archive.html) ) . These internet references to Mexican press reporting have not been entered into the arbitral record – except for the C-97 exhibit. Nevertheless, they provide publicly available information which needs to be used critically and cautiously – but in this case it merely confirms what the expert and witness statements from both sides already indicate and confirm. None of these statements and references have ever been contested by respondent. Accordingly, given the theoretical explanation (Rose), the reference (without proof) to close relationship of Guardia to influential politicians (Montano), the reference by Alcantara that the "shots were called from above" when it came to enforcement and the link made in Exhibit .. of Guardia to PAN politicians and to the PAN-supporting Catholic hierarchy, the *prima facie* evidence properly assessed leads to the presumption that Guardia was not effectively closed down because he was politically well connected and protected, and that possibly Thunderbird was closed down so rapidly in order to eliminate a competitor.

by higher government authorities and had a better way to persuade the courts. But that is not essential: With the evidence of a de-facto more favourable treatment of Guardia by the Mexican state (administration plus courts), Mexico has the burden of proof of explaining satisfactorily and justifying the available prima facie evidence of discrimination. I find the explanations not satisfactorily as there was no proof that enforcement was equally directed; Mexico did not present witnesses from its “Unidad de Gobierno”. Similarly, there was no satisfactory explanation why SEGOB singled out, after the change of government, Thunderbird rather than Guardia.

110. The acknowledgement of the legitimacy of government flexibility can not justify that Thunderbird was pursued with most vigour and priority when the dominant domestic competitor managed – by whatever ways – to continue his operations throughout at least 2004 – though Thunderbird did and could rely on the positive signal from the then government in August 2001 followed by six months of toleration. SEGOB should have given Thunderbird a negotiated transition period to recoup its expenditures and relocate its operations and equipment within a reasonable period in 2001. The government of Mexico is not prevented, in case of a change of government, to change its interpretation of the law – from the view that the Gambling Law prohibited only machines which “predominantly involved chance” to one where there was some substantial involvement of chance in addition to skill; but such a change of interpretation can not override the legitimate expectation created by the earlier government, in particular if it was reasonable for the investor to have confidence in such expectation and if it was clear to the old and new government that the investor had carried out substantial investment because of the government-created expectation that the earlier, more liberal interpretation of the law would be respected. As Jan Paulsson has said:

“Surprising departures from settled patterns of reasoning or outcomes... must be viewed with the greatest scepticism if their effect is to disadvantage the foreigner”<sup>157</sup>.

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<sup>157</sup> Op. cit, 2005, at p. 200

Was Thunderbird's legitimate expectation invalidated because of a presumption of corruption of SEGOB officials?

111. One issue has played an important, but not very visible role in the arbitration: The implications of the – uncontested – payment of a 300 000 \$ success fee to two Mexican lawyers – Aspe & Arroyo – for obtaining the August 15, 2000 “Oficio” from SEGOB. In principle, it is not exceptional that a success fee was paid for successful negotiations that produced a document that Thunderbird considered important for its investment process (including its relations with its financial backers). Both the Thunderbird CEO and Mexico’s expert Prof Rose testified on the considerable economic value that a license, or a sub-license legal instrument has when it allows operation in a not generally open market. There was an insinuation – never maturing to a full-fledged assertion backed by substantiated facts and evidence – hinting the possibility of corruption. One can not exclude that this insinuation had some influence on the case. The role of the success fee and its implication for the existence or not of a “legitimate” expectation has therefore to be squarely addressed as it would undermine a fair hearing, if the issue were allowed to fester, but would not be made transparent and fully discussed. The tribunal notes (para 150), after an extensive discussion of the success fee arrangements, that “these facts do not have a bearing on the tribunal’s analysis below” and that it can “only interpret the 3 August 20000 Solicitud letter on its face value”. But the insinuation about the success fee arrangements hangs like a heavy dark cloud over the case. It is difficult to see how it can not have an effect on the analysis of in particular the “Oficio” which, as I have suggested earlier, can not be done purely “on its face value” as it is part and parcel and in the end the formal outcome of a prolonged interaction between both parties; an examination of this interaction only allows to place the “Oficio” properly in the context of the investor seeking a regulator’s clearance by a formal letter confirming a more liberal interpretation of the Gambling Law and the regulator’s accommodation of this request, albeit in a convoluted and ambiguous format “protecting its back”. Since I consider that attention must be paid to the context of the Oficio, that it can not be interpreted purely on its own as a free-floating document without history and purpose, I consider that the “success fee” story may have coloured the tribunal’s award. For this reason, the success fee story and its possible implications for the legal effect of the “Oficio” in creating a legitimate expectation has to be faced head on – rather than be developed in detail, then hang ominously over the legitimate expectation claim, but finally be

dismissed as formally irrelevant and as such no longer a suitable object for a proper examination.

112. First, there is no doubt that the use of illicit practices such as direct or indirect bribery of government officials would be a reason to invalidate any legal effect of the “Oficio”, as indeed the legitimacy of Thunderbird’s claim as such. There is ample jurisprudence that a legitimate expectation protected by Art. 1105 of the NAFTA can not be created if deception, fraud or other illicit means were used to obtain the governmental assurance or other rights obtained from the government in this way<sup>158</sup>. There can be no international treaty protection for rights obtained by illicit means. In such cases, there may be an expectation, but not a “legitimate” one. It is generally very difficult to prove bribery as there is usually little if any paper trail. However, arbitral tribunals and courts, in particularly of more recent date and under the influence of the authoritative international conventions (mainly, but not exclusively the OECD anti-bribery convention) have been ready to use presumptions rather than full-fledged and hard to obtain full evidence. If a transaction creates enough suspicion so that – in the practice of the US Foreign Corrupt Practices Act – a “red flag” should show up on the face of the transaction, it is sufficient to require the party in control of such a transaction to prove that it was contrary to “red flag” indicators a proper one<sup>159</sup>. Note again the *Methanex v. US* award:

“The tribunal is not averse to trying to “connect the dots” as a way of testing *Methanex’s* hypothesis”, and:

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<sup>158</sup> Schonberg, 126; Mairal p. 77; See *MFM Underwriting*, 1 WLR 1595 (1990); *Matrix Securities*, 1 WLR 334 (1994) with a reference to “placing all cards face up on the table” and disclose all relevant circumstances.

<sup>159</sup> See Abdulhay Sayed, *Corruption in International Trade and Commercial Arbitration* 2003; A. Crivellaro, *Arbitration case law on bribery*, *Dossiers of the ICC Institute of World Business Law*, 109; several ICC awards published in: YCA 1999, 7-79, p. 72; ICC case 5622, YCA 1994, 1994, p. 107; ICC Case No. 6497, YCA 1999, 7-79; *Frontier AG v Thompson CSF*, ICC Case NO 7664, in: Herve Gattegno, *l’affaire Dumas*, Paris 1998; referred to: *Arbitration International*, 1999, 329, 332; ICC Case 8891; ICC case NO. 8694/1996; Fadlallah, *Les instrument de l’illicite*, in: *L’illicite dans le commerce international*, 291-298 (published by CREDIMI, Dijon, Eds Kahn & Kessedjian, 1996); I note the most recent work in the field by Richard Kreindler, *Strafrechtsrelevante und andere anstossige Vertraege als Gegenstand von Schiedsverfahren* (Contracts with criminal law implications and other problematic contracts as object of arbitration), Frankfurt, 2005 – based on Dr Kreindler’s earlier articles on the subject in English (available partly on TDM – [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com))

“inference is an appropriate mode of decision in circumstances in which firmer evidence is not available”  
(Part III, B, para. 57)

113. But in this dispute, respondent has hinted, insinuated, focused in cross-examination on the role of the two lawyer-lobbyists Aspe and Arroyo, raised and queries the payment modalities of the success fee (a transfer made from Mexico to an account in the US), but it has never explicitly and properly asserted and tried to substantiate that the success fee had been an instrument of bribery or that at least it indicated – as a “red flag” – a suspicion of bribery of SEGOB officials. Neither Mexico nor Thunderbird have made the key players – Msrs Orozco Aceves (Director General de Gobierno); Martinez Ortiz; Antunano – the signatory of the “Oficio”, Guadalupe Vargas, the successor director of SEGOB, the members of the “Unidad de Gobierno” which decided on enforcement priorities nor lawyers Aspe & Arroyo, available. I have advocated throughout this procedure for pressure under the – limited – powers of the tribunal to make them appear, but in the end the insinuation remained what it was – an insinuation without substantiation and without being available for proper and full testing before the tribunal. The tribunal therefore should, in my view, have drawn inferences from this failure of Mexico to produce these key witnesses and officials – I follow here the as mostly very persuasive view of the late F.A. Mann, one of the past masters of international investment law<sup>160</sup>.
114. In this situation, as always when we are faced with a “black box” in which relevant events occur but which we do not see, tribunals have to work with a system of presumptions and tests of plausibility. It is theoretically not impossible that the success fee and the work of the two lawyer-lobbyists Aspe & Arroyo had to do with illicit influencing of public officials. Similarly there is testimony by Mexico’s expert Prof Rose on the great economic value and natural attractiveness that lies in collusion between a domestic gambling operator and the national gambling regulator to foreclose the operation of a foreign competitor.<sup>161</sup>

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<sup>160</sup> F.A. Mann, *Foreign Investment in the International Court of Justice: The ELSI case*, 86 AJIL (1992), 92, pp. 94 and 99 – criticising the ICJ chamber in the ELSI case for not drawing inferences from the failure of Italy to present as witnesses the key officials involved in the ELSI affair.

<sup>161</sup> P. 806

“If they have closed one down and don’t close down a competitor who is very public, then there is the possibility, very strong possibility of bribes”.

115. One can infer therefore, the possibility that the energetic closure action against Thunderbird after Mr Guadalupe Vargas took office (without a commensurate enforcement energy and result against Guardia) might involve an underlying Guardia/SEGOB alliance<sup>162</sup>. But both these theories are conjecture rather than proven fact. Having worked in investment negotiations in developing and transition countries for over 30 years, I have rarely encountered a deal that was not surrounded by corruption gossip. Relying on gossip – as plausible as it may appear in particular in conspiratorial explanation models – is never a professional way to proceed in such matters.
116. A legitimate interpretation of the events in 2000 is equally plausible<sup>163</sup>: The outgoing government did consider liberalisation of gambling. Prof Rose, for Mexico, alluded to the window of opportunity that was open for a short while in 2000. The Mexican Congress had commissioned a study which, subsequently, in 2002 indicated the benefits of bringing the gambling industry back to Mexico. Senior politician and presidential hopeful Francisco Labastida had – as is uncontested – raised and supported the idea of “stealth liberalisation”

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<sup>162</sup> This issue is raised: Montano, p. 152, 153; the witness had no proof – such proof is usually hidden in the black box, but Prof Rose’s analysis provides a possible explanation. Respondent has never as far as I can read the record explicitly rejected the theory that there was an informal alliance between SEGOB director Guadalupe Vargas and Mexican competitor Guardia.

