The Spanish version is the original and shall prevail over this courtesy translation in all respects.

BEFORE THE HONORABLE ARBITRAL TRIBUNAL ESTABLISHED UNDER CHAPTER ELEVEN OF THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

CARGILL, INC.
(CLAIMANT)

V.

UNITED MEXICAN STATES,
(RESPONDENT)

ICSID CASE NO. ARB(AF)/04/05

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DEFINITIONS

For purposes of this Countermemorial:

ADM refers to Archer Daniels Midland Company;

ALMEX refers to Almidones Mexicanos, S.A. de C.V.;

ASA refers to the American Sugar Alliance, a U.S. association of producers with headquarters in Arlington, Virginia, to which the sugar producers and refiners of corn for U.S. sweeteners belong;

Cargill refers to the claimant, *Cargill, Incorporated*.

Cargill de México refers to Cargill de México, S.A. de C.V.

FTA refers to the Canada-United States Free Trade Agreement;

FTC refers to the Free Trade Commission, established pursuant to Article 2001 of the NAFTA.

CPI refers to Corn Products International Company, a producer of fructose that (i) competes with Cargill, ADM and TLIA in the United States; (ii) is the sole owner of CPIngredientes, S.A. de C.V., a producer of fructose that competes with Cargill de México and ALMEX in Mexico, and (iii) is the claimant in a separate proceeding filed under Chapter XI of the NAFTA, which is being pursued at the same time as this proceeding;

CRA refers to the Corn Refiners Association, a U.S. association of manufacturers with headquarters in Washington, D.C., to which the claimants belong;

WTO dispute refers to the dispute identified as WT/DS308 that the United States filed with the WTO Dispute Settlement Body on March 16, 2004 described in detail in paragraph III.C.2 of this Counter-Memorial;

Dispute between Mexico and the United States or **sweetener dispute** refers to the dispute that Mexico filed under the dispute settlement mechanism set forth in Chapter XX of the NAFTA by means of a request for consultation filed on March 13, 1998 pursuant to Article 2006 of the NAFTA described in detail in paragraph II.H of this Counter-Memorial;

Fructose refers to high fructose corn syrup (HFCS);

IEPS refers to the 20 percent tax applicable to soft drinks, hydrating and rehydrating drinks; and syrups or concentrates for preparing soft drinks dispensed in open containers using automated, electric, or mechanical apparatuses as set forth in Article 2, section I, paragraphs (G) and (H) of the Ley del Impuesto Especial Sobre Producción y Servicios (Special Production and Services Tax Law), which took effect on January 1, 2002 pursuant to the reforms to the law published in the

Official Gazette of the Federation on December 31, 2001, which is the only one claimed by the claimants in this proceeding;

WTO refers to the World Trade Organization;

SECOFI refers to the *Secretaría de Comercio y Fomento Industrial* (Ministry of Trade and Industrial Development), currently the Ministry of Economy, which reports to the Federal Public Administration of Mexico, and which changed its name on December 1, 2000;

NAFTA refers to the North American Free Trade Agreement.

TLIA refers to Tate & Lyle Ingredients Americas, Inc.;

USDA refers to the United States Department of Agriculture, an agency of the federal government of the United States of America;

USTR refers to the Office of the United States Trade Representative, an agency of the federal government of the United States of America.

I. INTRODUCTION

1. The Counter-Memorial is structured in the following manner:

- Part I presents a general overview of the main arguments of Mexico's defense.
- Part II deals with the relevant facts. The Claimant has completely neglected to describe the context of the motivating facts in this dispute, accordingly, Mexico must put the claim in its proper context, providing a detailed description of the record and the ramifications of the dispute's origin.
- In Part III, Mexico sets forth its legal arguments, which are divided into three sections. In the first, Mexico objects to the Tribunal's jurisdiction to hear some of the claims. In the second, Mexico presents specific responses to each of the Claimants' claims that Mexico has violated Articles 1102, 1103, 1105, 1106 and 1110. Finally, Mexico will address the legitimate use of countermeasures in accordance with international law, a fundamental defense that has both jurisdictional and merits elements.

2. Part IV sets forth the response to the claim for damages.

A. The Tribunal's Jurisdiction

3. Cargill's claim has several defects. In summary, Mexico believes that:

- the Claimant may not recover damages for loss of cash flow it allegedly suffered on HFCS that it contends it would have produced in the United States and would have exported to Mexico but for the "anti-HFCS" measures (in addition to loss of cash flow allegedly suffered by Cargill de Mexico);
- antidumping measures are governed exclusively by NAFTA Chapter Nineteen and their imposition is not contrary to the obligations contained in Part A of Chapter Eleven; therefore, the Claimant can not claim that it suffered a loss or damage. In addition, in any event, in accordance with the requirements of Chapter Eleven, the claim regarding the antidumping duty was already time-barred;
- in addition to the fact that the imposition of an import permit requirement is not a breach of Part A of Chapter Eleven, and therefore the Claimant can not claim that it suffered a loss or damages, the claim does not comply with Article 1119 since it did not identify the import permit as part of its claim**.** In addition, the import permit requirement is a trade measure that the Claimant apparently has admitted is governed by NAFTA Chapter Three;
- with respect to the claim of a violation of Article 1103, the Claimant has not demonstrated (nor even alleged) that a Canadian investor that has made (or is making or seeking to make) an investment in Mexico has received better treatment, in like circumstances, than that received by the Claimant, and
- the antidumping measure on HFCS and the IEPS did not violate Article 1105,

because this type of measure is outside the Tribunal's jurisdiction and the NAFTA expressly states that Article 1105 does not apply to tax measures.

4. Given that the Tribunal lacks jurisdiction to recognize two of the three measures of the Cargill claim and because of the other exceptions that Mexico sets forth, the Respondent requests that the Tribunal suspend the proceeding and, in accordance with Article 45 of the ICSID Arbitration (Additional Facility) Rules, resolve the objections to its jurisdiction as a preliminary matter.

B. Defenses to the alleged violations of Articles 1102, 1103, 1105, 1106 and 1110.

5. The Claimants argue that the IEPS on soft drinks violates Articles 1102 (National Treatment), 1103 (Most-Favored-Nation Treatment), 1105 (Minimum Standard of Treatment), 1106 (Performance Requirements), and 1110 (Expropriation). However, if one interprets and applies these articles correctly in their context and in light of their purpose and intent, it is clear that the claims cannot be sustained.

6. In summary:

- There was never a denial of national treatment because the Mexican sugar producers and the Claimant were not in like circumstances;
- The claim of denial of most-favored-nation (MFN) treatment does not have merit since the Claimant has not identified any Canadian investor that has invested (is investing or seeks to invest) in Mexico to whom better treatment has been accorded, in like circumstances, than that accorded to the Claimant;
- The import permit requirement – the only measure to which Article 1105 could conceivably be applied -- cannot be construed as a violation of the minimum standard of treatment at international law as established in the NAFTA;
- The tax does not establish prohibited performance requirements. It does not confer an advantage in the sense of Article 1106, nor is it a measure with respect to an investment owned or controlled by the Claimant;
- The tax can not be equated to an expropriation because it is a temporary measure, which at worst delayed, for a few months, Cargill de Mexico from resuming sales in a specific market sector in which, moreover, it had not participated in for four years.

C. Mexico adopted the IEPS as a countermeasure in response to the United States violations of its obligations established in the NAFTA

7. In the legal arguments of this submission, Mexico will address why it believes that the tax is not a breach of Articles 1102, 1103, 1106, and 1110 of the NAFTA, but Mexico considers it important for the Tribunal to understand clearly the facts and circumstances surrounding the implementation of the tax and the fact that it concerns a countermeasure adopted in accordance with international law.

8. The Memorial argues that the tax was the last of a series of Mexican measures to protect the Mexican sugar industry from the competition represented by HFCS imported from the U.S. or produced in Mexico by the investments of American investors.[1] The tax was actually adopted as a response to the U.S. refusal to comply with its NAFTA obligations (i) regarding the access of Mexican sugar to its markets; and (ii) to submit to the dispute settlement mechanism established in Chapter Twenty of the treaty itself, including the jurisdiction of an arbitration panel established pursuant to Article 2008 of the NAFTA. The United States deliberately obstructed the functioning of the dispute settlement mechanism by refusing to appoint the panelists it was required to appoint once Mexico filed its request pursuant to Article 2008 and by subsequently giving instructions to its section of the Secretariat to refrain from doing so. The Mexican market faced substantial sugar surpluses, and Mexico was forced to bear the cost of the unilateral interpretation by the United States of its obligations established under the NAFTA and its refusal to submit to the jurisdiction of an arbitration panel. Therefore, after many bilateral meetings and warnings to the United States, Mexico was forced to impose countermeasures.

D. Additional defenses to the claim for damages

9. Cargill's claim for the alleged loss of profits on the sale of fructose produced in the United States that it could have exported to Mexico "but for" the IEPS cannot be claimed in this proceeding. Although the Claimant can claim the damages suffered in its capacity as investors of a Party (i.e., as owner of Cargill de Mexico), it cannot claim the damages that it suffered in its capacity as a producer of goods in the United States.[2] All three NAFTA Parties, including the U.S. government, agree in this respect.

10. The claim for the alleged loss of profits is extremely exaggerated. It is based on numerous invalid premises and includes unsustainable estimates with respect to the size of the HFCS market, the market participation of Cargill de Mexico and the prices that the producers would have had to pay for HFCS "if not" or the IEPS. This overestimation is partly a consequence of the fact that the Claimant's damages expert projects the HFCS market from 1998 onwards as if the antidumping measures had never been imposed, which led him to project a 2002 HFCS market that is 275% larger than that observed in Mexico in 2001.

II. STATEMENT OF FACTS

A. Preliminary Comments

11. In this pleading Mexico will focus on responding to the claimant's characterization of the facts, particularly the argument that the tax was the latest in a series of measures intended to protect an inefficient Mexican industry from the competition represented by a superior, lower-priced product exported from the United States and produced in Mexico based on investments by U.S. investors.

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[1] Memorial, ¶¶ 4,6.

[2] This defense is stated as a limited challenge to the Tribunal's jurisdiction as detailed in Section III, Jurisdiction of the Tribunal and Section IV.4, Defense against Claim for Damages.

12. Because the Claimants neglect to refer to the sweeteners dispute, which is what caused the adoption of the tax as a countermeasure, Mexico will describe in detail the context in which it arose, the United States' breach of its NAFTA trade obligations, the adverse effects that this had on the Mexican sugar industry, the efforts of Mexico to establish a panel to resolve the dispute, the refusal of the United States and the steps that, under the circumstances, the President and the Congress considered necessary to take in order to protect the legitimate interests of Mexico.

B. The sugar trade and its relationship with HFCS

13. To respond to the Claimant's allegations on the facts, Mexico will first put the claim in its proper context. In order to do this, it is necessary to understand the interrelationship between sugar and HFCS, as well the nature of international trade in sugar and the manner in which it is regulated. Accordingly, below we review (i) the nature of the world market for sugar; (ii) the U.S. Sugar Program, under which the United States maintains above-world-market prices for sugar primarily by restricting imports; and (iii) the common interests of the U.S. sugar and HFCS producers, as reflected in their joint political efforts.

1. The Sugar World Market

14. The Tribunal should be aware of the unusual nature of the world market for sweeteners. Three basic types of sugar are traded in the world market: (1) Raw sugar is minimally processed sugar containing some impurities. It is extracted from harvested sugarcane that has been processed in a sugar mill. It is a stable, inert product that does not rapidly deteriorate, is easily shipped, and can be stored for lengthy periods before being refined. It is the most widely traded type of sugar. (2) Refined cane sugar is processed so as to remove all impurities. (3) Finally, there is an intermediate form of sugar called standard sugar, known in Mexico as "*estándar*". In terms of processing it is a semi-refined sugar that falls between raw sugar and refined sugar.

15. Sugar refiners' profits are based on what is known in the market as the "refiner's margin". The refiner obtains a gross return equal to the difference between the selling price of the refined sugar and the cost of the raw sugar. Deducting from this amount all refining and other costs associated with the production, sale and delivery of the sugar yields the "refiner's net margin". The net margin for the production of the sugar is affected by fluctuations in sugar cane costs and, in particular, by refined sugar prices in the market. If raw sugar costs increase and refined sugar prices decrease, the refiner's margin shrinks and can go negative.

16. Raw cane sugar is traded internationally under the New York Board of Trade (NYBOT) Sugar No. 11 (World) Futures Contract ("No.11 Contract").[3] In the U.S. market, raw sugar is traded under the NYBOT Sugar No. 14 (Domestic) Futures Contract ("No. 14 Contract").[4] Outside the U.S., refined sugar is traded internationally under the London International Financial

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[3] The NYBOT is the predecessor of the Coffee Sugar and Cocoa Exchange (CSCE). Antonious González, Andrés Constatin. PhD Thesis in Economics. Harvard University, August 1997. Exhibit R 07. The terms of the No. 11 Contract are set out in Exhibit R 04.

[4] The terms of the No. 14 Contract are set out in Exhibit R 05

Futures and Options Exchange (LIFFE) No. 5 White Sugar Futures Contract ("No. 5 Contract").[5] There is no futures exchange for standard sugar.

17. Sugar is widely produced: more than 120 countries produce sugar. It is one of the most highly protected agricultural markets. Many States, including the United States and now Mexico (as a result of NAFTA), restrict access to their markets to support domestic prices. Consequently, production is encouraged by high support prices and surpluses emerge that must then be disposed of on the residual world market at distress prices. The American Sugar Alliance (a group comprising U.S. producers which lobbies the U.S. Congress and U.S. in order to maintain high prices) has calculated that from 1983/84 through 1998/99, the world average cost of producing sugar was 16.3 cents/lb. (U.S. dollars) but the world market price was only slightly more than half of the cost of production: 9.5 cents/lb.[6] Approximately 70 percent of world sugar sales are made at each country's regulated domestic price. As a consequence of this widespread government intervention, the world sugar market is called a residual market.[7]

18. World refined sugar prices can fluctuate dramatically. During the second half of the 1990s when Mexico entered into surplus, there was a substantial downturn in the world market. No. 5 Contract prices declined from an average of 17.41 cents/lb. in fiscal year 1996 to 9.10 cents/lb. in fiscal year 2000 and world raw sugar prices (the No. 11 Contract price) declined from 12.40 cents/lb. to 7.53 cents/lb.[8] The refiner's margin inherent in these figures dropped from 5.01 cents/lb. in fiscal 1996 to 1.57 cents/lb. in fiscal 2000.[9] In the first quarter of 2001, it dropped to 0.55 cents/lb.[10]

19. It was during this period that the Mexican sugar producers had a large surplus of *estándar* sugar. Abundant and extraordinarily cheap high quality "whites" were available in the world market at that time.[11]

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[5] The terms of the No. 5 Contract are set out in Exhibit R 06.

[6] USDA Economic Research Service, Sugar & Sweeteners Situation and Outlook Yearbook, p.42. Exhibit R 07.

[7] Testimony of Jack Roney, Director of Economics and Policy Analysis on Behalf of the American Sugar Alliance on "*The Future of U.S. Sugar Policy*", Committee on Agriculture, United States Senate, Washington D.C., July 17, 2001 ("Roney Testimony"), p. 6. Exhibit R 08.

[8] USDA Economic Research Service, Sugar & Sweeteners Situation and Outlook Yearbook, p. 42, Tables 2 and 3. Exhibit R 07.

[9] Ibid.

[10] Ibid.

[11] The USDA reported in "Sugar: Mexico to Export Sugar Again in MY 1999", 10 April 1999, that:

"The sugar export forecast for Mexico in MY 1999 is 900,000 MT which is almost 6 percent lower than in MY 1998. This outlook, however, is tempered by the final results of actual sugar production and substitution by alternative domestic and imported sweeteners. It is important to note that domestic prices for sugar are higher than the international prices. Therefore, the sugar industry considers exports as a double-edged sword – they are necessary to reduce storage costs, but unprofitable due to low international prices. Also, the Mexican industry agreed on exporting excess sugar on a per mill quota basis to prevent downturns in domestic sugar prices. Domestic sugar is priced between U.S.$400 to U.S.$500 MT, while it is exported at approximately U.S.$300 MT. Sugar exports under the U.S. quota for MY 1999 will be approximately 27,000 MT, including both raw and refined sugar. The Mexican sugar

20. It is also important to understand that due to the long cycles of sugarcane production, growers cannot respond to market signals quickly. The NAFTA tribunal in *GAMI Investments, Inc*. v. *United Mexican States* examined the sugar market in the course of considering (and dismissing) another Chapter Eleven claim against Mexico. In its award, the tribunal noted:

> 45. Agricultural economics tend to be complex. The Mexican sugar industry is characterized by special complicating factors. The productive life of sugarcane is 4-8 years. Farmers (cañeros) are understandably disinclined to convert their fields to other crops early in the cycle. The supply of sugarcane therefore responds slowly to the market. Sugarcane is processed optimally within 24 hours of harvesting. (48 hours is a maximum given the loss of sucrose.) Mills must therefore be readily accessible. Cañeros cannot operate without mills in proximity. Once a mill is constructed it depends on input from cañeros in the area. Once the mill is built it depends on that area's sugarcane growers' production. Mr. Antonius estimates that the price paid for sugarcane represents approximately 70% of the sugar mill's cost. GAMI describes this as a "relationship of mutual dependence." Mr. Antonius strikingly speaks of a "bilateral monopoly."[12]

21. In Mexico and elsewhere, sugarcane production does not respond quickly to changes in the refined sugar market. This is one of the complicating factors of the trade in sugar.

2. The U.S. Sugar Program

22. Historically, the U.S. government has regulated the sugar industry by means of a federal Sugar Program that maintains a high support price which guarantees generous returns to American sugar cane and sugar beet growers. Its primary mechanisms consist of: (i) a "non-recourse" loan price support administered by the United States Department of Agriculture's Commodity Credit Corporation (CCC); and (ii) tariff-rate quotas (TRQs) that restrict imports of refined and raw sugar.[13] In the absence of this program, consumers would have access to cheaper imported sugar.

23. The Program also provides direct protection to sugar refiners. For example, even though its domestic sugar market amounts to approximately 10.5 million tons, the United States' WTO global quota for imported white sugar is a mere 22,000 tons. The vast majority of the sugar imported by the United States –approximately 1.1 million tons– is raw sugar that is then refined by U.S. refiners.

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industry, however, keeps pressing the Mexican government for more access to the U.S. market, equivalent to a relatively free access to the Mexican market for HFCS (prior to the imposition of antidumping duties). The sugar industry claims there is danger of having to close 15 to 20 mills, resulting in layoff of about 100,000 workers, due to the high levels of imported HFCS, higher levels of sugar production and a flat sugar consumption. According to the industry, there are approximately 149,000 sugar cane growers, 32,000 blue collar workers and 5,500 employees."

Exhibit R 09.

[12] *GAMI*, Final Award, ¶ 45.

[13] See USDA, Economic Research Service, Farm Commodity Policy: 1996-2001 Program Provisions.

24. The CCC loan program is the principal means for supporting the domestic U.S. price. Although designed as a price support program for growers, loans are not granted directly to them. They are granted to refiners and other sugarcane or sugar beet processors. This is because sugarcane and sugar beets, being bulky and very perishable, must be processed by a nearby mill or plant into raw sugar (or refined sugar in the case of beets) which can then be stored and traded. To qualify for loans, processors must agree to provide part of the loan payment to the producers in proportion to the amount of the loan value accounted for by the sugar beets and sugarcane delivered by the growers.[14] The sugar loan program is "non-recourse"; the growers pledge their crops as collateral for the loans and, instead of paying a penalty, they simply lose their collateral and the United States government has no recourse against them. Hence, if the price of refined sugar declines, producers may find it more profitable to forfeit their crops and take the loan proceeds rather than the sum that the processors can afford to pay them. Even though the U.S. Congress instructed the USDA to manage the program so as to avoid crop forfeitures, in practice this has not been possible.[15]

25. The support price has enriched the growers, particularly the sugar beet grower-owned cooperatives of the U.S. Midwest where the growers are entitled to 22.9 cents/lb. in non-recourse price support loans even though their cost of production has been as low as 9 cents/lb.[16]

26. With such generous returns, beet growers and processors and cane growers have developed strong relationships with U.S. legislators. They, in turn, have supported the Sugar Program's continuance and have resisted pressures for reform.

C. The NAFTA's treatment of trade in sugar

1. Trade liberalization under the NAFTA

27. The NAFTA was the first regional free trade agreement that sought to integrate the economies of two developed States and a developing country that sought an instrument that would allow it to hasten its economic development. Mexico's comparatively lesser state of development was particularly manifest in agriculture, where high poverty levels are present. While Canada and the United States had well-developed agricultural support and trade adjustment programs, Mexico did not. Moreover, Mexico's farmers represent a higher proportion of the work force and a far greater proportion of its people rely on the agrarian economy compared to the United States or Canada.

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14 Congressional Research Service, Sugar Policy Issues, 16 May 2005, p. 2 and 3. Exhibit R 10.

15 Roney Testimony, p. 2. Exhibit R 18. Sugar and Sweeteners – Summary. Exhibit R 07.

16 Congressional Research Service, Sugar Policy Issues, May 16, 2005. pp. 2 and 3. Exhibit R 10.

Employment in the Agricultural Sector

	1998	2000	2002
	as a percentage of total employment / jobs		
Mexico (1)	18.8	17.5	17.4
Canada (2)	3.5	3.0	2.7
United States (2)	2.5	2.4	1.6

Data sources:
National Employment Survey 2004, Chart 18A (*Encuesta Nacional de Empleo*)
Monthly Labor Review, November 97, 99, 01 and February 2004.
Statistics Canada
(1) Based on population employed in the agricultural sector.
(2) and (3) Based on the number of jobs in the agricultural sector.
Includes: forestry, fishing and hunting.

28. NAFTA established a free trade area in accordance with Article XXIV of the GATT. One of its objectives is to liberalize cross-border trade in goods and services. Chapter Three of the NAFTA regulates goods' access to the market in general; however, a number of sectoral chapters were included because of the special issues associated with such sectors. Agriculture was one such chapter. Its commercial regime is contemplated in Chapter Seven. It is common for governments to intervene in the agricultural sector – more so than in the case of manufactured goods – and the trade in goods frequently suffers from distortions. Hence the difficulty in negotiating rules governing agricultural trade liberalization.

29. The NAFTA includes more than just trade in goods. NAFTA's trade in goods rules are supplemented by what were known at the time as the "new" trade issues which include the trade in services, intellectual property, government procurement, and other related matters. The investment protection disciplines –in Chapter Eleven– fall within a larger, more comprehensive, agreement on trade liberalization[17], which is relevant to the interpretation of the Treaty.

30. This point, although trite, is important to note because, as discussed above, the instant case is part of a larger dispute over bilateral trade in sweeteners arising from the restrictions on Mexican sugar imposed by the United States. Sharp lines of difference divide the Mexican sugar industry (cane growers and millers) and the U.S. sweeteners industry (cane, sugar beet and corn growers and refiners and processors).

31. These divisions reflect historical, competitive, and other differences stemming from the fact that one industry has developed in a State with a highly developed economy, whereas the other in a developing country with an emerging economy. There have been disputes between U.S. and Mexican producer interests (represented by their respective national industry organizations). The two governments have been adverse in interest during the consultation and negotiation procedures as well as in dispute settlement proceedings under the WTO and the NAFTA. The

[17] NAFTA is the second free trade agreement to include regulations to protect investment. Its predecessor, the free trade agreement between Canada and the United States (FTA) was first to include a chapter on State-to-State investment (Chapter 16). However, this Agreement contained less substantive disciplines and contained only dispute settlement mechanism. See Exhibit R 11.

measure at issue in this case was challenged in WTO proceedings initiated by the United States, and, as already noted, the United States is adverse in interest to Mexico in the dispute under the NAFTA to the point were it has refused to submit to NAFTA dispute settlement. Mexico will revert to these facts in Part III.H.

2. NAFTA's treatment of agricultural trade[18]

32. The three Parties initially sought to negotiate a trilateral agriculture chapter but this proved difficult and ultimately impossible. The NAFTA was negotiated at the same time that the GATT Uruguay Round of Multilateral Trade Negotiations ("the "Uruguay Round" or "MTN") were taking place. The United States and Canada had already signed a Free Trade Agreement (FTA) which entered into force in 1988, during the first years of the Uruguay Round, at a time when there was no clear consensus as to how to liberalize multilateral trade in agricultural goods. When the NAFTA was being negotiated (1991-1992) there was still no agreement within the MTN on how to achieve this and the different positions on the issue were far apart. However, the possibility of substituting quotas with tariffs was being discussed.

33. Prior to the Uruguay Round, countries maintained quantitative restrictions (quotas) on the importation of many agricultural goods. Quantitative restrictions are absolute barriers to trade and there is great discretion exercised by governments when granting import permits. The proposal discussed at the Uruguay Round was to transform those quantitative restrictions into tariffs, since they are more transparent and, although they could be very high, there is the possibility of gaining access to a market by paying them. Moreover, this framework allowed for subsequent negotiations to reduce the tariffs, as was the case with manufactured goods within the GATT. This was the way in which countries decided to convert their quotas into tariffs. This process was called "tariffication". This was one of the most complicated areas of negotiation in the Uruguay Round.

34. The NAFTA negotiations initially started out as bilateral negotiations between Mexico and the United States (the inclusion of Canada was a logical step since Canada already a free trade agreement with the United States: the FTA). One of the United States' conditions was to achieve free trade in all products, including agricultural products. Mexico agreed. However, Canada and the United States had excluded certain agricultural products from their FTA and had not contemplated the tariffication of quantitative restrictions in that agreement.

35. Consequently, Section A of Chapter Seven, which establishes the trade regime for agricultural products contains a limited number of trilateral dispositions. Specific commitments concerning trade liberalization were negotiated bilaterally, and therefore there is a section specifically regulating trade between Mexico and the United States (Section A of Annex 703.2), between Canada and Mexico (Section B of Annex 703.2) and between the U.S. and Canada which basically incorporated the terms of the *United States – Canada Free Trade Agreement*.

36. Like all free trade agreements, the NAFTA contains exceptions to general rules, reservations, sector-specific rules, transition periods, *etc*. that are necessitated by differences in

[18] See in general Ildefonso Guajardo's witness statement. Exhibit R 01C.

national trade regulation, by different levels of development, and, in some cases, by distinct national producer interests.

37. The U.S. sugar industry is a prime example of such an interest. Mexico will address this next.

3. Bilateral trade in sweeteners

38. Sweeteners trade between Mexico and the United States is more complex than it appears at first sight and comprehends more than just HFCS and sugar imports and exports. It also includes domestic production of HFCS, which was practically non-existent in Mexico prior to NAFTA's entry into force (even though there was an important corn milling industry which produced other corn-related products such as starches). The investment trade regime established in the NAFTA opened the possibility for its development. U.S. HFCS producers took advantage of trade and investment opportunities. Trade in corn also has a close relationship with the impact of the bilateral trade in sweeteners.[19]

39. Insofar as trade in sugars and syrups[20] between the U.S. and Canada is concerned, it is regulated in accordance with their FTA, which allowed the U.S. to impose quantitative restrictions on refined sugar imports from Canada.[21] With the advent of the WTO, the United States converted these restrictions into very high tariffs. Since Canada does not maintain a sugar program, all U.S. sugar exports were subject to the tariff rate contemplated in the FTA, which was progressively eliminated.[22]

40. Canada and Mexico agreed only that Mexico would apply its MFN tariff to Canada's sugar exports and Canada would maintain a similar tariff on Mexico's exports.[23]

a. The sugar regime within the NAFTA

41. As a result of the pressure exerted by the U.S. industry, trade in sugar was subjected to one of the longest tariff elimination periods. It was to be liberalized over a 15 year period. However, the trade liberalization process originally negotiated was to Mexico's benefit. Dr. Luis de la Calle, the former Undersecretary of International Trade Negotiations of the Secretary of Economía from 1999 to 2002, explains:

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[19] Witness statement of Mr. Luis de la Calle, ¶ 13. Exhibit R 01A.

[20] In accordance to the definition on Annex 703.2 "sugars and syrups" did not include increased high fructose corn syrup (HFCS).

[21] Canada, which did not have a program to help the sugar industry (since its refineries import raw sugar from the international market and the beet sugar producers only supply 15% of the national market) did not obtain any additional access to the U.S. market. It only formalized the right to place 8,000 tons of the initial 22,000 tons of refined sugar global quota. This sugar must be originating beet sugar. It does not include imported raw sugar from the world market that is refined in Canada.

[22] Nonetheless, after NAFTA came into effect, Canada imposed antidumping duties on dumped U.S. refined sugar imports.

[23] Annex 703.2, section B, ¶¶ 11 and 12.

> …The United States historically has been a deficit sugar producer and this situation is not likely to change in the short or long run. Its import commitments in the WTO are approximately 1.1 million tons per year, which are assigned amongst several sugar producing countries of the world. Hence, even though paragraphs 13-22 and Annex 703.2 [of the NAFTA] establish a reciprocal commercial regime concerning sugar, in reality it is the U.S. sugar regime made applicable to Mexico.[24]

42. Dr. Luis de la Calle explains the trade regime in the following terms:

> 5. The Treaty establishes a two-level progressive liberalization regime in three stages. First, Article 302.2 establishes a tariff-quota system under which a certain quota would be free of any tariffs and any amount exceeding that quota would be subjected to a progressively decreasing tariff starting at a base-tariff-rate, which would be completely eliminated on [1 October] 2008. This is what is known as a second-tier duty.[25]

43. It is a specific tariff, that is, an amount that is charged on the imported volume. The tariff started at 36.451¢/Kg. (U.S. currency) and is reduced annually. Dr. de la Calle continues:

> … The three stages are relevant for determining the tariff-free quota: the first goes from 1994 to 2000, the second from 2000 to 2008 and the third starts on 2008. Because the sugarcane harvest starts in October, trade is liberalized within the Treaty in "marketing years", which start on 1 October and end on 30 September of the following year.
>
> 6. The Treaty establishes a minimum fixed tariff-free quota of 7,258 tons per marketing year during the transition period. Mexico, in addition would be able to export its net production surpluses within the following limits:
>
> a. 25,000 tons during the first six marketing years, that is from October 1994 to September 2000;
>
> b. 150,000 tons in the seventh marketing year (2000-2001) and 110% of the maximum limit of the previous year, starting on the eight marketing year and until the tenth marketing year (October 2001 until September 2008)
>
> 7. However, if Mexico achieved a net production surplus in two consecutive years during the transition period (even if it achieved this in a given year and it was expected to achieve it during the following year), it could export its total net production surplus to the United States. Mexico was a net surplus producer in all marketing years between 1995 and 2001.
>
> 8. The net production surplus is the amount of domestic sugar production from sugar cane (the NAFTA also contemplates sugar produced from sugar beet, however, Mexico in practice does not produce

[24] Testimony of Dr. Luis de la Calle, ¶ 4. Exhibit R 01 A.

[25] Ibid., ¶ 5.

> sugar from sugar beets), that exceeds domestic consumption, and includes direct as well as indirect consumption in the form of sugar containing products. The NAFTA has a formula to adjust the estimated net production surplus for the following year based on current production and effective consumption.
>
> 9. In this way NAFTA contemplated that Mexico would move from being a net sugar importer to a net sugar surplus producer, with increasing surpluses during the transition period.
>
> 10. Mexico and the Untied States established a customs union on sugar, that is, they maintain the same tariff towards other countries, the most-favored nation tariff. In the NAFTA Mexico agreed to replicate the high MFN tariff that the United States maintains on sugar. Since the most-favored nation tariff is very high (approximately 36 cents per kilo), it prevents hedging between the world and domestic prices; in other words, it guarantees that sugar will not be imported in order to satisfy domestic consumption and sugar produced in the country being exported. In this way, under the system envisioned in the NAFTA, Mexico and the United States would only export their surpluses.[26]

b. The HFCS trade regime

44. Dr. de la Calle notes:

> 11. HFCS's commercial regime is simpler. Article 302.2 establishes a tariff rate that would decrease linearly over a ten year period starting at 15% and ending at zero on 1 January 2004.[27]

c. The relationship between sugar and HFCS within the NAFTA

45. Both Mexican and U.S. negotiators were aware that sugar and HFCS were substitutes in certain industrial applications and hence compete in certain market segments. The Treaty, therefore, contemplates the gradual integration of both countries' sweetener markets. Dr. de la Calle adds:

> 12. Although the tariff elimination scheme is not the same for sugar and HFCS, NAFTA negotiations achieved an equilibrium that would allow the integration of both countries' sweetener industries, and would allow for sugar and HFCS to compete in equitable conditions.[28]

46. Mexico and the United States expected prices to converge as the two markets became integrated: Mexico's domestic price would increase and the price in the United States would fall until equilibrium was reached. With the establishment of a common market and a high MFN tariff,

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[26] Ibid., ¶¶ 5 -10.

[27] Testimony of Luis de la Calle, ¶ 11. Exhibit R 01A.

[28] Testimony of Luis de la Calle, ¶ 12. Exhibit R 01A.

prices were expected to stabilize at a higher level. Negotiators were also aware of HFCS penetration in Mexico's sweetener market.[29] As long as the price for sugar in Mexico increased to a level close to that observed in the U.S., Mexico would experience a similar sugar displacement phenomenon. Obviously, the Mexican market would be a logical place for U.S. producers to dispose of their HFCS surplus once the tariffs on HFCS were reduced and eliminated.