<sup>163</sup> One can find support for this approach in the Methanex v. US award (supra) where the tribunal, when faced with the accusation of political corruption of California governor Davis based on evidence of a 300 000+ \$ political contribution and a special meeting (the governor was flown at quite a distance for a private meeting with Archer Daniels senior executives (i.e. Methanex’ US competitor) gave credence to the testimony of the (Archer Daniels employed or contracted) participants in this meeting about the “innocence” of the meeting, while finding that the regulatory process characterised by a normal course of legislation and transparency suggested the incriminated regulation was – or could easily – be justified as a normal outcome of the California regulatory process to accommodate environmental and related citizens’ concerns. In other words, the Methanex tribunal built a high threshold of proof for corruption allegations and allowed any possible prima facie evidence to be rebutted by showing that there was a perfectly reasonable explanation for the incriminated regulatory outcome.

through an interpretative assurance. Thunderbird's uncontested narrative of government contacts indicates that SEGOB officials were appreciative of Thunderbird's willingness to engage rather, as Guardia, confront the government. The sudden emergence of the "predominantly either skill – then yes, or predominantly chance, then no" - criterium in the "Oficio" of August 2000 attests that the criteria used for liberalising gambling regulation in other jurisdictions had come to the attention of SEGOB and found favour with its senior officials. That success fees or "lump sum payments" are paid for lobbyists (often lawyers) for achieving results – rather than just letting them maximise billable hours – is not unusual and not in industries where government licensing – by way of formal concessions or less formal interpretative comfort letters – is of great value. Dealing with governments, including, but not only, developing countries is always a difficult matter, particularly for foreign investors. It is likely to be rare to find a case where local lobbyists – "government relations experts" – do not have to be employed. They come with risks, but their involvement is in practice inevitable.

117. But what must ultimately decide this issue is that Mexico has the burden of proof – even if such burden can be discharged in an easier way by evidence of sufficient "red flag indicators". Mexico is responsible for the very formal conduct of its officials; there is the presumption of the validity, legitimacy and effectiveness of the Oficio of August 2000. Insinuating corruption but not submitting it for proper testing in legal combat is not an instrument that tribunals should pay any attention to, directly or indirectly, explicitly or implicitly. To quote the recent *Methanex v US* award in the context of examining the prospect of inferring conduct for which indicator "dots" might be available, but not the proof of the full story:

"therefore, to establish undue influence, Methanex would, at least, have to be in a position to allege if not also to demonstrate that a legal violation took place" (part III, Chapter B, para 22)

The Methanex tribunal was not impressed with the claim for improper behaviour on the part of the regulating state, though the assertions and facts in Methanex were stronger than the hints and innuendo in Thunderbird. As in Methanex, there was a reasonable explanation for the context and underlying policy of SEGOB under the earlier government to test and marginally expand the boundaries of the gambling law embodied in the Oficio. As a result, the Thunderbird allegations should deserve even less consideration than

similar, but factually much more substantiated, allegations in the Methanex case.

118. Mexico, however, has not put forward any substantiated assertion or evidence; it has refrained from putting forward the main witnesses under its control, that is the SEGOB officials past and present. Thunderbird has equally refrained from putting forward Aspe & Arroyo, over which it presumably has less control than Mexico over its own officials. But the issue of bribery affecting the Oficio is something that Mexico has to prove, while Thunderbird only has to come forward with counter-evidence once Mexico has provided prima facie evidence of at least “red flag signals”. Insinuation without the readiness to come forward and have a substantiated allegation properly debated and tested before the tribunal is a poisonous way to conduct litigation. It has become more and more frequent in investment arbitration as both claimants and defendants raise such hints, without being ready to submit them to a full and fair trial. Tribunals should actively discourage this tactic and ensure it plays no role, directly or indirectly, in their deliberation. For these reasons, I see in the light of the evidence available and the defense made by the respondent no reason to question the validity of the legitimate expectation created by the “Oficio” in combination with SEGOB’s subsequent conduct and sudden reversal once new powers took over. If Mexico had wished to question the legitimacy of the expectation created, it should have openly and directly, with substantiated assertions and proper evidence – mainly making its own officials in SEGOB (including the higher-level SEGOB officials which directed its enforcement efforts above Lic Alcantara and which issued the Oficio) available for testimony and cross-examination before the tribunal<sup>164</sup>.

### **Compensation**

119. Since the majority of the tribunal rejected all claims by Thunderbird, I do not need to get into the details of how compensation should have been calculated. But I can provide an outline. I concur largely with Mexico’s back-up argument that at most “reliance damages”, that is damages which were directly and reasonably caused by reliance of Thunderbird on the “Oficio”, later confirmed by SEGOB toleration,

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<sup>164</sup> See here the Turkish-Greek Mixed Tribunal, *Megalidis v Turkey*, of 26 July 1928 which uses the method of inference in case of a respondent state which was unwilling to produce evidence under its control relying on the maxim “omnia presumuntur contra spoliatores”. The tribunal inferred that the claimant’s factual assertions were correct; these could have been rebutted by Turkey if it had made the evidence under its control available.



are owed. It is widely recognised that a “legitimate expectation” can only then lead to compensation if there was “detrimental reliance”, i.e. a link between the expectation and investment made – a principle which in American takings law has led to the notion of “investment-backed expectations”<sup>165</sup>. That detrimental reliance must also be a “reasonable” one (see *Waste Management II v. Mexico*, supra). For a normal business person engaged in foreign investment in Mexico, the “Oficio” and the subsequent conduct by SEGOB must have allowed the conclusion that the government was ready to accept the operation of the gaming machines envisaged – something which not only the Oficio, but also other factors (the high-level encouragement of Thunderbird, the discussion about liberalisation of an obsolete gambling law) supported.

120. The fact that the “Oficio” may have been only one of the various factors in its investment process is not an objection. Business decisions are usually made on the basis of several significant reasons and a single, causative relationship between one key factor – the Oficio – and the overall subsequent conduct by the investor is hard to establish. There is enough evidence that the interpretative assurance by SEGOB was an important factor for Thunderbird for opening the facilities which were already more or less ready and for adding new facilities. There was credible evidence by the CEO of Thunderbird, Jack Mitchell, by P. Watson, the business development consultant and by other credible references to the importance attached to this “comfort letter” by the financial backers. Plus, the payment of the success fee itself indicated that the comfort letter was for Thunderbird a matter of great significance. If the “Oficio” had not been very important for Thunderbird’s investment process as the majority award (para 164) suggests, why did then Thunderbird pay instantly the not insignificant amount of 300 000 \$ to those who helped to arrange it?<sup>166</sup>

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<sup>165</sup> *Pennsylvania Coal v Mahon*, 260 US 393 (1972) – discussed in more detail in my article with Dr Abba Kolo., *Environmental Regulation, Investment Protection and regulatory taking in international Law* 50 ICLQ 811-848 (2001)

<sup>166</sup> Witness Mitchell, , 234, 235; 279, 280-285. The conditions of the success fee commitment letter spelled out that the fee was only payable if there was “no opposition or limitation to our operations”. Business logic and this in so far credible testimony dictate that Thunderbird did not commit and pay the 300 000 US \$ for nothing, but because it was important for increasing the legal certainty of its operations, at least in the eyes of its private investors.

121. Thunderbird's position is that compensation were owed (estimated at over 100 M US \$) as if its operations had been well established, were likely to run at a high rate of profitability unencumbered by future competition or regulatory measures and should be compensated on the basis of projecting an initial measure of profitability, after disregarding initial start-up costs, into a long-term future. That, however, is not a legally viable proposition: First, that would equate a "legitimate expectation" with a firm, long-term concession contract. But a legitimate expectation under Art. 1105 of the NAFTA is a much weaker legal position than a long-term concession contract. As all precedents show, governments retain flexibility to reverse a legitimate expectation in a reasonable way with transitional measures. A comfort letter may create a legally protected legitimate expectation even if it is not crystal-clear; but it is by far not the equal of a proper long-term concession contract. Even if we had a long-term, legally valid concession contract, one would have to take into account that the initial high profitability stemming from a successful start-up operation of a newcomer in a hitherto largely closed market is likely to give way as other competitors move in and thus, in the normal process of economic logic, depress the profitability. In cases of legitimate expectation (detrimental reliance), at most the government owes the investor the "negative interest", i.e. the expenditure the investor has undertaken with confidence in the reliability of the government position communicated. But it does not give a claim to the "positive interest", i.e. to be placed into a situation as if the government had committed in the form of a valid long-term concession contract.
122. The claimant can only reasonably be assumed to have relied on the "Oficio" from about August 2000 to February 2001 when the first dark clouds started to cover the sky over Thunderbird. By then, it had received a warning, could have easily appreciated the weakness of its legal and political decision in light of the ambiguities of the "Oficio" and the entry into power of a new government. By February 2001, it can no longer be assumed to have continued to invest in full confidence in SEGOB's comfort letter. By October 2001, it was clear that there was a serious problem and the wise course of action would have been to stop operations and take the machines out of Mexico. The relevant expenditures incurred in direct detrimental reliance are therefore quite modest. They can also not include the 300 000 \$ success fee which was not an investment after and because of the "comfort letter", but rather a payment to the lawyer-lobbyists for getting the comfort letter. Finally, in line with Art. 39 of the ILC

Articles on State Responsibility and the MTD v Chile tribunal (paras 240-243), the absence of a rigorous due diligence<sup>167</sup> in terms of ambiguous qualification of the machines in its “Solicitud”<sup>168</sup> and the unquestioned reliance on the “Oficio” in spite of its manifold obfuscations and ambiguities, should lead to a reduction of the compensation due under the concept of mitigation of damage and contributory negligence. While I do not have at this stage to calculate the hypothetical compensation in detail as the tribunal has rejected the claim, I would not have advocated a compensation award exceeding 500 000 \$.

123. To sum up: The award I have advocated would have provided a fair and equitable solution. Neither would it have produced exorbitant damages likely to undermine the acceptance of the investment arbitration regime nor would it have let Mexico – which played contradictory games with Thunderbird – come out of the arbitration without a good-governance signal: To be more careful with official assurances to investors and to be more respectful of the expectation created with such assurances even in the context of a change of government, senior staff and policy direction<sup>169</sup>. This is not a zero-sum issue: If Mexico’s official declarations and assurances are given legal effect by way of application of the legitimate expectations concept under Art. 1105 of the NAFTA , Mexico can enhance the credibility and effectiveness of its policy tools to encourage foreign investment. To deny such effect is to reduce the effectiveness of instruments available to governments required to micro-manage an investment promotion policy in relation with specific investors. To Thunderbird and other entrepreneurial companies in a similar situation, the award would also have sent a due-diligence and good-governance signal as well: To be more careful with ambiguously drafted government assurances, with local lobbyists promising to control government conduct and to phase investment more prudently

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<sup>167</sup> This was also the approach of MTD v Chile, paras. 242, 243; ; Mairal, 159-160

<sup>168</sup> Where sometimes reference is made to “involving skill” and sometimes to the “non-implication of chance”.

<sup>169</sup> The authoritative Encyclopaedia of Public International Law – on “good faith”, p. 601 by A. D’Amato – notes in this respect: “Nations must be more careful than ever before of what they say because they may be held to it. This expanded role for the concept of good faith indeed appears to be consistent with its roots in a natural law conception of international law. Nations ought to be able to rely upon the pronouncement of other nations, as well as to have their own declarations taken seriously and with the expectation of legal enforceability”. See also at p. 525 on the similar principle of “estoppel”.

in alignment with the degree of legal assurance received – and not to make exorbitant damage claims with no legal foundation. Both parties should, in my view, have settled the matter much earlier, in the sense of a negotiated “velvet exit” of Thunderbird from Mexico and not in the style of an abrupt expulsion of the investor out of Mexico.

### **Costs**

124. The tribunal orders the claimant to pay  $\frac{3}{4}$  of the arbitration cost and to pay to Mexico  $\frac{3}{4}$  of the costs of Mexico’s own legal expenditures. It applies therefore the principle of “**costs follow the event**” to attorney costs. Such a practice is relatively frequent in civil-law litigation, less so in international commercial arbitration, but mostly with considerable limitations and judicial and tribunal competence to reduce such costs<sup>170</sup>. It is not at all practice in North American litigation and arbitration; some US courts have prohibited awards of attorney fees in arbitration<sup>171</sup>. “Fee shifting” is as a rule only allowed in case of misconduct – contempt of court, incompetent or unacceptable litigation conduct, bad faith in arbitration or frivolous claims”<sup>172</sup>.

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<sup>170</sup> Note the Himpurna tribunal’s consideration of the cost issue which suggests that also in civil law countries – such as Indonesia – cost of legal representation are in practice rarely awarded in significant amounts.

<sup>171</sup> Most recent and extensive analysis: J. Gotanda , Chapter 3 (Attorneys Fees & Costs) in: Damages in Private International Law, Preliminary Draft for 2006 Hague Academy Lecture, at page 19 and notes 85-89. See the UNIDROIT and American Law Institute draft principles and rules on transnational civil procedure (2002), at para 32:

32.3: “the prevailing party must ordinarily be reimbursed its reasonable costs and expenses from the losing party”

32.5:” the courts may reduce or preclude reimbursement against a losing party that had a reasonable factual and legal basis for its position.”- The Commentary says: “Under the American rule, each party bears its own costs and expenses, including its attorneys’ fees”. It seems that in Mexico itself, under its civil procedural code, the principle is as in civil countries – costs follow the event (Art. 7), but this is reportedly tempered by the fact that judges often (mostly?) apply their discretion under Art. 8 to allocate the costs of legal representation to each party. Communication received from a Mexican colleague.

<sup>172</sup> *Widell v Wolf*, 43 F3rd 1150 (7th Cir 1994); Gotanda, p. 20, notes 90-94.

125. One of the US federal judges most respected for an understanding of economic analysis recently ruled that in international sales the loss claimed under Art. 74 CISG did not include attorney fees<sup>173</sup>. The Uncitral rules – Art. 40 – constitute a compromise between the “European” and the “American rule”<sup>174</sup> by establishing a slight (but not mandatory) preference for the “costs follow the event” rule for the arbitration cost, but leave it in the tribunal’s discretion to allocate the costs of legal representation (Art. 40 (1) and (2)). I can not follow the tribunal’s position (paras 213) that the Uncitral rules prefer that the losing investor pays to the prevailing government legal representation (“attorney”) costs: Section (1) of Art. 40 of the Uncitral rules prefers (without obligation) the “loser pays” principle for arbitration costs, but then, in section 2, different and distinct from section (1) leaves it fully open to the tribunal how to allocate legal representation (“attorney”) costs<sup>175</sup>. The distinction between Art. 40 (1) and Art. 40 (2) can not be simply explained as giving “larger discretion” (a term that is hard to appreciate – what is the difference between “discretion” and “larger discretion”?). It must mean something sensible. The only explanation is – in accordance with Myers v Canada<sup>176</sup> – that the limited preference for the “European Rule” for arbitration costs in Art. 40 (1) is omitted in favour of complete neutrality between the European and American rules with respect to “attorney costs” in Art. 40 (2). If it were otherwise, the distinction between arbitration costs (Art. 40 (1) and legal representation costs (Art. 40 (2) would not have been necessary. It is true that according to Art. 1135 the tribunal is empowered to award cost and that reference is made to applicable arbitration rules – including Art. 40 (2) UNCITRAL rules. But I suggest that a tribunal has to exercise its discretion under Art. 40 (2) of the UNCITRAL rules in conformity with well established standard practice; it is well established in administrative law that discretion is not unfettered and arbitrary, but needs to be exercised in line with established principles and practice. What is “appropriate and reasonable in the circumstances” (para 216) does not confer arbitrary discretion on the tribunal in its cost

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<sup>173</sup> Judge Posner, Zapata Hermanos v Hearthside Baking, 313 F3rd 385 (7th Cir. 2002)

<sup>174</sup> I also understand that China and Japan do not follow the “costs follow the event” principle, see Unidroit/ALI commentary

<sup>175</sup> Art. 40 (1) : “the costs of arbitration shall in principle be borne by the unsuccessful party. However...” – Art. 40 (2), in contrast, says “with respect to the costs of legal representation.., the arbitral tribunal... shall be free to determine which party shall bear such costs”

<sup>176</sup> Myers v Canada, final award, paras 11, 12, 34.

decision, but only discretion within the boundaries of established jurisprudence. That jurisprudence has developed the principle that legal representation costs can only be awarded in case of spurious claims or bad-faith litigation tactics.

126. The tribunal's decision to order the losing investor-claimant to pay most of the costs of legal representation of the winning state respondent is a significant departure from established jurisprudence by all previous NAFTA tribunals and by most, if not virtually all other BIT-based ICSID cases. It is not required as a measure of damages; the distinction of the award of attorney costs for investor-claimants and not for respondent governments that can sometimes be observe, can be advocated on the basis of this concept: Only – successful – claimants can reasonably argue that attorney costs form part of their damages claim; respondent governments can only argue procedural law principles. It is not required by the Uncitral rules which are relied upon in investment arbitration to provide a standard set of procedural rules; reference to them was not intended to import the “European rule” to investment arbitration under the NAFTA nor does their specific language (Art. 40 (2) require application of the “European rule”. Since Art. 40 (2) of the Uncitral rules provides for arbitral discretion, such discretion must, I propose, be exercised in harmony with the well developed jurisprudence of, first, the NAFTA tribunals and, second, other ICSID-based BIT awards<sup>177</sup>. I am therefore bound to disagree with the tribunal's departure from well established jurisprudence. Should an investment tribunal operating under a treaty decide to diverge from well established jurisprudence, it should provide in detail and depth the why such deviation should be exceptionally justified. It is also my view that such deviation should be the subject of a proper hearing (orally or in writing) for both parties and based on extensive, in-depth reasoning to establish the compelling need for such an exceptional approach.
127. There are three recent and relevant surveys of the cost decisions: M. Buehler, in a survey that is focused on international commercial arbitration – not investment arbitration – concludes that in “mixed arbitration (meaning investor-state), too, the loser-pays rule seems to be the exception rather than the rule”. “In most cases, the tribunals simply ordered each party to bear half of the procedural costs and left the parties' costs where they fell.” “Waste Management v. Mexico seems to be the only case where the private party was ordered to bear the procedural costs because it lost its case (nonetheless, legal costs

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<sup>177</sup> Investment disputes resolved under European arbitration institutions rather follow the “European principle” of cost shifting.

were not allocated”<sup>178</sup>. – The survey of N. Rubins<sup>179</sup> focusing on investment arbitration notes that :

“awards of costs or legal fees against unsuccessful claimants in investment arbitration cases appear to be exceedingly rare” and that “investment arbitration tribunals have examined the issue on a case-by-case basis, more often than not dividing the arbitration costs equally between the parties, and, more frequently yet, ordering each party to bear its own legal fees”.

The most recent and exhaustive survey by Professor Gotanda finds that:

“One trend that has developed is the tribunals’ hesitation in awarding attorneys fees against a private party under the ICSID rules. Where there is case law awarding attorneys’ fees against a losing government party, there is a noticeable lack of cases where tribunals order a losing private party to bear the winning party’s cost of representation. Even where the private party’s claim or defense fails in its entirety tribunals have opted not to award attorneys’ fees and split the costs of the proceeding between the two parties”<sup>180</sup>.

A most recent survey on “ICSID Arbitration Awards and Cost”<sup>181</sup> finds, on a survey of 14 awards:

“The fourteen arbitration decisions reviewed indicate that, with few exceptions, the tribunals generally allocate one half of the arbitration costs to each party. In addition, the tribunals generally hold each party responsible for their own representation costs”.

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<sup>178</sup> M. Buehler, Awarding Costs in international commercial arbitration: an Overview, in: 22 ASA Bulletin 2/2004 at p. 261

<sup>179</sup> The Allocation of Costs and Attorney’s Fees in Investor-State Arbitration, ICSID Review - Foreign Investment Law Journal, Volume 18 Number 1, Spring 2003, p. 109

<sup>180</sup> Gotanda, 2005, p. 41, notes 191-192 with reference to SPP v Egypt; Maritime Intl Nominees v Guinea; Benevenuti and Bonfant v Congo; Olguin v Paraguay;

<sup>181</sup> Wilson, Cain and &Gray, in TDM 2005 ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com)) at p. 15-18

And it concludes that only “reckless” or “bad faith” claims have led to claimant responsibility for respondent’s representation costs:<sup>182</sup>

“Unless there is a significant error, inconvenience of unreasonable action on the part of one party, it is most likely that each party will bear half of the arbitration costs and their own respective representation cost”.

128. Since this tribunal is departing from general practice, unanimously identified by all recent commentators, the issue requires closer analysis, both in terms of precedential cases (“how exceedingly rare is this tribunal’s approach?”) and in terms of the particular criteria that might, exceptionally and in specific cases, justify the U-turn as made by this tribunal. Before I do this, an observation is called for on the significance of precedent in international investment arbitration. The difference of the role of precedent in commercial arbitration from its role in international investment arbitration may explain why the tribunal made its unusual cost decision, without giving the parties the chance to comment on this departure, and without detailed reasoning to justify its departure. In commercial arbitration, there is no formal and very limited practical “persuasive” precedent. The reason is simply that most awards are still confidential; only a few are published or made public in sanitised form. The award is in the main an explanation to the parties of the reasoning of the tribunal, and there is no requirement or expectation of transparency, including its consequence of respect for established jurisprudence or the need to explain a significant deviation from well-established principles. Similarly, commercial arbitration as a rule applies specific rules of contracts; investment arbitration, on the other hand, applies treaty provisions that are general; in their investment protection core content, the investment treaties (with the equivalent of the multilateral treaties now well over 3500) express common principles and very similar, often identical language<sup>183</sup>. Every interpretation that is public is likely to exercise a general effect and will be taken up by counsel and tribunals in subsequent cases.

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<sup>182</sup> In the supplementary decision requested by claimant in *Alex Genin v Estonia*, claimant was ordered to pay also the respondent’s legal representation costs – a case that reinforces the view that standard practice is to award legal representation costs to losing claimant only in case of frivolous claims or bad-faith litigation.

<sup>183</sup> Philippe Kahn, Report of the French Section of the Hague Academy Research Seminar on international investment law, 2006, forthcoming;



129. But that is different in investment arbitration: It is not two equal parties who agreed specifically to submit a dispute to confidential resolution, but it is the investor only which raises a matter usually involving public policy and administrative misconduct (as measured under a treaty's obligations) against the host state. Investment arbitration is in substance a special form of international quasi-judicial review of governmental conduct using as a default the methods of commercial arbitration<sup>184</sup>. Following criticism for alleged "secrecy" (i.e. confidentiality in commercial arbitration language), awards are increasingly made public and debated – this is the now uniform practice in NAFTA Chapter XI arbitration and increasingly also so in ICSID cases, with all indicators pointing towards greater transparency. As a result of this primarily international and public-law character of investment arbitration, with transparency and public debate, the principles and practices of international law with respect to precedent become more relevant compared to the almost non-existent and at most illustrative character of precedent in commercial arbitration. That difference still needs to be appreciated<sup>185</sup>. In international and international economic law – to which investment arbitration properly belongs – there may not be a formal "stare decisis" rule as in common law countries, but precedent plays an important role. Tribunals and courts may disagree and are at full liberty to deviate from specific awards, but it is hard to maintain that they can and should not respect well-established jurisprudence. WTO, ICJ and in particular investment treaty jurisprudence shows the importance to tribunals of not "confronting" established case law by divergent opinion – except if it is possible to clearly distinguish and justify in-depth such divergence. The role of precedent has been recognised de facto in the reasoning style of tribunals, but can also be formally inferred from Art. 1131 (1) of the NAFTA – which calls for application of the "applicable rules of international law"; these include, according to Art. 38 of the statute of the International Court of Justice : "International custom, as evidence of general practice accepted as law" and "judicial decisions" as "subsidiary means for the determination of rules of law".