47. There is another important factor in the bilateral trade in sweeteners: domestic HFCS production. Dr. de la Calle explains:

> 13. There is an additional element that plays an important role in the context of the bilateral trade in sweeteners: Mexico's HFCS production from corn imported from the United States. The NAFTA established a tariff-rate quota on corn which contemplates an annual tariff-free quota of approximately 3 million tons; any amount in excess of the quota would pay a tariff that would be eliminated over a 15 year period. HFCS is obtained primarily from the milling of yellow corn. Mexico mainly produces white corn, which is less suitable for HFCS production and is normally destined for human consumption. Mexico imports great quantities of yellow corn, which is primarily used as animal feed and other agro-industrial uses such as starch and HFCS production.
>
> 14. HFCS production in Mexico from imported U.S. yellow corn was contemplated during the NAFTA negotiations as a possibility. It is for this reason that the importation of yellow corn from the U.S. also plays an important role in the balance of the trade in sweeteners.[30]

48. Domestic HFCS production, which is based on the preferential importation of corn under the NAFTA, affects the bilateral trade in sweeteners.

49. Mexico's corn imports are also subject to a tariff-quota which is also eliminated over a 15-year period. Mexico grants a 2.5 million ton tariff-free quota which grows 3% on an annual basis. The preferential tariff is the greatest between the *ad valorem* or specific tariff, and it is eliminated in 15 annual stages starting on a 215% *ad valorem* tariff or USD $0.206 per kilogram.

50. Since NAFTA's entry into force and due to Mexico's internal supply needs, Mexico has been importing quantities in excess of the quota duty-free. A portion of such imports has been destined for HFCS production.

51. Trade in corn and sweeteners thus have a close relationship.

D. The U.S. sugar lobby's opposition to the NAFTA

52. The U.S. sugar industry strongly opposed trade liberalization with Mexico. It was concerned that if the then-lower priced Mexican sugar gained access to the market, it would

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[29] First Communication from the United States in the case: *Mexico – Tax measures on soft drinks and other beverages*, ¶ 13. Exhibit R 12.

[30] Testimony of Luis de la Calle, ¶¶ 13 and 14. Exhibit R 01 A.

depress prices and destabilize it. This led to strident opposition to the NAFTA and immense pressure by the U.S. sweeteners industry on the Clinton Administration, who took office in 1993, the year NAFTA was submitted for final approval by Congress.

53. In the ten years prior to the NAFTA's entry into force, the United States' support price was on average 1.5 to 2.5 times the prevailing world price for raw sugar and the refined price was correspondingly higher.[31] Prices of sugar in the Mexican and United States' markets were expected to converge under the NAFTA regime. To the Mexican sugar industry, this meant the opportunity to export to the high-priced U.S. market. To U.S. producers, this meant a decline in the U.S. market price and depressed returns to growers. The U.S. sugar industry saw the NAFTA as a major threat.[32]

54. While the approval process was underway in Congress, the U.S. sugar industry commenced strenuous lobbying efforts in opposition to the NAFTA and threatened to prevent the Treaty's passage.[33]

55. Notwithstanding the sugar lobby's vigorous opposition, the Treaty was signed by Presidents Bush of the United States, President Salinas of Mexico and Prime Minister Mulroney of Canada on 17 December 1992. However, President-elect William Clinton, who was to take office in January 1993, expressed reservations to certain aspects of the Treaty, and it was not clear it would achieve congressional approval. The approval process in the United States required a majority approval in both chambers of the Congress.[34] The sugar industry put enormous pressure on the Administration and on the U.S. Congress.

E. The United States links sugar and HFCS and requests clarification of this relationship in the NAFTA

56. Given the pressure from the sugar lobby and its fear that Mexico would be able to export large volumes of sugar, the new United States Trade Representative ("USTR") wrote to Mexico's then Secretary of Commerce and Industrial Development expressing his concern that Mexico could generate sugar surpluses without increasing its sugar production. The NAFTA already prevented Mexico from importing low-cost world sugar for domestic consumption and then exporting its own production to the higher-priced U.S. market[35]; but the new administration

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[31] USDA Economic Research Service, Sugar & Sweeteners Situation and Outlook Yearbook, May 2001, pp. 42-43. Exhibit R 07.

[32] See Letter of 16 April 1993 from several U.S. Congress Representatives. Exhibit R 13. Also see press release of September 14, 1993 from the Times Picayune. Exhibit R 14.

[33] Ibid. The U.S. industry recently made a similar effort to oppose the US-Central America Free Trade Agreement (CAFTA). See Roney Testimony, Director of Economics and Policy Analysis. American Sugar Alliance, June 7, 2005, before the Senate Committee on Agriculture, Nutrition & Forestry. Exhibit R 15.

[34] The NAFTA is not considered an international treaty under the U.S. legal system, but an executive agreement which is not incorporated into it. The submission to [the U.S.] Congress is a law initiative that implements it and is subject to the ordinary law-making process. In contrast, international treaties require only approval by the Senate, and need a qualified majority vote of at least two-thirds of the members of the Senate. Once approved, they are transformed into Supreme Law of the Land.

[35] Annex 703.2(17) of NAFTA.

argued that the surplus could also increase if HFCS displaced sugar. In the words of the United States Trade Representative ("USTR"), this could produce "inequitable results" and he stated further that this issue had acquired an "extraordinary importance" in the United States. This was a consequence of the pressure exerted by the sugar sector. He proposed the exchange of letters to clarify the way in which HFCS would be contemplated in the "net production surplus" calculation.

57. Ambassador Michael Kantor, the then-USTR, specifically alluded to the linkage between HFCS and sugar since the former is "clearly a complete substitute" of sugar in certain industrial applications and emphasized specifically the case of soft drinks. Ambassador Kantor wrote to Secretary Jaime Serra Puche on this issue:

> One of the issues I raised was the ambiguity in the sugar provisions of the NAFTA. This issue has assumed extraordinary importance. In response to my concerns, you asked that I set out in writing the nature of the ambiguity and how we believe it could be resolved.
>
> In brief, Appendix 703.2.A.11 of the NAFTA defines sugar for domestic consumption as "all sugar and syrup goods", a definition that would properly include high HFCS corn syrup (HFCS). HFCS is a sugar syrup that clearly is a complete substitute for sucrose sugar syrups, particularly in uses such as soft drinks. The ambiguity arises, however, because the appendix considers sugar for production to be "all sugar and syrup goods derived from sugar cane or sugar beets grown in a Party's territory". Appendix 703.2, Section C. provides a similarly narrow definition of sugar "for imports" into each country, "for purposes of this Annex".
>
> To resolve this ambiguity and assure a common and equitable definition of sugar, I propose that we exchange side letters to clarify that, in determining a party's "net production surplus" status, sugar will be considered to include raw or refined sugar derived directly or indirectly from sugar cane or sugar beets, liquid refined sugar, and high HFCS corn sweetener…[36]

58. Members of the U.S. Congress from sugar-producing states also intervened on the sugar industry's behalf. The Senator for the state of Louisiana, John Breaux, wrote to Secretary Serra. He confirmed that the objective of the NAFTA was to integrate the sweeteners markets of both countries in a 15-year time period. However, he indicated that American producers could not accept the "possibility of Mexico cutting this period in half by substituting sugar with corn sweeteners". He also indicated that unless the "issue of sugar substitution" was adequately resolved, American sugar producers would oppose the treaty and neither he nor other members of the U.S. Congress would support it.[37]

59. From Mexico's perspective there was no ambiguity: the definition of "sugar or syrup good" did not include HFCS. The effect of including HFCS in the calculation of the net production surplus would be to reduce the volume of exportable surpluses in accordance with

[36] Letter from Michael Kantor to Jaime Serra Puche dated 26 July 1993. Exhibit R 16.

[37] Letter from John Breaux to Jaime Serra Puche dated September 15, 1993. Exhibit R 17.

Annex 703.2, discounting those that were not the result of an increase in sugar production. However Mexico understood the concern and agreed to find an equilibrated solution. Dr. de la Calle states:

> 18. Mexico did not agree that an ambiguity existed. In Mexico's view there was no doubt that HFCS was included in Annex 703.2. However, Mexico understood the preoccupation expressed by the United States regarding artificial sugar surpluses arising from HFCS's market penetration, and was willing to find an equitable solution.[38]

60. In the months that followed, the governments and the sugar industries of both countries discussed the issue and the way to solve it. Dr. Herminio Blanco, Head of the Office for the NAFTA Negotiations and Ambassador Rufus Yerxa, Deputy USTR, were put in charge of the negotiations. The final round of negotiations took place in Washington in the offices of Ambassador Yerxa.[39]

61. On 3 November, a day before President Clinton formally submitted the NAFTA and the implementation law to Congress for their approval, the Mexican sugar industry informed Dr. Serra that they had reached an agreement with the U.S. sugar industry in the sense that the "concept of self-sufficiency", that is, the concept of net surplus producer, would "involve… sugarcane and sugar beet sugar and high fructose corn syrup" and added that they had agreed to request their respective governments to increase the applicable quota contemplated in Annex 703.2 from 150,000 to 250,000 tons.[40] This way, instead of the increasing quota contemplated in paragraph 15 of Section A of Annex 703.2, there would be a fixed quota, which compared to the increasing quota, would allow Mexico to export a higher volume to the United States during the first years of the transition period and a lower volume during the last years.[41]

62. On late 3 November and early 4 November 1993, two draft letters were produced (one in Spanish and one in English) and initialed by the Chief Negotiators.[42] The letters, which reflected the agreement, were to be signed by Secretary Serra and Ambassador Kantor. They were the only officials with the authority to do so, and were also responsible for trade in each country.

63. The President of the United States submitted both drafts to Congress as part of the "NAFTA package" on 4 November 1993.[43] He indicated that it was a final agreement with Mexico. However, the Ministers did not exchange signed letters until later.[44]

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[38] Testimony of Luis de la Calle, ¶ 18. Exhibit R 01A.

[39] Testimony of Ildelfonso Guajardo, ¶ 8. Exhibit R 01C.

[40] Letter from Carlos Artolozaga Noriega to Jaime Serra Puche dated November 3, 1993. Exhibit R 18.

[41] See testimony of Ildelfonso Guajardo, ¶ 7. Exhibit R 01C.

[42] Exhibit R 133. See the testimonies of Luis de la Calle, ¶ 21, Exhibit R01A, and Ildefonso Guajardo, Exhibit R 01 C.

[43] Message from President William Clinton to the United States Congress, November 4, 1993. Exhibit R 19

[44] Testimony of Ildefonso Guajardo, ¶ 9. Exhibit R 01C.

64. While reviewing the text of the signed documents, Dr. Blanco noted the United States had included a phrase that had not been part of the agreement. The drafts indicated that paragraph 16 of Section A of Annex 703.2 –which contemplates the possibility of Mexico exporting its total production surplus if it achieved net surplus production status in two consecutive years—would cease to apply.[45] This was beyond a clarification. It implied the abrogation of a paragraph of the Treaty that had already been signed by the Presidents of Mexico and the United States and Canada's Prime Minister.

65. Mexico indicated to the United States that that had not been part of the agreement and was neither contemplated in the initial proposal by the United States,[46] nor in the original letter sent by Ambassador Kantor.[47] Ambassador Kantor replied that a new proposal was drafted and that that proposal was the basis of the final agreement.[48]

66. In his letter of 8 December 1993, Ambassador Kantor indicated to Dr. Serra that they needed to confirm the agreement reached on 3 November 1993 by means of a formal exchange of letters. He attached the original letter from the United States signed by him, and indicated that Mexico's response would constitute a formal exchange of letters.[49] The letter signed by Dr. Serra does not include the phrase regarding the cancellation of paragraph 16 of Annex 703.2(A).[50]

67. There was no agreement. Mexico did not confirm the United States' interpretation because it did not reflect the agreement and therefore, there was no "formal exchange of letters" that would establish an agreement between Mexico and the United States.[51]

68. There is another important difference between the letters: the U.S. letter only includes HFCS consumption in the net production surplus calculation, while Mexico's letter includes both HFCS consumption and production. This difference also existed between the draft letters initialed on 3 November 1993. The economic effect was that the exportable net production surpluses would be further reduced. Dr. de la Calle explains:

> 24. The inclusion of HFCS in the net surplus production calculation has the effect of reducing the total surplus volume because, as pointed out by Ambassador Kantor in his letter of 26 June 1993, sugar displaced by HFCS would be subtracted. Mexico agreed to discount the effects of HFCS in the calculation of the net production surplus, however, by only taking into account HFCS consumption, as the US established in its letter, the disequilibrium that initially concerned the US would be inverted,

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[45] Testimony of Ildelfonso Guajardo, ¶ 10. Exhibit R 01 C. See draft letters with comments made by Herminio Blanco. Exhibit R 20.

[46] Draft of October 27, 1993 sent from the Deputy USTR. Exhibit R 120.

[47] Letter from Michael Kantor to Jaime Serra Puche dated 26 July 1993. Exhibit R 21.

[48] Letter from Michael Kantor to Jaime Serra Puche dated December 8, 1993. Exhibit R 22.

[49] Ibid.

[50] Letter from Jaime Serra Puche to Michael Kantor dated November 4, 1993 (sent on December 22, 1993). Exhibit R 23.

[51] Testimony of Luis de la Calle, ¶ 23. Exhibit R 01A. Testimony of Ildelfonso Guajardo, ¶ 11. Exhibit R 01C.

> because not taking into consideration the domestic HFCS production had the effect of artificially lowering the net production surplus. Mexico's letter simply alluded to HFCS; it considered both production and consumption of HFCS. This maintained the equilibrium because the exportable surpluses would be the result of subtracting the total consumption of sugar and HFCS from the total production of sugar and HFCS. The formula suggested by the US increases the amount to be subtracted, and thus results in an artificially lower volume, because it ignores the effects of domestically produced HFCS. In other words, domestically produced HFCS would displace sugar –in the same way imported HFCS does- and as a result the United States would allow a lower export volume, but not because HFCS was not domestically produced.[52]

69. Mexico tried to resolve the differences. It failed to do so. Towards the end of 1993, Mexico and the United States not only did not reach an agreement, but were aware that they had a disagreement.

> It is clear that Mexico and the United States did not reach an agreement, and it is equally clear that at the end of 1993 both countries knew they had a disagreement.[53]

70. The United States' initial concern of an imbalance in its market caused by increased sugar exports by Mexico ended up causing an imbalance in the Mexican market by establishing a formula that resulted in artificially low exportable sugar surpluses. Moreover, it limited the volume that Mexico could export, unilaterally canceling a provision of the Treaty. Dr. de la Calle states:

> 25. Thus, the United States was concerned with an inequity it perceived in the treaty, but the proposed solution did not establish equitable conditions, it rather created an inequity for Mexico in an attempt to provide additional protection to the U.S. sugar industry, while providing an advantage to US HFCS producers in the United States and in Mexico at the same time. The impact of this inequity would, therefore, fall exclusively on the Mexican sugar industry. This was not acceptable to Mexico.[54]

71. The United States did not avoid the "inequitable results" it referred to in its letter of 26 June 1993, nor the "involuntary effects" referred to in its proposal of 27 October 1993. The difference is that it created an inequity that would fall exclusively on the Mexican industry.

F. Mexico becomes a surplus producer

72. The NAFTA entered into force on 1 January 1994.

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[52] Testimony of Luis de la Calle. Exhibit R 01A.

[53] Ibid., ¶ 27.

[54] Ibid., ¶ 25.

73. Mexico and the United States tried to reach an agreement with respect to the concerns expressed by the United States, but failed to do so. The position maintained by the United States was unacceptable to Mexico because it put the Mexican sugar industry at a disadvantage. Since no agreement was possible, Mexico's position was that the original terms of the NAFTA prevailed; however, the dispute related to the access of Mexican sugar to U.S. territory, which the United States alone controls. Dr. de la Calle testifies as follows:

> 26. Mexico's position on the side letters was that, because the Parties never reached an agreement, the original terms of NAFTA, as signed by the Presidents of Mexico and the United States and the Prime Minister of Canada, prevailed. However, the United States opened or closed the valve at will, since it has complete control over the products imported duty free into the US.[55]

He adds:

> 27. Although sugar was a constant source of concern for Mexico, its ability to export significant amounts of sugar to the US would start in October 2000 and the generation of a surplus depended on certain market conditions in both countries that were not present in 1994 and 1995, and that would commence in 1996.[56]

74. In 1995 Mexico moved from being a net sugar importer to a net surplus producer.[57] Several factors explain this result: First, sugar mills' productivity increased as a result of new investments in plant and equipment made after the mills were privatized.[58] Second, encouraged by the new sugar mills' owners, sugarcane growers sought to increase their productivity and increase the planted area.[59] Third, the U.S. HFCS industry, which, in the words of the USDA, "was plagued with excess capacity", saw Mexico as an attractive and nearby market to export its production. Mexico's increasing imports of U.S. HFCS and domestic production from corn imported from the U.S., which started in 1995, displaced sugar from certain market segments, particularly the soft drink segment, as the United States had anticipated.[60] Fourth, there was a generalized expectation

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[55] Ibid., ¶ 26.

[56] Ibid., ¶ 27.

[57] From 1985 to 1988, Mexico had a sugar surplus. From 1989 to 1994, Mexico was in deficit. Mexico once again produced a surplus between 1995 and 2002. See the *Resumen Anualizado de Balance Azucarero de Mexico, Evolucion historica por año de calendario a partir de 1989*. Exhibit R 24.

[58] The USDA noted in 1996 that the industry was increasing its output due to better harvesting and post-harvest technology as well as higher factory yields. *See* USDA, "Mexican Sugar Output Forecast to Decrease", September 17, 1996, p. 1. Exhibit R 25.

[59] The USDA noted in its report entitled "Mexican Sugar Exports to Increase", April 10, 1998, p. 3, that the *cañeros* (Mexican sugar cane growers) had been making technical improvements. Sugarcane yields per hectare increased from an average of 68MT/ha in 1990 to about 72 MT/ha in 1997 due to technical improvements. Exhibit R 26.

[60] USDA Economic Research Service, "U.S. Mexican Sweeteners Trade Mired in dispute", *Agricultural Outlook*, September 1999, p. 18. The USDA noted that although HFCS sales in the United States increased by 13 percent in the 1994-1997 period, the increase was not large enough to absorb the production surplus. "As a result, the

in the Mexican sugar industry that it would be able to export its surpluses to the U.S. market – which did not occur because the U.S. unilaterally implemented its own understanding of the agreement.

75. The Mexican sugar producers began to make substantial investments –and did so on the basis that the ability to export surpluses to the higher-priced United States market would generate higher returns for sugar destined to that market as well as provide a safety net for the continued health of the domestic market, which would be in equilibrium even with HFCS penetration.

76. By the mid-1990s Mexico had sugar surpluses which grew rapidly. From 1995 to 2000 domestic sugar production rose from 4.4 million to 4.9 million tons, reaching its maximum level in 1997 with 5.1 million tons.[61] The total harvested area grew from 537,106 hectares to 601,988 hectares in the same time period, reaching its maximum in 1998 with 641,625 hectares.[62] Sugar surpluses went from 230,302 tons in marketing year 1994/1995 to 428,272 tons in 1999/2000, and reached their maximum in 1997/1998 with 1,148,722 tons.

77. The Mexican financial crisis during the mid-1990s led to an important downturn in sugar consumption. Domestic consumption between 1995 and 2000 averaged only 4.0 million tons and reached its maximum level in 2000 with 4.2 million tons.[63]

78. Excess capacity of HFCS in the United States led to greater imports in 1994, which together with the domestically produced HFCS, displaced a greater amount of sugar.[64]

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sector faced tough adjustments, with some smaller operations leaving the business and others selling to or attracting investors from among larger companies." Exhibit R 27.

[61] See Comité de la Agroindustria Azucarera, Desarrollo Operativo Capo-Fábrica 1996/2001. Exhibit R 28. The USDA Report entitled, "Mexico Sugar Annual 2000", (4 October 2000) notes on page 3: "In recent years, the Mexican industry has achieved higher mill yields and recovery rates. Mill yields in MY [Marketing Year] 1998 were 10.78 percent, but the estimate for MY 1999 is 10.90 percent." Exhibit R -29. The USDA Report entitled "Mexican Sugar Production/Export Forecast Up" (30 January 1997), noted on page 2: "The Mexican Sugar production forecast for MY 1997 has been raised by about 2 percent, to 4.67 MMT (raw value), based largely on increased area. However, some sources estimate even higher production due to good weather conditions and higher cane yields. The milling industry also indicates that, due to improved efficiency in harvesting and milling, sugar yields are up the last two years." Exhibit R 30. The USDA Report entitled, "Mexico, Sugar, Mexican Sugar Exports Increased for MY 1997/98" (30 September 1998) stated at page 1: "FAS/Mexico has raised its MY 1997/98 estimate for Mexican sugar exports for to 1.28 MMT (raw value) because of greater production than earlier estimated and an almost flat domestic demand. The MY 1998/99 sugar export forecast has been revised upward to 1.0 MMT from the previous forecast. Mexican sugar production estimates for MY 1997/98 have been revised upward to 5.49 MMT raw value because of favorable weather and improved mill efficiencies." Exhibit R 31.

[62] Ibid.

[63] Mexico Sugar: "Mexico's Sugar Production Down to 5 MMT", FAS GAIN USDA, 14 February 2000, p.1. Exhibit R 32.

[64] In a report entitled "High Mexican Sugar Production Forecast", 4 April 1997, USDA reported that in 1997, Mexico initiated an anti-dumping investigation on HFCS imports from the United States, stating at page 4: "… The Mexican Chamber for the Sugar and Alcohol Industries alleges that the price level at which U.S. HFCS is imported prevents domestic sugar prices from reaching maximum potential levels, thus prejudicing domestic negotiations between the sugar industry and FINAZA (Mexican Sugar Financing Institution). Also, it is claimed that the sugar industry's investment projects are threatened by undeR priced HFCS imports….[T]he Mexican industry indicates that,

79. In summary, Mexico experienced an excess supply of sugar caused by an increase in production, increased HFCS consumption and stagnant domestic sugar consumption. The surpluses could only be sold in the domestic market, which would have depressed prices even further, or in the world market at a substantial loss (during the same period the world price of sugar (Contract No. 11) fell from 11.31 cents per pound to 7.93 cents per pound, reaching its lowest level in 1999 at 6.35 cents per pound.)[65]

G. Mexican mills encounter financial distress

80. The financial condition of the Mexican sugar mills began to deteriorate with the 1995 financial crisis. The peso devaluated *vis-à-vis* the dollar and interest rates skyrocketed in turn substantially increasing the financial burden of the mills.

81. The Mexican government took many actions to alleviate the situation affecting the sugar sector, including providing refinancing to companies operating under the debt load incurred in the privatization process[66] and paying the storage costs of taking 600,000 MT of sugar off the domestic market.[67] The situation was so serious that Mexico's President wrote a letter to the President of the United States in the hopes of finding a solution.[68]

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despite the increase of 20 percent in the import duty, HFCS is still being offered at prices competitive with sugar." Exhibit R 33. A USDA Report entitled "Mexican Sugar Production to Increase for MY 1997/8", 30 September 1997, stated on page 2: "The increasing use of HFCS is a concern for the sugar industry, because if domestic demand continues to be low for MY 1997/98, exports and ending stocks are expected to be higher." Exhibit R 31. The USDA Report entitled, "Mexican Sugar Exports to Increase", 10 April 1998 stated on page 6 that "[w]ith the high levels of imported HFCS and higher levels of sugar production, the [Mexican] sugar industry claims there is a danger of closing of (sic) 15 to 20 mills, resulting in layoff of about 100,000 workers." Exhibit R 26. In A USDA Report entitled "Mexican Sugar Exports Increased for MY 1997/98", 30 September 1998 noted on page 3: "The sugar industry maintains that sugar consumption has not been growing because alternative imported and domestic sweeteners have displaced sugar." Exhibit R 31. The USDA also noted that "sugar consumption has remained flat because of increased usage of alternative sweeteners, both imported and domestic." USDA Report entitled "Mexico Sugar Semi-Annual 2000", October 10, 2000, Exhibit R 29 at page 3.

[65] London Sugar No. 11 Contract. Exhibit R 04

[66] The USDA report entitled: "Mexico Sugar: Mexico to Export Sugar Again in MY 1999", dated 10 April 1999, p. 3 noted:

> The principal factor affecting the industry's ability to improve efficiency continues to be financial problems, and the non-availability of credit. In fact, in November 1998 the government and FINAZA (Mexican Sugar Financing Institution) initiated a plan to restructure most sugar mills' debt which has increased to approximately U.S. $2.0 billion… The industry insists that the debt growth and the inability to repay is due to a decrease in domestic sugar consumption and low international sugar prices compared to domestic production costs and low international sugar prices compared to domestic production costs, all of which contributed to the industry's petition for antidumping protection against imports of U.S. high fructose corn syrup (HFCS).

Exhibit R 09.

[67] The USDA report entitled "Mexican Sugar Exports to Increase", 10 April 1998, p. 10, noted that: "The industry agreed to hold approximately 600,000 metric tonnes of sugar off the market during MY 1997/98, 1998/99 and 1999/2000 to prevent a downturn in prices. The government will finance storage costs." Exhibit R 26.

[68] Letter from President Ernesto Zedillo Ponce de León to President William Clinton, 14 July 1997. Exhibit R 34.

82. By 2000, the situation was critical. The nation's sugar mills had a combined indebtedness of $2 billion U.S. Many mills were unable to make the final payments to their growers which put the pre-liquidation payment for the next harvest at risk. They were also unable to meet other financial obligations. The growers, in turn, could not finance the planting of their next year's crops.[69]

83. The seventh marketing year started in October 2000. According to Mexico's interpretation of the NAFTA, it had the right to export its net production surplus, which in the year 2000/2001 rose to approximately 650,000 tons (even if Mexico's own interpretation of the letter was applied, the surplus still would have been in the order of 400,000 tons). The United States assigned Mexico a quota of only 116,000 tons, while the Mexican market absorbed nearly 600,000 tons of HFCS.

84. The quota assigned to Mexico by the United States was insufficient. The average price in the Mexican market in 2001 was 22.7 cents per pound, while the No. 5 Contract price averaged 8.38 cents per pound during the same year.

85. In May 2001, the USDA commented on the Mexican situation and its own projections for "insignificant growth" in the Mexican:

> … these projections indicate insignificant growth and are premised on the sugar industry's continuing financial crisis (accumulated debt load of an estimated $1.5 billion), low world sugar prices, and limits on exports into the U.S. market.[70]

86. The USDA recognized that with increased domestic sugar production, among the factors that contributed to what it called "the crisis of 2001/02" were "[f]irst, <u>the U.S. quota for Mexican sugar remained far below the additional 250,000-ton minimum they hoped to be negotiated</u>" and "second, Mexican imports of HFCS from the U.S. rapidly increased, displacing domestic sugar used in soft drinks".[71] [Emphasis added.]

87. The Tribunal cannot ignore the imbalance resulting from the combination of Mexico's compliance with the phased-in market access commitments for HFCS and the United States' violation of its own commitments regarding sugar.

H. Facts relating to Mexico's countermeasures defence

88. Mexico considers that the tax, although inconsistent with Article 301 of the NAFTA (which incorporates GATT Article III), is not inconsistent with its NAFTA Chapter Eleven

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[69] In accordance with Article 12(b) of the Sugarcane Decree, the most significant payment to be made by the mills to the sugarcane growers is the pre-payment made prior to the harvest, which is equivalent to 80% of the net sugarcane received by the mill. However, at the beginning of the harvest season, the mills have not yet received income derived from sales of sugar. Exhibit R 35.

[70] USDA Economic Research Service, *Sugar & Sweeteners Situation and Outlook Yearbook*, p. 9. Exhibit R 07.

[71] Ibid., p. 2.

obligations. Without prejudice to the foregoing, if the Tribunal were to find that the tax potentially violated any of the Chapter Eleven provisions invoked by the Claimant, Mexico would then raise the defence of countermeasures.

89. The Claimant anticipated this, and sets out at Section G of its Memorial a series of arguments in support of its claim that "Mexico has no viable justification for its anti-HFCS measures."[72]

90. That section of the Memorial is instructive because quite apart from its confusion of separate measures and the history and rationales relating thereto, it actually assists in making one of Mexico's central points. For that reason, the Respondent will review the Claimants' assertions and arguments in some detail.

1. The principal underpinnings of Cargill's claim that Mexico had no right to take countermeasures

91. Cargill argues that:

> Mexico will argue that a *purported* violation of NAFTA by the United States, based on the United States' position in the side-letter dispute, authorizes Mexico to *actually* violate NAFTA in turn.[73] [Italics in original.]

92. It then conjoins the anti-dumping duty investigation with the tax:

> …Mexico did not request that a Chapter 20 arbitration panel be established until August 2000. That was almost three years after Mexico initially imposed its unlawful anti-dumping duties on HFCS imports from the United States. In other words, Mexico launched its anti-HFCS campaign long before any purported lack of cooperation by the United States in the Chapter 20 proceedings.[74]

93. Then it points out that Mexico imposed the IEPS tax precipitously:

> … Mexico imposed the IEPS tax … just 4½ months after it requested formation of a Chapter 20 arbitration panel. A 4½-month delay, even if Mexico were right that it was the fault of the United States, cannot justify such extreme measures.[75]

94. Finally, it argues that Mexico did not invoke the prescribed procedure for compelling the establishment of a panel:

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72 Memorial, Section G.

73 Memorial, ¶ 287.

74 Memorial, ¶ 290.

75 Memorial, ¶ 291.

> Mexico failed to take advantage of mechanisms within Chapter 20 itself to resolve any impasse in the appointment of arbitrators. Chapter 20 expressly offers a cure for any failure of a Party to appoint a panelist: "*If a disputing Party fails to select its panelists within such [15-day] period, such panelists shall be selected by lot from among the roster members who are citizens of the other disputing Party.*" Further, Chapter 20 states that the FTC "Shall establish an arbitral panel." The FTC also has the responsibility to "supervise the implementation" of NAFTA, "resolve disputes that may arise regarding its interpretation or application," and "consider any other matter that may affect the operation of this Agreement." NAFTA thus plainly contemplates that a Party will resort to the FTC or to the specified lot selection in the event of another Party's failure to cooperate in the selection of a Chapter 20 panels – not engage in its own unilateral violations of NAFTA.[76] [Italics in original; underlining added.]

95. Mexico considers that it is necessary to respond to certain aspects of these assertions, both to clarify the facts and to provide additional context for the Tribunal's consideration of the countermeasures defence.

2. Response to the errors and mischaracterizations of the facts presented by the Claimant

96. First, although the Claimant's characterization of Mexico's countermeasures defence is generally correct, it is necessary to refine it and explain the facts. Mexico will revert to this below.

97. Second, the countermeasures defence is advanced in relation to the tax, not in relation to the anti-dumping duty proceeding. Leaving aside the fact that the antidumping investigation does not fall within the Tribunal's jurisdiction[77], it is necessary to note that that case was independent from and pre-dated the tax.

98. The antidumping investigation was initiated in February 1997 in response to a request filed by the Mexican sugar industry. In conformity with the NAFTA, each Party retains its antidumping laws.[78] Under Mexican law, as in the United States and Canada, the competent authorities must investigate a properly documented complaint filed by a domestic industry with standing to complain about the alleged dumping.[79] If at the end they resolve to impose duties, as Mexico did

[76] Memorial, ¶ 292. Footnotes omitted.

[77] See Section III.A.2.

[78] NAFTA, Article 1902.

[79] Final Resolution from the Unidad de Prácticas Comerciales Internacionales (UPCI) of the Ministry of Economics. The domestic sugar sector (the CNIAA, which was a interested party accordingly with the UPCI) brought request to initiate an investigation, UPCI, after concluding that it had the requisite standing to complain about imports of HFCS initiated the investigation. It determined that there was dumping of HFCS in Mexico. Its determination was overturned by a NAFTA Chapter Nineteen panel mainly in relation to the injury determination and ordered it to revoke the duties. It is well established in the law of State responsibility that a State is not internationally responsible for the acts of private parties. The Sugar Chamber (CNIAA) was within its rights under Mexican law to request an investigation and under the WTO Agreement and the NAFTA, Mexico was within its rights to investigate the

in that case, the final determination can be challenged by the other State at the WTO or by interested private parties (*e.g*., exporters and importers of the subject goods) in binational panels established under Chapter Nineteen of the NAFTA.

99. Although the antidumping investigation led to the imposition of duties on imports of HFCS originating in the United States, Mexico later revoked them and refunded the duties to the interested parties, including Cargill, following WTO and NAFTA binational panel resolutions against Mexico.

100. Mexico is by no means the only country (as a Member of the WTO or a Party to the NAFTA) to ever have an antidumping duty overturned by an international panel.[80] The important result is that, in contrast to the United States' behavior in the Chapter Twenty case, consistent with its WTO and NAFTA obligations, Mexico submitted to international review of its antidumping order and when instructed to revoke it, Mexico complied.

101. For the purposes of this case it is important to note that the countermeasures defence arises in relation to the tax, not in relation to the antidumping. Cargill errs in attempting to conjoin the defence to the antidumping duties.

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complaint. The remedy, which was used by both the United States and by its HFCS producers, was to invoke the WTO Anti-dumping Agreement and NAFTA Chapter Nineteen. Those remedies worked and the order was rescinded. Exhibit R 134.

[80] The following table updated to 2005 shows the number of finalized cases under Chapter Nineteen of NAFTA in which countervailing duties have been overturned:

NAFTA CHAPTER 19 – 1994-2005:

Review of decisions of:	Overturned
United States	13
Canadian	2
Mexican	6

See Gustavo Vega Canovas et al. Mexico, Estados y Canada: *Resolucion de controversias en la era post Tratado de Libre Comercio de America del Norte*. Judicial Research Institute (Instituto de Investigaciones Juridicas), Mexico, 2005 p. 61. The United States has lost at least 10 cases before special groups of the WTO Panels: *United States – Antidumping Measure on Shrimp from Ecuador*, WT/DS335/R (January 30 2007); *United States – Measures Relating to Zeroing and Sunset Reviews*, WT/DS322/AB/R (January 9 2007)*United States - Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, adopted December 17 2004; *United States - Softwood Lumber from Canada*, Panel report WT/DS277, adopted on March 24 2004; *United States - Continued Dumping and Subsidy Offset Act of 2000 (Byrd Amendment)*, Appellate Body report WT/DS217/AB/R, WT/DS234/AB/R, January 16 2003; *United States - Countervailing Measures Concerning Certain Products from the European Communities*, Appellate Body report WT/DS212/AB/R, December 9, 2002; *United States - Certain Softwood Lumber from Canada*, Panel report WT,DS236/R, September 27 2002; *United States - Stainless Steel Plate in Coils from the Republic of Korea*, Panel Report WT/DS179/R, December 22, 2000; *United States - Lead and Bismuth Carbon Steel products originating in the EC*, Appellate Body report WT/DS138/AB/R, May 10, 2000; *United States - Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea*, Panel report WT/DS99/R, January 29 de 1999.

102. Cargill's third allegation that Mexico imposed the tax just four and a half months after requesting the establishment of the Chapter Twenty Panel. This is erroneous. In fact, the Panel was requested on 17 August 2000 and the tax was enacted on 31 December 2001, sixteen and a half after Mexico had completed all requirements for the Panel's establishment.

103. This leads to Mexico's next point. Mexico agrees with much of what is stated in paragraph 292 of the Memorial with the exception of one point, namely, that it failed to avail itself of the mechanisms contained in Chapter Twenty to force the Panel's establishment.

3. Mexico's failed attempt to establish the Chapter Twenty Panel to hear Mexico its U.S. sugar market access grievance

104. Appendix A describes the dispute settlement proceedings as set forth in Chapter Twenty of the NAFTA and the form in which it operated in the three previous disputes between the NAFTA Parties.

105. By the mid-1990s, Mexico formed the view that the United States was not going to comply with its market access commitments for Mexican-originating sugar as established in the NAFTA. Mexico also believed that the United States' interpretation of the side letters did not reflect the Parties' agreement. (In fact, Mexico's sugar market access rights was an issue that pre-dated NAFTA's entry into force and in which no agreement had been reached.[81])

a. Mexico begins to develop a sugar surplus

106. It is necessary for this Tribunal to be aware of a key fact at issue: the United States and Mexico decided to negotiate a bilateral agreement that would lead to free trade in all agricultural goods.[82] The sugar sector in the United States posed particularly difficult problems for U.S. negotiators due to the high level of protection from imports inherent in that program.[83] U.S. negotiators therefore requested Mexico to raise its most favored nation (MFN) tariff to replicate the high MFN tariff (the so-called Tier II tariff) employed by the United States so that, like in the United States imports of sugar from third countries into Mexico's market would also be restricted.[84] The United States proposed then that the two Parties would eliminate their respective MFN tariffs on a preferential basis over a period of 15 years.

107. Mexico's adoption of its MFN tariff to that of the United States protected its sugar market in the same way that the United States protected its market. This led to an increase price of sugar to a level approximating the U.S. price. This turn an opportunity in the Mexican market for U.S. HFCS producers, who had benefited in United States when the United States implemented an

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81 Witness statement of Dr. Luis de la Calle, ¶ 27. Exhibit R 01A.

82 In this respect, the NAFTA's agricultural chapter differed form other chapters; the three Parties negotiated three bilateral market access agreements (annexed to Chapter Seven as Annexes 703.1 (Canada-United States), 703.2, Section A (Mexico and the United States) and 703.2, Section B (Canada and Mexico).

83 See discussion of the Sugar Program at Section II.B.2.

84 See Annex 703.2, Section A, paragraph 17.

earlier version of the Sugar Program in 1981. The high price of sugar acted as a "price umbrella" for HFCS.

108. The higher price for sugar also stimulated investment in that sector.[85] Investors saw not only the opportunity to serve the domestic market in which, as a consequence of the high price of sugar, they would generate significant returns, but also the possibility of serving the U.S. market which is roughly twice the size of the Mexican market.

109. Following NAFTA's entry into force, Mexico and the United States met annually as required by Annex 703.2(A)(13) to determine whether Mexico was a net surplus sugar producer. Although they differed as to the formula to be used to calculate the surplus, both countries agreed that as of 1995 Mexico had a sugar surplus.

110. Starting in 1995, due to investment in the sector leading to higher productivity and due to the entry of HFCS into the sweeteners market, a sugar surplus began to be generated in Mexico and it continued for the balance of the decade. This situation led to the possibility of Mexico exercising its rights under the NAFTA.[86] However, the definition of such rights was in dispute and that is precisely what Mexico eventually sought to have resolved by an independent panel.

111. There was a disagreement between the two countries with regards to determining the way in which the "net production surplus" was to be calculated. The United States counted only consumption of HFCS in Mexico while Mexico counted production and consumption of HFCS. There was also disagreement as to whether beginning in marketing year 2000 Mexico would be entitled to export its entire sugar surplus as stated in paragraph 16 of Annex 703.2, Section A.[87] The sugar surplus mounted and began to destabilize the sugar sector. Mexico sought increased access to the U.S. market and to avoid an already anticipated trade dispute.

b. Mexico initiates high-level contacts

112. Beginning in 1997, as the Mexican sugar surplus began to overhang the domestic market, access to the U.S. market became increasingly important and was raised at the highest levels of the two governments. On 14 July 1997, President Zedillo wrote to President Clinton to express his concern and to discuss the possibility of Mexico's gaining greater access to the U.S. market, especially in the light of HFCS' penetration in Mexico. President Zedillo indicated that imports of HFCS had increased 250% in the previous year, which, combined with the limited market access of Mexican sugar, could generate significant surpluses that would affect the welfare of thousands of *campesinos*:

> Due to NAFTA, the commercial relations between Mexico and the U.S. have experienced an unprecedented dynamism, which prompted the creation of new businesses and jobs on a day-to-day basis, and thus, an increase in our country's well-being.

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[85] Witness statement of Dr. Luis de la Calle, ¶ 4. Exhibit R 01A.

[86] *Ibíd*, ¶ 7.

[87] The United States took the position that paragraph 16 had been cancelled by agreement. Mexico strongly disagreed.

> The treaty has been successful, mostly due to the role that the two countries have played in promoting it and by seeking new opportunities to continue increasing the commercial investment flow.
>
> Today, the sweetener market offers great opportunities to increase our bilateral trade. On one hand, as I noted when you visited Mexico last May, the Mexican sugar industry has increased its production. This happened as a result of an increased modernization and investment effort, to the point that the industry is now capable of meeting the increasing demands of sugar imports of your country: Simultaneously, Mexico represents an outstanding market for the American corn syrup producers, due to the increasing displacement caused by this product to the consumption of sugar cane. As these products complement each other, they open the possibility to have an integrated sweetener market in our countries.
>
> The corn syrup imports in Mexico have increased more than 250% in the last 12 months. All of these imports come from the U.S. In contrast, Mexico has participated marginally in your country's import quotas, regardless of its increasing necessities (the Mexican sugar imports represented less that 1.5% of total U.S. imports in the '96-97 cycle). Even in March and May of the present year your country assigned additional quotas for a total of 400,000 tons and Mexico did not get any benefit from this. The limited access possibilities for the Mexican sugar market to enter the U.S. market, in addition to the increasing imports of corn syrup, could result in a significant surplus that could seriously affect thousands of Mexican *campesinos.*
>
> I am sure that considering that the U.S. already has an unrestricted access to the Mexican market, and if we work together, we could find ways in which the Mexican sugar could benefit from the increased import quotas that your country has assigned. It is one more opportunity to further the fruitful bilateral relation between our countries.
>
> I reiterate to you, Mr. President, the assurance of my highest and distinguished consideration.[88]

113. During 1997, SECOFI officials met with USTR and USDA officials. Meetings were held at the ministerial and vice-ministerial level. Dr. Luis de la Calle testifies that:

> 31. Starting in 1997, the Mexican sugar access to U.S. markets became a subject of the utmost importance, which Mexico attended [to] in all levels. During the first quarter of 1997 SECOFI and the *Secretaria de Agricultura* had preliminary discussions with USDA officials. They encountered a favorable reaction and the USDA formulated a proposal. On 20 March 1997, in the context of the NAFTA's Free Trade Commission meeting, Mexican officials led by Dr. Herminio Blanco, then-Secretary of

[88] Letter, dated 14 July 1997, from President Ernesto Zedillo Ponce de León to President William J. Clinton. Exhibit R 34.

> Commerce and Industrial Promotion, met with USTR officials to discuss the issue, including the proposal by the USDA.
>
> …
>
> 33. Mexican officials continued to meet with U.S. officials. High level meetings were held between Dr. Jaime Zabludovsky, then Undersecretary of International Commercial Negotiations for Mexico and Ambassador Peter Scher, U.S. Deputy Trade Representative for Agricultural Issues. Mr. Eduardo Solis, who participated in the NAFTA negotiations concerning agricultural issues and who was SNCI's Coordinator for North America, and I, frequently accompanied Dr. Zabludovsky to those meetings. Mexico expressed the importance of re-establishing the discussions on the different interpretations of the so-called side letters. The United States refused to discuss this issue.
>
> 34. There was no progress with the United States.[89]

c. Mexico requests consultations under Article 2006

114. On 13 March 1998, Mexico took the first official step of initiating dispute settlement under NAFTA Chapter Twenty by formally requesting consultations under Article 2006 by letters addressed to Ambassador Barshefsky, and Minister Sergio Marchi of Canada.[90]

115. Consultations were held on 15 April 1998. No resolution of the dispute was reached. During the year's Free Trade Commission (FTC) meeting held on 29 April, Mexico communicated that the consultations had failed to resolve its concerns.[91]

d. Mexico then requests a meeting of the Free Trade Commission

116. Discussions continued throughout 1998, again without any agreement being reached. Consequently, on 13 November 1998, Mexico requested a meeting of the FTC pursuant to Article 2007 of the Treaty. The United States objected and Mexico reiterated its request on 5 January 1999.[92] The FTC did not meet immediately because Mexico and the United States continued to search for a solution through negotiations for the better part of the year.[93] These too failed to resolve the dispute and on 3 November 1999 Mexico insisted on a FTC meeting.[94] The meeting

[89] Witness statement of Luis de la Calle. Exhibit R 01A.

[90] Letters from Herminio Blanco Mendoza to Charlene Barshefsky and Sergio Marchi, respectively, dated 13 March 1998. Exhibit R 36.

[91] Luis de la Calle witness statement, at ¶ 36. Exhibit R 01A.

[92] Letters from Herminio Blanco Mendoza to Charlene Barshefsky and Sergio Marchi, respectively, dated 5 January 1999. Exhibit R 37.

[93] Testimony of Luis de la Calle at ¶ 40. Exhibit R 01A.

[94] Letters from Herminio Blanco Mendoza to Charlene Barshefsky and Pierre Pettigrew, respectively, dated 3 November 1999. Exhibit R 38.

took place in Washington on 17 November 1999 with high level officials responsible for the coordination of the NAFTA participating at the proposal of the United States.[95]

117. Although no agreement was reached within the FTC, meetings between the two Parties continued. Dr. de la Calle, then-Undersecretary of International Commercial Negotiations, held no less than 10 meetings with the USTR between June and October of that year. He also met with representatives of the U.S. sugar and HFCS industries.[96]

e. Mexico requests the panel's establishment

118. A period of intensive negotiations took place between the two NAFTA Parties with a view to agreeing on a resolution of the dispute by 1 August 2000. This was not achieved. With the seventh marketing year approaching under the NAFTA transition period (the sugar marketing year begins on 1 October of each year), a major social crisis was emerging in Mexico because sugar mills were defaulting on their financial arrangements and unable to pay their growers.[97] The cane-growers in Mexico are farmers who depend on the sugarcane crop for their annual income. Due to their total dependency on revenues obtained from selling their sugarcane crops, they are active in voicing their concerns.[98]

119. On 17 August 2000, the ASA issued a press release protesting Mexico's request for NAFTA Chapter Twenty dispute settlement.[99] Mexico will revert to this below.

120. By 17 September 2000, the United States had neither designated panelists nor agreed on the presiding member of the Panel. Mexico then requested the Mexican Section of the NAFTA Secretariat to appoint the panelists in accordance with Article 2011. Since the United States was the respondent Party in the case, its administration was the responsibility of the United States Section of the NAFTA Secretariat and therefore the Mexican Section requested the United States Section to appoint the panelists. The United States Section, which is a government office situated in the United States' Department of Commerce, responded that it received orders only from its government and therefore would not act on Mexico's request. It was instructed not to do so. According to Dr. de la Calle:

> …Given the U.S. refusal to name its panelists, Mexico requested the National Section of the Secretariat to randomly appoint the panelists from the list of panelists. The head of the Mexican Section of the Secretariat asked the head of the U.S. Section to appoint panelists, since, according to the rules of the treaty, the Respondent's Section is responsible for administering the process. The U.S. Section is an office of the U.S.

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95 Letter from Susan Esserman to Herminio Blanco, 15 November 1999. Exhibit R 49.

96 Testimony of Luis de la Calle at ¶ 41. Exhibit R 01A.

97 Throughout this time, the United States Department of Agriculture repeatedly reported on the growing crisis in Mexico and Mexico's concerns for a resolution of the dispute. See Section II.H.4.

98 Letters from Herminio Blanco Mendoza to Charlene Barshefsky and Pierre Pettigrew, respectively, dated 17 August 2000. Exhibit R 40. See also press releases regarding the canes growers. Exhibit R 41.

99 American Sugar Alliance press release "U.S. Sugar Industry Greatly Disappointed at Mexican Action", 17 August 2000. Exhibit R 42.

> Department of Commerce and its head is employed by that agency. The U.S. Secretary stated that she could not proceed with Mexico's request because she only received instructions from the United States. At the instruction of the U.S. Government, she refused to act.[100]

121. Mexico nevertheless continued with its efforts to constitute the Panel. It proposed to the United States persons who could constitute the Panel. On various occasions the United States indicated it would make a counter-proposal, but it never did. After numerous efforts it became obvious that the United States would not do so; it would not allow the Panel to be established to hear Mexico's grievance.

4. Throughout 1998-2000, the United States Department of Agriculture was aware of the sugar sector crisis in Mexico and Mexico's efforts to resolve it with the United States

122. Throughout the 1998-2000 period, the United States' authorities were fully aware of the growing crisis in the sector. The USDA regularly reported on the situation, the nature of the dispute between the Parties and the Mexican government's efforts to resolve it either through negotiations or under Chapter Twenty. For example, in 1998, the USDA's Foreign Agricultural Service reported:

> The Mexican sugar industry... is pressing the Mexican government for more access to the U.S. market, equivalent to relatively free access to the Mexican market for HFCS. This was prompted by the announcement from the USTR Office of an additional sugar allocation of 200,000 MT under the U.S. tariff-rate quota (TRQ) for fiscal year 1998, which did not increase Mexico's allocation. <u>The Mexican government has requested consultations under NAFTA Chapter Twenty. The objective is to clarify the content of the letters that were exchanged between the U.S. and Mexico in 1993, concerning the Mexican access to the U.S. sugar market</u>. SECOFI [the then Mexican trade department] believes Mexico is entitled to increased access to the U.S. market. Another key definition that Mexico wants to clarify is the process to determine net producer status, which, according to SECOFI, seems to be different in both letters.
>
> The Mexican sugar industry wants the U.S. sugar quota to be higher, in agreement with the higher Mexican sugar production. Basically, the Mexican sugar industry is not against U.S. HFCS imports into Mexico; what they want is to gain access for more than the 25,000 MT of sugar currently allowed under the TRQ for Mexico. With the high levels of imported HFCS and higher levels of sugar production, the sugar industry claims there is danger of a closing of 15 to 20 mills, resulting in layoff of about 100,000 workers.[101]
>
> [Emphasis added.]

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[100] Testimony of Luis de la Calle. ¶ 41.Exhibit R 01A.

[101] Report of the U.S. Embassy in Mexico City to the USDA/FAS, Washington D.C., 10 April 1998, p. 6. Exhibit R 26.

123. In a report entitled, "U.S.-Mexico Sweetener Trade Mired in Dispute", published by the USDA in September 1999, the economic interests at stake were described as follows:

> Disagreement persists among the U.S. and Mexican sugar industries and the U.S. high-fructose corn syrup (HFCS) industry over interpretation of the North American Free Trade Agreement (NAFTA). Trade in sweeteners between Mexico and the U.S. is addressed directly by provisions of NAFTA, as well as other trade agreements, but as these industries have grown, pressure on trade agreements has increased, leaving the future of U.S.-Mexico sweetener trade uncertain…
>
> Behind the Mexican sugar industry's interest in this dispute is the remarkable rebound in Mexican sugar production since implementation of NAFTA. As recently as the November-October marketing-year 1994, Mexico produced only 3.8 million MTRV (metric tons, raw value) of sugar. By marketing-year 1998, Mexico produced a record of nearly 5.5 million...
>
> The U.S. HFCS industry's interest in the sweetener dispute stems from expectations that the NAFTA provisions regarding HFCS might provide another market for U.S.-produced HFCS. The U.S. industry has been plagued with excess capacity - the larger HFCS companies have added significant production capacity, and several new plants have opened. Some experts have estimated HFCS annual production capacity may have grown by 3.5 million tons (dry basis) between 1994 and 1997.
>
> Although domestic HFCS sales have increased by more than 13 percent during this period, the increases have not been sufficient to absorb increases in capacity. Prices have declined as supply outstrips demand...[102]

124. As the USDA noted, with the U.S. market for HFCS (and, it might be added, sugar) overstocked, disposing of HFCS in Mexico was an obvious way to reduce the surplus situation in the United States and adjust the margins in the United States market. (Mexico adds parenthetically, that from the perspective of many U.S. industry participants, this would be particularly helpful so long as the United States restricted the access of Mexican surplus sugar to its market).

125. In a section of the USDA report entitled, "*NAFTA Sugar Provisions Remain in Dispute...*", it was noted:

> U.S. sugar producers closely monitor the potential impacts of the sweetener trade disagreements under NAFTA. The original NAFTA document, in effect since January 1994, contained provisions related to trade in sugar that were opposed by many U.S. sugar producers. They feared NAFTA provisions allowing increased HFCS exports to Mexico would lead to the substitution of HFCS for sugar in Mexico, which in turn would lead to a Mexican sugar surplus that could be exported to the U.S.

[102] USDA, Economic Research Service, "U.S. -Mexico Sweetener Trade Mired in Dispute", Economic Research Service, Agricultural Outlook/September 1999, pp. 17-18. Exhibit R 27.

In order to secure support for NAFTA in Congress, the U.S. and Mexican governments exchanged side-letters that altered the sugar provisions of the original NAFTA text. Since implementation of NAFTA, however, there has been a trade dispute between Mexico and the U.S. centering on interpretation of the content and validity of the side-letter agreement.

The original provisions of NAFTA subjected Mexican sugar exports to the U.S. to several conditions. During the 15-year NAFTA transition period, Mexican exports were to be limited to no more than Mexico's projected net production surplus of sugar - sugar production less domestic sugar consumption - but at a minimum, Mexico was allowed to ship 7,258 metric tons of raw sugar duty-free. For the first six years of NAFTA, duty-free access was limited to no more than 25,000 MTRV. In year 7, the Mexican duty-free access quantity was to become 150,000 MTRV, and each subsequent year, the maximum duty-free quantity was to increase by 10 percent. These maximums could be exceeded, however, if Mexico had achieved net production surplus status for two consecutive marketing years.

But the side-letter agreement changed key NAFTA sugar provisions. Under the side agreement, projected Mexican sugar production will have to exceed Mexican consumption of both sugar and HFCS for Mexico to be considered a net surplus producer, making it less likely that Mexican sugar would qualify for duty-free access. In addition, the side letter provided for an annual limit on duty-free access of 250,000 metric tons from 2001 2007, eliminating the possibility of unlimited duty-free access should Mexico become a net surplus producer for 2 consecutive years.

The Mexican government has disputed the validity of the side letter. Moreover, Mexico maintains that its version of the side letter does not count HFCS consumption in the formula that defines net surplus producer status, nor limit exports to 250,000 tons per annum during 2001-07. Based on its interpretation of the NAFTA agreement, Mexico is entitled to export total net surplus production to the U.S. on a duty-free basis beginning in October 2000.

On March 12, 1998, the Mexican Secretariat of Commerce and Industrial Development (SECOFI) asked for consultations with the U.S. on the validity of the disputed side letter under NAFTA. No agreement was forthcoming, so on November 15, 1998, Mexico formally requested a NAFTA Commission to resolve the issue, although no Commission meeting has yet been held, by agreement with Mexico. The Commission has several options for resolution, none of which are binding unless both parties agree. If the Commission cannot resolve the dispute within thirty days after it has convened or another time agreed to by both parties, either party may request an arbitration panel to adjudicate the issue. Some observers expect a negotiated settlement will be reached, but it is difficult to project the outcome of the dispute.[103]

[103] *Id.*, pp. 18-19.

[Emphasis added.]

5. Throughout 2001, the United States rebuffed Mexico's attempts to appoint panelists

126. In January 2001, the Parties resumed negotiations, this time led by the new Secretary of Economía (formerly SECOFI), Dr. Luis Ernesto Derbéz, and the USTR Representative, Ambassador Robert Zoellick. Undersecretaries and other officials of both Parties also continued to meet.

127. Mexican officials continued to insist on the Panel's establishment. During a meeting at the Undersecretary level, held in August 2001, more than a year after Mexico requested the Panel's establishment, the United States indicated that the government was under great pressure from its industry and that Mexico should not expect this to happen, and suggested that it would be better to negotiate instead. Dr. de la Calle testifies:

> 47. During a meeting between a Mexican delegation and USTR officials led by Ambassador Johnson on 24 August 2001, I stated that unless we could find a solution to the problem of Mexican sugar access to the US market, Mexico would be forced to restrict HFCS' access to the Mexican market. I also reiterated the necessity of establishing the panel Mexico requested a year before. <u>The response of Ambassador Johnson was that he did not have a positive answer to give us in that regard. He said that the US government was under a lot of pressure from the sugar sector, that Mexico should not expect anything and that it would be best to find a negotiated solution to the problem. I responded that Mexico's concerns went beyond the sugar dispute: they affected the treaty's integrity. The dispute settlement procedure was precisely the means for resolving controversies that otherwise could not be resolved by the Parties through consultations and negotiations. Moreover, I stated that this was an inequitable situation, since HFCS producers had had access to international panels constituted under the NAFTA and the WTO</u>. With respect to a negotiated solution, Mexico had been making proposals, it had submitted several proposals to the United States without receiving any response. I stated that this put the U.S. willingness to arrive at a solution into question. <u>Ambassador Johnson simply responded that finding a negotiated solution was preferable than resorting to NAFTA's dispute settlement procedure</u>. In spite of our disappointment with regard to the US response, I stated our willingness to find an integral solution that would take into account both HFCS and sugar.[104]
>
> [Emphasis added]

128. Starting in September 2001, a number of events occurred.

129. First, at the beginning of September 2001, the Federal Executive found it necessary to expropriate 27 of Mexico's 61 sugar mills in order to prevent the imminent financial collapse of

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[104] Ibid., at ¶ 47.

the industry and to ensure that cane-growers were paid for their crops delivered to the mills and could finance the planting of the next year's crop.[105]

130. Second, following President Fox's "*Informe de Gobierno*" on 1 September 2001, the Secretary of the Economy, Luis Ernesto Derbéz appeared before the Congress and reported to it on the state of progress, or rather the lack thereof, of the resolution of the sugar market access dispute.

131. Third, on 18 September 2001, legislators from several Mexican political parties proposed issuing a Decree prohibiting HFCS imports as well as corn destined to domestic HFCS production. Deputy Eduardo Andrade, who submitted the proposal to the Chamber of Deputies, stated:

> … it is an authority act by the Mexican Congress to defend the sugarcane industry, a basic industry in our country. That is our responsibility. Here we are, 500 governing leaders without opinion. Our function is to transform our opinions into government acts and this one must be transformed because it has ample support, in a fundamental act of government, that I insist, affects a national industry that generates two and half million direct and indirect jobs, but one that ultimately affects everyone because we could eventually end up making tax payers pay 19 billion pesos in debts that otherwise would be paid by the industry. And the industry cannot fulfill those commitments because there is a violation to the North American Free Trade Agreement by the United States, who committed to receive our sugar surplus in accordance with the terms of the Treaty as it was signed, not the text of those other letters they claim to exist which validity has correctly been dismissed by the Senate of the Republic; the issue is we would not have on million tons of sugar in our warehouses had the terms of the Treaty been respected, if that sugar has to be sold in the domestic market to avoid having the tax payers burdened with a burden similar to the FOBAPROA.[106]
>
> [Emphasis Added]

132. The Congressional initiative stated in its recitals:

> That the national sugar industry is facing a profound crisis, in response of which the Federal Executive decided to expropriate 27 sugar mills…
>
> That more than two million Mexican depend on the sugar industry since it generates jobs in the countryside and in the sugar mills that process sugarcane.
>
> That the domestic sugar market has been affected by the lack of compliance of the United States with the North American Free Trade Agreement, since it should have absorbed Mexico's production surplus in accordance with the terms of said Treaty since October 2000.

[105] Decree by which the sugar mills are expropriated. Exhibit R 121.

[106] Stenographic version of the session of the Chamber of Deputies, 18 September 2001, p.8. Exhibit R 43.

> That the lack of compliance with the Treaty is linked to the indiscriminate entry of high fructose corn syrup from the United States of America and subsidized corn to produce said sweetener in our country, and therefore, a million tons of sugar remain in our warehouses and neither the United States' market needs nor the Mexican market needs have been fulfilled as they should have under the NAFTA.
>
> That it is indispensable to free the markets for that sugar to be consumed in our country and to restitute the sugar mills' working capital to maintain the sugarcane industry in operation.
>
> That the characteristics and extension of sugarcane allows for hundreds of thousands of fellow countrymen that work in the countryside to support themselves.
>
> That any impact on this crop could generate social reactions that would affect the peace in the countryside and national security.
>
> That the necessity of adopting exceptional measures when faced by emergencies of an economic, political or social nature or when the country's security or that of its inhabitants is compromised is recognized internationally…".[107] [Emphasis added.]

133. Fourth, on 26 September 2001, the United States assigned Mexico a 148,000 ton sugar quota. Mexico's sugar surplus in that marketing year was approximately 650,000 tons. On Mexico's interpretation of its NAFTA market access rights, it had been legally entitled to export its entire surplus to the United States as of 1 October 2000.

134. By virtue of Mexico's having received less access to the United States market than that to which it had a right and in light of the United States' refusal to submit to the Chapter Twenty NAFTA dispute settlement mechanism, the possibility arose that Congress would adopt a tax on soft drinks sweetened with HFCS as opposed to cane sugar. In October 2001, Ambassador Robert Zoellick, expressed his concern to Dr. Derbéz. Dr. de la Calle testifies:

> 50. During a meeting between Dr. Derbez and Ambassador Zoellick in October, the latter expressed his concern. Dr. Derbez stated that the Secretary did not want the adoption of the tax either and that he preferred to act from the Executive, <u>but made it clear to Ambassador Zoellick that, by refusing to appoint panelists for the NAFTA Chapter Twenty case and by not making a reasonable effort to resolve the dispute through negotiations, the United States had left him without any means to negotiate this with Congress</u>. Dr. Derbez reiterated Mexico's willingness to find a solution. Ambassador Johnson and I also discussed the matter during a meeting held during that month in which I again proposed several ways in

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[107] Parliamentary Gazette, year IV, No. 840, Wednesday 19 September 2001.*Id.*, p. 10. Exhibit R 44.

> which we could reach an agreement. We received no response from the United States.[108]

135. Throughout the autumn of 2001, the Executive was pressed by the Mexican Congress to explain why the United States was: (i) failing to provide the market access for sugar to which Mexico thought it was entitled; and (ii) why the United States was not allowing the Panel to operate as intended by Chapter Twenty.[109] Mr. Ildefonso Guajardo, then a Federal Deputy, testifies that Secretary Derbéz appeared before Congress in September 2001 and acknowledged that the United States was still not agreeing to establish the Panel. The Congress continued to monitor this refusal throughout the autumn of 2001:[110]

> 20. … [By December 2001] almost three years had passed since Mexico initiated dispute settlement proceedings and more than a year since Mexico requested the establishment of a panel. According to the NAFTA, the dispute settlement procedure, including consultation and the Commission stages, should have been resolved in less than a year.
>
> 21. Once a panel is requested, it must issue its final resolution within five months, including the month the parties have to name their panelists. The Secretary of Economía explained that the constitution of panel was still being pursued and that on the last meeting with his US counterpart it was agreed that the panel will be established soon.
>
> 22. However, the rest of the year elapsed without an agreement between Mexico and the United States on the constitution of the panel, and Congress did not envision their reaching a negotiated or jurisdictional solution –unfortunately, time has proved us right. [111]

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[108] Testimony of Luis de la Calle. Exhibit R 01A.

[109] The following statements by Mexican legislators are indicative: “At the same time, the document [point of agreement of the Senate on October 10, 2000] establishes that the Senate of the Republic, in use of its constitutional faculties in the matter of foreign policies, exhorts the Federal Executive Power to advocate for actions and mechanisms for the accomplishment of the agreements included in NAFTA, as for taxes to be applied on HFCS imports” [this latter a reference to the fact that U.S. parties were able to invoke NAFTA Chapter Nineteen]. Senator Fidel Herrera Beltrán; Exhibit R 45. “Certainly there is pressure coming from American industries, but also, the neighbouring country [the United States] does not respect the agreements on the sugar matter with Mexico. However, he highlighted, if there is resentment or controversy coming from the producers of HFCS in the United States, then a global revision of the matter on the Free Trade Agreement must be done, and then it should be seen who is not complying with the signed agreements.” Deputy Enrique de la Madrid; Exhibit R 46. “This panel [about access to the sugar market] was requested more than one year ago and we have not even been able to establish it yet. What are we missing for the establishment of this panel? Which factors have impeded -for more than 12 months of the present administration- to give a sure start to a panel, which can clearly clarify what exportable Mexican sugar surplus is? Deputy Ildefonso Guajardo Villareal; Exhibit R 47. “This crisis would find equilibrium and solutions if it abides to the terms originally agreed under NAFTA, concerning the commercialization of sugars and syrups and its access to the market of the United States of America”. Senator Raymundo Gómez Flores; Exhibit R 48. See also the testimony of Idefonso Guajardo, ¶ 34. Exhibit R 01C.

[110] Witness statement of Ildefonso Guajardo, ¶ 45. Exhibit R 01B.

[111] Id. at ¶¶ 20 and 22.

136. Throughout this period Mexican officials warned their United States counterparts that in view of the sectoral crisis and the United States' refusal to either find a mutually satisfactory solution or to submit the matter to the Panel as requested by Mexico one year previously, Mexico would be forced to take action to restrict HFCS's participation in the Mexican sweeteners' market.

137. Prior to the enactment of the tax, Mexico had been negotiating with the United States since 1993; intensively since 1997. Efforts were made at all levels: Presidents, Secretaries, Undersecretaries and other high-ranking officials without yielding any positive results. More than two and a half years had passed since Mexico initiated a formal dispute settlement proceeding and more than a year since it requested the establishment of the Panel. The United States response was that Mexico should not expect the matter to be heard by an international tribunal.

138. In contrast, when Mexico's actions were challenged through the institutional channels of various international treaties, Mexico submitted to the jurisdiction of international tribunals and complied with their resolutions.

139. Since NAFTA's entry into force, the Parties have requested the establishment of a Chapter Twenty arbitral panel on four occasions. Mexico's Panel request to resolve the United States' sugar market access dispute has been the only one that has not advanced[112]

140. In sum, over the sixteen months between Mexico's request for the Panel's establishment and the enactment of the tax (not the four and a half months as the Claimant contends), Mexico did everything within its power to convince the United States to submit to Chapter Twenty dispute settlement.

141. Mr. Guajardo adds:

> 24. The Secretary of Economía appeared before Congress at the beginning of December 2001. He once again stated that the Secretary was pursuing the establishment of a panel, but that US hasn't accepted it yet. He pointed out that there was no legal means to compel the appointment of panelists and that this has been a permanent issue with the United States. He also informed that he will meet with his US counterpart in order to have a serious discussion about the issue.
>
> 25. Towards the end of the year, although the Secretariat had held several discussions at the highest level in regard to the sugar dispute and specifically in regard to the establishment of a panel, the US continued to refuse Mexico's request. Then a reform proposal for the IEPS tax law establishing a 20% tax on soft drinks sweetened with fructose was presented for discussion. This was the option Congress finally decided to take.

[112] In the other three proceedings, the Parties to NAFTA established the panels by appointing the respective panelists: *Tariffs applied by Canada to certain US-origin agricultural products* (CDA-95-2008-01), *U.S. safeguard action taken on broom corn brooms from Mexico* (USA-97-2008-01), and *Cross-Border Trucking Services and Investment* (USA-98-2008-01).