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<sup>184</sup> Also Gaillard, *Jurisprudence du CIRDI*, 2004, at p. 7; further references see *supra* (including *SGS v Philippines* at para. 97).

<sup>185</sup> *Brower-Brueschke, the Iran-US Claims Tribunal*, 1998, 655; Gaillard, *op.cit. supra*; P. Norton, *op.cit. supra*

130. In consequence, it appears to me that at the very least that, if a tribunal wishes in a significant question, to adopt a novel philosophy that diverges from well established principles is under an obligation to provide the parties with an opportunity of a full debate – such as calling for a “separate argument on the allocation of fees and expenses after rendering a decision on the merits”<sup>186</sup> – and to provide extensive reasoning which shows that the tribunal is both familiar with established jurisprudence and is prepared to justify its departure from such jurisprudence with in-depth reasoning. While the parties have both claimed all relevant costs, one should assume that they expected and assumed reasonably that the tribunal would follow general NAFTA and ICSID practice with respect to the attorney cost issue. If the tribunal wishes to diverge, it should give the parties the opportunity of a full hearing, at least in writing, to focus on this issue.
131. Arguably, in the context of NAFTA jurisprudence it is not proper at all for any tribunal – whatever their “depth of reasoning” and regardless of whether full hearing was afforded to the parties on the point of divergence – to diverge in a significant way, as this tribunal does here; for such purposes the NAFTA has set up the intergovernmental NAFTA Free Trade Commission (Art. 2001); in cases of similar significance this Commission has provided an authoritative guideline<sup>187</sup>.
132. A review of publicly accessible prior NAFTA awards indicates that there is no precedent for ordering a losing claimant to pay the legal expenses of government except in the case of spurious claims or bad-faith litigation. *Waste Management v. Mexico*<sup>188</sup> is often seen as an exception in so far as the claimant was ordered to pay the cost of the arbitration – but it was not ordered to pay the legal expenses of the respondent. In *Azinian v. Mexico*, in spite of finding fraudulent conduct with respect to the contracting out of a municipal concession

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<sup>186</sup> N. Rubins, op. cit. 120; *Pope-Talbot v Canada*, Award in respect of Damages, May 31, 2002, para 92; *Waste Management v Mexico*, Decision on Mexico’s preliminary objections concerning the previous proceedings, June 26, 2002, paras. 52-53 – reserving to “a later stage questions relating to the costs and expenses of the present phase of the proceedings”.

<sup>187</sup> Such as the Interpretation made on July 31, 2001; on its implications: *Pope-Talbot*, Award on Damages, 31 May 2002, at paras. 8-67;

<sup>188</sup> *Waste Management v. Mexico I*, Decision on Jurisdiction, ICSID Case No. ARB (AF/98/2 of June 2, 2000; rendered by a majority of the tribunal. The case dealt with non-compliance by *Waste Management* of procedural requirements for a NAFTA claim under Art. 1121 (2)(b).

contract, the tribunal split the costs of the arbitration, with each party bearing its own legal expenses. It argued among others that the “novelty of the issues” and professional conduct by counsel as reasons for its cost allocation in a case that might be seen as a “spurious” or “frivolous” claim by a company that did not measure up to a reasonable standard of integrity and competence<sup>189</sup>.

133. In order to seek justifications for the tribunal’s cost award, we need therefore to seek out the few cases where an award of legal expenses against the losing claimant was – at least to some extent – determined or mentioned: There has been up to now almost no ICSID case<sup>190</sup> where losing claimant had to pay respondent government’s cost. In some cases, the legal costs of the claimant had to be paid by the respondent government, taking into account relative success, efficient conduct and the principle of full compensation of investor damages suffered<sup>191</sup>. In the Myers case<sup>192</sup>, the government of Canada pointed out explicitly that it was NAFTA chapter XI practice not to award legal representation costs. The tribunal itself held that “

“Some arbitral tribunals are reluctant to order the losing party to pay the winner’s representation costs, unless the winner has prevailed over a manifestly spurious or unmeritorious position taken by the loser”. (para. 33)

134. Even in long-term concession contract cases resembling investment disputes, the practice is rather to let each party bear its legal costs, even if the losing respondent has to bear 100% of the tribunal costs<sup>193</sup>. In other recent cases (e.g. Noble v Romania), the “Arbitral

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<sup>189</sup> Para 125: “The claim has failed in its entirety. The Respondent has been put to considerable inconvenience. In ordinary circumstances it is common in international arbitral proceedings that a losing claimant is ordered to bear the costs of the arbitration, as well as to contribute to the prevailing respondent’s reasonable costs of representation.” I suggest that while the tribunal did not as yet identify explicitly appreciate the differences between private-commercial arbitration and public-investment arbitration, it did so intuitively (and correctly).

<sup>190</sup> I discuss the Methanex v US award rendered after the main text of this opinion was prepared later.

<sup>191</sup> C Schreuer, *The ICSID Convention*, p. 1226, para 21, 22 with a discussion of special features of the MINE v Guinea case; the principle was also that each party had to bear, irrespective of losing or winning, its own legal expenses.

<sup>192</sup> 30 December 2002 Decision on costs, para. 48, available at [www.naftaclaims.com](http://www.naftaclaims.com); see also dissenting opinion by arbitrator B. Schwartz

<sup>193</sup> Himpurna v Indonesia, Final Award v PT Perusahaan Listrik Negara, XXV YCA (2000) at p. 106; the tribunal also took in mind that recovery of “significant” legal costs was foreign to the legal system of Indonesia

Tribunal deems it fair and reasonable that the cost burden be shared equally between the parties, each bearing its own legal and other expenses and 50% of the arbitration costs” (para 236) though “all the claims ultimately failed” (para. 235).

135. Dr Benhamida, in a recent publication in TDM<sup>194</sup>, reviewed about 26 NAFTA and ICSID decisions rendered against the investor in favour of the state. In 19 of these cases, the tribunals decided that every party has to bear its own legal representation costs and to share the arbitration expenditures (tribunal, supporting institution). In all others where the tribunal awarded the winning respondent all or part of legal representation costs an element of either spurious claim or bad-faith litigation tactic was present. In *Soufraki v. UAE* (not a NAFTA case), the tribunal ordered the claimant to bear 2/3s of the arbitration cost – but each party to assume its litigation expenses. The only possibly relevant investment awards we have been able to identify<sup>195</sup> outside the context of the NAFTA and outside the context of arbitration rules mandating the “costs follow events rule” (e.g. Stockholm Chamber of Commerce) are the – unanimous - Generation Ukraine v. Ukraine award and the Uncitral-based (non-NAFTA, non-ICSID) *Link Trading v. Moldova* case.
136. In the *Generation Ukraine* case<sup>196</sup> the tribunal did award all costs Ukraine had paid into ICSID and added a contribution of 100 000 \$ to Ukraine’s legal fees (In the *Link Trading* case the “contribution” was 22 200 \$). But one needs to read the award to get a flavour for

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<sup>194</sup> W. Benhamida, in: TDM 2005 ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com))

<sup>195</sup> Since there are probably well over 100 cases, and none surveyed has the type of cost allocation this tribunal now determined, it has been very difficult for find any even remotely comparable case. I have, however, tried very hard with my research support team to review even remote cases not rendered under the NAFTA or within the ICSID system. The only case we have been able to identify is *Link-Trading Joint Stock Company v Moldova*, an (presumably unpublished) UNCITRAL award of April 18, 2002. In this – Uncitral rules and BIT-based case – the tribunal required the wholly unsuccessful claimant to pay 22000 US \$ towards the costs of the respondent government, a cost risk factor that constitutes less than 2% of this *Thunderbird v. Mexico* allocation of respondent government legal expenditures. Noah Rubins, at p. 126, has only identified one case, *Scimitar v Bangla Desh*, ICSID Award of April 5, 1994 where costs were awarded to respondent against losing claimant; but it seems such costs did not include legal representation costs of Bangla Desh and the litigation strategy of claimant was contradictory and in the end led to a de-facto withdrawal from the case.

<sup>196</sup> ICSID Case No. ARB/00/9, Award of 16 September 2003.

the reasons. Not only was the claim rejected in its entirety and no possible reason for a justified claim was found to exist, but the tribunal was also extremely dissatisfied with the claimant's conduct before the tribunal. In other words: It considered the claim as spurious and a not justifiable waste of the resources and attention of respondent and tribunal, both in terms of jurisdiction, merits and conduct before the tribunal.

“The Claimant's written presentation of its case has also been convoluted, repetitive, and legally incoherent. It has obliged the Respondent and the Tribunal to examine a myriad of factual issues which have ultimately been revealed as irrelevant to any conceivable legal theory of jurisdiction, liability or recovery. Its characterisation of evidence has been unacceptably slanted, and has required the Respondent and the Tribunal to verify every allegation with suspicion”. (para 24/2\_; - “The Claimant's position has also been notably inconsistent.” (para 24.3) - Moreover, the Claimant's presentation of its damages claim has reposed on the flimsiest foundation. (para. 24.4) - The Claimant's presentation has lacked the intellectual rigour and discipline one would expect of a party seeking to establish a cause of action before an international tribunal. This lack of discipline has needlessly complicated the examination of the claim. (para 24.6) “. “The claimants submissions .. have been seriously flawed due to the absence of a coherent analysis” (para. 20.26)

The “contribution” of 22200 US \$ to the respondent's attorney costs in the Link Trading case (under Uncitral rules) could prima vista be seen as supporting, marginally, the cost decision in this award. There is, however, no review of precedent and only a very general reference to Art. 40 of the Uncitral rules in the award. But the tribunal also expressed, in its cost decision, dissatisfaction with the litigation conduct of claimant. It noted that the costs significantly exceeded what the tribunal estimated for the security deposit: “due principally to the unsolicited further submission of Claimant” (para. 96). This reference suggests that the 22200 US \$ contribution reflected an unnecessary increase of the arbitration cost due to unreasonable litigation conduct by claimant. The case, therefore, rather supports the principle that attorney costs of prevailing respondent can only be allocated to the unsuccessful claimant if there was in the tribunal's judgment evidence of unreasonable, cost-enhancing, conduct. E contrario, the Link Trading award therefore follows the rule that Art.

40 (2) of the Uncitral rules has to be applied in investment disputes so that the losing claimant does not have to pay the respondent's costs of legal representation. Since there is no such evidence or indication in the Thunderbird award of any professional cost-inflating or otherwise "bad faith" misconduct, the Link Trading case provides another example of a "jurisprudence constante": Each party, in particular respondent, have to bear their own attorney costs.

137. The only NAFTA/ICSID case<sup>197</sup> where the parties' legal costs were awarded to the prevailing government<sup>198</sup> is the Methanex v US case that came out in August 2005<sup>199</sup>. The tribunal here recognizes, based on a survey of 1991 – i.e. before investment cases became widespread and at a date where modern NAFTA/ICSID jurisprudence on costs did not exist (as it does now):

"Certain tribunals are reluctant to order the unsuccessful party to pay the costs of the successful party's legal representation unless the successful party has prevailed over a manifestly spurious position taken by the unsuccessful party."