> 26. The tax was approved without any objections. Both Senators and the Deputies were aware of the damage suffered by the sugar industry and the efforts of many years to try to arrive at an ideal solution with the United States, and although many Deputies including me, did not think this was an ideal solution –the ideal solution would have been to reach a satisfactory agreement ensuring that both Parties would preserve the equilibrium in their respective sweeteners market, or a panel ruling on the rights and obligations of both Parties– the tax constituted a legitimate and proportionate reaction to the United States violations.[113]

142. There is no doubt that there was a genuine legal dispute between the two NAFTA Parties over the terms of Mexican sugar's access to the United States market. The WTO Panel later established to examine the GATT-consistency of the tax recorded that the United States had conceded that fact.[114]

143. Similarly, there is no doubt that all necessary steps for the Panel's establishment were taken by Mexico. The United States later told the WTO Panel that (five years after the fact):

> …the dispute Mexico has brought against the United States under NAFTA (regarding the U.S. tariff-rate-quota on Mexican sugar) <u>is presently in the panelist selection stage</u>.[115]
>
> [Emphasis added.]

144. With these facts in mind it is possible to correct the Claimant's characterization of Mexico's position in paragraph 292 of the Memorial where it states: "NAFTA authorizes a Party to take countermeasures in only one circumstance – after a Chapter 20 panel has issued a final report and the Parties have not reached a mutually satisfactory resolution of their dispute"[116] in the following manner: Where: (i) one NAFTA Party forms the view that another NAFTA Party is in breach of its NAFTA obligations; (ii) there is a genuine legal dispute between the Parties; (iii) that Party takes all necessary steps to submit its grievance to a Chapter Twenty Panel; and (iv) the other Party obstructs such dispute settlement, the first can invoke its customary international law rights to take a countermeasure, *i.e.,* take action inconsistent with the NAFTA, because it is responding to a prior unlawful act of the other Party.

145. Mexico recognizes that the NAFTA restricts the right of a Party to take countermeasures until after the panel process has been completed and the Respondent has failed to bring itself into compliance with the panel's report. But it can be seen at once that this conventional treaty text restricting the use of countermeasures cannot restrict a State's customary international law rights if the offending State impedes the initiation of the Chapter Twenty proceeding.

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113 Testimony of Ildefonso Guajardo. Exhibit R 01C.

114 WTO Panel Report, ¶ 8.232, and footnote 453, recording the United States' response to Panel question No. 73, ¶¶ 62-64. Exhibit R 49.

115 Answers of the United States to Questions of the Panel in Relation to the First Substantive Meeting with the Parties, answer to question number 7, p.9. Exhibit R 50.

116 Memorial, ¶ 293.

146. A *lex specialis* can apply only if it is permitted to operate as the Parties to the *lex specialis* intended.

147. Mexico cannot be bound by Article 2019 when, though no fault of its own, it was prevented from obtaining a Panel finding that the United States violated its market access commitments. Otherwise, a recalcitrant respondent Party could, by obstructing dispute settlement, prevent the complaining Party from obtaining redress under the Treaty and from asserting its customary law rights in the event of the Treaty's breakdown.

148. As shall be discussed in its Legal Submissions, Mexico was well within its customary international law rights to take action against the United States:

- it was the United States that demanded in the original NAFTA negotiations that Mexico replicate the high MFN tariff in order to protect its sweeteners industry.[117] The foregoing measure created the market opportunity for HFCS in the Mexican market;

- it was the United States, not Mexico, which then established the linkage between sugar and HFCS in the "side letter" negotiations;

- by adopting an interpretation with which Mexico fundamentally disagreed, *i.e*., that HFCS should be considered in calculating the net production surplus, but only consumption of HFCS , it was the United States that essentially punished Mexican sugar producers for every sale of sugar that they lost to HFCS. Not only did they lose the sale in Mexico, but that sale was deducted by the United States from Mexico's net production surplus;

- the United States maintained the position that the Parties had agreed to eliminate a critical provision of the agreement on the transition to free trade in sugar (paragraph 16 of Annex 703.2 which allowed Mexico to export its entire surplus to the United States if it enjoyed consecutive surplus years). This interpretation was one that Mexico strongly disagreed with and it communicated such to U.S. officials at the time, the United States ensured that much smaller quantities of sugar would be permitted to be exported to its territory. In doing so, the United States imposed all of the NAFTA adjustment burden on Mexico.

- it was the United States, not Mexico, that refused to submit the dispute to a Chapter Twenty Panel; and

- therefore, when the Treaty's mechanisms had broken down such that Mexico could not have its grievance heard, Mexico was legally entitled to invoke its customary international law rights *vis-à-vis* the United States.

[117] NAFTA Annex 703.2, ¶ 17.

6. The U.S. sweeteners' industry opposition to a resolution of the dispute

149. Although the role played by the U.S. sweeteners industry in thwarting a mutually satisfactory resolution of the NAFTA dispute and in pressuring the United States government to resist Chapter Twenty dispute settlement are not facts that the Tribunal must consider in its analysis of Mexico's legal right to adopt countermeasures. However, the Tribunal may find it of interest to explore why the United States acted as it did.

150. At paragraph 120 of this Counter-Memorial, it was noted that on the very day that Mexico requested the Panel's establishment, on 17 August 2000, the ASA issued a press release expressing its "shock and disappointment that the Mexican government and the Mexican sugar industry are disputing the validity of the sugar provisions of the NAFTA" and stated that it was "committed to support the U.S. government in its efforts to maintain the sanctity of the international agreements entered into by the United States and approved by Congress".[118] The Tribunal has also been directed to the evidence of Dr. de la Calle, who testified that in August 2001 he was told by his United States counterpart not to expect the Panel to be established because the U.S. administration was under strong pressure from its sugar industry.[119] The evidence is that in addition to whatever reasons it might have had for not wanting to submit to NAFTA dispute settlement, the United States Administration was pressured to take the position that it did by the American Sugar Alliance and its members and allies in Washington, D.C.

a. The ASA's membership in the 1990s and early 2000s

151. The American Sugar Alliance would more accurately and properly be described in 1995-2005 period as the American Sweeteners Alliance.

152. Notwithstanding its name, the ASA has been, at least up to 2005, a national coalition of growers and processors of sugar and corn sweeteners dedicated to protecting the high support price for sugar, which price has historically acted as a "price umbrella" for HFCS.

153. The ASA describes itself as a "national coalition of growers, processors and refiners of sugar beets, sugarcane, and corn for sweetener".[120]

154. The Tribunal may well ask, why corn growers and refiners of corn for sweetener would be members of the American Sugar Alliance. The answer lies in the long-standing shared interest that United States sugar and HFCS producers have had in the continuance of the Sugar Program, at least until the last few years when the U.S.-Mexico sweeteners dispute drove a wedge between the U.S. sugar producers and some of the HFCS producers.

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[118] American Sugar Alliance press release "U.S. Sugar Industry Greatly Disappointed at Mexican Action", 17 August 2000. Exhibit R 42.

[119] Witness statement of Dr. de la Calle, ¶ 47. Exhibit R 01A.

[120] *See* American Sugar Alliance website: About ASA: What is the American Sugar Alliance? http://www.sugaralliance.org/desktopdefault.aspx?page_id=4. Press release of August 2, 2002: http://www.sugaralliance.org/desktopdefault.aspx?page_id=19&news_id=256.

b. A Shared Interest in the Sugar Program

155. The U.S. Sugar Program is an agricultural support program that is designed to keep the price of sugar sold within the United States at well above the "world market" price. Since the early 1980s, sugar has been priced in the United States market at between two and three times the price of world sugar.

156. The Sugar Program would be unworkable if world market-priced sugar, such as that produced in Canada, could enter the United States market.[121] No consumer would purchase U.S. sugar if it could have access to much cheaper imported sugar.

157. Accordingly, in order to support that high domestic price the United States employs an import restricting Tariff Rate Quota (TRQ)[122] which permits a very small amount of refined sugar (22,000 metric tons (MT)) to be imported under its duty-free (Tier I) tariff. Once that quota is filled, the high Tier II tariff applies. The tariff has no revenue generating objective; it is intentionally set at a level that makes it virtually impossible to export to the United States, since it is prohibitively expensive to import sugar in the United States.

158. Protected by that Tier II tariff, United States sweeteners producers can sell their goods at a higher price than that which would otherwise prevail in the United States market.

c. The Sugar Program benefits HFCS producers

159. U.S. HFCS producers have also benefited from the Sugar Program because they sell their product at a discount to the prevailing price of sugar. If the price of sugar is maintained at a high level, HFCS sales are guaranteed and conversely, if the price of sugar declines, so too does the price of HFCS.[123] HFCS has a price sensitivity to sugar. Any reduction or elimination in U.S. tariff protection could have the effect of allowing potentially lower priced sugar to enter the U.S. market and therefore affect market conditions and returns to U.S. sweeteners producers. This is why the NAFTA has been feared by many members of the U.S. sweeteners industry: it was the

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[121] This explains why in their bilateral agricultural deal under the NAFTA, the United States refused to grant Canada any new market access to the U.S. sugar market. Canadian originating sugar is free to compete for the miniscule 22,000 MT global quota that the United States maintains for access to its over 10 million MT sugar market.

[122] The Sugar Program also employs a non-recourse loan program to support the price of sugarcane and sugarbeets. Exhibit R 116. "Imports Restraints Update", pp.16-20.

[123] This is evidenced in the SEC filings of one of Cargill's competitors, Corn Products International, Inc. As a publicly traded company whose entire business is corn wet milling, CPI reports on the impact of market conditions on its financial prospects. Thus, for example, CPI's Annual Report for the year ending 31 December 2002 noted: "Several of the Company's products also compete with products made from raw materials other than corn. High HFCS Corn Syrup and monohydrate dextrose compete principally with cane and beet sugar products….Fluctuations in prices of these competing products may affect prices of, and profits derived from, the Company's products. . .. Due to the competitive nature of the corn refining industry and the availability of substitute products not produced from corn, such as sugar from cane or beet, end product prices may not necessarily fluctuate in relation to raw material costs of corn." Exhibit R 51. In a investment relations meeting held between the analysts and portfolio administrators, on May 25, 2005, a CPI officer confirmed that "the price [of HFCS] in Mexico correlates very closely to the price of sugar in Mexico " Exhibit R 52.

first Free Trade Agreement in which the United States agreed to eliminate, by means of a phased reduction, its Tier II tariff on imports of sugar originating in another country.

160. It has been documented not only by the ASA itself but by academic and other commentators and United States government agencies as well that the U.S. Sugar Program has protected and conferred benefits not only on sugar growers and producers but also corn growers and refiners.[124] The ASA has successfully opposed consumers' attempts to reform the U.S. Sugar Program and has pressed the USDA and the United States Trade Representative to restrict sugar imports as much as possible under the United States' WTO and NAFTA commitments.[125]

161. Over the years, the ASA has developed very strong support in the United States Congress. In a report published in 2001, the Cato Institute called the Sugar Program "a failure by every measure except its political support in Congress."[126]

162. The corn growers and refiners have historically been the sugar industry's ally in supporting the continuance of the Sugar Program because, with a high support price for sugar, once HFCS became commercially viable in the 1970s and saleable for certain applications such as soft drinks at a lower cost, the corn growers and processors developed an interest in ensuring the continued maintenance of a high support price for sugar.

163. As one U.S. academic noted:

> The sugar program does not involve substantial budget outlays but nonetheless makes producers better off by driving up market prices. This is readily accomplished for sugar, because up to the 1980s about half of U.S. sugar consumed was imported. Therefore, import controls could raise the U.S. price as desired. By the summer of 1985 the New York landed price was 21 cents per pound while the New York off-shore price (world market) price was 3 cents per pound. This level of support was sufficient to maintain a new industry of high-HFCS corn syrup (HFCS) as a substitute for sugar. With costs estimated at 8 to 16 cents per pound, HFCS could not exist in competition with sugar at world market prices.[127]
>
> [Emphasis added.]

164. Similarly, the Cato Institute noted:

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124 Exhibit R 08 and R 15. Testimony of Mr. Roney.

125 As a 2001 report prepared by the Congressional Research Office noted: "Prior to the early 1980s, domestic sugar growers supplied roughly 55% of the U.S. sugar market. This share grew over the last 15 years, reflecting the price protection provided by a sugar program. In FY2004, domestic production filled 87% of U.S. sugar demand for food and beverage use. As high fructose corn syrup (HFCS) displaced sugar in the United States during the early 1980s, and as domestic sugar production increased in the late 1980s, foreign suppliers absorbed the entire adjustment and saw their share of the U.S. market decline." CRS Issue Brief for Congress: IB95117: Sugar Policy Issues, April 13, 2001, p. 3. Exhibit R 53.

126 "America's Bittersweet Sugar Policy", The Cato Institute, December 4, 2001, p. 2. Exhibit R 54.

127 Bruce Gardner, *Farm Commodity Programs as Income Transfers*, Cato Journal, Vol. 6, No. 1 (Spring/Summer 1986), p. 253. Exhibit R 55.

> Corn growers benefit from the U.S. sugar program because inflated sugar prices create an artificial incentive for confectioners, soft drink makers, and the like to switch to corn syrup, which serves as a substitute for sugar.[128]

165. The US government has also recognized this interest:

> Since the sugar program keeps domestic sugar prices higher than they would otherwise be, manufacturers of sugar's main competitor – HFCS – can keep their prices higher was well. GAO estimates that manufacturers of HFCS receive an additional $548 million annually as a result of the sugar program. HFCS manufacturers' benefits are also concentrated: Four HFCS firms accounted for 87 percent of domestic production in 1990. This concentration of benefits occurs largely because of the substantial investment required to produce HFCS, which makes it difficult for new firms to enter the market.[129]

166. If U.S. raw sugar prices fell to world raw sugar prices, as in Canada, particularly as in western Canada, sugar would be more competitive with HFCS and could either take away market share or depress HFCS margins.[130] Mexico understands that, depending on the price of world raw sugar, soft drinks bottlers in Canada play the sugar and HFCS producers off against each other in order to extract pricing concessions.[131] Therefore, HFCS prices and margins tend to be lower in Canada than in the United States.[132]

167. Thus, historically in the very large United States sweeteners market, U.S. sugar and HFCS producers have had common interests. Their shared interest in preserving Sugar Program and the high U.S. support price is confirmed by the fact that corn farmers, processors and refiners have been members of the American Sugar Alliance and were represented in its Executive Committee by one of the claimants in one of the other Chapter Eleven claims against Mexico, Archer Daniels Midland Company (ADM).

168. ADM has been particularly active in both the financing of and the governance of the American Sugar Alliance.[133] ADM was represented on the ASA's Executive Board at all material

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128 "America's Bittersweet Sugar Policy", The Cato Institute, December 4, 2001, p. 5. Exhibit R 54.

129 United States General Accounting Office, *Review of the U.S. Department of Agriculture Sugar Program*, 16 April 1993, Executive Summary at p. 4. Exhibit R–56.

130 Claimant argues that HFCS has replaced sugar at Canada. That it is not entirely true. Although HFCS plays a role in the Canadian sweeteners market, it has not driven sugar out of the soft drinks market. Canada has a significantly lower domestic price for sugar (because it has no domestic support program for sugar beets and its refiners import low-priced raw sugar from the world market). Soft drinks and other industrial users in Canada retain the ability to use liquid sugar whose market share varies depending upon the cost of raw sugar on the world No. 11 market. Sometimes sugar drives HFCS out of certain industrial accounts. *Rogers Sugar Income Fund* Annual Report, p. 8. Exhibit R 57.

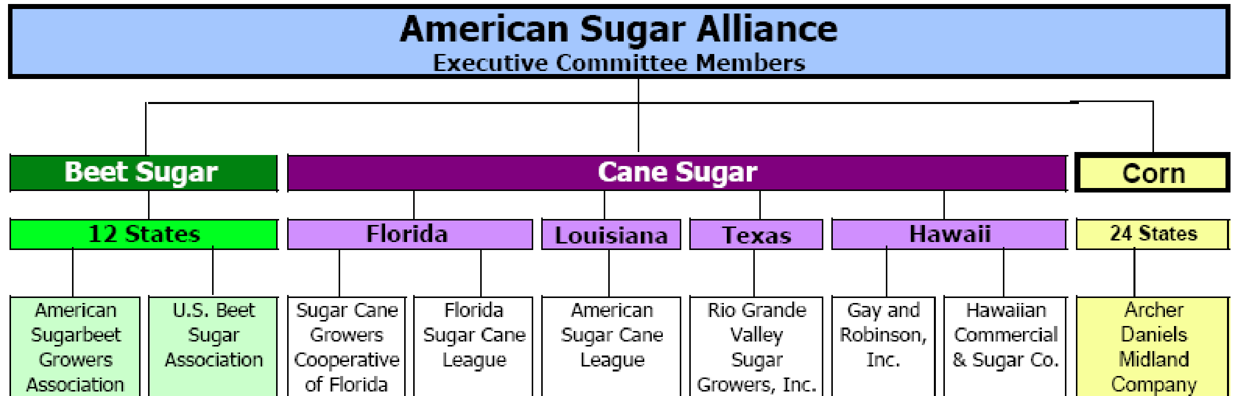
131 Rogers Sugar Income Fund Annual Report,, p. 8. Exhibit R 57.

132 CPI's Annual Reports for the years ending December 31, 1998 and 1999, for example, noted that prices were lower in Canada, at pp. 6, 9, and 10, respectively. Exhibits R 58 and R 59.

133 "ADM: A Case Study in American Corporate Welfare." Exhibit R 60.

times through its Senior Vice President and Special Advisor to the Chairman of ADM's Board, Mr. Martin Andreas.[134] ADM has held the view that maintaining the price of sugar is beneficial to its interest as a producer of HFCS.

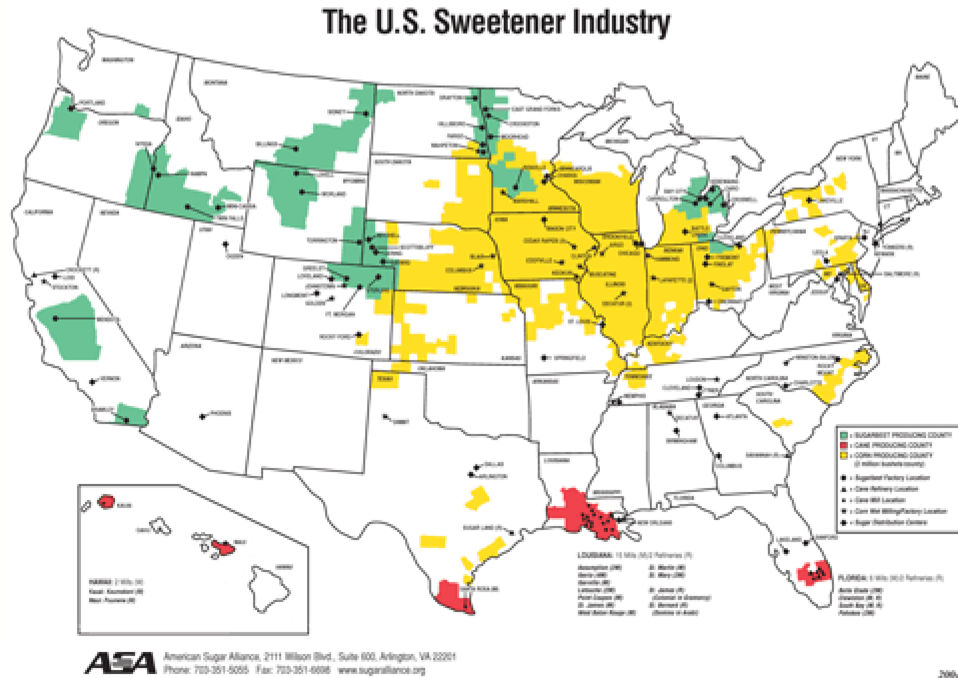
169. The table reproduced below shows the ASA's Executive Committee and membership at the relevant time.



Source: American Sugar Alliance: http://www.sugaralliance.org/files/docs/ASAflowchart.pdf

170. The ASA has regularly emphasized the shared interests of sugar and corn sweeteners producers. For example, its website contains a map of the United States showing corn and sugar production:

[134] According to Gordon Adkins, in February 2000, ADM's Mr. Andreas reported that "he had talked with asa (sic) people and that they are scared and very concerned now that the us sugar program will just go bye bye period and that they want to meet with us" [*i.e*, the CRA]. (The quote was all in lower case.) Mr. Andreas also "kind of alluded to questioning our [*i.e.*, the CRA's] getting involved in sugar policy." Exhibit R 61.



171. Mexico does not know whether Cargill was a member of the ASA at the relevant time and it expects that Cargill will clarify in its Reply what relationship, if any, it had with the ASA during the period 1995-2005. What Mexico does know is that the other U.S. HFCS producers have either admitted or not disputed that they were members of the ASA at that time or otherwise maintained silence in this respect.[135]

d. The CRA-ASA Discussions of 2000

172. Mexico's initiation of consultations with the United States spurred a number of responses in the United States. As shall be seen, the ASA took the opportunity posed by the negotiations held by the two governments to prevent a solution to Mexico's grievances regarding market access, and instead sought to force a re-negotiation and an undoing of what had been previously agreed in the NAFTA.[136]

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[135] Another NAFTA claimant, Tate & Lyle Ingredients Americas, Inc. (TLIA) also owned a major sugar refinery operation in the United States at the material time. Tate & Lyles' then U.S. sugar subsidiary, American Sugar Refining, Inc., was also a member of the ASA prior to its sale in 2001.

[136] A set of talking points prepared by the CRA for a meeting with USTR Zoellick, dated 9 April 2003, noted: "Sugar is poised to get more than they did even in the NAFTA side letter in some respects (raw/refined requirements, raising the tariff on tier two imports, growth based on U.S. sugar consumption, potential limits on sugar trade post 2008, re-export controls, etc.) for a minimal price – roughly 50,000 metric tons above the side letter. Such an increase in Mexican sugar access into the U.S. market will not impact domestic sugar prices, given the size of the U.S. sugar market (10 million metric tons)." Exhibit R 62.

173. Cargill has disclosed a number of documents pertaining to the CRA's efforts to advance the interests of its members in relation to the sugar-HFCS dispute. An interesting point of departure for reviewing the CRA's relationship with the ASA can be found in some "talking points" prepared in February 2000 for a planned meeting between the CRA with the ASA.

> Corn Refiners/Sugar Industry
>
> *Note: Unity among CRA members is crucial, if we are to have a constructive discussion with ASA. It's essential that we put time and energy into developing a CRA consensus before scheduling any meeting. The talking points offered below are intended to help clarify key issues to be discussed with sugar producers.*
>
> Talking points for meeting
>
> 1. Past coalitions of sugar producers, corn growers and corn refiners have been effective in keeping a domestic sugar policy in place. Close working relationships among these groups have helped generate success.
>
> 2. Growth in U.S. sugar production is jeopardizing the future of the sugar program.
>
> 3. USDA's administration of the sugar program appears to be inconsistent with the intent of the FAIR Act. Instead of announcing a recourse loan for sugar in the 1999/2000 marketing year, a non-recourse loan was put in place. This will have the effect of constraining consumption growth while encouraging additional output. CRA supports the U.S. sugar program on the understanding that it will be allowed to work as written.
>
> 4. The substantial reduction in U.S. sugar imports has aggravated trade relations with Mexico, which has led to curtailed marketing opportunities and considerable financial damage for U.S. corn refiners.
>
> 5. U.S. obligations to Mexico under NAFTA require offering a sugar import quota of 250,000 metric tons for the marketing year beginning Oct. 1, 2000. Unless U.S. sugar production falls substantially from 1999's level, it will be challenging to import the WTO minimum of 1.1 million metric tons and the 250,000 metric tons from Mexico without oversupplying the U.S. market.
>
> 6. Accommodating imports of 250,000 metric tons from Mexico is essential to U.S. wet corn millers. Unless Mexico receives this expected increase in access to the U.S. sugar market, corn millers are highly unlikely to receive improved access to Mexico's HFCS market. Any effort to use antidumping, countervailing duty or other measures to reduce imports of sugar form Mexico will be resisted resolutely by CRA.[137]

[137] Exhibit R 63. Talking Points, 14 January 2000, p. 6.

[Italics in original, underlining added, except for headings.]

174. The "talking points" are illuminating for a number of reasons.

175. First, the note at the outset of the document speaks for itself. Although the CRA represent the interests of its members insofar as the U.S.-Mexico dispute was concerned, in the late 1990s and early 2000s, some of the CRA's members were also members of the ASA, which held a very different view of how to resolve the dispute between Mexico and the United States. The prospect that one or more members of the CRA might take a different position in its capacity as a member of the far more politically powerful ASA was obvious. Hence, the call for "unity among CRA members…".[138]

176. Second, the talking points are illuminating for their acknowledgement (at paragraph 1) of the interest that the HFCS and sugar producers have historically shared in the Sugar Program's continuance and their coalitions in pursuit of that objective.

177. Third, the talking points recognized that the reduction in U.S. sugar imports was aggravating trade relations with Mexico.

178. Fourth, the talking points are notable for the statement that Mexico should receive 250,000 MT of market access on 1 October 2000. (As events transpired, the United States gave Mexico less than half of that and considerably less than Mexico believed it had a legal right to export.[139])

179. It is also evident from Cargill's document production that Archer Daniels Midland closely reflected the ASA's positions in its discussion of what position the Corn Refiners Association should take *vis-à-vis* the ASA and the United States government in response to Mexico's market access grievance.

180. On 2 February 2000, directors of the CRA held a strategy meeting in Chicago. Cargill's Gordon Adkins attended and sent an email to his colleagues reporting on the substance of the discussions. Noting that "the tone of the meeting was that something needed to be done even to the extent of eliminating the sugar program entirely"[140] due to the absence of controls on production of sugar that created a surplus in the United States, insofar as the Mexican market access was concerned, ADM proposed to the other members of the CRA that to propose Mexico that Mexican sugar producers would be permitted to export 250,000 metric tons (MT) of raw sugar to the United States in marketing year 2000/2001 with an increase of 20,000 MT each year

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[138] This concern was echoed in an email from Mr. Dan Pearson of Cargill to other Cargill personnel: "If CRA can keep the membership united, the organization could play a role in seeking changes to U.S. sugar policy." Exhibit R 64.

[139] Exhibit R 65. Federal Register Notice issued 2 October 2000.

[140] Email from Gordon Adkins to various Cargill personnel, dated 4 February 2000 regarding a Corn Refiners Association meeting held on 2 February 2000 at the Chicago Hyatt Regency. Exhibit R 66.

for each of the next 5 years and that the scheduled reduction, under NAFTA, of the United States' Tier 2 Tariff should be eliminated.[141]

181. This "solution" was fully consistent with the ASA's desire to prevent Mexican sugar mills from adding value to their raw sugar and exporting any refined sugar (known in the trade as "whites") into the United States to compete with U.S. sugar refiners. The NAFTA had imposed no such differentiation on Mexican sugar, but rather contemplated that the Mexican sector could export sugar in whatever form the individual companies considered to be most commercially appropriate.

182. The ADM proposal, which reflected the ASA's policy position, would allow U.S. sugar refiners to control the pace of entry of Mexican sugar imports into the U.S. market by restricting the Mexican exports to only raw sugar (which is not fit for human consumption and must be refined before it would be sold to the end users in the United States' market).

183. U.S. sugar refiners would thus determine if and when they wished to purchase Mexican raws for refining, having regard to prevailing United States market conditions. From the sugar industry's perspective, this would have the advantage of not increasing the overall amount of refined sugar available for sale in the United States and thus would not lead to price depression in the refined sugar market. U.S. sugar producers would not have to compete with Mexican refined or *estándar* sugar.

184. ADM's suggestion that the NAFTA's scheduled reduction and eventual elimination of the Tier 2 tariff, reflected the ASA's objective of undoing a central part of the NAFTA's sugar trade provisions.[142]

185. Eliminating the scheduled removal of the Tier 2 tariff was a unacceptable to Mexico. It involved amending the NAFTA in order to eliminate one of Mexico's best export market opportunities in agricultural trade.

186. This proposal came from a major U.S. HFCS (not a sugar) producer to its fellow HFCS producers. The fact that ADM proposed these positions is significant because as the principal financial supporter of the ASA, as a member of its board, ADM was in a strong position to influence the ASA's policy *vis-à-vis* the United States government and Mexico.

187. The documents produced by Cargill indicate that there was disagreement within the CRA on the correct approach to be taken by the CRA, but the ADM/ASA view evidently prevailed. After the Chicago meeting, drafts of the CRA position were circulated and ADM's position on the Sugar Program generally (as opposed to the restrictions on Mexican sugar), which had evidently been against the Sugar Program's continuance at the 2 February meeting, changed. In an email from Cargill's Doug Linder to other Cargill personnel, dated 17 February 2000, it was noted that:

> Chuck [Connor, president of the CRA] thinks ADM want to push this to over all improve their stock price and that is why Marty [Andreas] and

[141] Íd.

[142] See Section II.B.2.

> Larry [Cunningham, both of ADM] have switched positions on the issue.[143]

188. The CRA's then-President, Mr. Charles Connor, circulated a draft of a proposal that the CRA intended to present to the ASA as a vehicle for the two associations to move ahead jointly.[144] Mr. Dan Pearson of Cargill's Government Relations' office commented:

> I've offered some comments on the draft we've just received from Chuck Connor.
>
> Frankly, I'm disappointed not to have gotten a more specific evaluation of any problems that other CRA members might have with the draft we sent yesterday. Some of Chuck's changes make his document quite a bit worse that what we provided to him, yet there's no explanation as to why he has muddied things up. My sense is that we put more time and effort into our draft than ADM/CRA did into the earlier one.
>
> I'm particularly irritated about including provisions that are sure to irritate the Mexicans: limiting their TRQ imports to raws instead of whites; and cutting off access for Tier II sugar. We already know that the CRA proposal will cause some heartburn to ASA and we're prepared to deal with that. I don't think it helps our cause to tick off the Mexicans, too. If CRA can't think of ways to help increase Mexico's sugar access into the United States, then it should probably stay out of the debate. As an example of a better approach, if CRA wants to try something about Tier II sugar, it should argue that Mexico should be given sufficient access under the TRQ to make Tier II imports unnecessary.
>
> Perhaps worst of all, Chuck's new version omits points 4 and 5 from our draft. Those are the provisions expressing CRA's opposition to cutting off access for Mexico's 250,000 metric tons of TRQ access and opposition to including those 250,000 MT as part of the WTO minimum imports. In a very real sense, that was the most meaningful part of our draft in terms of communicating a bottom-line position to ASA. Those are the items CRA should be willing to fight for, while much of the stuff in Chuck's draft is just window dressing that obfuscates the main issues…[145] [Emphasis added.]

189. It can be seen from subsequent documents that the HFCS producers did not maintain unity *vis-à-vis* the ASA. Within the CRA there were differences of opinion respecting the proposal to force Mexico to renounce the benefits that it had obtained during the NAFTA negotiations (i.e., the gradual elimination of the Tier II Tariff in its favor). The ASA gained the upper hand in pressing its case for restricting Mexico's sugar market access.

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143. Exhibit R 66.

144 Memorandum, dated 16 June 2001. Exhibit R 68.

145 Memorandum, dated 25 February 2000, from Dan Pearson. Exhibit R 67.

190. For example, the CRA's Mr. Connor later reported on a meeting that he held with Greg Frazier, U.S. Agricultural Trade Ambassador:

> Greg informed me that the Zedillo/Clinton discussions were preceded by a more substantive meeting between Mexican Secretary Blanco and U.S. Trade Ambassador Charlene Barshefsky. Blanco was apparently interested in having the two Presidents outline vague details of a possible agreement. But Barshefsky insisted that they report that good progress had been made to date and negotiations should continue. They agreed that the deadline for concluding these discussions should be "well in advance of October 1." Both sides apparently understand that "well in advance" means August 1, 2000.
>
> Greg met with the U.S. sugar industry earlier this week to measure their reaction to the plan. He reports that the American Sugar Alliance insists that any deal including the following:
>
> 1. Any sugar imports from Mexico must be "needs based";
> 2. Elimination of tier-two sugar;
> 3. Cannot preclude other legal challenges (no peace clause);
> 4. Mexico must reduce subsidies to their domestic sugar industry; and
> 5. Any deal must be long term (2008) or more.[146]

191. These conditions, in particular, numbers 1 and 2, as already noted, were completely unacceptable to Mexico. Essentially, the ASA wanted to roll back a part of the bilateral agricultural bargain that offered significant opportunities to the Mexican sugar sector. On the ASA's approach, Mexican sugar would be permitted into the United States when the U.S. industry thought it was "needed".

192. It may be mentioned that at this time, the United States sweetener industry was experiencing the combined effect of both excess HFCS production and excess production of refined sugar, reducing the price of sugar at its lowest level in 15 years. For a discussion of the United States sugar surplus in the 1990s, see Appendix B of this pleading.

193. The 1 August 2000 deadline to which Ambassador Frazier referred was not met. On 10 August 2000, a CRA delegation met with Ambassador Frazier and the Deputy Assistant USTR for Mexico, John Melle, to discuss the negotiations with Mexico regarding the sweetener market. The note records the view of Dan Pearson of Cargill that the United States did not want to submit to a NAFTA Panel:

> <u>Frazier clearly does not want Mexico to request the formation of a panel under its NAFTA Chapter 20 case to clarify the meaning of the sugar side letter.</u> He thinks that U.S. sugar interests won't want negotiations to continue if the Chapter 20 action is moving forward. He has cautioned de la Calle that seeking a panel would have the effect of shifting the issue out of the control of trade negotiators; they would have to read what was happening in the newspapers instead of being at the center of the action.

[146] Memorandum dated 16 June 2000. Exhibit R 68.