138. The Methanex award mentions that "other tribunals consider that the successful party should not normally be left out of pocket in respect of the legal costs reasonably incurred in enforcing or defending its legal rights" – but it does not mention such cases, in particular investment claims where the government has prevailed. It also does not discuss the contrast between arbitration and legal costs as is set up between section 1 and section 2 of Art. 40 of the Uncitral rules nor does it give any more detailed reasoning. But from the procedural history of the case, one can infer that the tribunal was not satisfied with the way claimant conducted its claim, in particular with respect

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<sup>197</sup> In Nagel v Czech Republic, available at [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com), the tribunal awarded to the prevailing respondent 80% of its legal representation costs. It considered the claim not tenable. But the case has been decided under the SCC rules which apply the "European" principle of costs follow the event and is thus not relevant for NAFTA or ICSID claims.

<sup>198</sup> The ICSID annulment committee in the CDC v Seychelles case awarded 83.345 £ to CDC (original claimant which prevailed in the annulment), but is based its award (para, 89, 90) on its consideration that the "Republic's case before this Committee was fundamentally lacking in merit. While we refrain from going so far as to say that it was frivolous, we can state unequivocally... that the Republic's case was, to any reasonable and impartial observer, most unlikely to succeed".

<sup>199</sup> Cost decision at para. 9 – 12 of part V of the award,

to evidence<sup>200</sup>. Given this situation, the Methanex case should be seen as awarding attorney costs to prevailing respondent for the well-established reasons (even mentioned in the award) at para. 9), that is either frivolous claims or claims where the tribunals have developed a practice of penalizing unprofessional conduct by the party against which the cost determination is made. To quote:

“The tribunal decided that this documentation was procured by Methanex unlawfully ... in violation of a general duty of good faith imposed by Uncitral rules and, indeed, incumbent on all who participate in international arbitration”<sup>201</sup>.

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<sup>200</sup> This relates in particular to in the end unjustified allegations of a “secret meeting” with the Governor of California and what appears to have been theft of documents for use in the arbitration, the issue of the “Vind” documents, final award at p. 154 or page 26, 27 of Part II – Chapter I). The implication of paragraph 54 of this chapter – at p.1 153 – is that the tribunal suggested that Methanex did not conduct the arbitration in good faith.

<sup>201</sup> P. 155 at para 58 of the final award. A comparison of the detailed cost submission by the US (approx 3 M US\$) with a cost submission statement of Methanex (“Methanex respectfully advises that the order of magnitude sought from the United States is US\$11 to US\$12 million”) suggests that there had been serious problems in the normal professional relationship between Methanex litigation group and the tribunal, as well as a serious imbalance in the cost submissions (i.e. a very detailed breakdown of about 3 M US\$ by the US and a general reference of “11-12 M US\$) by Methanex. That would suggest an additional reason for the tribunal exercising its powers under Art. 40 (2) of the Uncitral rules in allowing the US full recovery of its legal representation cost. The Methanex cost decision appears very much to include, or be fully based on, punitive elements – i.e. factors such as spurious claim and cost-increasing bad-faith litigation conduct. The Methanex award (p. 298 and para. 10 there) suggests as one way of justifying its cost decision: “In the present case, the Tribunal favours the approach taken by the Disputing Parties themselves, namely that as a general principle the successful party should be paid its reasonable legal costs by the unsuccessful party.” I would not necessarily agree with this reasoning: The parties are almost compelled by the psychological pressure of litigation to claim at the onset that both arbitration costs and legal representation costs should be awarded to them in case they prevail; to require a party, in particular a claimant, to make at the beginning of the litigation an extended argument why they should not pay legal representation costs in case they lose, is from that aspect of litigation psychology not a practical option. Parties, in particular the claimant, can only then be expected to focus on and develop such an argument in case the case on the merits has already been dismissed and the tribunal calls for a separate debate on the cost allocation.

139. From this survey, it is safe to infer that it is by now a standard principle of international investment law, in particular in the NAFTA context, but also in other ICSID cases, that in principle, each party bears its own legal costs and the costs of the arbitration are shared. Exceptions to this rule have occurred very rarely with respect to the arbitration expenditures and in favour of the winning claimant, but never – except for a limited “contribution” to the government’s legal expenses in the *Generation Ukraine and Link Trading v Moldova* case – in the case of a losing claimant. The only concept under which this so far well-established rule has not been observed or a different treatment suggested is for “manifestly spurious or unmeritorious” positions taken by the loser, unprofessional conduct and significant breach of good-faith in arbitration<sup>202</sup>. There are a good reasons for this approach which has so far been intuitively, but not yet explicitly appreciated by tribunals in thrall to the attitudes prevalent in commercial arbitration: Investment arbitration is not a reciprocally agreed and structured method of dispute resolution. It is a unilateral right of investors – not mirrored by a reciprocal government right – to claim against alleged misconduct by governments under an investment treaty<sup>203</sup>. It is in substance comparable at most to national and international judicial review of administrative conduct – rather than to the reciprocal “contract” model of commercial arbitration. Governments can not sue investors because investors can not breach the treaty disciplines such as “expropriation”, discrimination or fair and equitable treatment. They focus exclusively on governmental action targeting foreign investors. Governments have made this asymmetric right available because it helps them to attract capital and improves their internal governance, and the perception of their governance quality internationally.
140. This principle of cost allocation in international judicial review of government conduct is also applied in GATT litigation. There has been a formal proposal to award litigation costs to winning developing countries because of the prohibitively high costs of WTO litigation; one can see this as a similar concept to the idea that investors – in particularly smaller companies – should not be penalized for complaining about host state breach of treaty investment protection

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<sup>202</sup> SD Myers Final Award on Costs, para 33; Gotanda, 2005, p. 49 ff: citing delay tactics, reprehensive or unreasonable conduct as factors that have moved international commercial arbitral tribunals to award attorneys’ costs. This is also my explanation for the *Methanex v US* cost award.

<sup>203</sup> In French, the concept is therefore named “arbitrage transnational unilateral” – Walid Benhamida, *Arbitrage Transnational Unilatéral*-, Doctoral Thesis, University of Paris II, Forthcoming (as monograph).



obligations; the common idea is that for under-resourced claimants access to justice is illusory if the cost (and risk) of litigation is prohibitive<sup>204</sup>. Costs of the winning respondent have also not been awarded in UN Compensation Commission cases; in the Iran-US Claims Tribunal cases, in a small number of cases where Iran prevailed, it was awarded very modest costs (a few thousand dollars)<sup>205</sup>. It is worth noting that the Iran-US Claims Tribunal relied, in order to reject award of attorney costs, inter alia, on the fact that in the US each party bears its own attorney fees. Its approach of avoiding generalization of a particular legal-culture approach to the cost issue makes sense to me.

141. The judicial practice most comparable to treaty-based investor-state arbitration is the judicial recourse available to individuals against states under the European Convention on Human Rights; again, states have to defray their own legal representation expenditures, even if they prevail.
142. Imposing the risk of government attorney costs on losing investors in effect undermines the very purpose of such treaties; it raises the litigation risk in factual situations which are as a rule ambiguous, confused and contradictory to a prohibitive level, in particularly for smaller companies for whom litigation risk is high and where a government enjoys significant superiority in terms of expertise, experience and resources available for defense against NAFTA arbitration. In this particular case, we have had a well integrated, highly competent, coordinated and seamlessly functioning government defense team consisting of over 7 or 8 Mexican and

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<sup>204</sup> WTO Document TN/DS/W/19 of 9 October 2002, Negotiations on the Dispute Settlement Understanding, proposal on DSU by several developing countries at p. 2: The proposal is that in case of winning a WTO case the under-resourced developing country (only) should be awarded litigation costs from the respondent developed state. Note that para 210 of the award concedes that for an “investor with limited financial resources” “considerations of access to justice may play a role”.

<sup>205</sup> Gotanda, 2005, p. 47; *Sylvania v Iran*, 8 Iran-US CTR 298, 324 (1985): “so far, the tribunal has not awarded costs in all cases and even when it has, the amounts have generally been less than claimed. Chamber two has never awarded any costs, chamber one has awarded relatively small amounts of costs in only a few cases and Chamber Three has in general awarded costs to the successful party in an amount well below the one claimed, using a range between 5000 and 25000 \$ with costs of 70 000 \$ awarded in one case”. On the UNCC: communication from Jim Loftis of Vinson & Elkins, former senior counsel with the UNCC; (June 16, 2005).

international lawyers, including from two expert law firms, hardened by many rounds of NAFTA Chapter XI litigation facing a small entrepreneurial company with (equally competent I should add) two outside single-practitioner lawyers. The tribunal's break-out from – for good reasons – established NAFTA and BIT/ICSID jurisprudence on cost allocation can only be seen as foreclosing access to this type of justice for smaller companies. But that is not the objective of the NAFTA treaty which, to promote trade, new employment opportunities (note the Preamble of the NAFTA), increase investment opportunities and eliminate barriers to trade in, and facilitate cross-border movement of goods and services (Art. 102) is not intended to provide access to investment arbitration only to major US and Canadian multinational companies. The approach to costs in this award suggests that investment arbitration is only for the very large companies, leaving out entrepreneurs with initiative, willingness to take (sometimes perhaps recklessly) risk and who may not have the same “international corporate style” appeal of the “men in dark suits”. But there is no indication that this was the intention of the negotiators of such treaties. The highly unusual cost award thus casts a “chill” over attempts by junior companies to rely on the NAFTA's investment protection regime and makes that recourse – very high-risk anyway<sup>206</sup> – doubly prohibitive because of the now added cost risk. In effect and in practice, it makes recourse to independent justice for smaller companies prohibitive.

143. The only reason possible to use the reversal of standard NAFTA and BIT cost jurisprudence is legitimate reliance on the principle of “manifestly spurious claims” and grave professional misconduct by claimant and its advocates<sup>207</sup>. But it is hard to find such evidence in the Thunderbird – Mexico case. The tribunal itself has been explicitly positive about the professional conduct of the arbitration by claimant (para 213). If the claim had been “manifestly spurious”, the tribunal could have accepted Mexico's request for bifurcation and in a

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<sup>206</sup> Barton Legum, *Lesson Learned from the NAFTA: The New Generation of U.S. Investment Treaty Arbitration Provisions*, 19 ICSID Rev. 344 (2004); this study notes that so far no NAFTA case against the US has ever succeeded and identifies in detail the substantial litigation risks; the investor litigation risk assessment by this study would have to be compounded were this tribunal's approach to costs to be followed.

<sup>207</sup> The “unprofessional conduct” criterium shows up in the *Generation Ukraine v. Ukraine* case, but also for an isolated incident in the *Pope-Talbot v Canada* case, award of 26 November 2002; it is clear that a serious breach of good faith in litigation contributed, and probably determined, the cost decision in the *Methanex* case, see *infra*.

preliminary decision rejected jurisdiction and admissibility. The implication of ICJ jurisprudence on the requirement that claims be founded *prima facie* in law and in fact, suggests that manifestly spurious claims should be rejected in a preliminary phase<sup>208</sup>. There is also the practice of the Iran-US claims tribunal to dismiss a claim that is manifestly without merit<sup>209</sup>. But this tribunal rejected the Mexican request for a preliminary phase focusing on jurisdiction and admissibility issues only. This conduct of the tribunal hardly suggests that the claim was manifestly spurious. The fact that it had to rely on a painstaking *ex-post* analysis of a convoluted and ambivalent Mexican “comfort letter” (“oficio”), arrived at after years of in-depth argument involving dozens of fine-comb-handling lawyers and evidence from both sides, does not help to establish a “manifestly spurious claim”.