> Frazier speculated that hard-liners in SECOFI and the Mexican sugar chamber are pushing for the Chapter 20 panel in the hopes that this would lead to increased tensions and have the effect of closing the border to sweetener trade. If Mexico could eliminate HFCS imports and cut off corn imported for use in domestic HFCS production, its sweetener demand would be equal to its domestic sugar production. Although there was no way to tell, Frazier's concern about a Chapter 20 panel could be driven by doubts as to whether the U.S. position would prevail.[147] [Emphasis added.]

194. It has already been seen that on the same day that Mexico requested the establishment of the Panel, 17 August 2000, the ASA issued a press release expressing its "shock and great disappointment" that Mexico would invoke its NAFTA dispute settlement rights.[148]

195. From that point on, the ASA and its members exerted pressure on the government of the United States to not submit to dispute settlement.[149] Mexico has already defended two of the three Chapter Eleven claims brought by the U.S. HFCS producers and it has yet to see any evidence that the corn refiners members of the ASA disassociated themselves from the ASA's attempts to pressure the United States government to resist NAFTA dispute settlement.[150]

196. An example of the ASA's advocacy efforts can be seen in testimony given by its Director of Economics and Policy Analysis, Mr. Jack Roney, before the United States Senate in July 2001:

> **Address the Mexico Access Issues**. The NAFTA requires the United States to: import up to 276,000 tons of sugar per year duty-free from Mexico through 2008, whether we need the sugar or not; reduce our second-tier tariff on sugar imports from Mexico to zero by 2008; and have free trade in sugar with Mexico beginning in 2008.Mexico is disputing the legitimacy of the NAFTA sugar provisions, and is claiming, through a dispute resolution process it initiated, that Mexico should have virtually unlimited duty-free access to the U.S. sugar market, beginning this year. Furthermore, unlimited quantities of second-tier Mexican sugar could swamp the U.S. market at any time….The U.S. is abiding by its NAFTA sugar commitments. However, the U.S. sugar market is oversupplied, financially depressed, and does not need an additional pound of Mexican sugar. Furthermore, the Mexican sugar surplus that it seeks to unload on the U.S. market is the result of Mexican government subsidies so generous that, since the NAFTA began, production has increased far in excess of Mexican needs.

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147 Memorandum dated 11 August 2000. Exhibit R 69.

148 Exhibit R 70.

149 Witness statement of Dr. de la Calle, ¶ 47. Exhibit R 01A.

150 Mr. Connor of the CRA had this to say about Mexico's invocation of Chapter Twenty: "…Greg Frazier informs me that USTR has now received a formal request to establish a NAFTA panel to review the validity of the so-called sugar side letters. This request will result in some sharply worded rhetoric from both sugar industries and both governments. Nevertheless, I am convinced that it is a necessary step before the settlement negotiations can proceed. In effect, nobody seeks a truce when you still have weapons to fire. USTR will respond by suggesting that Mexico's access for sugar on October 1 will be at or near zero..." Exhibit R 71.

> …
>
> *Unless the Mexican access problems are resolved, no long-term sugar policy that we propose here today could possibly be effective.*[151]
>
> [Boldface and italics in original]

197. Mr. Roney also noted in his Senate testimony that the U.S. industry was: "[t]hreatened by lack of control of our borders from subsidized sugar, more specifically, by … second-tier sugar from Mexico" and that "U.S. sugar industry fully supports efforts by the Administration to renegotiate sugar access provisions of the NAFTA in a manner that will restore balance to the sugar markets of both countries."[152] These conclusions reveal the U.S. industry's strong opposition to the liberalization agreed upon by the United States and Mexico in the NAFTA.

198. Throughout this time, the ASA advocated its position on behalf of both the sugar and HFCS producers. For example, on 4 December 2001, the ASA's Mr. Roney appeared before the U.S. International Trade Commission (ITC) to give testimony on the ITC's study into "significant U.S. import restraints" (*i.e*, the Sugar Program's TRQ). Noting that the "ASA is the national coalition of growers, processors , and refiners of sugarbeets, sugarcane, and corn for sweeteners", Mr. Roney described, among other things, the way in which the Sugar Program protected the HFCS industry and criticized the ITC's study of that program:

> "The U.S. sugar and corn sweetener industry's vulnerability to unmitigated exposure to world dump market sugar is greater than observed in previous work by the USITC…"
>
> "…the USITC ignored the jobs generated by the corn sweetener industry, which is also dependent on U.S. sugar policy to prevent lower-price, subsidized world dump market sugar from replacing U.S. high fructose corn syrup."
>
> "U.S. corn sweetener producers are the most efficient in the world. But current world sugar price levels, around 6-7 cents per pound, are well below even U.S. HFCS production costs. In the absence of U.S. import restraints, it is highly likely that low-priced dump-market sugar would replace not only U.S. sugar production, but also U.S. corn sweeteners."
>
> "Elimination of the U.S. sugar import restraints and support-price program would be devastating to American sugar and corn farmers and processors, and would result in severe economic costs to American consumers…"
>
> "Corn sweeteners – half the U.S. caloric sweetener market - would also be

151. Mr. Roney's Testimony, p. 15. Exhibit R 08.

152. Ibid.

> severely threatened at world dump market refined sugar price levels that have long been below U.S. HFCS prices and remain so…"[153]

199. In the two following years (2002-2003), the U.S. HFCS and sugar industries and the Mexican sugar industry held many meetings without any results. During this time, while the ASA was seeking to restrict Mexican sugar access, the CRA worked with its U.S. Congressional allies to threaten U.S. countermeasures against the Mexican countermeasures against the United States over the inability to find a solution to its market access grievance and the continued obstruction of the dispute settlement mechanism. Cargill has presented documents that show that the CRA worked with the leader of the Senate Finance Committee, Charles Grassley of Iowa, to introduce the "Special 301" legislation to respond to countries, particularly Mexico, whose tax had been labeled by the CRA president, Audrae Erickson, as "the poster child" to use for his new legislation.[154]

200. An e-mail from Ms. Erickson of the CRA to an employee of Senator Chuck Hagel is illustrative:

> Per your recent conversation with Jeff Cotter of Cargill, please find attached a draft letter from Senator Hagel to Ambassador Zoellick. As you know, we are working closely with USTR on this issue and they have been very supportive of Congressional pressure - <u>calls for retaliation in particular</u> – to resolve the sweetener dispute. Please feel free to call John Melle, Deputy Assistant USTR for Mexico/Canada for additional information in that regard… <u>It is very important that a letter from Senator Hegel mention the possibility of retaliation specifically</u>. Otherwise, the Mexicans will view the letter as a softening of the U.S. Congressional position on this issue.[155] [Emphasis added]

201. Senator Grassley's threat of reprisal lead the president of the *Cámara Nacional de la Industria Azucarera y Alcoholera* (CNIAA) to write a letter to the senator reminding him of the entire dispute's unfortunate history:

> …I sincerely appreciate your frustration with this situation and its impact on your constituents, but felt it necessary and appropriate to communicate with you our equal frustration with the chronic failure of the United States to live up to its obligations under NAFTA concerning market access for Mexico's sugar.
>
> …
>
> The validity of the side letters and the United States' one-sided interpretation of the agreement is the basis for a demand by Mexico for a

153. Mr. Roney's Testimony, Director of Political and Economic Analysis, American Sugar Alliance, International Trade Commission Investigation No. 332-325, *The Economic Effects of Significant U.S. Import Restraints: Third Update*, 4 December 2001, pp. 2, 6, 17. Exhibit R 72.

154. See Exhibit R 73.

155. Email dated 20 November 2003, from Audrae Erickson to Dan Archer. Exhibit R 74.

> NAFTA dispute settlement Panel. That Panel, requested more than three years ago, was never seated because the U.S. repeatedly blocked the appointment of the requisite panellists. In the meantime, the U.S. government and industry have attempted to threaten and cajole Mexico and its industry into renegotiating the NAFTA sweetener provisions in a manner that would cede our domestic market to imported HFCS made with subsidized corn without reciprocal access for our refined sugar that is displaced in the process.
>
> Just as the importance of corn and HFCS production is an important economic, social and political constituent interest motivating your introduction of the legislation last week, the critical social and economic importance of sugar production to hundreds of Mexican communities and the millions of Mexicans that depend on it for their livelihood prompted the implementation of the so-called HFCS tax. The tax, Senator, is the product of our frustration and exasperation at the unwillingness of the United States and its industry to act as an honest broker in seeking a fair and responsible resolution to this long-festering bilateral sweetener dispute…[156] [Emphasis added]

202. Cargill's own documents demonstrate the power of the ASA and its allies in Washington. Having seen the ASA's effectiveness in advancing its agenda to restrict Mexican sugar imports, an email communication from Cargill's Rob Johnson to Pat Bowe and Martin Muenzmaier, dated 17 June 2004, commented:

> I agree that the US sugar industry has been the biggest problem in resolving the dispute in line with the general goals of the NAFTA.[157]

203. Mr. Bowe responded in similar terms:

> Warren had met with pres. Fox a year ago December when Fox told Warren a deal was done. It then was stalemated on the US side. All along the Mexicans have not really been the problem as much as the US sugar industry and their deep rooted political connections... [158]

204. The CRA also appeared to be privy to the U.S. Government's reasons for not submitting to NAFTA dispute settlement. Another an email of Cargill from Audrae Erickson, Mr. Connor's successor as president of the CRA, dated 13 January 2006, discussed Mexico's threat to impose another measure in place of the tax after it lost the WTO case:

> …Minister Garcia de Alba has been quoted in the Mexican press stating that Mexico's next measure will be to raise Mexico's tariff on HFCS to the WTO level (thereby complying with WTO rules), but that would force us to a NAFTA panel, which we clearly do not want. Nor does the U.S. administration want to litigate the validity of the NAFTA side letter in the

156. Setter from José O. Menchaca to Senator Charles Grassley, 3 December 2003. Anexo R 75.

157 Internal Cargill emails dated 16 and 17 June 2004. Exhibit R 76.

158 Ibid.

> remaining months of the President's TPA [Trade Promotion Authority]. If Mexico plays that card, it will result in severe political fallout between Mexico and the United States… [159] [Emphasis added.]

205. The risk to which Ms. Erickson was alluding was the prospect that Mexico's view of what actually occurred in the side letter negotiations might be accepted by the Chapter Twenty Panel.[160]

e. The "New Look" American Sugar Alliance

206. Not entirely coincidentally, in Mexico's view, after the corn refiners' membership in the ASA was brought to the attention of the *CPI* and the *ADM/TLIA* tribunals, the ASA's website and publications suddenly and dramatically changed: ADM was no longer listed as a member of its Executive Committee. Martin Andreas, Senior Vice President and Assistant to the Chairman of ADM, was no longer listed as the ASA's Vice-Chair. A number of references to the ASA's representing the corn growing, processing and refining industry were purged from the website.[161] Recently, the ASA has ceased to underscore the link between sugar and corn. On the ASA's Annual International Sweetener Symposium formerly highlighted the "U.S. sweetener industry" as being "made up of more than one million beet, cane and corn farmers who produce sugar and corn for sweetener, as well as thousands of other Americans who work in sweetener production and processing…"[162], its 2006 brochure was more terse. The sugar-corn linkage is no longer so prominently emphasized.

207. The corn growing, processing, and refining sectors are now described as "others dedicated to preserving a strong domestic sweetener industry".[163] Yet even after its make-over, in June 2006, the ASA's Mr. Jack Roney was still describing the American Sugar Alliance in testimony before the U.S. International Trade Commission as:

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[159] Email dated 13 January 2006, from the CRA's Audrae Erickson to Pat Bowe, Jeff Cotter and others at Cargill. Exhibit R 77.

[160] U.S. government sensitivity to Mexico's intended Chapter Twenty challenge continues. Mexico found it necessary to refresh its request for consultations in order to expand them to include the United States' obstruction of NAFTA dispute settlement. When the U.S. Administration was advised of Mexico's intention to establish the Panel now that it can compel one under the Article 2010 Roster of Panelists, agreed with effect as of 1 December 2006, senior U.S. officials requested that Mexico not send the request until after the scheduled visit of President Bush to Mexico in mid-March 2007. Mexico complied out of courtesy. Exhibit R 122. See also, letter of Undersecretary Beatriz Leycequi to the ADM/TLIA Tribunal, dated 20 March 2007. Exhibit R 78.

[161] It appears that this occurred in February 2006. Even so, in an effort to show how broadly based the U.S. sweeteners industry is, the revised ASA website still displays the corn-growing states and the corn wet milling/factory locations.

[162] ASA 21st International Sweetener Symposium, 2004. Exhibit R 79.

[163] American Sugar Alliance 23rd International Sweetener Symposium, 2006. Exhibit R 80. Even so, the Director of Economics and Political Analysis of ASA, Jack Roney, recently appear before the United States International Trade Commission on June 16 2006, and described the ASA as *"the national coalition for growers, processors and refiners of sugar beets, sugarcane and corn for sweeteners*". Exhibit R 81.

> "… the national coalition of growers, processors, and refiners of sugarbeets, sugarcane and corn for sweeteners."[164]

208. This evidence assists in explaining why the United States rebuffed Mexico's attempts to submit its market access grievance to Chapter Twenty and why the proposals for a resolution of the dispute were so unbalanced. The United States government was under tremendous pressure from the ASA. While the evidence suggests that Cargill did not share the ASA's views or indeed those of ADM, the fact remains that the ASA, acting on behalf of its members, including its HFCS producer members, pushed for greater restrictions on Mexican sugar imports and pressured its government not to submit to dispute settlement under Chapter Twenty.

209. It is therefore evident that, in addition to the U.S. government's reasons for not submitting the dispute to NAFTA Chapter Twenty, there was strong pressure against the resolution of Mexico's grievance, which would improve its market access. These are the facts that led the Mexican Congress to act.

7. Executive Action

210. Mexico applied an 18% MFN tariff rate on HFCS imports. In other words, with the exception of the rates negotiated in free trade agreements, the rate applicable to HFCS imports was 18%. However, the WTO consolidated tariff rate was 210%, with one exception with an applicable rate of 156%.[165] On 11 October 2001, the Executive raised the MFN tariff rate applicable to HFCS imports to the maximum level permitted under the WTO.[166]

211. On 31 December 2001, the Executive published a Decree that established new tariff rates applicable to the importation of goods under the NAFTA and other trade agreements for 2002.[167] U.S. HFCS imports would now require a permit issued by the Secretary of Economía. In case the importer had no permit, the importation would be subjected to the MFN tariff established in the Decree of 11 October 2001. The Decree of December 2001 establishes:

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[164] Exhibit R 81.

[165] The consolidated tariff is the tariff included in the WTO's members lists of concessions under Article II of the GATT of 1994, which they are obliged to maintain. However, it is common for a member to apply a lower tariff, the "applied tariff", while retaining the faculty of increasing such tariff to the consolidated tariff level.

[166] See "*Decreto por el que se modifican diversos aranceles de la Tarifa de la Ley del Impuesto General de Importación*" (Decree by which several tariffs of the Law on the General Import Tax are modified), published in the Diario Oficial de la Federación [Mexico's oficial gazzette] on 11 October 2001. Exhibit R 82.

[167] The NAFTA like many other free trade agreements, does not specify the applicable annual tariff rate during the tariff-elimination period; distinct "speeds" or "categories" were negotiated; goods would be liberalized according to the corresponding negotiated schedule. Within the NAFTA, four categories were negotiated, identified with the letters A, B,C, and D. Tariffs applicable to goods classified under category A were eliminated on the date the Treaty entered into force; the tariffs applicable to goods classified in category B were eliminated in 5 years; the tariffs applicable to category C goods were eliminated in ten years; and category D goods were free of any duties and remained that way after the NAFTA entered into force (other goods, for example sugar, were liberalized differently). For this reason, the Federal Executive has published year after year a decree that translates it into a specific tariff rate or specific tariff.

> ARTICLE 49.- The importation of North American goods contemplated in the tariffs identified with a "PFR" code in the "Note" of the Appendix, would be subject to the tariff under the column "EE.UU." of the Appendix, provided that the importer attaches to the importation documents an import permit issued by the Secretary of Economía. If this condition is not fulfilled the rate contemplated in Article 1 of the Law on the General Tax on Imports will apply [that is the rate the Executive modified by means of the Decree of 11 October 2001] without any reduction. <u>Said permit would be granted automatically by the Secretary of Economía in accordance with the international rights and obligations acquired by Mexico. If, after publishing it in the Official Gazette, the Secretary of Economía announces that the Federal Government has decided to suspend the preferential benefits derived from the North American Free Trade Agreement, in accordance with Mexico's rights and obligations, due to the United States' lack of compliance with the obligations acquired by its government in the trade in sweeteners or other products, the Secretary of Economía will cease granting, or will limit the issuance of the import permits referred to in this article</u>.[168]
>
> [Emphasis Added]

8. Suspension of the Tax

212. On 5 March 2002, the Executive decided to suspend the application of the tax by means of a Decree.[169] Dr. de la Calle explains:

> 52. The adoption of the tax by Congress was understandable given the long history of the dispute with the United States, the numerous meetings and discussions held during several years in order to find a negotiated solution, and the reiterated refusal of the United States to subject itself to dispute settlement. In fact, Congress' objective was the same as that of the Administration; however the Executive never considered the tax to be an adequate measure. We agreed completely with the Congress' objective but disagreed as to the means. We considered Congress' intervention, via a tax, to re-orient production to be an error in policy and were concerned it could set a negative precedent. Consequently, the President published a decree suspending the tax.
>
> 53. In the meantime, the measure adopted by the Executive in December was still in force and the Secretary of Economía decided to grant an import quota for HFCS of 148,000 tons with the NAFTA. The

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168 See "Decreto por el que se establece la Tasa Aplicable para el 2002 del Impuesto General de Importación para las Mercancías Originarias de América del Norte, la Conunidad Europea, los Estados de la Asociación Europea de Libre Comercio, el Estado de Israel, el Salvador, Guatemala, Honduras, Nicaragua, Costa Rica, Colombia, Venezuela, Bolivia, Chile y República Oriental de Uruguay", published in the Diario Oficial de la Federación [Mexico's oficial gazzette] on 31 December 2001. Exhibit R 131.

169 *See Decreto por el que se exime del pago de los impuestos que se indican y se amplia el estimulo fiscal que se menciona* (Decree by means of which payment of the referred taxes is exempted and the referred fiscal incentive is extended.), 5 March 2002. Exhibit R 83.

> quota was equivalent to the US quota for Mexican sugar. Any imports exceeding the quota would pay the MFN tariff.[170]

213. On 22 April 2002, the Secretary of Economía suspended the automatic issuance of import permits for HFCS with the preference contemplated in the NAFTA and established an import quota of 148,000 tons, which was equivalent to the sugar quota the United States assigned México during that marketing year.[171] The *Acuerdo* states:

> That the sugar industry is an activity of high social impact because of its production and the employment it generates [sic]; that sugar as the product generated by it is a staple good and, by reason of its high caloric content, constitutes a basic element in the diet of low-income population; and that the activities it consists of, such as the sowing, the harvest and the industrialization of the sugar cane, are of public interest;
>
> That the national sugar industry is experiencing a severe crisis, which prompted the Executive to expropriate 27 sugar mills by means of an expropriation decree (Decreto por el que se expropian por causa de utilidad pública, a favor de la Nación, las acciones, los cupones y/o los títulos representativos del capital o partes sociales de las empresas que adelante se enlistan) published in the official gazette (Diario Oficial) on 3 and 10 September of 2001;
>
> That the causes of "public utility" on which the expropriation was based, refer to the fulfillment of collective necessities linked to the supply of food and other staple goods to cities and populated areas; to the defense, conservation and development of natural resources; the creation, promotion or conservation of an enterprise for the benefit of the collective; as well as the preservation of activities of public interest, such as the sowing, the harvest and the industrialization of the sugar cane;
>
> That more than two million Mexicans depend on the sugar industry, since it generates employment in both the sugarcane fields and the factories dedicated to the processing of the sugarcane;
>
> That on 20 December 1993, the North American Free Trade Agreement was published in the official gazette;
>
> That as a result of NAFTA negotiations a balance in the sweetener sector was sought with the purpose of establishing conditions for Mexican Sugar access [to the US market] and US HFCS, until free trade could be achieved in both products in January of 2008;
>
> <u>That the United States of America has refused to provide access to Mexican sugar in the terms established in Annex 703 of the NAFTA</u>;

[170] Testimony of Luis de la Calle. Exhibit R 01A.

[171] See *Acuerdo por el que se establece un cupo de importación a la frucosa de los Estados Unidos de América* (Agreement that establishes an import quota on fructose from the United States of America), 22 April 2002. Exhibit R 84.

That, because of the breach by the United States of America, the situation of the national sugar industry is seriously threatened by US HFCS imports into Mexico under the NAFTA, because, being that sugar and HFCS are perfect substitutes for certain industrial uses, the domestically-produced sugar is displaced, while the surpluses cannot be exported in the equilibrium terms provided by the NAFTA;

That the United States of America has refused to settle the dispute through the appropriate channels created by the NAFTA;

That in such circumstances, the Convention of Vienna on the Law of Treaties, published in the official gazette on 14 February 1975, allows the Mexican authorities to adopt the measures it deems necessary to face the situation.

That the purpose of such measures is to restore the balance in the sweetener sector negotiated in the NAFTA by suspending concessions granted to the High Fructose Corn Syrup [sic].

That the United States of America granted an import quota of 148,000 tons to Mexican sugar; that measure adopted by the Mexican government will have to be in accordance with it, and that with the objective of balancing the sweetener sector and establishing favorable conditions for the trade of Mexican sugar and US HFCS, it is advisable to apply the mechanism of direct allocation;

That article 49 of the Decree which establishes the applicable rate for the 2002 General Import Tax for merchandise from North America the European Community, the States of the European Free Trade Association, the State of Israel, El Salvador, Guatemala, Honduras, Nicaragua, Costa Rica, Colombia, Venezuela, Bolivia, Chile and the Eastern Republic of Uruguay, stipulates that the import of US HFCS will be subject to the preferential tariff indicated in the column labeled "EE.UU." of the Appendix of this Decree, provided that the importer encloses an import permit issued by the Ministry of Economy to the pedimento, and that if such prerequisite is not fulfilled the applicable rate will be the one prescribed in the Import Tax Law without any reduction;

That, the second paragraph of Article 49 of the Decree indicates that, in case the Federal Government decides to suspend the preferential tariff established in the NAFTA, by reason of a US breach of its treaty obligations regarding sweeteners trade, the Secretariat of Economy will restrict the issuance of import permits for US HFCS;

That on 18 January 2002, the Ministry of Economy published the Import and Export Tax Law in the official gazette which came into force on 1 April and derogates the Import Tax Law of 18 December of 1995, and

> That on 9 April of the present year, the Commission of Trade (Comisión de Comercio Exterior) gave its favorable opinion to this measure…[172] [Emphasis added.]

214. The suspension of the tax by the Executive caused a debate in Congress. The Executive and Congress agreed on the ends, but differed on the means to accomplish them. In the Senate, Senator Raymundo Gómez Flores, suggested a compromise "in order to exhort the Head of the Federal Executive to resolve, within its faculties, the serious problem faced by the national sugar industry". Senator Gómez stated:

> In addition to the structural problems faced during the last decade, the Sugar Industry is now facing a structural crisis, characterized by a substantial surplus that tends to grow due to the competition of imported or domestically produced HFCS from subsidized corn imported into Mexico at a symbolic tariff. This crisis would find its way towards an equilibrium and a solution if the original terms of the North American Free Trade Agreement concerning the trade in "sugars and syrup goods" and access to the U.S. market were observed.
>
> The execution of the NAFTA provided an incentive to the industry and the agreements, which were approved in 1993, established that the sugar export flows between the countries would be calculated based on each country's surpluses. The surplus is calculated as the estimated sugar production, minus the projected consumption. The Treaty itself establishes that starting on marketing year 2001, Mexico would have the possibility of exporting all of its surpluses to the United States, duty-free; however, the neighboring country has decided to limit our right to export by changing the original [surplus] calculation established in the NAFTA on the pretext of some parallel documents exchanged by trade authorities of both countries that were never ratified by the Mexican Senate.
>
> At some point, the sugar industry requested the then-SECOFI to review the facts and initiate antidumping proceedings, and hence, SECOFI established countervailing duties to HFCS that helped to reduce the progress of the sweetener, although it did not stop domestic production from subsidized imported corn which did not even pay the tariff stipulated in the NAFTA.
>
> In October 2000, following a proposal made to the Senate by a parliamentary group from my party in, a punto de Acuerdo [an agreement] was reached, demanding full compliance with the terms of the NAFTA and stating that the side-letters were never approved by the Mexican Senate.
>
> In exercise of our right to provide the sugar industry with a support mechanism that ensures the disposal of sugar surpluses, the Legislative Power approved last month, in December, an addition to the Federation

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172 *Ibid*.

> Income Law for fiscal year 2002, that establishes a 20% tax on HFCS used by the soft drink industry to the detriment of the sugar industry.
>
> This stipulation [the tax] was temporarily suspended by means of a Decree published by the Federal Executive on 5 March, deferring the application of the tax for 7 months, which left the basic industry of the Mexican countryside in a state of defenselessness.
>
> The Legislative power is obliged to continue the National Sugar Sector's defense, either through negotiations and agreements or through other existing legislative and judicial means.
>
> The stability of the cañero [sugarcane] countryside, which supports nearly 3 million Mexicans and the viability of a fundamental industry, depends on it.
>
> This legislative body considers unacceptable that Mexico continues to comply with international commitments to the detriment of its responsibility to defend its national interests above any other considerations.
>
> Considering the above, and seeking to contribute to a solution to the complex problem faced by the sugar industry and based on the Articles 71(II) of the Political Constitution of the United Mexican States, and Section II of Congress' Interior Government Regulation, I submit the following proposal for your consideration:
>
> PUNTO DE ACUERDO [Agreement]
>
> First, members of the LVIII Legislature of the Senate exhort the head of the Federal Executive Power to make use of all foreign policy instruments at its disposal to compel the Untied States to comply with the NAFTA, which establishes our country's right to export our sugar surplus to the U.S. market…[173]

215. In his witness statement Mr. Guajardo adds:

> 28. Congress adopted the tax precisely because of the damage suffered by the Mexican industry and sugarcane sectors as a consequence of the NAFTA violations by the United States. The Executive had no power to suspend the application of a tax mandated by Congress. Neither was there a solution to the dispute concerning Mexican sugar exports nor had a panel been established, notwithstanding the more than a year and half passed since it was requested.
>
> 29. That was what clearly motivated the debate within Congress. The Deputies considered that the United States would continue to

[173] Speech by Senator Raymundo Gómez Flores when presenting an agreement proposal in regard to the sugar industry, 19 March 2002, p. 1. Exhibit R 85.

> inappropriately benefit its productive sectors by violating its international obligations at the expense of Mexican producers.[174]

216. At the podium, Mr. Guajardo stated:

> Sadly, they have not understood that the tax approved by this Sovereignty in addition of protecting the national sugar industry, is or could have been a valuable negotiation instrument vis-à-vis the neighboring country to the North. The NAFTA agreements signed by the country would not be infringed with this decision.[175]

217. During the same session, Senator Gerardo Buganza stated:

> We created a Special Follow-Up Commission for the expropriation process to ensure that the mills would be returned to the private sector within 18 months, in that instance Congress support was also needed and provided to the Executive, we explained to the United States, through our counterpart, the American Senators, that the application of the side-letter was inappropriate, and I don't want to get into the story of Kantor or Serra Puche, we simply went to the U.S. Embassy to see whether a change in [the trade in] sweeteners was something they were willing to discuss.
>
> Of course, after nothing happened in December, Congress determined to establish this tax on the use of sweeteners other than sugarcane sugar specifically on soft drinks and we believe that this was a measure to increase sugar consumption and help the sugar industry.[176]

218. Mr. Guajardo states:

> 31. … [I]t was not the first time that the United States refused to comply with its NAFTA obligations. In a different case, the cross-border trucking services case, the United States had violated its commitment of allowing Mexican transport vehicles to enter into its territory. Mexico also initiated dispute settlement proceedings in this case. SECOFI requested the establishment of a panel during the fall of 1998. Throughout the time I was employed by the Secretary, the United States refused to constitute the panel. Finally, after 15 months of delay the United States decided to name panelists. The panel issued a resolution favorable to Mexico in February 2001. By the time I appeared before Congress with regard to the suspension of the tax by the Executive, more than a year had passed since the panel issued its resolution and the United States still had not complied with it. I alluded to this during my intervention.

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[174] Testimony of Ildefonso Guajardo. Exhibit R 01C.

[175] Transcript of the session of the Congress' Permanent Commission (Comisión Permanente del Congreso de la Unión) of 6 March 2002, p. 3. Exhibit R 86.

[176] Ibid, ps. 13-14.

> 32. The Executive had not been able to reach an agreement with the United States to resolve the sugar dispute. As long as fructose continued to gain a bigger share in the Mexican market and Mexican sugar was prevented from entering into the United States, the United States had no incentive to reach an agreement. With the adoption of the tax, Congress gave the Executive a negotiating instrument to reach a solution. I pointed this out during another intervention before Congress in April of 2002.
>
> The interest we had in Congress was to resolve the dispute; to restore equilibrium.[177]

219. Congress submitted a constitutional controversy to the Supreme Court; the Supreme Court ruled that the Executive lacked legal faculties to suspend the tax and ordered the reenactment of the tax. The Executive abided by the Supreme Court's ruling.

I. Summary of the Facts

220. In summary:

- Since the NAFTA's entry into force, Mexico has considered that its domestic sugar industry was entitled to greater access to the U.S. market than that which was effectively provided by the United States.

- The United States restricted the access of Mexican sugar surpluses to its market. The alternatives for Mexico's industry were to sell in the world market at a significant loss, sell it in the domestic market, thereby further depressing prices and incurring significant losses in the process, or incur the high cost of storing the sugar and face price suppression due to the existence of an overhang of large sugar inventories.

- Mexico faced growing HFCS market penetration that was displacing Mexican sugar from a traditional market segment, further exacerbating the surplus.

- Mexico sought to have its market access complaints resolved through the NAFTA's institutional Chapter XX dispute settlement procedure.

- The United States' competent authorities, the USDA and the USTR acknowledged the existence of a bilateral dispute, but the United States trade authorities refused to submit to dispute settlement under Chapter Twenty of the NAFTA.

- Mexico also sought a negotiated solution, but has been unable to find one.

- Since NAFTA's early years, Mexico and the United States have held several meetings and negotiations in which Mexico explained its position on the interpretation and application of the NAFTA; the difficulties faced by the Mexican sugar industry as a result of HFCS' penetration of the Mexican market; the

[177] Testimony of Ildefonso Guajardo. Exhibit R 01C.

necessity of having the dispute settled in a way that would allow both products to compete in conditions of equilibrium; the importance of resolving the dispute through the dispute settlement procedure; and the possibility of adopting measures if all other options failed.

- In the context of an ongoing dialogue regarding the problem, Mexican officials warned the U.S. that Mexico would have to take action to protect its own interests under the NAFTA.[178]

- Notice of the measures was given and received by the United States in a timely manner and consistent with the applicable rules of international law.

- Mexico adopted countermeasures only after the efforts to establish the Panel and to find a negotiated solution failed.

- Until the tax, the impact of U.S. restrictions and the burden of NAFTA adjustment had fallen solely on the Mexican industry, which was already facing serious difficulties.

- The measure claimed by Cargill was commensurate with the damages suffered by Mexico.

[178] Testimony of Luis de la Calle, ¶ 47. Exhibit R 01A.

III. LEGAL ARGUMENTS

A. Jurisdictional Objections

221. Mexico requests that, pursuant to Article 45 of the Arbitration (Additional Facility) Rules of the ICSID, the Tribunal rule that it lacks jurisdiction to hear this dispute.

222. Even if the Tribunal were to determine that it has jurisdiction to hear Cargill's claim or a part thereof, Mexico considers it crucial that the Tribunal issue its determination before the proceedings on the merits continue. This would avoid unnecessary briefings by the parties and the corresponding costs and resources dedicated to this claim.

223. Cargill's claim is an effort to copy the claims of other U.S. manufacturers of high fructose corn syrup (HFCS) in the cases of *CPI* and *ADM/TLIA*. However, Cargill's situation differs because it does not have a subsidiary that manufactures HFCS in Mexico and Cargill is claiming substantial damages based on its investments in facilities in the United States. Additionally, its claim differs in that it is seeking damages based on the imposition of an antidumping order on HFCS and on the adoption of an import permit measure, both of which relate exclusively to trade in goods and not investment.

224. The arbitration claim has numerous deficiencies that cannot be remedied:

- Consistent with the territorial basis of the NAFTA, Chapter Eleven is designed to afford protection to investments of persons of a Party <u>in the territory of another Party</u>. A private party can invoke Chapter Eleven only in respect of another Party's treatment of the Claimant and/or its investment <u>within</u> that other Party's territory. Cargill's HFCS manufacturing facilities are in the United States and not Mexico. Therefore, no action or omission of Mexico can give rise to a Chapter Eleven claim

- The Tribunal lacks jurisdiction over Cargill's claim for damages based on the imposition of antidumping duties on imported HFCS for two principal reasons. First, that claim is time-barred because Cargill did not bring this claim within three years from the date it became aware of the antidumping measure. Second, antidumping measures are governed exclusively by NAFTA Chapter Nineteen and are not investment measures. In any event, Cargill was made whole by the refunding of the antidumping duties years ago by Mexico, and Cargill itself says that the antidumping case affected its access to the market only until the end of 2001[179].