144. Similarly, I do not share the tribunal’s statement that, in order to distinguish itself from the Azinian award (NAFTA protection was sought for a fraudulently obtained concession contract with no indication of governmental misconduct), that NAFTA jurisprudence was no longer “novel”. It may be useful to cite here the approach of the Vivendi v. Argentina annulment committee commenting on and endorsing the cost decision of the original Vivendi tribunal (para 117, 118) which made each party bear its own expenditures:

“It observed that the dispute raised “a set of novel and complex issues not previously addressed in international arbitral precedent..... Moreover, Argentina was entitled to

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<sup>208</sup> Oil Platforms, Iran v US, Preliminary Objections, 12 December 1996, paras 16-2; also Art. 28 (6) of the 2004 US model BIT, available at: [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com) :

“When it decides a respondent’s objection under paragraph 4 or 5, the tribunal may, if warranted, award to the prevailing disputing party reasonable costs and attorneys’ fees incurred in submitting or opposing the objection. In determining whether such an award is warranted, the tribunal shall consider whether either the claimant’s claim or the respondent’s objection was frivolous, and shall provide the disputing parties a reasonable opportunity to comment”

<sup>209</sup> Parvis Karim Panahi v US , 28 Iran-US CTR 225, 228 (1992); Cyprus Petroleum v Iran, 11 Iran-US CTR 70, 71 (1986) – I rely here on a comment by V. Heiskanen, for TDM ([www.transnational-dispute-management.com](http://www.transnational-dispute-management.com)) 2005 on “Frivolous claims”.

take the position it took, which itself raised a difficult and novel question of public importance concerning ICSID and the operation of investment protection agreements on the model of the BIT.”

In the light of the importance of the arguments advanced by the parties in connection with this case, the Committee considers it appropriate that each party bear its own expenses incurred...”

145. The issues at stake here – allocation of the risk of ambiguity of a governmental assurance, the scope of disclosure to government before obtaining a comfort letter – raise hitherto in BIT jurisprudence unsettled questions of how to apply the principle of “legitimate expectation” under Art. 1105 of the NAFTA. While there have been recently several awards on the question, no easily applicable doctrine of legitimate expectation under Art. 1105 of the NAFTA has so far evolved. It appears to me far from settled that one can dismiss easily a national treatment claim in a situation where the foreign investor – having pursued a cooperative approach – is closed down immediately and effectively, with no luck at all with domestic courts, while government enforcement is never successful with a politically well-connected domestic competitor. Also, the evidence of the government counsel huddling for over 13 hours discreetly with a senior judge in the case does at least raise questions of due process under international, if not national, standards. The tribunal may not have felt such procedural flaws in their aggregate reached the threshold of a breach of Art. 1105, but that is not to say that claimant made a frivolous claim in raising the issue of administrative denial of justice. I doubt that a reasonable, objective observer would have come at the outset to the conclusion that Thunderbird’s claim was frivolous and manifestly unjustified.
146. Under these circumstances, I must conclude that there is no evidence, so far and on the record of the case, of a “manifestly spurious” claim. One could have thought to define “winning” by a relation of the investor’s claim (about 100+ M US \$) to the outcome – zero in the award, about 500K US \$ in my reckoning). But that would be a practice of civil law litigation not applicable here. This was a North-American investor, incorporated in Canada but largely run from the US and with a US approach. It (and its counsel) followed what seems to be the standard US practice of making arguably “excessive” monetary claims. But international tribunals have to be careful with cultural prejudices; NAFTA litigation is not meant to penalize claimant and its counsel for what is normal in their own

jurisdiction, but which might be seen in other jurisdictions not as acceptable. A measure of cultural tolerance is required in transnational dispute resolution.

147. Another reason one could think of would be that the claim related to gambling, an industry that is seen in many religious quarters as not very salubrious and provoking a moral opprobrium. But gambling, while usually heavily regulated, of the type at issue here (slot machines) is an entertainment activity that is widely practiced around the world<sup>210</sup> and can not be per se condemned as not worthy of investment treaty protection. The next reason I can think of as providing a justification for this decision deviating significantly from standard investment arbitration practice is the suspicion raised by the payment of the success fee – i.e. that possibly the two lawyers who arranged for the comfort letter may have shared that fee with Mexican officials. If it were so, I would have no hesitation whatsoever to penalize the claimant for daring to use an investment treaty to protect the fruits of unethical behaviour. As I have argued earlier, I would not require full proof, but rather enough corroborating indicators leading to a reversal of the burden of proof on claimant. But Mexico has not raised this suspicion openly, with substantiated argument and evidence and with a credible effort to bring its own officials who were involved in the comfort letter to the tribunal. In that situation, I consider that we have to disregard insinuations of bribery if they are not properly raised, substantiated and open to a fair hearing. Otherwise, and with this award, a signal is sent out to respondent governments to insinuate corruption as a standard defense technique; it is persuasive and effective, without having to stand up to the proper scrutiny of a full and proper litigation debate. The negative proof of non-corruption, is rarely possible. There is no foreign investment where a close interaction, mostly with use of local consultants, with the government can be avoided. The whiff of corruption can therefore be made to appear in virtually any foreign investment project.

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<sup>210</sup> Mexico's expert Professor Rose attests the pervasive liberalisation and legalisation of such operations: p. 776: "This explosion of legal gambling hasn't been just in the US. It's everywhere in the world".

To conclude: While I have sympathized with my colleagues' view not to find a breach of the principle of "legitimate expectation" under Art. 1105 of the NAFTA , I find no reason to reverse a well established NAFTA and ICSID jurisprudence consisting in letting each party, winning or losing, bear its own legal expenses and share the costs of arbitration short of clear evidence of either gross professional misconduct on the part of a party in arbitration or a manifestly spurious claim.

Thomas Wälde  
St Andrews, December 2005

Annex: Decision on Costs in Arbitration rendered against the investor (investor-state) arbitration<sup>211</sup>

Case	Decision on cost
<p><b>1. Noble Ventures, Inc. v. Romania</b>, ICSID Case No. ARB/01/11 (US/Romania BIT)- Final Award, 12 October 2005, § 230 <i>et seq.</i></p>	<p>The Tribunal dismissed the claims. The tribunal decided that each party shall bear the expenses incurred by it in connection with the arbitration and that the arbitration costs, including the fees of the members of the Tribunal, shall be borne by the parties in equal shares.</p> <p>The tribunal said that “233. Provisions regarding the Tribunal’s decision in the matter of costs are to be found in Art. 61(2) of the ICSID Convention and Arts. 28 and 47 (j) of the ICSID Arbitration Rules. Noting that none of these provisions mentions specific criteria for the decision on costs, the Tribunal takes into account the following particular considerations:</p> <p>234. On one hand, it is a principle common to both national laws and international law that a party injured by a breach must be compensated for its losses and damages, which include arbitration costs. On the other hand, the “loser pays” principle is not common to all national laws or international law, and in particular is stated in neither the ICSID Convention nor the ICSID Arbitration Rules.</p> <p>235. On the issue of costs the Tribunal has taken into consideration all the circumstances of this case. In particular, it notes that, although all the claims</p>

<sup>211</sup>Excerpted from the forthcoming comment by W. Benhamida in TDM (2005) at [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com). I acknowledge gratefully Dr Benhamida’s consent.

	<p>ultimately failed, the Claimant succeeded on certain issues, notably the fundamental legal issue of the umbrella clause contained in Article II(2)(c) of the BIT as a basis for liability under the BIT in this case and the factual issue with regard to the diligence exercised by SOF after the execution of the SPA, albeit without causal significance. The Tribunal also has in mind that the basic flaws in the SPA are to be attributed to both SOF and the Claimant.</p> <p>236. Therefore, using the discretion that it has under the ICSID Convention and the ICSID Arbitration Rules, the Arbitral Tribunal deems it fair and reasonable that the cost burden be shared equally between the parties, each bearing its own legal and other expenses and 50 % of the arbitration costs”</p>
<p><b>2. Methanex Corporation v. United States of America</b> UNCITRAL (NAFTA)- <u>Final Award, 3 August 2005</u>, Part V.</p>	<p>The Tribunal dismissed the claims. The tribunal applied UNCITRAL Rules. The Tribunal observed that it has a broad discretion in relation to its award in respect of costs under Articles 38 and 40 of the UNCITRAL Rules.</p> <p>The Tribunal determines that there is no compelling reason not to apply the general approach required by the first sentence of Article 40(1) of the UNCITRAL Rules. Although over the last five years, Methanex has prevailed on certain arguments and other issues against the USA, Methanex is the unsuccessful party both as to jurisdiction and the merits of its Claim. There is no case here for any apportionment under Article 40(1) of the Rules or other departure from this general principle. Accordingly, the Tribunal decides that Methanex as the unsuccessful party shall bear the costs of the</p>



arbitration.

With regard to disputing party legal costs, the Tribunal observed that the practices of international tribunals vary widely. Certain tribunals are reluctant to order the unsuccessful party to pay the costs of the successful party's legal representation unless the successful party has prevailed over a manifestly spurious position taken by the unsuccessful party. Other arbitral tribunals consider that the successful party should not normally be left out of pocket in respect of the legal costs reasonably incurred in enforcing or defending its legal rights.

In the present case, the Tribunal favours the approach taken by the Disputing Parties themselves, namely that as a general principle the successful party should be paid its reasonable legal costs by the unsuccessful party.

In this case, the USA has emerged as the successful party, as regards both jurisdiction and the merits. The Tribunal has borne in mind that, at the time of the Partial Award, it could have been argued that the USA had lost several important arguments on the admissibility issues; but over time the Partial Award does not affect the end-result of the dispute overall, as decided by this Final Award.

Likewise, the issues on which the USA did not prevail in this Award were of minor significance. The Tribunal does not consider any apportionment appropriate under Article 40(2) of the UNCITRAL Rules.

Accordingly, the Tribunal decides that Methanex shall pay to the USA the amount of its legal costs reasonably incurred in

	these arbitration proceedings. <sup>212</sup>
<b>3. <i>Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. Peru</i></b> , ICSID Case No. ARB/03/4 (Peru/Chile BIT), Decision on Jurisdiction, 7 February 2005. p. 25 <i>et seq.</i>	The Tribunal holds that it has no jurisdiction to hear the merits of the present claim. The Tribunal decides that each Party shall pay one half of the arbitration costs and bear its own legal costs
<b>4. <i>Consortium Groupement L.E.S.I.-DIPENTA v. Algeria</i></b> , ICSID Case No. ARB/03/08 (Algeria/Italy BIT) - <u>Decision on Jurisdiction</u> , 10 January 2005 (French), § 43 <i>et seq.</i>	Le Tribunal arbitral n'est pas compétent pour connaître du litige entre le Consortium L.E.S.I. – Dipenta et la République algérienne démocratique et populaire. Chaque Partie supporte la moitié des frais de l'arbitrage et supporte ses propres frais de représentation
<b>5. <i>Gami Investments, Inc. v. Mexico</i></b> , UNCITRAL (NAFTA), Final Award, 15 November 2004, § 134 <i>et seq.</i>	<p>The tribunal declared that it has jurisdiction over the claims but it dismissed them in their entirety. The tribunal nevertheless finds equitable that each side bears its costs.</p> <p>The Tribunal said that “There are two reasons for not giving Mexico any recovery in this respect. The first is that Mexico raised an unsuccessful jurisdictional objection which became a major feature of the proceedings. The costs associated with that special hearing were significant. The second is that GAMI grievance must be considered as serious. It raised disquieting questions with respect to regulatory act and omission. The Tribunal said that UNCITRAL rules accorded the arbitrators broad discretion with allocation of cost. It concluded that each party bears its own</p>