- Similarly, Cargill's claim of a violation of the most-favored-nation treatment obligation of Article 1103 – on the basis that imports of HFCS from Canada were theoretically accorded better treatment than imports from the United States – is also beyond the Tribunal's jurisdiction for two related reasons: First, Cargill has not identified any investment of a Canadian investor <u>in Mexico</u> that allegedly received

179 Memorial, ¶ 101.

better treatment than the investment of a U.S. investor. Second, a complaint that more favorable treatment has allegedly been accorded to a product of another NAFTA Party is one directed at the treatment of a good, not an investment.

- The claim based on the imposition of the import permit requirement is also beyond the Tribunal's jurisdiction because that measure involves trade in goods and is governed by Chapter Three, not Chapter Eleven.

225. Each of these defects is addressed below.

1. Chapter Eleven does not afford protection to an investor's investments in its home country

226. In accordance with the customary rules of international law, set forth in the Vienna Convention on the Law of Treaties, it must be borne in mind that the Chapter Eleven falls within a broader free trade agreement which provides for the liberalization of trade in goods and services by producers situated in the territories of the Parties.

227. With respect to trade in goods, the NAFTA contemplates that goods produced in the territory of one Party may be exported to the territory of one or the other NAFTA Parties. Chapter Three, "National Treatment and Market Access for Goods", establishes the rules governing the treatment that the importing Party must accord to such goods. Should one NAFTA Party consider that another Party is not complying with its Chapter Three obligations, it may request consultations under Article 2006, and if those fail to resolve the matter, it may proceed to State-to-State dispute settlement under Chapter Twenty. A private party has no right of standing to invoke Chapter Twenty dispute settlement.[180]

228. As a general rule, the NAFTA's mechanism for the settlement of disputes is established in Chapter Twenty. There are two exceptions to that rule: (i) investor-State arbitration for an alleged breach of a specified, and exhaustive, list of obligations contained in Section A of Chapter Eleven and two sub-paragraphs of certain obligations in Chapter Fifteen; and (ii) Chapter Nineteen binational panel proceedings for review of national trade remedy measures. Each provides private parties with direct access to international jurisdiction, but only in respect of a circumscribed subject-matter.

229. In other words, Chapter Eleven tribunals do not have authority to address violations of other chapters of the NAFTA, in the same way a Chapter Nineteen panel cannot address anything other than a review of a Party's final antidumping or countervailing duty determination.[181]

230. The premise of Chapters Three and Seven (the latter is the chapter on agriculture) as well as other chapters of the Agreement that provide for cross-border movement of goods, services and certain classes of professionals and businesspeople[182], is that producers of goods in one NAFTA

[180] This is plain from the terms of NAFTA Articles 2003-2019.

[181] See Article 1904(2).

[182] See NAFTA Chapters Six, Nine, Ten, Twelve, Thirteen, Fourteen, and Sixteen.

Party need not establish themselves in the territory of another NAFTA Party in order to serve that market. To the contrary, those chapters seek to reduce barriers to trade so that producers situated in one NAFTA Party enjoy better terms of access to the markets of each of the other NAFTA Parties than they enjoyed prior to the Agreement's entry into force.

231. However, while providing for the liberalization of trade in goods, the NAFTA did not go so far as to establish a full customs union or common market with no remaining restrictions on trade between the Parties.[183] Each NAFTA Party retains the right to restrict imports in accordance with the Treaty's terms, subject always to another NAFTA Party's right to have any such restriction reviewed by a panel for its NAFTA-consistency and its obligation to bring itself into compliance with any dispute settlement Panel report that may find against it.

232. Chapter Eleven provides for the liberalization of investment flows. While many commercial actors are content to take advantage of NAFTA's trade liberalization by producing goods or services which will then be exported to the territory of another Party, some find it advantageous to produce such goods or services in the territory of another Party by means of an investment. Hence, Chapter Eleven's role in the Treaty is to provide a measure of international law protection to persons who decide to make an investment in the territory of another Party.

233. Article 1101 establishes the Chapter's scope and coverage. Its meaning indicates that Chapter Eleven applies to measures relating to "investors of another Party" and "investments of investors of another Party in the territory of the Party." It is to be noted that the term "investor" is defined in Article 1139 as follows:

> **Investor of a Party** means a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment;

234. Thus, an "Investor of a Party" is a person that seeks to make, is making, or has made an "investment," and Chapter Eleven applies to measures relating only to "investments" of an investor of a Party in the territory of the NAFTA Party that has adopted or maintained the measure. Accordingly, the obligations of Chapter Eleven are owed by a NAFTA Party only with respect to an "investor" of another Party that seeks to make, is making, or has made an investment within its territory. This derives from the fact that the term "investment" is used to define "investor."

235. Just as the balance of the Agreement's chapters distinguishes between the goods, services and service providers, temporary business travelers, *etc*. of the Parties, Chapter Eleven employs a territorially-based distinction; Section B itself is entitled "Settlement of disputes between a Party and an Investor of Another Party". The operation of the Agreement as a whole is predicated upon distinguishing between goods, services, and investments based upon their origin (in the case of goods) or nationality (in the case of services or investment) and then establishing what treatment must be accorded to them.

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[183] Article 101, Establishment of the Free Trade Area, confirms that the Parties were establishing a lesser form of economic integration than a customs union or common market.

236. The scope of Chapter Eleven is set out in Article 1101, which states:

> (1) This Chapter applies to measures adopted or maintained by a Party relating to:
>
> (a) investors of <u>another</u> Party;
>
> (b) investments of investors of <u>another</u> Party <u>in the territory of the Party</u>; and
>
> (c) with respect to Articles 1106 and 1114, all investments in the territory of the Party. (Emphasis added.)

237. Thus, for a claim to be within the scope of Chapter Eleven, the Mexican governmental measures must "relate to" a U.S. (or Canadian) claimant as an investor in Mexico, or "relate to" investments of those U.S. (or Canadian) claimants "in the territory" of Mexico. In fact, Mexico is unable, as a legal matter, to adopt measures regulating investment in the United States or Canada, because Mexico lacks the jurisdiction to do so. Accordingly, it is not possible for a measure adopted by Mexico to relate, in the sense required by Article 1101, to investments of U.S. persons that are not in Mexico.[184]

238. The territorial limitations of Chapter Eleven are further reflected in the specific obligations it imposes.

239. Article 1102(1) and (2) obliges each NAFTA Party to accord to investors of the other Parties, and to investments of investors of the other Parties, treatment no less favorable that it accords, in like circumstances, to its own investors, and to investments of its own investors:

> with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

The Claimant's claim for damages for alleged harm to its U.S. operations would require the Tribunal to interpret this provision to apply to a *Mexican* measure that relates to "the establishment, acquisition, expansion, management, conduct, operation or sale or other disposition of investments" <u>in the United States</u>. But Mexico lacks jurisdiction to regulate investments within the United States in any manner. Article 1102 is plainly by its terms directed at comparing the treatment of nationals and foreign nationals within the national territory.

240. Besides the fact that the territorial limitation is obvious from its context and plain wording, Article 1102 imposes the requirement that the investors or investments be in "like circumstances." Persons in different countries cannot logically be "in like circumstances" for the purposes of

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[184] This limitation on the scope of Chapter Eleven is reflected in the U.S. Statement of Administrative Action (SAA) submitted to the U.S. Congress with the NAFTA for approval in 1993. The SAA's description of Chapter Eleven included the following statement:

> The chapter applies where such firms or nationals ["Investor of a Party"] make or seek to make investments <u>in another NAFTA country</u>.

(Emphasis added). SAA at 140, H. Doc. 103-159, Vol. 1, 103d Cong., 1st Sess. (1993) at 589.

evaluating the impact of a Party's measure that can have legal effect in only one of the two countries.

241. Likewise, Article 1105(1) (which is inapplicable to the principal measure at issue in this claim because, under Article 2103, Article 1105 cannot apply to a taxation measure) provides:

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

The "treatment" to which this Article refers similarly is the treatment accorded to investments of investors of another Party within the territory of the NAFTA Party whose conduct is at issue.

242. Article 1106(1) provides:

> No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory…

This Article expressly refers to performance requirements imposed on investments within the territory of the Party. Cargill's U.S. investments were not, and could not be, made subject to a performance requirement by Mexico.

243. Article 1110(1) provides:

> 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 …

This Article also expressly refers to the expropriation by a Party of an investment in its territory. Because the Claimant's U.S. operations are not in Mexico, that U.S. property could not be expropriated by Mexico.

244. Mexico, the United States and Canada are in agreement on the territorial limitations of Chapter Eleven. In its Article 1128 submission in the *Bayview* case, the United States made the following statements:

> 3. … [A]ll of the protections afforded by the NAFTA's investment chapter extend only to investments that are made by an investor of a NAFTA Party in the territory of another NAFTA Party, or to investors of a NAFTA Party that seek to make, are making, or have made an investment in the territory of another NAFTA Party.
>
> * * *
>
> 10. Were this not the case, the scope of Articles 1102(1) and 1102(2) would differ dramatically, leading to absurd results. The United States, for instance, would be obligated under Article 1102(1) to accord national

> treatment to a Canadian national that made an investment in Canada even though it would have no obligation to accord national treatment to that Canadian investment itself. Such an interpretation of the national treatment obligation in the NAFTA would make no sense and would be contrary to the Treaty's object and purpose.

Similarly, in its memorial on jurisdiction in the proceedings *In Re NAFTA Chapter Eleven/UNCITRAL Cattle Cases*, the United States stated:

> Under claimants' interpretation of Chapter Eleven's scope, every national of a NAFTA Party that believes its business has been adversely affected by a border measure of another NAFTA Party would be an "investor" entitled to invoke Chapter Eleven's dispute resolution procedures. Such an interpretation would constitute a radical departure from the obligations that the NAFTA Parties, or any State Party to an international investment agreement, have ever undertaken with respect to foreign investors. It would create an avenue for direct claims against States by foreign nationals for matters that are, like the claims here, quintessentially trade disputes, in clear circumvention of the mechanisms provided in NAFTA Chapter Twenty and elsewhere for the resolution of such disputes through State-to-State dispute settlement procedures. Nothing in the NAFTA supports such a result.[185]

and:

> In each instance where the provision obligates a Party to provide a level of treatment to investors, it does so only with respect to the investor's investments that are in the territory of the State that has adopted or maintained the measure at issue.[186]

245. Canada took a similar position in the case *S.D. Myers, Inc. v. Canada*:

> "The [Article 1102(1)] obligation does not mean that the national treatment obligation applies to the investor's activities in its home country. The obligation only applies to the investor with respect to its investment in the foreign country . . . .".[187]

246. The fact that Cargill happens to have an investment in Mexico does not change the previous analysis. A claim for damages resulting from Mexico's treatment of Cargill's investment in Mexico can at least potentially be within the Tribunal's jurisdiction; a claim based on the alleged effect of Mexico's measures on Cargill's investments in the United States cannot.

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185 Memorial on the Preliminary Issue of Respondent the United States (1 December 2006) p. 3.

186 Ibid. at 10-11 (emphasis in original).

187 See *S.D. Myers, Inc. v. Canada*, Government of Canada Counter Memorial, ¶ 259 (5 October 1999).

2. The antidumping order on HFCS is not within the Tribunal's jurisdiction

247. Cargill's claim is presented in a vague manner, in that neither the Notice of Intent, the Request for Arbitration, nor the Memorial precisely identify the measures on which the claim is said to be based.[188] Cargill's Memorial describes Mexico's antidumping measure on HFCS at great length in the same section of its Memorial in which it describes the tax on the use of HFCS in soft drinks; Cargill expressly relies on the antidumping measure as the basis for its Article 1105 claim; and Cargill also bases its damages calculation on the antidumping measure. It is therefore necessary for Mexico to point out that the antidumping measure is not within the Tribunal's jurisdiction.

248. Cargill's claim based on the antidumping measure on HFCS is beyond the Tribunal's jurisdiction because (i) it is untimely and (ii) antidumping measures are governed exclusively by NAFTA Chapter Nineteen.

a. The antidumping claim is time-barred

249. A NAFTA tribunal's jurisdiction over claims based on Section A of Chapter Eleven derives from NAFTA Article 1122(1), which provides:

> Article 1121: Consent to Arbitration
>
> 1. Each Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement. [Emphasis added.]

250. A respondent NAFTA Party does not consent to arbitration under the Arbitration (Additional Facility) Rules (or the other applicable arbitral rules) unless the claimant has submitted its claim "in accordance with the procedures set out in" the NAFTA.

251. The procedural requirements are found in Articles 1116 to 1121, inclusive. Article 1116(2) provides:

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

252. This limitations period is binding and fully enforceable. As noted by the tribunal in the *Feldman* case:

> … the Arbitral Tribunal stresses that, like many other legal systems, NAFTA Articles 1117(2) and 1116(2) introduce a clear and rigid limitation defense which, as such, is not subject to any suspension (see *supra*, para. 58), prolongation or other qualification. Thus the NAFTA

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[188] Chapter Eleven, of course, requires a decision based on the applicable law and not *ex aqueo et bono*. A finding of a violation must therefore be precisely linked to a specific measure.

> legal system limits the availability of arbitration within the clear-cut period of three years, and does so in full knowledge of the fact that a State, *i.e.*, one of the three Member Countries, will be the Respondent, interested in presenting a limitation defense. The quality of one Party as a State as well as all specificities and constraints necessarily connected to any state activity neither exclude nor qualify resort to the defense of limitation.[189]

253. The *Feldman* tribunal also held that the three year limitation period must be traced back from the date that the claim is submitted to arbitration, meaning the date on which the request for arbitration was made.[190]

254. As the Claimant itself describes, the antidumping investigation was initiated in 1997 and the final order was issued in January 1998[191]. Supposing (without conceding) that this type of claim could be submitted pursuant to NAFTA Chapter Eleven, it should have been submitted at the latest in January 2001, three years after the measure in question was issued. In fact, the antidumping measure was subject to a different NAFTA remedy, governed by Chapter Nineteen (as well as the WTO Agreement on Anti-dumping) to which Cargill and the other U.S. HFCS producers had a right of access through the U.S. government. Mexico duly submitted to the jurisdiction of dispute settlement bodies convened under those other jurisdictions. Mexico complied with the findings of those bodies, and the antidumping duties were refunded in full to Cargill. As previously mentioned, Cargill itself says that the antidumping case affected its access to the market only until the end of 2001.[192]

255. The Claimant seems to be aware of this limitation in the context of its discussion of the timeliness of its claims based on the IEPS tax and import permit, since it states at paragraph 27 of the Memorial:

> NAFTA Articles 1116.2 and 1117.2 bar a claim "if more than three years have elapsed" from the date on which the investor or enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor or enterprise has incurred loss or damage. Cargill's claims are timely. They seek damages incurred after and resulting from Mexico's enactment of the IEPS Tax and HFCS permit requirement in January 2002 and were filed within three years thereof, specifically, in December 2004.

256. Yet notwithstanding this clear knowledge of the impact of the limitation period, the Claimant still relies on the antidumping measure in calculating its alleged damages. Specifically, the Claimant's damages expert, in paragraph 80 of his report, bases his projection of Cargill's market share of the so-called "but for" Mexican market (*i.e.*, a market that would have existed "but for" the measures the Claimant alleges violate Chapter Eleven) on the market share that

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189 See *Marvin Roy Feldman v. United Mexican States ("Feldman")*, Award, Case No. ARB(AF)/99/1 (Dec. 16, 2002), at ¶ 63.

190 See *Feldman*, Interim Decision On Preliminary Jurisdictional Issues, (Dec. 6, 2000) at ¶¶ 39-47.

191 See Memorial, ¶¶ 84-86.

192 See Memorial, ¶ 101.

Cargill had in 1997, before the antidumping order was issued, and assumes that there would have been no antidumping order. Cargill also expressly cites the antidumping measure as the basis for its claim that Mexico violated Article 1105.[193]

b. Antidumping measures are governed exclusively by Chapter Nineteen and are therefore outside the jurisdiction of a Chapter Eleven Tribunal

257. Wholly independent of the un-timeliness of the claim against the antidumping measure, Chapter Eleven tribunals do not have jurisdiction over claims regarding the administration of antidumping laws. This issue was considered in detail and decided by the tribunal in the case *Canfor Corporation and Terminal Products, Ltd. v. United States*, which agreed with the United States' position that the application of a NAFTA Party's antidumping law is governed exclusively by Chapter Nineteen. That tribunal stated:

> 273. In conclusion, (i) having regard to all the foregoing considerations, (ii) in light of the objective of efficient proceedings as set forth in Article 102(1)(e), and (iii) notwithstanding the principle that exclusion clauses are to be interpreted narrowly, the text of Article 1901(3) does not, in the judgment of the Tribunal, leave room for any other interpretation than that the entire Chapter Eleven does not apply with respect to the antidumping law and countervailing duty law of a State Party to the NAFTA. As previously quoted, that text specifically stipulates: ". . . no provision of any other Chapter of this Agreement shall be construed as imposing obligations . . ." (emphasis added). Based on the foregoing analysis, the inescapable conclusion must be that the exclusionary language of Article 1901(3), in the absence of an express exception to the contrary, encompasses all obligations stemming from Chapter Eleven, including those related to dispute settlement. That preclusion necessarily encompasses all claims related to conduct of Commerce, the ITC and other government entities and officials prior to, during and subsequent to preliminary and final determinations in relation to United States antidumping and countervailing duty laws.[194]

258. The same holds true with respect to the antidumping order imposed by Mexico on the importation of HFCS; that measure is outside this Tribunal's jurisdiction and cannot be the basis for a claim of violation of Chapter Eleven.

3. The Claimant has not alleged a measure that could violate Article 1103

259. In its Memorial, the Claimant added to its case, apparently as an afterthought, an allegation that Mexico violated Article 1103 – the most-favored-nation (MFN) provision of Chapter Eleven – because allegedly (i) HFCS from Canada could be imported into Mexico more easily than HFCS

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[193] See Memorial at ¶ 235 ("Stability, predictability, and Cargill's reasonable expectations were defeated by Mexico's anti-dumping duties ….").

[194] Decision on Preliminary Question (6 June 2006), ¶ 273.

from the United States; and (ii) allegedly CPI arranged to export small quantities of HFCS from Canada to Mexico from its Canadian subsidiary.[195]

260. Yet, having made this claim, the Claimant has not even alleged that any Canadian investor in Mexico in like circumstances to it received more favorable treatment. Rather, it seems to allege that CPI – another U.S. investor – in effect received more favorable treatment than it did.[196]

261. Article 1103 provides as follows:

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

262. Article 1103 does not address treatment of an investor of a Party as compared to treatment of another investor of the same Party. That is because the national treatment obligation fundamentally is designed to address discrimination based on the <u>nationality</u> of an investor. Thus, even if Mexico discriminated among investors of the United States – which Mexico denies – that could not constitute a violation of Article 1103 (or Article 1102).

263. If the Claimant intended to argue that Mexico's measures discriminated between the treatment of Cargill's investment in the United States and CPI's investment in Canada, that allegation is well beyond the scope of Chapter Eleven, because as discussed above, Chapter Eleven applies only to a NAFTA Party's treatment of an investment within its own territory.

264. In fact, however, it is apparent that the Claimant is seeking to allege that Mexico did not accord most-favored-nation treatment to U.S.-originating HFCS as compared with HFCS originating in Canada:

> 219. Mexico differential treatment of HFCS imported from the United States and HFCS imported from Canada leads to the same conclusion … -- that such discrimination violates NAFTA's MFN requirements.[197]

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[195] See Memorial, ¶¶ 209-219. Perhaps inconsistently, the Claimant's witnesses testify that only small quantities of Canadian HFCS were exported to Mexico and that such sales would have to be made at a loss because of the high costs of transportation. See Ortega witness statement, ¶ 101; and Cotter witness statement, ¶ 68.

[196] See, for example, Memorial, ¶ 215: "Cargill's claim satisfies the second element because Mexico's permit requirement treated Cargill less favorably than Corn Products."

[197] Memorial, ¶ 219.

The problem for the Claimant is that (i) Chapter Eleven applies only to the treatment of investment, not to the treatment of goods (which is a distinct topic covered by NAFTA Chapter Three), and (ii) even Chapter Three does not contain an MFN requirement for trade in goods.[198]

265. For these reasons, the Claimant's allegation of a violation of Article 1103 is also beyond the Tribunal's jurisdiction.

4. The Claimant doesn't alleged that the import permit measure constituted a violation of Chapter Eleven

266. The Claimant has also alleged that the requirement to obtain an import permit to benefit from the NAFTA's preferential duty rate constituted a violation of Chapter Eleven to the extent that the permit requirement interfered with its ability to sell HFCS for uses other than in soft drinks. The Claimant's argument has two defects.

267. First, the Claimant's Notice of Intent to Submit Request for Institution of Arbitration Procedures exclusively described the soft drinks tax as the only basis for its allegations of violations of NAFTA Chapter Eleven. By seeking to add the import restriction as a basis for its claim only in the Memorial, the Claimant has acted inconsistently with the notice requirements of Article 1119.

268. Second, the import permit requirement is a trade measure, not an investment measure. The Claimant itself alleges, in paragraphs 155 and 157 of the Memorial, that the permit requirement violated NAFTA Article 309 and GATT Article XI (both of which prohibit quantitative restrictions on imports and exports). Article 309 is part of NAFTA Chapter Three which, by virtue of Articles 1116 and 1117, falls outside of the jurisdiction of a Chapter Eleven tribunal.[199]

269. Confirming that the Claimant's allegation relates to trade in goods and not to investment, in its description of its Article 1102 claim the Claimant states that the import permit requirement "resulted in Cargill's loss of its right to favorable NAFTA duties …."[200]. That is a trade in goods issue not within the scope of Chapter Eleven; it can only be the subject of State-to-State dispute settlement under Chapter Twenty.[201]

270. It is significant in this regard that the United States and Mexico have entered into an MOU under which there was mutual agreement that imports of U.S. HFCS into Mexico would be subject to a quantitative restriction, just as imports of Mexican sugar into the United States are subject to quantitative restrictions. Under the Claimant's interpretation, the MOU violates Chapter Eleven.

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[198] The NAFTA incorporated separate, bilateral negotiations over tariff reductions and market access between Mexico and the United States, Mexico and Canada, and the United States and Canada. For that reason, an MFN obligation would have been inappropriate.

[199] See United Parcel Service of America, Inc. v. Government of Canada, Award on Jurisdiction, ¶¶ 47, 50-51, 60-69.

[200] Memorial, ¶ 200.

[201] The Claimant does not seem to specifically address the import permit requirement under its Article 1105 and 1106 claims, and it makes only a passing reference to the duration of the import permit requirement as part of its Article 1110 claim.

That interpretation makes no sense. The nature of a measure as directed at trade cannot be changed simply by attempting to re-label it as an investment measure.

271. Finally, there is an important threshold factual issue regarding to what degree the import permit requirement actually affected Cargill de Mexico. The Claimant states that the permits were "unobtainable," and that "Cargill tried but was unable to get any guidance from Mexico as to how it could obtain an HFCS import permit."[202]

272. However, the Claimant's own documents contradict its claim. A 20 August 2002 e-mail sent by Federico Zermeño entitled "Fructose import permit" states "[w]e were told by Economy Sec people that our permit is ready and we can start importing FX as of tomorrow if we wanted to."[203] On August 21st, Eddie Ortega responded: "great news !! lets get orders asap and start shipping product."[204] Then, on August 23rd, Nydia Trejo sent an e-mail entitled "HFCS IMPORT PERMIT," in which she advised her colleagues:

> Please be advised that I have the import permit in my hands already. Paperwork will be advised to the chb at the border and we are ready to ship.[205]

Thus, on the Claimant's own evidence, it appears that Cargill de Mexico actually obtained a permit shortly after the requirement for permits was imposed in 2002.

273. The Claimant also states that "[e]ach time Cargill applied for HFCS permits, the applications were denied," citing applications submitted between January and July 2005, which it says "were all denied."[206] But on January 18, 2006, Nydia Trejo sent an e-mail stating:

> Hi everyone. I got grat {sic} news for you. After a long pause, we finally got the permits! we are set up to import HFCS into Mexico again. The customs brokers will be notified today. We are ready to move those 5,200 tons right away, let's get them moving![207]

274. The Claimant should explain why it submitted this claim when its own documents completely contradict it.

5. The alleged violation of Article 1105 is based on measures outside the Tribunal's jurisdiction

275. The Claimant has based its Article 1105 claim on a combination of three Mexican measures: the antidumping order on HFCS, the soft drinks tax, and the import permit

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202 Memorial, ¶¶ 152, 153, 156.

203 Exhibit R 87.

204 Exhibit R 88.

205 Exhibit R 89.

206 Memorial, ¶ 160.

207 Exhibit R 90.

requirement. But as discussed above, the antidumping order is outside the Tribunal's jurisdiction, both because of the Article 1121 limitations period and the fact that antidumping measures are governed exclusively by Chapter Nineteen. Moreover, Article 2103 provides that, except as set out in that Article, nothing in the NAFTA applies to tax measures, and the exceptions to this exception do not include Article 1105; accordingly, Article 1105 cannot be applied to tax measures such as the soft drinks tax. Indeed, the Claimant acknowledges this exclusion on page 72, footnote 333 of the Memorial.

276. Simply describing these measures along with the import measure does not change their status as being outside the Tribunal's jurisdiction.

B. Responses to the claims on their merits

1. Mexico has not denied national treatment to the Claimant or its investment within the meaning of Article 1102

277. The Claimant's argument that the tax violated Article 1102 relies on an incorrect interpretation of that article and ignores the relevant factors.

a. Article 1102 establishes an obligation different than Article 301 and GATT Article III

278. The Claimant's Article 1102 argument is premised on the assumption that WTO jurisprudence on the interpretation of GATT Article III – which deals with national treatment of imported goods – is directly relevant in interpreting Article 1102. For example, at paragraph 187 of its Memorial, the Claimant asserts that "NAFTA tribunals frequently rely on GATT/WTO decisions when interpreting and applying NAFTA Article 1102." That assertion is inaccurate, to say the least, considering that the Claimant failed to even mention a recent decision that examined this very question in great detail and flatly rejected the approach now urged by the Claimant.

279. The award in the *Methanex* case contradicts the Claimant's attempt to equate GATT Article III with NAFTA Article 1102.[208] That tribunal rejected the attempt to equate the concept of "like goods" with the "like circumstances" of Article 1102:

> 29. …the Tribunal begins with an inquiry into the plain and natural meaning of the text of Article 1102. Paragraphs 1 2, and 3 of Article 1102 enjoin each Party to accord to investors or investments of another Party "treatment no less favorable that it accords, in like circumstances, to its investors [or investments] …." These provisions do not use the term of art in international trade law, "like products," which appears in and plays a critical role in the application of GATT Article III. Indeed, the term "like products" appears nowhere in NAFTA Chapter 11
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> ….

[208] See *Methanex Corporation v. United States of America*, Award on jurisdiction and merits, 3 August 2005, ¶¶ 29, 33–35, 37, Section IV, chapter B, pp. 14–18 (ps. 257–261).

> 33. It is thus apparent from the text that the drafters of NAFTA were careful and precise about the inclusion and the location of the respective terms, "like goods," "any like, directly competitive or substitutable goods, as the case may be," and "like circumstances." "Like goods" is never used with respect to the investment regime of Chapter 11 and "like circumstances," which is all that is used in Article 1102 for investment, is used with respect to standards-related measures that might constitute technical barriers to trade only in relation to services; nowhere in NAFTA is it used in relation to goods.
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> 34. It may also be assumed that if the drafters of NAFTA had wanted to incorporate trade criteria in its investment chapter by engrafting a GATT-type formula, they could have produced a version of Article 1102 stating "Each Party shall accord to investors [or investments] of another Party treatment no less favorable than it accords its own investors, in like circumstances with respect to any like, directly competitive or substitutable goods." It is clear from this constructive exercise how incongruous, indeed odd, would be the juxtaposition in a single provision dealing with investment of "like circumstances" and "any like, directly competitive or substitutable goods."
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> 35. In any event, the drafters did not insert the above italicized words in Article 1102; and it would be unwarranted for a tribunal interpreting the provision to act as if they had, unless there were clear indications elsewhere in the text that, at best, the drafters wished to do so or, at least, that they were not opposed to doing so. In fact, the intent of the drafters to create distinct regimes for trade and investment is explicit in Article 1139's definition of investment.
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> …
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> 37. …here, the text and the drafters' intentions, which it manifests, show that trade provisions were not to be transported to investment provisions. Accordingly, the Tribunal holds that Article 1102 is to be read on its own terms and not as if the words "any like, directly competitive or substitutable goods" appeared in it.

280. Accordingly, under *Methanex*, it is not appropriate to state that, simply because sugar and HFCS compete in certain markets, distributors of sugar and HFCS are in like circumstances. (Note that the Claimant's investment in Mexico does not produce HFCS.) Article 1102 has unique terms that require a distinct analysis.[209]

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[209] This type of issue was raised, in reverse, in the GATT panel decision *United States - Measures Affecting The Importation, Internal Sale And Use Of Tobacco* (1994), BISD 41S/I/131. The case involved, among other issues, a U.S. program under which fees were assessed on both U.S. and imported tobacco to compensate the government for the cost of a domestic price support system, known as the "No Net Cost Assessment". The fees were assessed in a different manner on imports (importers paid 100% of the fees, while for domestic tobacco the fees were split equally between the producer and the first domestic purchaser). In addition, it was proven that the fees ultimately were used for the exclusive benefit of domestic producers. It was clear that the measures had a discriminatory intent and impact. In rejecting the Article III claim, the panel noted that Article III requires national treatment of goods, not of producers.

281. In this regard, it is important to keep in mind that the provisions of the treaty vary based on the respective subject. The provisions governing one matter (*i.e*., trade in goods) must not be confused with those governing another (*i.e*., investment). According to the principle of effectiveness, in the interpretation of the treaties, meaning must be given to all of the NAFTA's provisions and a meaning given to one obligation is not to be given to another obligation cast in different terms.

282. As a result, since the provisions relating to trade in goods are not applicable to investment, the GATT and WTO precedents regarding "similar products" are not applicable for comparing the treatment that is accorded to foreign investors and their investments with respect to the treatment accorded to domestic investors and investments. Even if sugar and HFCS are "similar products" for certain purposes, that does not mean that the sugar and fructose producers or distributors are in "like circumstances."[210]

283. This was expressly found by the tribunal in the *GAMI* case. The tribunal held that even where the class of investors produced exactly the same good (in that case, sugar), that did not in and of itself indicate that the producers were "in like circumstances" for the purposes of Article 1102. That tribunal found that severely financially distressed Mexican sugar companies that were expropriated due to their financial condition were not "in like circumstances" to less financially distressed Mexican sugar companies that were not expropriated.[211]

284. In *Pope & Talbot*, the claimant complained about the effect of Canada's implementation of an international agreement with the United States to settle a trade dispute regarding exports of Canadian lumber to the U.S. The settlement agreement required Canada to impose export quotas on lumber exporters, such that exports up to a certain quantity could be exported free of charge, exports up to a certain higher level were subject to a fee, and exports beyond that level were subject to a higher fee. Canada's implementation of the arrangement resulted in the burden of the quotas being placed on producers in certain provinces and not others, and in different quota allocations among the covered provinces as well as within each province. The Claimant – a U.S. owned lumber company in Canada – asserted that it had been discriminated against because lumber producers in other provinces, and some within its own province, received better treatment. The *Pope & Talbot* tribunal concluded that, even though the other companies produced the exact same product and sold their products in competition with the Claimant, they were not in like circumstances. Although Mexico does not agree with the legal standard as articulated by the *Pope & Talbot* tribunal, it is significant that the case involved differential treatment that resulted from an intergovernmental dispute between Canada and the United States, and that the tribunal

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Ibid. at ¶ 107. Because the total fees imposed on imported and domestic tobacco were the same, there was no violation of Article III.

[210] Indeed, the Appellate Body of the WTO has stated that, because of textual differences, indicate that the word "similar" does not always have the same meaning, even within the same article. *European Communities – Measures affecting asbestos and asbestos-containing products*, Report of the Appellate Body, WT/DS135/AB/R, adopted April 5, 2001, ¶¶ 94–96. Exhibit R 91. The Appellate Body added that products that compete against each other are not necessarily "similar": "We are not saying that *all* products which are in *some* competitive relationship are "like products" under Article III:4." Ibid. ¶ 99.

[211] See *GAMI Investments, Inc. v. United Mexican States*, Final Award of the Tribunal, ¶ 114.

recognized that in that situation the claimant was not in like circumstances with other companies in its same industry.[212]

285. Having established that Article 1102 requires a different analysis than GATT Article III and NAFTA Article 301, Mexico will now explain why (i) the tax did not discriminate within the meaning of Article 1102; and (ii) even if it did, why neither Cargill nor Cargill de Mexico was in like circumstances with Mexican sugar producers.

b. The Tax did not discriminate against investments on the basis of nationality

286. A violation of the obligation of national treatment in Article 1102 requires discrimination on the basis of nationality. In *The Loewen Group, Inc. and Raymond L. Loewen v. United States*, the tribunal stated:

> The effect of these provisions [Article 1102 (1) and (2)], as Respondent's expert Professor Bilder states, is that a Mississippi court shall not conduct itself less favourably to Loewen, by reason of its Canadian nationality, than it would to an investor involved in similar activities and in a similar lawsuit from another state in the United States or from another location in Mississippi itself. We agree also with Professor Bilder when he says that Article 1102 is direct only to nationality-based discrimination and that it proscribes only demonstrable and significant indications of bias and prejudice on the basis of nationality, of a nature and consequence likely to have affected the outcome of the trial.[213]

287. All three NAFTA Parties have expressed this view in various NAFTA proceedings. The United States expressed its position as follows:

> 2. Application of the national treatment provision of NAFTA Chapter 11 should be undertaken in two stages. A Tribunal should ask (i) whether a Party has accorded less favorable treatment to investors or investments on the basis of nationality, and, if so, (ii) whether the investor or investment accorded less favorable treatment was "in like circumstances" with domestic investors or investments accorded more favorable treatment.
>
> 3. The objective of the national treatment provision is to prohibit discrimination against foreign investors and investments, in law and in fact, on the basis of nationality. Implementation of the national treatment provision requires a comparison of a measure's treatment of domestic investors and their investments with that of their counterparts from other NAFTA Parties. If the measure, whether in fact or in law, does not treat foreign investors or investments less favorably than domestic investors or

[212] *Pope & Talbot v. Canada*, Award phase 2, April 10, 2001; ¶¶ 83-104.

[213] See *The Loewen Group Inc. and Raymond Loewen v. United States*, Award, ¶ 139. The *Feldman* Tribunal also agreed: "It is clear that the concept of national treatment as embodied in NAFTA and similar agreements is designed to prevent discrimination on the basis of nationality" or "by reason of nationality…". Award, ¶ 181.

> investments on the basis of nationality, then there can be no violation of Article 1102 and a Tribunal should proceed no further. Only if presented with some evidence of less favorable treatment on the basis of nationality should a Tribunal examine the question of which investors are "in like circumstances."
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> 4. The phrase "in like circumstances" ensures that comparisons are made with respect to investors and investments on the basis of characteristics that are relevant for the purposes of the comparison. The objective is to permit the consideration of all relevant circumstances, including those relating to a foreign investor and its investments, in deciding to which domestic investors and investments they should appropriately be compared, while excluding from the consideration those characteristics that are not relevant to such a comparison.
>
> 5. The circumstances relevant to the comparison will vary by case. The relevant inquiry is not limited to whether investors or investments produce the same product: merely because investors or investments produce the same product does not mean that they are "in like circumstances." For example, the fact that producers of such products are located in different geographical or political regions may also be germane to the question of whether they are in like circumstances.[214]
>
> [Emphasis added]

288. Canada expressed it in the following terms:

> 165. …Article 1102(2) requires each NAFTA Party to treat investments of investors of another Party ("foreign investments") no less favourably than it treats investments of its own investors ("domestic investments") "in like circumstances." By alternately ignoring and misinterpreting the critical "in like circumstances" qualification, the Investor attempts to convert Article 1102 into a special right for a NAFTA investor to pick the best treatment given to any enterprise in the same sector anywhere in the country.
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> 166. Article 1102(2) does not prevent a Party from implementing a measure that affects investments differently as long as the measure neither directly nor indirectly discriminates on the basis of nationality as between foreign and domestic investments.
>
> 167. Determination of "like circumstances" must be made on a case-by-case basis, depending on the facts and treatment at issue in each situation. However, there is no basis even for inquiring into a distinction between circumstances where, as here, there is neither an allegation nor evidence

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[214] See Second Article 1128 Submission of the United States in the case *Pope & Talbot v. Canada*, ¶ 225. Exhibit R 92.

> that the distinction is motivated by or has the effect of discriminating by nationality.[215]

289. Mexico submits that the Tribunal should give due deference to the consistent position of the three NAFTA Parties.[216]

290. The dispute giving rise to this international claim has always been about two substitutable products: the market access (or more precisely the lack of market access) granted by the United States to Mexican-originating sugar and the market access granted by Mexico to HFCS. It has nothing to do with the nationality of capital. When the tax was imposed U.S. and Mexican capital was invested in HFCS production in Mexico (in CPIngredientes) and likewise there was U.S. and Mexican capital (and indeed British capital) invested in the Mexican sugar sector.

291. Tate & Lyle, the British conglomerate that owns Tate & Lyle Ingredients America, Inc., a co-owner of the Mexican HFCS producer Almex and a claimant in another Chapter Eleven proceeding based on the HFCS tax, also has an equity interest in Mexican sugar production. For example, Tate & Lyle's 2002 Annual Report contains the following description of the impact of the tax:

> Almex, our Mexican joint venture corn wet miller, suffered lower profits due to the continued imposition of a tax on soft drinks containing HFCS. A dispute with the Mexican Government over import duties was satisfactorily resolved.
>
> Occidente, our Mexican cane sugar miller, had an improved performance due to increased demand for sugar as a result of the same tax on drinks containing HFCS.[217]

292. In this regard, it is crucially important to note that like Tate & Lyle, Cargill is an investor in Zucarmex, one of Mexico's largest sugar mill companies.[218] Accordingly, Cargill, as an investor in the Mexican sugar sector, benefited from the HFCS measures just as Mexican investors in the sugar sector did.

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215 *Pope & Talbot v. Canada*, Statement of Defence of the Government of Canada, dated 29 March, 2000. Exhibit R 93. The tribunal in *Pope & Talbot* did not accept the standard formulation of the three NAFTA Parties. However, in the application of its own version of the standard, the tribunal focused on whether there was proof of discriminatory treatment on the basis of nationality. Award ¶¶ 79-81.

216 Consistent with Article 31 of the Vienna Convention, the tribunal in the *ADF* case noted: "…whether a document submitted to a Chapter 11 tribunal purports to be an amendatory agreement in respect of which the Parties' respective internal constitutional procedures necessary for the entry into force of the amending agreement have been taken, or an interpretation rendered by the FTC under Article 1131(2), we have the Parties themselves —all the Parties— speaking to the Tribunal. No more authentic and authoritative source of instruction on what the Parties intended to convey in a particular provision of NAFTA, is possible." Even if not in the form of a decision by the Free Trade Commission, tribunals must give weight to a common position of the three NAFTA Parties in accordance with the rules for treaty interpretation established in Article 31 of the Vienna Convention.

217 Tate & Lyle 2002 Annual Report, Exhibit R 94.

218 Cargill invested $20 million in Zucarmex. Exhibit R 95. It should be noted that Cargill bought its interest in Zucharmex in 2002, after the tax went into effect, enabling it to take advantage of a business opportunity created by the tax.

293. Obviously there was no discrimination against investment based on nationality; the investments of foreign investors such as Cargill and Tate & Lyle were benefited or disadvantaged in the same manner as investments by Mexican investors in the same industries. On this basis alone, the Tribunal should conclude that there was no violation of Article 1102.

c. Cargill de Mexico was not in like circumstances with Mexican sugar producers

294. If the Tribunal were to find that there was discrimination against Cargill's investment in Mexico on the basis of nationality – which Mexico strongly rejects – it would next have to analyze whether Cargill's investment in Mexico, Cargill de Mexico, was in "like circumstances" with the Mexican sugar cane growers and sugar mills. (As explained above, Cargill's U.S. operations are not protected by Article 1102 and can not suffer damages within the meaning of Chapter Eleven.)

295. The only factor identified by the Claimant in which Cargill de Mexico was in like circumstances with Mexican sugar producers was that both Cargill de Mexico and the sugar producers sold sweeteners to soft drink bottlers in competition with each other.

296. There are a number of important ways, however, in which Cargill de Mexico and the Mexican sugar producers were not in like circumstances.

(1) Cargill de Mexico is a distributor of diverse products; the Mexican sugar producers are limited to one

297. The Claimant's investment in Mexico, Cargill de Mexico, was created in 1972 and, according to its website, is engaged in the following businesses:

- Edible Oils and Fats
- Acidulants
- Animal Feed
- Sugar
- Fertilizers
- Grains and Milling
- Financial Services

Of particular interest is that Cargill de Mexico lists "Cargill Azucar" as one of its businesses, and Cargill Azucar describes itself as a major producer of sugar in Mexico, describing the activities and products of Zucarmex as its own.[219] At the same time, Cargill de Mexico is not a producer of HFCS; it only re-sold imported HFCS.

298. In addition, Cargill de Mexico's transfer station at Tula could be used to distribute other products, such as glucose, soybean oil and flour.[220]

[219] See http://www.cargill.com.mx/imgcont/azucarmx/index.html. Exhibit R 96.

[220] See memorandum dated 9 March1996. Exhibit R 97.

299. In contrast, Mexican sugar producers are limited to one product. The *GAMI* tribunal concisely summarized the economic situation of the sugar producers as follows:

> 45. Agricultural economics tend to be complex. The Mexican sugar industry is characterized by special complicating factors. The productive life of sugarcane is 4-8 years. Farmers (cañeros) are understandably disinclined to convert their fields to other crops early in the cycle. The supply of sugarcane therefore responds slowly to the market. Sugarcane is processed optimally within 24 hours of harvesting. (48 hours is a maximum given the loss of sucrose.) Mills must therefore be readily accessible. Cañeros cannot operate without mills in proximity. Once a mill is constructed it depends on input from cañeros in the area. Once the mill is built it depends on that area's sugarcane growers' production. Mr. Antonius estimates that the price paid for sugarcane represents approximately 70% of the sugar mill's cost. GAMI describes this as a "relationship of mutual dependence." Mr. Antonius strikingly speaks of a "bilateral monopoly."[221]

300. Accordingly, the sugar producers were in an economically more vulnerable situation.

(2) The market for sugar was highly regulated, while the market for HFCS was not

301. Another crucial distinction between companies involved in the sugar and HFCS businesses was that the market for sugar was highly regulated – not just by Mexico, but also by the United States – while the market for HFCS was not. For this reason, companies operating in the two sectors were in very different circumstances.

302. As discussed above, at the insistence of the U.S. Government, the NAFTA obliged Mexico to adopt measures to increase the Mexican market price of sugar, as a *quid pro quo* for Mexico's obtaining increased access to the U.S. sugar market. The increase in Mexican sugar prices resulting from Mexico's undertaking under the NAFTA to impose MFN global import restrictions as demanded by the United States, artificially created a market for HFCS in Mexico. The United States then unilaterally insisted on linking Mexican exports of sugar to consumption of HFCS in Mexico.

303. Specifically, pursuant to Annex 703.2(14)(c), the amount of sugar that Mexico was permitted to export to the United States was supposed to be based on the amount by which Mexico was a net surplus producer of sugar. But the U.S. government unilaterally decided that every ton of HFCS consumed in Mexico would be deducted from the amount of sugar that Mexico could export to the United States – regardless of whether that HFCS was imported into Mexico or produced there. In this manner, the U.S. government made HFCS and sugar interests legally adverse in Mexico, in a manner that went well beyond simple economic competition. The effect of the U.S. approach to calculating Mexico's quota was as follows: for every sale the Mexican sugar producers lost in competition with HFCS, they actually lost two sales – the first sale to the

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221 See *GAMI*, ¶ 45.

soft drink producers in their domestic market, and another sale to the United States, because of the deduction the U.S. government made to the quota.

304. Moreover, NAFTA Annex 703.2(16) allowed Mexico to export its entire sugar surplus to the United States if it had surpluses for two consecutive years, and the U.S. government took the view that this provision had been cancelled.

305. As a result of the U.S. positions on these issues, Mexican sugar producers were limited to selling in Mexico and a choice of exporting at a very significant loss to the world market or storing their sugar at a high cost with a price-depressing overhang on the domestic market. Meanwhile, HFCS producers and distributors enjoyed increased access to the Mexican market while the U.S. sweetener industry (including HFCS producers) was protected by the minimal access to the U.S. market that the United States gave to Mexican sugar. When Mexico sought to have the Parties' differences resolved by an impartial Panel, the United States also blocked the NAFTA's dispute settlement mechanism, so Mexico had no recourse for resolving the disagreement within NAFTA's terms.

306. The uneven implementation of the NAFTA had an important impact. HFCS gained a growing share of the Mexican sweetener market while Mexican sugar faced significant restrictions in gaining access to the U.S. market (the protected, local market of the Claimant and its fellow U.S. HFCS and sugar producers). During marketing years 1996/1997 through 2000/2001, more than 2.6 million tons of HFCS were consumed in Mexico, while Mexico was only able export 230,000 tons of sugar to the U.S. market, notwithstanding the fact that it had a collective excess of 3,081,359 tons. In marketing year 2000/2001 alone, Mexico had an excess of 294,512 tons of sugar, but the U.S. government only allowed the importation into U.S. territory of 116,000 tons. Meanwhile, the penetration of HFCS in the Mexican market reached its highest level – 590,000 tons – during that same year.[222]

(3) The sugar industry was being devastated economically, the HFCS industry was not

307. Because of the U.S. refusal to allow Mexico to export its sugar surplus to the United States, the Mexican industry's situation by 2001 was so serious that the government was forced to intervene by expropriating 27 sugar mills, at a cost to the government of over $100 million, to protect the mills' productive capacity and the livelihood of thousands of sugar cane farmers. In contrast, U.S. sugar producers and HFCS producers such as Cargill, in contrast, benefited from the U.S. government's actions: they kept the U.S. sweeteners market well protected from Mexican import competition, thus forcing all of the adjustment burden on the Mexican sugar sector.

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[222] See "Cuadro Exportaciones de Azúcar"; May 17, 2004 Report of the Dirección General de Industrias Básicas; and Comité de la Agroindustria Azucarera, "Resumen Anualizado del Balance Azucarero de México" (July 23, 2003). Exhibit R 98. The highly active role of the U.S. sweeteners industry in the dispute is also an important factor. U.S. HFCS producers such as ADM, TLIA and CPI were members of the American Sugar Alliance, which pressured the U.S. government to restrict imports of Mexican sugar and refuse to submit to the Chapter Twenty dispute settlement procedure. Mexico does not know whether Cargill was also a member of the ASA at the relevant time. Regardless of whether Cargill support those efforts, its fellow U.S. HFCS producers shared responsibility with the U.S. government for the condition of the Mexican sugar industry.

Indeed, ultimately a collapse of the Mexican sugar industry would have benefited both U.S. sugar and HFCS producers.

308. Although the counter-measures defense is a complete answer to the claims, the Tribunal would not need to find that the United States was in violation of the NAFTA to recognize that sugar and HFCS producers and distributors were not in like circumstances in Mexico, and that the underlying situation arose directly from actions taken by the U.S. government that adversely affected the internal Mexican market for sweeteners. The factual situation in the Mexican market resulting from the uneven implementation of the NAFTA – whether legal or not – objectively put the sugar producers in different circumstances than HFCS producers and distributors.

2. The tax did not deny MFN treatment to the Claimant or its investment

309. Mexico has already addressed this issue in the section on jurisdictional objections. Should the Tribunal decide to treat this issue as arising under the merits rather than as a jurisdictional matter, the Respondent incorporates by reference its above arguments as being a response to the merits of the Article 1103 claim as well.

3. The Claimant has not described any violation of Article 1105

310. The Claimant bases its assertion of a violation of Article 1105 on an alleged "broad-based anti-HFCS campaign," which apparently is intended to included the soft drinks tax, the antidumping order and the import permit requirement. But as discussed above, the antidumping order is outside the Tribunal's jurisdiction, both because of the Article 1121 limitations period and the fact that antidumping measures are governed exclusively by Chapter Nineteen. Moreover, Article 2103 provides that, except as set out in that Article, nothing in the NAFTA applies to tax measures, and the exceptions to this exception do not include Article 1105. Accordingly, Article 1105 cannot be applied to tax measures such as the soft drinks tax.

311. The Claimant does not explain why it believes that combining two measures that are beyond the Tribunal's jurisdiction could transform them so that they would be within the Tribunal's jurisdiction. That is nonsensical.

312. The Claimant's fallback position is to say that "Mexico's HFCS import permit requirement (another component of that campaign) alone would be sufficient to constitute a violation of Article 1105."[223] Mexico will address this allegation in detail.

a. The Claimant's error in relying on *Tecmed*

313. Initially, it is important to note that the Claimant's argument regarding Article 1105 relies heavily on the case *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, which the Claimant repeatedly characterizes as a "NAFTA panel."[224] However, *Tecmed* was not a NAFTA

[223] Memorial, p. 72, fn. 333.

[224] The Claimant cites *Tecmed* in ¶¶ 223, 231, 238, 244 and 251 of the Memorial.

arbitration; it arose under the Mexico–Spain Bilateral Investment Treaty and did not purport in any manner to interpret or apply the NAFTA.

314. Moreover, the *Tecmed* tribunal's statement on the duty of governments to promote and protect foreign investments is not a standard that has been embraced by all subsequent tribunals and in fact has recently been rejected by an ICSID Annulment Committee chaired by the former President of the International Court of Justice, H.E. Judge Guillaume Gilbert.

315. *Tecmed* asserted:

> The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparent in its relations 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 policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or regulations issued, or the resolutions approved thereunder, but also to the goals underlying such regulations.[225]

Mexico's concerns with that tribunal's proposed standard are fourfold: (i) in the name of consistency, absence of ambiguity, and transparency, it postulated a degree of clarity, simplicity and unity of regulatory goals that no State, not even the most developed, can attain; (ii) it exhibited a lack of understanding of the complexity of government and the need for governments to make decisions, sometimes urgently, based on the information at hand which, as other tribunals have recognized, might be imperfect, or incomplete, or even wrong;[226] (iii) it seemed to relieve the investor of the duty to inform itself of the law, including through obtaining the advice of professional advisors retained to act in its interests, by casting upon the State a duty to "mentor" the investor on the State[227]; and (iv) it seemed to believe that the investor's subjective expectations are the source of the State's treaty obligations.

316. The State's duty is not to tutor or mentor the private party, but rather to make information available to it to that it can become acquainted with it and to act upon it, if necessary, with the

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225 *Tecmed* Final Award, ¶ 154.

226 *S D. Myers*: "Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of misguided economic or sociological theory, place too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes…" (¶ 261), cited with approval in *GAMI Investments Inc. v. United Mexican States*, ¶ 93, and in *Saluka Investments B.V. (The Netherlands) v. The Czech Republic*, ¶ 284.

227 A point noted by the *MTD* tribunal when it cut the damages claim by 50% in light of the investor's contributory fault, *i.e*., its failure to properly protect its own legal interests when entering into the transaction which gave rise to the international claim. (Award, ¶¶ 242-243.) This point was also emphasized by the annulment committee when it cited Article 39 of the ILC's Articles on Responsibility of States for Internationally Wrongful Acts of 2001. The committee agreed that "[t]here is no reason not to apply the same principle of contribution to claims for breach of treaty brought by individuals." (Decision of the Annulment Committee, ¶ 101.)

advice of counsel or other professional advisors. This is but one aspect of the *Tecmed* award's defects.

317. The ICSID annulment committee chaired by Judge Guillaume[228] recognized the serious misstatement of the law in *Tecmed* in the annulment proceedings in *MTD Equity Sdn. Bhd. and MTD Chile S.A. v Republic of Chile*. After receiving expert evidence on the point by Sir Arthur Watts and Mr. Jan Paulsson, the Committee noted:

> 61. The Committee can appreciate some aspects of these criticisms [of *Tecmed*]. For example the *TECMED* Tribunal's apparent reliance on the foreign investor's expectations as the source of the host State's obligations (such as the obligation to compensate for expropriation) is questionable. The obligations of the host State towards foreign investors derive from the terms of the applicable investment treaty and not from any set of expectations investors may have or claim to have. A tribunal which sought to generate from such expectations a set of rights different from those contained in or enforceable under the BIT might well exceed its powers, and if the difference were material might do so manifestly.[229]

318. It warrants noting that the implication of this statement giving one "example" of a questionable aspect of *Tecmed* is that there are others, as indeed Mexico believes is the case. In fact, the *MTD* tribunal's award escaped annulment on the ground that it formulated a different standard of fair and equitable treatment than that expressed in *Tecmed* and that *Tecmed* was simply cited "in support of this standard, not in substitution for it."[230] This indicates that had the *MTD* tribunal relied on *Tecmed* as the applicable international law standard for fair and equitable treatment, it would have exceeded its powers to apply the governing law and its award would have been annulled.

319. Accordingly, Mexico submits that any reliance on *Tecmed* for governing legal principles would be misplaced.

b. The "Reasonable Expectations" argument

320. The Claimant argues that, under *Tecmed*, "a treaty's inclusion of 'fair and equitable' treatment language requires 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.'"[231] As discussed above, this theory that reliance on the foreign investor's expectations can be the source of the host State's obligations has been discredited by *MTD*.

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[228] Judge Guillaume was joined by Professor James Crawford and Dra. Sara Ordoñez Noriega.

[229] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v Republic of Chile* ICSID Case No. ARB/01/7, Decision of Annulment Committee, dispatched 21 March 2007, ¶ 67.

[230] Ibid., ¶ 70.

[231] Memorial, ¶ 231.

321. Just as importantly, the Claimant's suggestion that it was in any taken by surprise by the imposition of the import licensing requirement – the only measure that is conceivably relevant to the Article 1105 claim – is flatly contradicted by the evidence.

322. For example:

- Mexico HFCS Plant Feasibility Study: Tula, Hidalgo (4 Nov. 1994),[232] Executive Summary, p. 2:

  > There are several important factors to consider in projecting the growth of HFCS in Mexico.
  >
  > * * *
  >
  > H) POLITICAL INFLUENCES: The other critical factor to consider in our decision making process is the government/political question in Mexico. With the recent announcement by our competition to build HFCS capacity in Mexico, we would be the only major wet miller who has not announced. This could be important in a situation where a government-imposed quota would be applied on imported HFCS due to local Mexican production. The perception of Mexican produced HFCS could be viewed more favorable by the government and would demonstrate our long term commitment to our customers.

  Section V, Mexico Government/Political Section, p. 21:

  > ... If Cargill's long term goal is to achieve a 33% market share in Mexico, we must consider the government/political factors of building in Mexico in conjunction with analyzing HFCS capacity from an economic perspective.
  >
  > The key factors are:
  >
  > A) Potential risk of government-imposed quota limiting quantities of HFCS imports, or the potential risk of elimination of HFCS imports because of domestically produced HFCS (longer term).
  >
  > By Cargill not building in Mexico, we take the risk of our competitors and the sugar mills petitioning the Mexican government for protection of a now, local industry (HFCS). Assuming CPC/Arancia does build HFCS capacity as they have announced, and with ADM/Tate & Lyle's plant in Guadalajara, Cargill would be the only major wet miller without HFCS capacity in Mexico. As the HFCS duty declines to 0 over the next 9 years, our competitors would have a strong argument for local support of their investment employing Mexican workers, paying Mexican taxes. I believe it is safe to say that if there is a quota imposed on HFCS, the wet miller without local HFCS production would be at the most risk.

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[232] Exhibit R 99.

- Cargill Internal Memo from Gordon Adkins to Mike Urbanic and others on Mexican sugar producers (6 Aug. 1996):[233]

> We just received the attached story on Reuters regarding sugar producers in Mexico threatening legal action against HFCS imports. This was anticipated as a possible reaction from Mexican sugar producers as there have been increasing discussions in recent months by both Coke and Pepsi about approving and using 55 HFCS in their flagship brands in Mexico.
>
> * * *
>
> We have been discussing this issue with our legal department on a regular basis and they have also been in contact with Mike Meyer of O'Melveny & Myers -- our Washington, DC legal counsel specializing in international trade issues. Mr. Meyer's strong position has been that sugar producers will NOT have legal standing to file an antidumping complaint because 55 HFCS and sugar are not identical products. Under WTO rules, the products must be identical, not just functionally interchangeable. The only companies that could legally trigger an antidumping investigation are those manufacturing HFCS--of which there are none, today.
>
> Nevertheless, Mexican sugar producers are upset over the growing threat of 55 HFCS imports particularly with Coke and Pepsi and will pursue every avenue possible to block it.

- Draft letter to USTR Charlene Barshefsky (17 July 2000) faxed from Jeff Cotter to Dan Pearson:[234]

> It is possible that a bilateral sweetener settlement might establish quantitative restrictions on imports of HFCS into Mexico.

- Memorandum from Corn Refiners Association to Board of Directors (including Jeff Cotter of Cargill) regarding status of NAFTA Chapter Nineteen litigation regarding antidumping order (28 Aug. 2000):[235]

> If we reject any settlement offer and then lose on the key elements of our NAFTA challenge, can we expect to gain <u>any</u> additional access in the foreseeable future? ….
>
> If CRA successfully ends the duties with our NAFTA case, what kind of civil unrest against corn sweeteners can be anticipated in Mexico? Will this unrest be any different than what we are likely to face if limited additional access is obtained through a negotiated settlement?

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233 Exhibit R 100.

234 Exhibit R 101.

235 Exhibit R 102.

Obviously Cargill was well aware of the possibility of restrictions on imports of HFCS long before the import licensing requirement was imposed.

323. The Claimant's suggestion that Mexico was obliged to guarantee the success of Cargill's trading activities, even after the United States blocked imports of Mexican sugar, is wrong both legally and logically.

c. The transparency argument

324. The Claimant asserts that Mexico violated Article 1802 by not promptly publishing the criteria for the issuance of import permits, and that this constitutes a violation of Article 1105.[236] The Claimant again relies on *Tecmed* as well. But Article 1802 is not part of Chapter Eleven and falls outside the Tribunal's jurisdiction.

325. It has long been a basic rule of *conventional* international trade law that the State has a duty to publish information relating to its laws and regulations so that interested parties can consult it so as to be able to order their affairs. For example, Article X of the GATT 1947 (reproduced in GATT 1994) sets out a general rule (subject to a confidential information exception) requiring WTO Members to publish laws, regulations, judicial decisions and administrative rulings of general application relating to matters covered by the Agreement "*in such a manner as to enable governments and traders to become acquainted with them*." This requirement is incorporated into the NAFTA by Article 1802.

326. The tribunal in *Metalclad Corporation v. United Mexican States* followed this same type of theory in relying on Article 1802 to find a violation of Article 1105. Its failure to appreciate that transparency was a rule of *conventional* rather than *customary* international law was one of the reasons why its award was partially set aside on judicial review.[237]

d. The "arbitrary" argument

327. Cargill vaguely argues that actions taken by Mexico were "arbitrary, ambiguous and inconsistent," relying exclusively on *Tecmed*. But Cargill itself also states that it filed a legal challenge to the import permit requirement in 2006, "which is still pending." Cargill does not even allege that there has been problem with obtaining judicial review. In the absence of a determination of illegality under Mexican law, the Tribunal cannot proceed to analyze if the conduct of the Mexican authorities rises to arbitrariness under international law.

328. International law strictly defines the concept of arbitrariness. Both the majority and dissenting opinions so held in the *ELSI* decision of the International Court of Justice (ICJ):

> 124. It must be born in mind that the fact that an act of the public authority may have been unlawful in municipal law does not necessarily mean that the act was unlawful in international law, as breach of treaty or otherwise. A finding of the local courts that an act was unlawful may well

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[236] Memorial ¶¶ 243, 249.

[237] See Reasons for Judgment of Tysoe J. in *United Mexican States v. Metalclad Corporation*, ¶¶ 70-73.

> be relevant to an argument that was also arbitrary; but by itself, and without more, unlawfulness cannot be said to amount to arbitrariness. It would be absurd if measures later quashed by higher authority or a superior court could, for that reason, be said to have been arbitrary in the sense of international law. To identify arbitrariness with mere unlawfulness would be to deprive it of any useful meaning in its own right. Nor does it follow from a finding by a municipal court that an act was unjustified, or unreasonable, or arbitrary, that that act is necessarily to be classed as arbitrary in international law, though the qualification given to the impugned act by a municipal authority may be a valuable indication.

329. The Chamber added:

> 128. Arbitrariness is not something so much opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the Asylum case, when it spoke of "arbitrary action" being "substituted for the rule of law"…It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety. Nothing in the decision of the Prefect, or in the judgment of the Court of Appeal of Palermo, conveys any indication that the requisition order of the Mayor was to be regarded in that light..[238] [Emphasis added]

The holdings of the ICJ Chamber have been expressly approved by NAFTA tribunals.[239]

330. Mexico's acts at issue in this case, viewed fairly in light of the difficult circumstances in which the sugarcane growers and the mills found themselves, and given the state of the sugar industry worldwide, within the United States, and particularly within Mexico, cannot be viewed as rising to the level of arbitrary acts at international law. Indeed, as the Claimant itself describes, Almex was successful in obtaining an *amparo* against the import permit requirement; Mexico complied with the court's decision.[240]

331. The Claimant simply describes the conduct of the Mexican authorities as arbitrary, without more. It seems to believe that trying to cumulate effect of the three alleged violations (two of which are based on measures that do not fall within this Tribunal's jurisdiction) can somehow satisfy the requirement of arbitrariness under international law without the need for a precise legal examination.

332. Mexico submits that this is insufficient. As stated by another Chapter Eleven tribunal, "[l]abeling is … no substitute for analysis".[241] Beyond the realm of rhetoric, the Claimant has not established that the conduct of the Mexican authorities rose to the level of arbitrariness in violation

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238 *Elettronica Sicula, S.p.A.* (United States v. Italy), 1989 *ICJ Reports*, p. 15.

239 See *Mondev* Award, ¶ 108 ("The key point is that the Chamber accorded deference to the respondent's legal system in applying the standard, finding that even though the mayor's act of requisitioning the factory at issue in the case was unlawful at Italian law as an excess of power, mere illegality did not equate to arbitrariness at international law.") See also *ADF* Award, ¶ 190.

240 Memorial ¶ 157.

241 *Azinian*, Award, ¶ 90.

of international law. There was no "willful disregard of due process", no "act which shocks, or at least surprises, a sense of juridical propriety".[242]

333. NAFTA tribunals have consistently held that even admittedly poor administration of government programs (which Mexico says its not at issue in this case) does not amount to a violation of the minimum standard of treatment under customary international law. The *S.D. Myers* tribunal, for example, concluded as follows:

> 261. When interpreting and applying the "minimum standard", a Chapter 11 tribunal does not have an open-ended mandate to second-guess government decision-making. <u>Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive</u>. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections…
>
> 263. The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. <u>That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders</u>. The determination must also take into account any specific rules of international law that are applicable to the case.[243] [Emphasis in original]

334. The *Azinian* tribunal stressed that the NAFTA does not seek to provide an unlimited protection for those disappointments that foreign investors may encounter:

> 83. …It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints. It may safely be assumed that many *Mexican* parties can be found who had business dealings with governmental entities which were not to their satisfaction; Mexico is unlikely to be different from other countries in this respect. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.
>
> Such considerations are unavailing unless the Claimants can point to a violation of an obligation established in Section A of Chapter Eleven attributable to the Government of Mexico.[244] [Italics in the original.]

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[242] *ELSI*, Award, ¶ 128.

[243] S.D. Myers Award.

[244] *Azinian*, Award ¶¶ 83-84.

335. The *Feldman* tribunal cited the *Azinian* award with approval, and added:

> [T]o paraphrase *Azinian*, not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110. Governments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue.[245]

336. Thus, even on the facts as alleged by the Claimant, there is no violation of Article 1105.

e. The discrimination argument

337. The Claimant also suggests, in a cursory manner, that the evidence it has alleged in support of its claim of discrimination in violation of Articles 1102 and 1103 also supports its claim of violation of Article 1105. But Article 1105 plainly means something different than Articles 1102 and 1103. To suggest otherwise would be to ignore the most basic principles of treaty interpretation.

4. No performance requirements were imposed in connection with Cargill de Mexico

338. Article 1106(3) provides in pertinent part:

> No Party may condition the receipt or continued receipt of an advantage <u>in connection with</u> an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements…. [emphasis added]

A threshold issue, therefore, is whether a requirement was imposed "in connection with" Cargill de Mexico.

339. In fact, the tax measure was not a requirement in connection with Cargill de Mexico, and therefore the Claimant and Cargill de Mexico lack the required proximity. The problem with the Claimant's argument is that it would require a modification of the text of Article 1106, as follows:

> No Party may condition the receipt or continued receipt of an advantage [delete: "in connection with" and insert: "<u>by any person who purchases goods produced by or otherwise does business with"]</u> an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements…

However, Article 1106 does not contain the underlined terms. Chapter Eleven does not give the Claimant standing to pursue a claim of an alleged Article 1106 violation involving measures in

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245 *Feldman*, Award ¶ 112.

connection with the investments of third persons rather than themselves. That standing is conferred only on the Parties to the NAFTA – Mexico, the United States and Canada – which have remedies under Chapter Twenty.[246]

340. It warrants noting that no claimant that has invoked Article 1106 to date has attempted to challenge measures that did not apply directly to its own investment:

- In *S.D. Myers v Canada*, the claimant alleged that the measure at issue (a ban on exports of PCB waste):

  > … forced it to dispose of PCB contaminated waste in Canada, if such disposal were to occur at all. SDMI says that this resulted in a performance requirement requiring PCB disposal operators [i.e., SDMI and other such enterprises] to accord preference to Canadian goods and services and to achieve a given level of domestic content contrary to Canada's obligations under Article 1106.[247]

  The tribunal treated this alleged performance requirement as a measure that the claimant considered applied directly to it ("SDMI contends that CANADA's export ban breached Article 1106 of NAFTA because, in effect, SDMI was required, as a condition of operating in Canada, to carry out a major part of its proposed business, the physical disposal of PCB waste in Canada." [Emphasis added.] It is clear that both the claimant and the Tribunal saw the required element of proximity between the measure complained of and the investment of the investor that Mexico has pointed out is necessary.

- In the *ADF* case, the claimant argued that the measure complained of (a requirement to buy domestic steel for a federally-funded state highway project) violated Article 1106:

  > …by requiring preference to be given to United States-produced steel materials and products, if the Investor is to provide fabricated steel products to Federal-aid highway projects. In the present case, ADF International is obliged to purchase only U.S. steel and either to fabricate that steel in the U.S. itself, or to subcontract the fabrication to U.S. steel fabricators rather than to its Canadian parent. The Respondent's measures impose performance requirements relating to or connected with the "management, conduct or operation" of ADF International within the meaning of the chapeau of Article 1106 since those measures "directly impact the daily activities, operations and sales" of ADF International.[248]

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[246] Similarly, the Claimant cannot pursue a Chapter Eleven claim based on an alleged denial of national treatment to a third party, or an expropriation of that third party, even if it could prove indirect harm to itself.