<sup>212</sup> The tribunal considered there was significant bad-faith litigation – for a discussion: see separate opinion

	expenditures. The amount paid to the Tribunal is divided equally”.
<p><b>6. Loewen Group, Inc. and Raymond L. Loewen v. United States (II)</b>, ICSID Case No. ARB(AF)/98/3 (NAFTA). - Decision on Respondent's Request for a Supplementary, 6 September 2004, § 23 <i>et seq.</i></p>	The Tribunal rejected the Respondent's Request. The Tribunal ordered that each party shall bear its own cost and shall bear equally the expenses of the Tribunal and the secretariat.
<p><b>7. Joy Mining Machinery Limited v. Egypt</b>, ICSID Case No. ARB/03/11 (United Kingdom/Egypt BIT) -Decision on Jurisdiction, 30 July 2004, p. 25 <i>et seq.</i></p>	The tribunal decided that the Tribunal lacks competence to consider the claims made by the Company. Each Party shall pay one half of the arbitration costs. Each Party shall bear its own legal costs.
<p>8. <i>Soufraki v. United Arab Emirates</i>, ICSID Case No. <b>ARB/02/7 (Italy/United Arab Emirates BIT)</b>.- <b>Decision on Jurisdiction, 7 July 2004, § 85 <i>et seq.</i></b></p>	The Tribunal decided that the dispute falls outside its jurisdiction under Article 25(1) and (2)(a) of the ICSID Convention and Article 1(3) of the BIT. Taking into account the circumstances of the case and the Respondent's success with its jurisdictional objection, the Tribunal concludes that it is appropriate that the costs of the proceeding, including the fees and expenses of the Tribunal and the ICSID Secretariat, be borne two-thirds by Claimant and one-third by Respondent, but that each party bears its own legal costs and expenses in connection with the proceeding.
<p><b>9. Waste Management, Inc. v. United Mexican States (II)</b>, ICSID Case No. ARB(AF)/00/3 (NAFTA) -Final Award, 30</p>	The Tribunal decided that (a) the claim is admissible under Chapter 11 of NAFTA; (b) That the conduct of the Respondent which is the subject of the claim did not involve any breach of Article 1105 or 1110 of

April 2004, § 179 <i>et seq.</i>	NAFTA; (c) That Waste Management's claim is accordingly dismissed in its entirety; (d) That each Party shall bear its own costs and half of the costs and expenses of these proceedings.
<b>10. Consortium R.F.C.C. v. Kingdom of Morocco</b> , ICSID Case No. ARB/00/6 (Italy/Morocco BIT)- Final Award, 22 December 2003 (French), § 112 <i>et seq.</i>	Le Tribunal rejette les demandes du Consortium RFCC; met les frais d'arbitrage à parts égales à la charge du Consortium RFCC et du Royaume du Maroc; dit que chaque partie supportera ses propres frais et honoraires de conseils et de représentation engagés dans la présente procédure.
<b>11. Generation Ukraine, Inc. v. Ukraine</b> , ICSID Case No. ARB/00/9 (United States/Ukraine BIT)- Final Award, 16 September 2003, § 24.1 <i>et seq.</i>	<p><i>The claim fails in its entirety. The tribunal considered whether there are any reasons to attenuate the general rule than an unsuccessful litigant in international arbitration should bear the reasonable costs of its opponent.</i></p> <p>Counsel for the Claimant has suggested that "there's more documentation in this particular ICSID reference than has ever been in any previous ICSID reference." The Tribunal is not certain that such an affirmation is verifiable; it is certainly true that the written evidence and submissions in this case have been voluminous. But the Claimant's written presentation of its case has also been convoluted, repetitive, and legally incoherent. It has obliged the Respondent and the Tribunal to examine a myriad of factual issues which have ultimately been revealed as irrelevant to any conceivable legal theory of jurisdiction, liability or recovery. Its characterisation of evidence has been unacceptably slanted, and has required the Respondent and the Tribunal to verify every allegation with suspicion.</p> <p>The Claimant's position has also been notably inconsistent. Moreover, the</p>

	<p>Claimant's presentation of its damages claim has reposed on the flimsiest foundation. The Claimant's presentation has lacked the intellectual rigour and discipline one would expect of a party seeking to establish a cause of action before an international tribunal. This lack of discipline has needlessly complicated the examination of the claim. Even at the stage of final oral submissions in March 2003, counsel for the Claimant relied on two ICSID awards without mentioning that they had been partially annulled. While the Tribunal was fortunately aware of that limitation on the pertinence of those awards, this was due to the happenstance of the arbitrators' personal knowledge. The Tribunal assumes in counsel's favour that he was unaware of the annulments; that is bad enough, and does no credit to the Claimant.</p> <p>The Respondent has claimed costs of USD 739,309.80, representing "contract payments of lawyers [sic] and experts services and expenses for business trips". The Tribunal is unsatisfied with these uncorroborated costs submissions, and considers them vastly overstated.</p> <p>It awards all costs the Respondent has paid into ICSID, or USD 265,000 as well as a contribution of USD 100,000 to the Respondent's legal fees.</p>
<p><b>12. Loewen v. United States (I)</b>, ICSID Case No. ARB (AF)/98/3 (NAFTA) - Final Award, 26 June 2003, §240 <i>et seq.</i></p>	<p>In regard to the question of costs the Tribunal is of the view that the dispute raised difficult and novel questions of far-reaching importance for each party, and the Tribunal therefore ordered that each party shall bear its own costs, and shall bear equally the expenses of the Tribunal and the Secretariat.</p>

<p><b>13. <i>Yaung Chi Oo Trading PTE Ltd. v. Government of the Union of Myanmar</i></b> ASEAN Investment Agreement, I.D. Case No. ARB/01/1 - Final Award, 31 March, 2003, § 87 <i>et seq.</i></p>	<p>The Tribunal unanimously holds that it lacks jurisdiction in the case. As to the question of costs, the Tribunal notes that neither party sought costs at the end of the oral proceedings. For its own part, the Tribunal concludes that no order should be made in relation to the costs of the parties or the fees and expenses of the Tribunal. Each party has succeeded in part in terms of the issues which were argued before the Tribunal, even if in the result the Claimant fails on grounds essentially unrelated to the merits of its underlying claim. The tribunal concluded that each party shall bear its own costs, and shall bear equally the fees, costs and expenses of the Tribunal and the Secretariat.</p>
<p><b>14. <i>ADF Group Inc. v. United States</i></b>, ICSID Case No. ARB (AF)/00/1 (NAFTA). -Final Award, 9 January 2003, § 200.</p>	<p><i>In its Counter-Memorial, the Respondent asked the Tribunal for an order requiring the Investor to bear the costs of this proceeding, including the fees and expenses of the Members of the Tribunal, the expenses and charges of the Secretariat and the expenses incurred by the United States by reason of this proceeding. Having regard to the circumstances of this case, including the nature and complexity of the questions raised by the disputing parties, the Tribunal believes that the costs of this proceeding should be shared on a fifty-fifty basis by the disputing parties, including the fees and expenses of the Members of the Tribunal and the expenses and charges of the Secretariat. Each party shall bear its own expenses incurred in connection with this proceeding.</i></p>
<p><b>15. <i>Mondev International Ltd. v United States of America</i></b>, ICSID Case No. ARB(AF)/99/2 (NAFTA)-Final Award, 11 October</p>	<p>The Tribunal dismisses Mondev's claims in their entirety. As to the question of costs and expenses, the United States sought orders that Mondev pay the Tribunal's costs and the legal expenses of the United States on the basis that its claim was</p>

2002, § 158 <i>et seq.</i>	<p>unmeritorious and should never have been brought.</p> <p><i>The Tribunal said that “ NAFTA tribunals have not yet established a uniform practice in respect of the award of costs and expenses. In the present case the Tribunal does not think it appropriate to make any order for costs or expenses, for several reasons. First, the United States has succeeded on the merits, but it has by no means succeeded on all of the many arguments it has advanced, including a number of arguments on which significant time and costs were expended.</i></p> <p>Secondly, in these early days of NAFTA arbitration the scope and meaning of the various provisions of Chapter 11 is a matter both of uncertainty and of legitimate public interest.</p> <p>Thirdly, the Tribunal has some sympathy for Mondev’s situation, even if the bulk of its claims related to pre-1994 events. It is implicit in the jury’s verdict that there was a campaign by Boston (both the City and BRA) to avoid contractual commitments freely entered into. In the end, the City and BRA succeeded, but only on rather technical grounds. An appreciation of these matters can fairly be taken into account in exercising the Tribunal’s discretion in terms of costs and expenses.</p> <p><i>The Tribunal concluded that each party shall bear its own costs, and shall bear equally the expenses of the Tribunal and the Secretariat.</i></p>
<b>16. W. Nagel v. Czech Republic</b> , SCC Case 49/2002 (UK/Czech Republic BIT), Decision on Jurisdiction 9 September	The Arbitral Tribunal has reached the conclusion that Mr Nagel’s claims are to be dismissed in their entirety. This should normally have as a consequence that Mr Nagel should bear his own costs and also

2002, p. 166 *et seq.* (SAR version).

be ordered to pay the Czech Republic's costs and be ultimately responsible for the costs and expenses of the Arbitral Tribunal and the administrative fee of the SCC Institute.

However, the Arbitral Tribunal considers that some costs and expenses must be considered to relate to specific objections raised by the Czech Republic which were rejected by the Arbitral Tribunal. The Arbitral Tribunal considers it justified to take these circumstances into account when making an order about costs and expenses. Thus, while Mr Nagel should be responsible for his own costs in their entirety, he should be obliged to reimburse only 80 % of Czech Republic's costs.

Mr. Nagel has contested the reasonableness of Czech the Republic's cost claims. He has argued that the number of more than 3,267 hours indicated by the Republic as having been devoted to the case by lawyers and other timekeepers is excessive since there have been (a) no preliminary hearings or appearances of any kind, (b) no disclosures of documents, (c) only three days of evidentiary hearings in which the Republic cross-examined only one witness and produced the testimony of only four witnesses, and (d) only three written submissions from each side, none of unusual length. Mr. Nagel also argued that the claim of USD 118,041 for experts was excessive and unreasonable and pointed out that the testimony of one of the experts (...) had relevance, if at all, only to damages and that his costs should therefore be disallowed at this stage of the proceedings.

*The Arbitral Tribunal first notes that there is*



	<p><i>a very considerable difference between the amounts claimed by the two parties as compensation for costs.</i></p> <p><i>In view of the outcome of the arbitration, the Arbitral Tribunal finds that the parties should be ultimately responsible, [Mr Nagel for 90 % and the Czech Republic for 10 % of these costs and expenses</i></p> <p>In relation to the arbitrators and the Arbitration Institute, the parties shall be responsible, jointly and severally, for the payment of the amounts due to the arbitrators and the Arbitration Institute. As between the parties, Mr Nagel shall be responsible for 90 % and the Czech Republic for 10 % of the amounts due in this arbitration to the arbitrators and the Arbitration Institute.</p>
<p><b>17. Link-Trading Joint Stock Company v. Moldova,</b> UNCITRAL (US/Moldova BIT) – Final Award, 18 April 2002, § 83 <i>et seq.</i></p>	<p>The tribunal said that according to article 38 of UNCITRAL rules, the cost of arbitration including fees for legal representation and assistance shall in principle be borne by the unsuccessful party, although the tribunal may apportion such costs among the parties if it determines that this would be reasonable under the circumstances of the case.</p> <p>The Tribunal holds that the Claimant has failed to prove its claim of violation of the BIT by the respondent and the reasonable costs of arbitration shall be awarded to respondent.</p> <p>The respondent made a submission as to its cost (counsel fees and experts) for a total USD 144, 422, 80. The tribunal considered that it would be reasonable to award the respondent an amount of USD 22,200.</p>

	<p>As for the cost of arbitrators and secretariat, The tribunal said that these expenditures shall be heard by the claimant.</p>
<p><b>18. <i>Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v Estonia (II)</i></b>, ICSID Case No. ARB/99/2. (United States/Estonia BIT)- Decision on Request for Supplementary Decisions and Rectification, 4 April 2002, § 19 <i>et seq.</i></p>	<p>Claimants' Request for Supplemental Decisions and Rectification is denied. The Tribunal said that "19. The Claimants had their "day in court". In fact, they had their week before the Tribunal. Not content with the result, they initiated further proceedings, as was their right, making the Request which the Tribunal hereby denies.</p> <p>20. In the present instance, the Tribunal has no hesitation in ordering that the costs associated with Claimants' Request shall follow the result. Specifically, and in accordance with Article 61 of the ICSID Convention and Arbitration Rule 47(1)(g), the Tribunal orders that the costs of the present proceeding - that is, the expenses incurred by the parties as well as the fees and expenses of the members of the Tribunal associated with the Request - shall be paid in full by Claimants.</p> <p>21. In this regard, the Tribunal assesses the expenses incurred by the Respondent in connection with the present proceeding in the amount of US\$26,485.43, in accordance with the Respondent's Statement on Costs submitted on March 11, 2002, and assesses the fees and expenses of the members of the Tribunal associated with the Request in the amount of US\$14,769.15, in accordance with the Secretariat's communication of March 14, 2002.</p> <p>Accordingly, the Tribunal orders Claimants to reimburse Respondent the total amount of US\$41,254.58 within 15 days of the</p>

	date on which the present decision is dispatched to the parties”
<b>19. <i>Mihaly International Corporation v Sri Lanka, Award</i></b> , ICSID Case No. ARB/00/2 (United States/Sri Lanka BIT)- Decision on Jurisdiction, 15 March 2002, § 63.	The costs of the proceedings including the fees and expenses of the Arbitrators and the Secretariat shall be shared by the Parties in equal portion; and that (b) Each Party shall bear its own costs and expenses in respect of legal fees for counsels and their respective costs for the preparation of the written and the oral proceedings
<b>20. <i>Lauder v. Czech Republic</i></b> , UNCITRAL. (United States/Czech Republic BIT)- Final Award, 3 September 2001, § 315 <i>et seq.</i>	<p>According to Article 40 of the UNCITRAL Rules, the costs of arbitration shall in principle be borne by the unsuccessful party. However, the Arbitral Tribunal may apportion such costs between the Parties if it determines that apportionment is reasonable, taking into account the circumstances of the case. The same applies according to Article 40(2) with respect to the costs of legal representation and assistance. The Arbitral Tribunal can take into account the circumstances of the case and is free to determine which Party shall bear such costs or may apportioned such costs between the Parties if it determines that apportionment is reasonable.</p> <p>318. Among the circumstances the Tribunal has taken into account is its finding that the Respondent, at the very beginning of the investment by the Claimant in the Czech Republic, breached its obligations not to subject the investment to discriminatory and arbitrary measures when it reneged on its original approval of a capital investment in the licence holder and insisted on the creation of a joint venture. Furthermore, various steps were taken by the Media Council,</p>

	<p>especially, but not only, the 15 March 1999 letter to CET 21. Although the Arbitral Tribunal came to the conclusion that such acts did not constitute a violation of the Treaty obligations of the Respondent, the Claimant bona fide could nevertheless feel that he had to commence these arbitration proceedings. Furthermore, the behaviour of the Respondent regarding the discovery of documents, which the Claimant could rightly feel might shed more light on the acts of the Respondent, needs to be mentioned in this context.</p> <p>319. Taking all these circumstances of the case into account, the Arbitral Tribunal comes to the decision that each Party shall pay one half of the fees and expenses of the Arbitral Tribunal and the hearing cost and bear its own costs for legal representation and assistance and the costs of its witnesses.</p>
<p><b>21. <i>Olguín v Paraguay</i>,</b> ICSID Case No. ARB/98/5. (Peru/Paraguay BIT), Final Award, 26 July 2001, § 85 <i>et seq.</i></p>	<p>Although this Tribunal is rejecting all of Mr. Olguín's claims, it does not feel that it is fair to make him pay the costs for these proceedings.</p> <p>In the first place, the Respondent's questioning of this Tribunal's jurisdiction was flatly rejected, on the grounds expressed earlier. In the second place, as already stated various times in this Award, while the oversight exercised by the Paraguayan State through its bodies did not rise to a level of negligence that created liability to pay the losses suffered by the Claimant, it is also true that it cannot be considered to have been exemplary.</p> <p>Moreover, the conduct of the Republic of Paraguay needlessly prolonged these proceedings by repeatedly failing to meet the deadlines set by the Tribunal, in</p>

	<p>particular, the obligations imposed by the ICSID Administrative and Financial Regulations. For the above reasons, this Tribunal feels that it is fair that the parties each contribute part of the expenses arising from these proceedings, dividing the procedural costs in equal shares, and each assuming the costs for their legal representation.</p>
<p><b>22. Genin, Eastern Credit Limited, Inc. and A.S. Baltoil v Estonia (I)</b>, ICSID Case No. ARB/99/2, (United States/Estonia BIT)- Final Award, 25 June 2001, § 379 <i>et seq.</i></p>	<p><i>The Tribunal dismissed the claims. Two factors, in particular, have shaped the Tribunal's determination of the allocation of the costs of the arbitration. Both of those factors relate to the conduct of the parties as demonstrated by the written and oral evidence adduced by them.</i></p> <p>380. First, the Tribunal cannot but decry Mr. Genin's failure to cooperate with the Estonian banking authorities during the period in which the salient facts underlying the dispute took place. His concealment, right up until his cross-examination by Respondent's counsel during the hearing, of his ownership of the companies in question was an element of both substantive and procedural significance, with effect on the conduct of the arbitration. Claimants themselves concede, in their Post-Hearing Memorial, that Mr. Genin's conduct could be considered to have affected the case and that it is thus appropriate for the Tribunal to take this conduct into account when considering the allocation of costs. The Tribunal cannot but concur with both parts of that statement.</p> <p>381. On the other hand, as mentioned above, the awkward manner by which the Bank of Estonia revoked EIB's license, and in particular the lack of prior notice of its</p>

	<p>intention to revoke EIB's license and of any means for EIB or its shareholders to challenge that decision prior to its being formalized, cannot escape censure.</p> <p>382. Either of these factors, alone, might have impelled an award of costs against the offending party.</p> <p>383. Accordingly, and taking into consideration the circumstances of the case, the Tribunal determines that each party shall bear all of the expenses incurred by it in connection with the arbitration. The costs of the arbitration, including the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the ICSID, shall be borne by the parties in equal shares.</p> <p>The tribunal concluded that All of Claimants' claims are dismissed; (6) Respondent's counterclaim is dismissed; and (7) Each party shall bear all of its own costs and expenses incurred in connection with the proceedings, and the costs of the arbitration shall be borne by Claimants and Respondent, respectively, in equal shares.</p>
<p><b>23. <i>Gruslin v Malaysia</i>,</b> ICSID Case No. ARB/99/3, (Belgo- Luxembourg/Malaysia BIT)- Decision on Jurisdiction, 27 November 2000, § 27.4 <i>et seq.</i></p>	<p>The tribunal rejects the claimant's submission that the respondent should be ordered to pay any of the claimant's cost of his unsuccessful claim now dismissed for want of jurisdiction.</p> <p>The Tribunal invoked some considerations that militate against the claimant being awarded to pay the respondent's cost. Among these considerations the inequality of the position of the parties: the tribunal remarked that the claimant conducted the</p>

	<p>proceedings in person and with particular tenacity and was not assisted as the state was by counsellors. Second consideration: the fact that the respondent did not raise the approved project argument until the second round of pleadings. The tribunal concluded that each party shall bear all of its own costs and expenses incurred in connection with the proceedings, and the costs of the arbitration shall be borne by Claimants and Respondent, respectively, in equal shares.</p>
<p><b>24. Waste Management, Inc. v. Mexico (I)</b>, ICSID Case No. ARB(AF)/98/2, (NAFTA)- Decision on Jurisdiction, 2 June 2000, p. 240, ICSID FILJ version.</p>	<p><i>The majority said that the tribunal has no jurisdiction to hear the case because the claimant's breach of one of the requisites laid down by NAFTA Article 1121(2)(b) (waive their right to initiate or continue before any administrative tribunal or court under the law of any NAFTA Party, or other dispute settlement procedures, any proceedings.</i></p> <p>The majority orders the Claimant to pay the costs of the present arbitration proceedings, and each of the disputing parties to defray the respective costs occasioned by its own defence.</p> <p>The arbitral award has been adopted by a majority of the Arbitral Tribunal.</p>
<p><b>25. Azinian, Davitian, &amp; Baca v. Mexico</b>, ICSID Case No. ARB (AF)/97/2, (NAFTA)- Final Award, 1 November 1999, § 125 <i>et seq.</i></p>	<p>The claim has failed in its entirety. The Respondent has been put to considerable inconvenience. In ordinary circumstances it is common in international arbitral proceedings that a losing claimant is ordered to bear the costs of the arbitration, as well as to contribute to the prevailing respondent's reasonable costs of representation. This practice serves the dual function of reparation and dissuasion.</p>

	<p>The Tribunal said that “126. In this case, however, four factors militate against an award of costs. First, this is a new and novel mechanism for the resolution of international investment disputes. Although the Claimants have failed to make their case under NAFTA, the Arbitral Tribunal accepts, by way of limitation, that the legal constraints on such causes of action were unfamiliar.</p> <p>Secondly, the Claimants presented their case in an efficient and professional manner. Thirdly, the Arbitral Tribunal considers that by raising issues of defective performance (as opposed to voidness ab initio) without regard to the notice provisions of the Concession Contract, the Naucalpan Ayuntamiento may be said to some extent to have invited litigation. Fourthly, it appears that the persons most accountable for the Claimants’ wrongful behaviour would be the least likely to be affected by an award of costs; Mr. Goldenstein is beyond this Arbitral Tribunal’s jurisdiction, while Ms. Baca – who might as a practical matter be the most solvent of the Claimants – had no active role at any stage.</p> <p>127. Accordingly the Arbitral Tribunal makes no award of costs, with the result that each side bears its own expenditures, and the amounts paid to ICSID are allocated equally”</p>
<p><b>26. Tradex Hellas S.A. v. Albania</b>, ICSID Case No. ARB/94/2 (Jurisdiction based on foreign investment law not BIT) – Final Award, 29 April 1999, § 206 <i>et seq.</i></p>	<p><i>For its decision regarding the costs of the proceeding, the Tribunal first takes into account that Tradex prevailed in the procedure concluded by the Decision on Jurisdiction of 24 December 1996, and that now, Albania prevailed on the merits. Furthermore, though, taking the dispute as</i></p>



	<p><i>a whole, Tradex failed in its claim, it may be taken into account that, by no means, this claim can be considered as frivolous in view of the many difficult aspects of fact and law involved and dealt with in this Award.</i></p> <p>herefore, the Tribunal concludes that, in view of all the circumstances of this dispute, each Party should bear its own expenses and the costs of its own legal representation, and that the costs of the arbitration, covered by equal advance deposits by both Parties, should be borne by the Parties equally in shares of 50 %.</p>
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