[247] *S.D. Myers* v *Canada*, Partial Award, ¶ 140.

[248] ADF International, Inc. v United States of America, Award, ¶ 82.

Again, this claimant sought to prove that the measure complained of applied directly to its own investment.[249]

- In *Pope & Talbot, Inc.* v *Canada*, the claimant complained of measures (export controls on softwood lumber) that applied directly to its own investment and which required exporters like its investment "to export a given level or percentage of goods."[250]

341. It is also crucial to parse through the two aspects of the claim: first, Cargill's exporting activities from its protected home market, and second, Cargill de Mexico's activities as a trader of imported HFCS.

342. Mexico clearly cannot be liable to Cargill for the impact of an alleged performance requirement on its U.S. operations and its activities as a U.S. exporter of HFCS. That is a trade in goods issue, covered by NAFTA Chapter Three and not by Chapter Eleven.

343. Article 1106 also does not apply to discrimination against Mexican production of HFCS – that is, the production of HFCS by Almex and CPIngredientes in Mexico. Specifically, Article 1106 does not prohibit discrimination against one domestic product in favor of another domestic product. Of course, Cargill de Mexico never produced HFCS in any event. The only issue left is the effect of the tax on Cargill de Mexico's activity as a trader of imported HFCS within Mexico.

344. From the perspective of the soft drink producers –the only entities that were actually subject to the tax – the tax discouraged the use of HFCS, regardless of whether it was imported or produced in Mexico. So if the United States had initiated a Chapter Twenty dispute settlement case alleging a violation of Article 1106, that case would have raised a novel question about whether a measure aimed at a particular product, regardless of the product's nationality, could be considered a performance requirement within the meaning of Article 1106. But with respect to Cargill de Mexico's trading activities, the issue is much more attenuated, because the impact of the tax fell on one market for HFCS, and distribution of HFCS itself was just a small part of Cargill de Mexico's business. In other words, the Claimant is arguing that the tax was tantamount to a performance requirement in how it affected a part of Cargill de Mexico's trading business. Article 1106 does not apply to measures that are argued to be tantamount to a performance requirement or an indirect performance requirement. Article 1106 is not a catch-all provision designed to capture every type of perceived discrimination.

5. Response to the claim of expropriation

345. The expropriation claim is specious. Cargill attempts to characterize the effects of the so-called "anti-HFCS measures" as an expropriation of its "Mexican HFCS business". The use of these terms is calculated to conceal two fatal problems: (i) as a result of the anti-dumping duties,

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[249] The tribunal dismissed the claim because government purchases are excluded from the scope of Article 1106's application.

[250] *Pope & Talbot, Inc.* v *Canada*, Interim Award, ¶ 74. This claim was dismissed on the ground that the export control was "not a 'requirement' for establishing, acquiring, expanding, managing, conducting or operating a foreign owned business in Canada." Interim Award, ¶¶ 75-76.

Cargill was excluded from the Mexican market for HFCS for four years prior to the implementation of the IEPS and (ii) its investments in Mexico – Cargill de Mexico and the Tula distribution facility - have remained in its possession in control and have been profitably used for commercial activities unaffected by the IEPS.

346. As has been explained above, the Tribunal lacks competence to consider the anti-dumping duties as an alleged breach of Section A of Chapter Eleven. As will be explained below, Article 1110 requires the direct or indirect expropriation of an "investment of an investor of another Party". Cargill's so-called "Mexican HFCS business" does not fall within the treaty's definition of an investment.

347. In reality, the effects of the IEPS amounted at most to a temporary loss of a business opportunity, namely, Cargill de Mexico's inability to compete for market share in the Mexican soft drink sweetener market for a period of less than 30 months. Cargill de Mexico was the investment here; its business opportunities and expected market share are not investments within the definition of Article 1139.

348. Moreover, in the words of the most recent Chapter Eleven tribunal to interpret Article 1110:

> Expropriation requires a taking … [which] … must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof (i.e., it approaches total impairment) [and which] … must be permanent, and not ephemeral or temporary. …[251]

a. Additional facts relevant to the claim of expropriation

349. The Claimant asserts a claim of expropriation in the face of the following indisputable facts:

- Cargill is the sole shareholder in Cargill de Mexico which, since it began operations in 1972, has been a distributor of many agricultural goods and food products, including HFCS between 1993 and 1997, and refined sugar from October 2002 to date;[252]
- At all times, Cargill has enjoyed full ownership and control of Cargill de Mexico, including since the enactment of the IEPS. Cargill de Mexico has enjoyed substantial increases in its sales revenues since the tax was imposed;[253]
- Cargill also owns (and Cargill de Mexico operates) a distribution facility in

[251] *Fireman's Fund Insurance Company v. The United Mexican States,* Award, 17 July 2006 , ¶176 (publication by the ICSID of the public version is pending)

[252] Memorial, ¶13, Expert Report of Brent C. Kaczmarek, Navigant Consulting ("Navigant Report") ¶¶ 15-18, 44-54 Exhibit R 02, Report of Pablo Rion & Associates ("PRA Report"), ¶¶ 142-143.

[253] Navigant Report, ¶ 27; Exhibit R 120, Cargill de Mexico Financial Statements.

Tula, Hidalgo (the "Tula distribution facility") which has distributed, in addition to HFCS, many products completely unaffected by the IEPS, including glucose, soybean oil, and flour, and later became the site of an oilseeds plant, also unaffected by the IEPS;[254]

- Cargill de Mexico did not sell any HFCS in Mexico after 1997 as a result of the imposition of anti-dumping duties and thus, when the IEPS tax entered into effect on 1 January 2002, its market share was zero, as it had been for the previous four years;[255]
- Cargill de Mexico's first opportunity to re-enter the Mexican HFCS soft drink sweetener market "but for the tax" would have been following the removal of the anti-dumping duties in May 2002 but it would still have had to comply with the requirement to obtain a permit to import HFCS under the TRQ regime established by Mexico on 31 December 2001;[256]
- Cargill de Mexico had an opportunity to sell HFCS to soft drink bottlers in 2004 when FEMSA and other major bottlers began obtaining *amparos* against the application of the IEPS but Cargill de Mexico would still have had to comply with the requirement to obtain a permit to import HFCS under the TRQ regime established by Mexico on 31 December 2001;[257]
- Cargill de Mexico had a further opportunity to sell HFCS to Mexican soft drink bottlers in September 2005 when 250,000 tons of HFCS import quota was made available by Mexico to U.S. exporters, including Cargill, pursuant to the "Katrina Swap" but Cargill chose instead to sell its quota to a competitor;[258]
- Cargill de Mexico had yet a further opportunity to sell HFCS to Mexican soft drink bottlers in September 2006 when 500,000 tons of HFCS import quota was made available to U.S. exporters, including Cargill, pursuant to the 2006 Reciprocal Agreement, but Cargill has decided to refurbish the Tula distribution center with a view to reopening it within a year.[259]

b. The Claimant's investment in the territory of Mexico is Cargill de Mexico and the Tula distribution facility

350. Article 1110 states that a Party may not expropriate "an investment of an investor of a Party" unless it complies with the stipulated requirements, including payment of compensation based on the fair market value of the expropriated investment immediately before the expropriation took place. Article 1139 contains an exhaustive definition of what constitutes an

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254 Navigant Report, ¶26, PRA Report, ¶¶ 142-143.

255 Memorial, ¶101.

256 Navigant Report, ¶ 57, 61.

257 Ibid., ¶ 68.

258 Memorial, ¶ 176.

259 Ibid., ¶ 179

"investment" and Article 1101 clearly confines the application of Chapter Eleven to "investments of investors of another Party in the territory of the [host] Party." Thus the Claimant can only seek compensation for the expropriation of an investment (as defined) that it owns or controls and that is located in the territory of Mexico.

351. Cargill correctly contends that it has investments as defined in Article 1139 – including an enterprise (Cargill de Mexico), an equity security in an enterprise (shares in Cargill de Mexico), an interest in an enterprise that entitles the owner to share in income or profits of the enterprise (shares in Cargill de Mexico); an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution" (shares in Cargill de Mexico) and real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes (the land, plant and equipment comprising the Tula distribution facility).

352. Cargill incorrectly contends that it also has "interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory". As the continuation of that definition states, it applies to commitments of capital "such as (i) under contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise". The Claimant has not described, nor adduced evidence of, any investment that falls within this definition.

353. The Claimant is thus restricted to asserting a claim for the direct or indirect expropriation of Cargill de Mexico and/or the land, plant and equipment comprising the Tula distribution facility. There is no legal basis to claim expropriation of the Cargill's so-called "Mexican HFCS business", or expropriation of an opportunity to fully engage in that business, or expropriation of hoped for market share in that business.

354. The point was put succinctly by the *Methanex* Tribunal:

> The USA is correct that Article 1139 does not mention the items claimed by Methanex. [goodwill, market share and customer base] But in *Pope & Talbot Inc. v. Canada*, the tribunal held that "the Investor's access to the U.S. market is a property interest subject to protection under Article 1110". Certainly, the restrictive notion of property as a material "thing" is obsolete and has ceded its place to a contemporary conception which includes managerial control over components of a process that is wealth producing. In the view of the Tribunal, items such as goodwill and market share may, as Professor White wrote, "constitute an element of the value of an enterprise and as such may have been covered by some of the compensation payments". Hence in a comprehensive taking, these items may figure in valuation. But it is difficult to see how they might stand alone, in a case like the one before the Tribunal.[260]

[260] *Methanex Corporation v. The United States of America*, Final Award of the Tribunal on Jurisdiction and the Merits, August 3, 2006, http://www.state.gov/documents/organization/51052.pdf, page 283, ¶ 17. In this respect it reflected the views of the three NAFTA Parties and accepted the point made by Gillian White in Nationalization of Foreign Property, p. 49 (1961): "A property right, in order to qualify for the protection of the international law rules

c. The proper interpretation and application of Article 1110

355. The NAFTA does not establish rules of *stare decisis*[261] in that no award is binding except for the parties to a particular case, and other arbitral awards – particularly those rendered under other treaties with different grants of jurisdiction and governing law – must be considered with care.[262] For example, academic commentary based on the jurisprudence of the Iran-US Claims Tribunal (such as the work of Charles Brower cited by the Claimant) is inapt due to the fact that the terms of reference established by the *Algiers Accords* were broader than NAFTA; for example, in the area of measures relating to property rights, it permitted redress for both expropriation and "other measures affecting property rights". The inapplicability of Iran-US Claims Tribunal jurisprudence to the interpretation and application of Article 1110 has been expressly noted by other NAFTA tribunals in response to repeated attempts by claimants to rely on the more expansive and analytically loose approach taken to expropriation and other measures affecting property interests taken in some of the Iran-US cases.

356. Claimants in Chapter Eleven proceedings rely habitually on certain awards, such as *CME Czech Republic B.V (The Netherlands)* v *the Czech Republic* and *Metalclad v. United Mexican States*. *CME*, rendered by a bitterly divided tribunal, is cited, but *Lauder*, where a unanimous tribunal came to the diametrically opposite conclusion on the same facts, is not.[263] Similarly, *Metalclad*, set aside in part on judicial review and out-of-step with the seven following NAFTA cases that have dismissed claims of indirect expropriation, is frequently cited in support of the expropriation claim while the other jurisprudence which does not follow it either expressly or implicitly is either ignored or cited out of context.

357. In *Loewen v. United States of America*, Mexico intervened under Article 1128. Since the claimants there had relied on *CME*, Mexico pointed out that *Lauder* had arrived at the opposite conclusion before *CME* was rendered. It also pointed to the serious split within the *CME* tribunal such that the majority's criticisms of the dissenter and *vice versa* raised questions about the award's soundness. Mexico also noted that *CME* cited *Metalclad* with approval, evidently

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must be an actual legal right, as distinct from a mere economic of other benefit, such a situation created by the law of a State in favor of some person or persons who are therefore interested in its continuance. [T]he notion of goodwill is too vague to be regarded as a separate property right apart from the enterprise to which it is attached. This assumption gains support from the complete absence of any reference to goodwill or business reputation in any of the post-war decrees or compensation agreements examined by the writer. The most that can be said is that goodwill constitutes an element of the value of an enterprise and as such may have been covered by some of the compensation payments."

261 See Article 1135(1).

262 See *Waste Management, Inc. v. United Mexican States*, ¶¶ 145-149, 166-170 for a careful appraisal of "authorities" said to be persuasive in the NAFTA context but rejected as inapplicable.

263 *Ronald S. Lauder v. Czech Republic*, UNCITRAL Final Award, ¶¶ 196-204. This tribunal took a very different view of the meaning of expropriation; unlike *Metalclad* and *CME*, it found that a benefit to the State was a necessary element of the definition: "In addition, even assuming that the actions taken by the Media Council …had the effect of depriving the Claimant of his property rights, such actions would not amount to an appropriation – of the equivalent – by the State, since it did not benefit the Czech Republic or any person or entity related thereto, and was not taken for any public purpose." [¶ 203.]

unaware of the fact that that tribunal's findings on the point for which it was being cited had been set aside on judicial review.[264]

358. The United States commented on Mexico's Article 1128 submission. It agreed with Mexico's arguments and further stated "that the Tribunal should not rely upon the Partial Award rendered in *CME Czech Republic B. V. (The Netherlands)* v *the Czech Republic*". It noted that in addition to its being decided under a different treaty, and being irrelevant to the facts of its case, the award appeared "to be unsound in certain respects", "was decided over an extraordinarily bitter dissent", "reached the opposite conclusion of another tribunal under virtually identical facts in a parallel proceeding", quoted a participant in the arbitration as commenting that "this fundamental inconsistency 'brings the law into disrepute, brings arbitration into disrepute – the whole thing is highly regrettable'", and concluded that the award was questionable in various other respects.[265]

359. *Metalclad* is also cited by the Claimant even though its fair and equitable treatment finding[266] was set aside together with part of its expropriation finding. The Supreme Court of British Columbia: (i) set aside the Article 1105 ruling in its entirety[267]; (ii) set aside one of the two expropriation determinations (because the Article 1105 determination "infected" the expropriation determination)[268]; and (iii) expressed reservations as to the "extremely broad" definition of expropriation (but declined to intervene on a matter of law).[269] The *Metalclad* tribunal's *ex cathedra* pronouncement on the meaning of Article 1110 has been treated with caution by subsequent NAFTA tribunals.

360. Subsequent NAFTA proceedings have cited the British Columbia Supreme Court's reasons for judgment in preference to the tribunal's award. The majority in *Feldman* observed that *Metalclad*'s "principal rationale for …[the] determination [of expropriation] was substantially overturned by the reviewing court"[270] and stated: "[w]hile this Tribunal is not required to reach the same result as the British Columbia Supreme Court [in interpreting Article 1105], it finds this

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264 Second Article 1128 submission by the Government of Mexico in *The Loewen Group, Inc. and Raymond L. Loewen v. The United States of America*. Available at: http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_eua/Raymon/1128/Segundo_1128_Mexico.pdf.

265 Response of the United States of America to the November 9, 2001 Submissions of the Governments of Canada and Mexico pursuant to NAFTA Article 1128, dated 7 December 2001, pp. 4-6. Available at http://state.gov/documents/organization/6926.pdf.

266 Which in any event is inapplicable to a claim involving a taxation measure.

267 *United Mexican States v Metalclad Corporation*, Reasons for Judgment, Honourable Mr. Justice Tysoe, Supreme Court of British Columbia, 2 May 2001. Available at:http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Metalclad/BC-SCJ/sentencia_BC.pdf.

268 Ibid.

269 Ibid.

270 *Marvin Roy Feldman* v *United Mexican States*, Final Award,¶ 107: "there has been only one prior finding of a taking under Article 1110, in *Metalclad*, and the principal rationale for that decision was substantially overruled by the reviewing court, the Supreme Court of British Columbia." Available at: http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Marvin/laudo/laudo_ingles.pdf.

aspect of their decision instructive".[271] *Feldman* found further that *Metalclad*'s characterization of an ecological decree found to be a measure 'tantamount to expropriation' because it "barred forever the operation of the [claimant's] landfill"[272], was "rather strangely characterized"[273] because it was more properly characterized as a direct expropriation.[274] *Loewen* included *Metalclad* in a list of three prior NAFTA awards (together with *Myers* and *Pope & Talbot*) whose treatment of Article 1105 was such that to the extent that they "may have expressed … views [contrary to the Free Trade Commission's Note of Interpretation on Article 1105], those views must be disregarded".[275] *Waste Management II* avoided resolving the differences between the Supreme Court and the *Metalclad* tribunal on the interpretation of Article 1110 (but implied that the tribunal's definition was too broad) stating that it was "[l]eaving aside any question of the breadth of the definition of expropriation given by the *Metalclad* tribunal (at least when considered in isolation from the facts of that case)" [276] and found that even on that expansive definition, Mexico's actions in that case did not give rise to an expropriation.[277] *GAMI* noted that the reviewing court in *Metalclad* had held that it could not address the tribunal's definition of expropriation because of its finding that it lacked jurisdiction to do so.[278]

361. In only one case of ten NAFTA cases decided to date where expropriation has been alleged has an expropriation been found (*Metalclad*). In *Azinian*, *Waste Management*, *Myers*, *Pope & Talbot*, *Mondev*, *Loewen*, *GAMI, Thunderbird* and *Fireman's Fund*, the expropriation claim was dismissed. In *Metalclad*, after judicial review, the sole surviving ground for finding State responsibility was the tribunal's finding that an ecological decree "had the effect of barring forever the operation of the landfill"[279] (the sole asset of that claimant's enterprise). It warrants noting that the tribunal attached great importance to the permanent deprivation of the possibility of operating the hazardous waste landfill.

362. NAFTA cases have held that in order for a measure to be "tantamount to expropriation" its effects must be equivalent to an expropriation. A measure, such as a taxation measure, which is

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[271] Ibid.,¶ 133. See also ¶ 107 where the tribunal noted that "there has been only one prior finding of a taking under Article 1110, in *Metalclad*, and the principal rationale for that decision was substantially overruled by the reviewing court, the Supreme Court of British Columbia."

[272] Ibid., ¶ 146.

[273] Ibid., at footnote 29.

[274] Ibid.

[275] *Loewen* Award, 26 June 2003, ¶ 128. Available at: http://www.state.gov/documents/organization/22094.pdf

[276] It noted: "Leaving aside any question of the breadth of the definition of expropriation given by the *Metalclad* tribunal (at least when considered in isolation from the facts of that case)…", *Waste Management, Inc.* v *United Mexican States*, ¶ 159. See also its observation that the Supreme Court found the definition of expropriation to be "extremely broad" (at ¶ 154). Available at: http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Waste_2_management/laudo/laudo_ingles.pdf

[277] Ibid.

[278] *GAMI Investments, Inc.* v *United Mexican States*, Final Award, ¶ 131. Available at: http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Gami/escritos/GAMI_english.pdf.

[279] *Metalclad* Award, ¶ 109. Available at: http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Metalclad/laudo/laudo_español.pdf

not a direct expropriation, must at least result in the substantially complete deprivation of the Claimant's use and benefit of the investment at issue to be found to be a measure tantamount to expropriation. Put another way, the impairment or interference complained of must be of such permanence and degree as to rise to the level of an expropriation. This requirement is reflected in at least six awards rendered to date under Chapter Eleven.

363. In *Pope & Talbot* the tribunal held, *inter alia*, that Canada's export control regime on softwood lumber exports, which resulted in a diminution of profits in the claimant's enterprise, was not tantamount to expropriation because it was not equivalent to a taking. Although the tribunal agreed with the claimant that the right to participate in the softwood export market was a legal right that was capable of being expropriated[280], the question was whether interference with such rights resulted in a taking of the claimant's enterprise:

> While it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been "taken" from the owner.[281]

364. In *S.D. Myers* the claimant alleged that Canada's closure of its border to exports of PCB waste for a period of 18 months (to protect Canadian investors and preclude Myers from participating in the Canadian PCB waste remediation market) was tantamount to expropriation of its investment in the PCB waste remediation business. The tribunal, citing *Pope & Talbot* with approval, rejected the claim, holding that the temporary application of the impugned measure which prevented Myers from engaging in the PCB destruction business in Canada was not equivalent to the expropriation of its enterprise.

365. In *Feldman*, the claimant alleged that measures impeding his company's ability to export cigarettes and receive reimbursement of the applicable IEPS tax amounted to a creeping expropriation of the company's "cigarette export business". The tribunal, citing both *Pope &*

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280 A point with which the three NAFTA Parties disagree. See the U.S. Rejoinder in *Methanex* at ¶ 193 where it noted: "The Amended Statement of Defense demonstrated that goodwill, market share and customer base are incapable, by themselves, of being expropriated. Neither the international nor domestic legal authorities cited in the Reply support Methanex's contention that goodwill may be deemed a property right that, *by itself*, can be expropriated. Moreover, to the extent that the *Pope & Talbot* or *S.D. Myers* awards can be construed to favor a different result, the NAFTA Parties have expressed their disagreement with those decisions." The United States was referring in this regard to Canada's Second Article 1128 submission (stating that *Pope & Talbot* erred in equating market access to intangible property) and Mexico's Second Article 1128 submission (stating that insofar as *Pope & Talbot* or *Myers* can be read to support Methanex's position on goodwill, market share and customer base, those tribunals erred in interpreting Article 1139) and Mexico's Fourth Article 1128 submission stating that goodwill, market share and customer base are not property rights subject to protection under Article 1128. Available at www.state.gov/documents/organization/31977.pdf. See also Gillian White, Nationalization of Foreign Property, p. 49 (1961) and the *Oscar Chinn Case* (U.K. v Belgium) 1934 P.C.I.J. ser. A/B, No. 63. 65, where the PCIJ denied an expropriation claim for failure to identify a property right. when the claim complained of a government increased in funding for a state-owned competitor of the British river carrier operator with the result that the state-owned enterprise was granted a *de facto* monopoly. The Court held that it was "unable to see in [the claimant's] original position – which was characterized by the possession of customers … anything in the nature of a genuine vested right." [¶ 88.]

281 *Pope & Talbot, Inc. v. The Government of Canada*, Interim Award, ¶ 102. http://ita.law.uvic.ca/documents/Pope-InterimAward.pdf

Talbot and *S.D. Myers* with approval, refused to recognize the so-called cigarette export business as an "investment" and held instead that:

> [the challenged measure] …has not deprived the Claimant of control of his company … interfered directly in the internal operations … or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of business activity. .. Of course, he was effectively precluded from exporting cigarettes … However, this does not amount to Claimant's deprivation of control of his company.[282]

366. In *Methanex* the claimant alleged that a measure which resulted in its product being banned from the Californian market and that market being essentially transferred to ethanol was tantamount to expropriation. As noted above, the tribunal held, *inter alia*, that market share and goodwill do not stand alone as property capable of expropriation but could figure in valuation in the case of a comprehensive taking.[283]

367. In *Waste Management II* the tribunal considered whether the totality of conduct of various government entities was tantamount to expropriation of the claimant's investment in a waste collection concession. The tribunal distinguished between the effects of the impugned measures on the claimant's enterprise (which remained under its ownership and control) and their effects on the enterprise's contractual rights under the concession, finding that the claimant's enterprise was never seized or interfered with and that serial breaches of contractual obligations on the part of the contracting municipality fell to be determined under the contract, not as measures which were individually or collectively tantamount to expropriation. In so finding the tribunal stated:

> It is not the function of Article 1110 to compensate for failed business ventures, absent a virtual taking or sterilizing of the enterprise.[284]

368. In this case there has been no property transfer, no confiscation of property, no interference with management or control of an investment properly defined, no loss of the investment nor a paralyzing, sterilizing or virtual taking of the enterprise.[285] In Mexico's opinion, the *Waste*

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[282] *Marvin Roy Feldman v United Mexican States*, Final Award, ¶ 152.

[283] *Methanex Corporation* v *United States of America, Final Award*, Part IV Chapter D Page 7 ¶ 18. In this respect it reflected the views of the three NAFTA Parties and accepted the point made by Gillian White in Nationalization of Foreign Property, p. 49 (1961): "A property right, in order to qualify for the protection of the international law rules must be an actual legal right, as distinct from a mere economic of other benefit, such a situation created by the law of a State in favor of some person or persons who are therefore interested in its continuance. [T]he notion of goodwill is too vague to be regarded as a separate property right apart from the enterprise to which it is attached. This assumption gains support from the complete absence of any reference to goodwill or business reputation in any of the post-war decrees or compensation agreements examined by the writer. The most that can be said is that goodwill constitutes an element of the value of an enterprise and as such may have been covered by some of the compensation payments." Available at: www.state.gov/documents/organization/51052.pdf

[284] *Waste Management, Inc. v United Mexican States*, Final Award, ¶ 160. Available at: http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Waste_2_management/laudo/laudo_ingles.pdf

[285] Ibid., ¶ 160.

Management II tribunal's finding that "the loss of benefits or expectations is not a sufficient criterion for an expropriation…" is also applicable in this case.[286]

369. In *Thunderbird*, the expropriation claim was dismissed by the tribunal on factual grounds without its having to address the parties' submissions on the interpretation of Article 1110. [287]

370. Most recently, in *Fireman's Fund,* the expropriation claim was dismissed after the tribunal proffered its observations as to the interpretation of Article 1110(1):

> NAFTA does not give a definition for the word "expropriation." In some ten cases in which Article 1110(1) of the NAFTA was considered to date, the definitions appear to vary. Considering those cases and customary international law in general, the present Tribunal retains the following elements:
>
> (a) Expropriation requires a taking (which may include destruction) by a government-type authority of an investment by an investor covered by the NAFTA.
>
> (b) The covered investment may include intangible as well as tangible property.
>
> (c) The taking must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof (i.e., it approaches total impairment)
>
> (d) The taking must be permanent, and not ephemeral or temporary.
>
> (e) The taking usually involves a transfer of ownership to another person (frequently the government authority concerned), but that need not necessarily be so in certain cases (e.g., total destruction of an investment due to measures by a government authority without transfer of rights).
>
> (f) The effects of the host State's measures are dispositive, not the underlying intent, for determining whether there is expropriation.
>
> (d) The taking may be *de jure* or *de facto.*
>
> (h) The taking may be "direct" or "indirect."
>
> (i) The taking may have the form of a single measure or a series of related or unrelated measures over a period of time (the so-called "creeping" expropriation)

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[286] Ibid., ¶ 159. The *Waste Management II* tribunal considered this issue in the context of contractual violations: "It is also true that the City's breaches (not remedied by Guerrero and remedied only to a limited extent by Banobras) had the effect of depriving Acaverde of "the reasonably-to-be-expected economic benefit" of the project so far as the monthly fees due from the City were concerned. But that will be true of any serious breach of contract: the loss of benefits or expectations is not a sufficient criterion for an expropriation, even if it is a necessary one."

[287] Due to the absence of a legitimate expectation on the facts of that case.

> (j) To distinguish between a compensable expropriation and a noncompensable regulation by a host State, the following factors (usually in combination) may be taken into account: whether the measure is within the recognized police powers of the host State; the (public) purpose and effect of the measure; whether the measure is discriminatory; the proportionality between the means employed and the aim sought to be realized; and the bona fide nature of the measure.
>
> (k) The investor's reasonable "investment-backed expectations" may be a relevant factor whether (indirect) expropriation has occurred.[288]
>
> [Emphasis added, footnotes omitted.]

d. Neither Cargill de Mexico nor the Tula distribution facility suffered interference equivalent to a taking

371. It bears repeating that on 1 January 2002, when the IEPS and the permit requirement went into effect, Cargill had been out of the Mexican HFCS market for four years as a result of the anti-dumping duties and had no prospect of re-entering the market until the duties were lifted in May 2002. Simply put, neither measure interfered with any business activities that either of Cargill's investments, Cargill de Mexico and the Tula distribution facility, were engaged in at the time that the Claimant contends an expropriation occurred.

372. Cargill de Mexico's 2002 financial statement discloses that it was a trader, distributor and/or processor of corn, sorghum, wheat, beans, soy and sugar, and a producer of soybean oil and soy pasta. With the exception of sugar, which Cargill de Mexico began distributing in 2002, these are the same products that it was trading, distributing and producing prior to the IEPS. The financial statements also disclose that Cargill de Mexico's sales revenues increased every year from 2001 to 2005, growing from 7.0 billion pesos to 17.4 billion pesos during that five year period.[289]

373. Cargill's investment in the Mexican sugar industry in October 2002 underscores the fact that neither the IEPS nor the permit requirement ever rose to the level of an expropriation. Cargill de Mexico is a trading company that exploits market opportunities when they arise. With the loss of an opportunity to supply HFCS to the Mexican soft drink industry there arose an opportunity to distribute sugar. Cargill recognized this opportunity, which was created by the IEPS, and acquired a 15% interest in Zucarmex, the third largest sugar producer in Mexico. As part of the transaction, Cargill de Mexico was granted a four-year exclusive distribution contact whereby it would be paid the equivalent of US$10 per ton for selling Zucarmex products.[290]

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[288] *Fireman's Fund Insurance Company v. The United Mexican States,* Award, 17 July 2006 , ¶176 (publication by the ICSID of the public version is pending).

[289] Exhibit R 137. Cargill's financial statements.

[290] Exhibit R 02, PRA Report, ¶ 147-148.

374. As to the Tula distribution facility, if it was idle or underutilized, it had been in that state for four years prior to the introduction of the IEPS. In any case, there is record evidence indicating that (i) the land acquired for the facility had other intended uses at the time that it was acquired; (ii) the land was in fact used for establishment of an oilseeds plant after it was acquired; and (iii) the plant and equipment was used for the distribution of products other than HFCS, including glucose, soybean oil, and flour.[291]

375. The Claimant bears the burden of proving that an investment it owned in Mexico was expropriated. The contemporaneous evidence obtained by the Respondent through its request for production of documents establishes that effects of the IEPS (and the permit requirement, for that matter) never rose to the level of a taking of anything the Claimant can properly characterize as an investment, as defined in Chapter Eleven. Simply put, there was no taking, no virtual taking, no sterilization and no substantially complete deprivation of Cargill de Mexico's economic use or interference "approaching total impairment".

e. Problems arising from the Claimant's intention to continue in possession of its investments

376. The Claimant has never abandoned Cargill de Mexico or the Tula distribution facility. Rather, it is clear that the Claimant intends to continue to own and control both investments in order to exploit such market opportunities that may now exist or that may arise in the future, whether in the distribution of HFCS, sugar or other food products. This completely undermines the Claimant's ability to assert a claim for compensation arising from Mexico's alleged violation of Article 1110.

377. In the two cases involving Mexico where an indirect expropriation has been found to exist – *Metalclad* and *Tecmed* – although in both cases the claimants had abandoned further attempts to operate their business, the claimants remained possessed of the property and assets at issue when the awards in their favor were rendered. The tribunals in both cases ordered that the property and assets (hazardous waste landfill facilities) be transferred to the Mexican government upon payment of the sum awarded as compensation for expropriation which, in both cases, was based on the "fair market value" of the expropriated investment.

378. In this case, if there had been interference amounting to an expropriation, the Claimant would have abandoned at least the Tula distribution facility (or some distinct part thereof) and would now be in a position to tender title to Mexico upon payment of compensation in the sum awarded. However, the Claimant is not in a position to do so nor is it disposed to do so. There is simply no question of abandoning or turning over title to Cargill de Mexico (or any distinct part thereof), and it has remained in possession of the Tula distribution facility with the intention of using it to distribute HFCS now and in the future, in addition to the other products that it has been distributing all along..

[291] Ibid. ¶ 142-143.

379. A related problem is the Claimant's failure to adduce evidence of the fair market value of either investment. Tribunals established under the NAFTA have consistently held that measure of compensation for breach of Article 1110 is prescribed by Article 110(2): [292]

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

380. The Claimant has not adduced evidence of fair market value, reasoning that an award based on profits that it would have earned "but for" the tax is the best way to compensate it for the effects of the alleged breach.

381. The Claimant's difficulties with using the prescribed measure of compensation are several, and include the fact that on the presumed date of expropriation (1 January 2002) Cargill had been out of the Mexican HFCS market for four years, and the fact that Cargill remains in possession of both investments with the intention of participating in the Mexican HFCS now and in the future. This is a reflection of the central problem of the entire Article 1110 claim: the effects of the IEPS never rose to the level of an expropriation of either of Cargill's HFCS-related investments. Accordingly, the expropriation claim should be dismissed.

C. In the event that the Tribunal were to find against Mexico on its position that there is no breach of Chapter Eleven, Mexico pleads that the tax was legitimate countermeasure under international law

1. The background to the NAFTA's general disputes settlement mechanism

382. The NAFTA Parties took care to develop the Treaty's institutional mechanisms. They were cognizant of the problems that had plagued the GATT and just as the negotiators of what would become the WTO decided to reform GATT dispute settlement, the NAFTA Parties decided to create an effective means of resolving disputes that might arise between them. Chapter Twenty, "Institutional Arrangements and Dispute Settlement Procedures", establishes the rules for settling disputes arising between the Parties, that is, between the States. Section B of that chapter, entitled "Dispute Settlement", begins with the following two articles:

> **Article 2003: Cooperation**
>
> The Parties shall at all times endeavor to agree on the interpretation and application of this Agreement, and shall make every attempt through cooperation and consultations to arrive at a mutually satisfactory resolution of any matter that might affect its operation.
>
> **Article 2004: Recourse to Dispute Settlement Procedures**

[292] See *Metalclad* Award, ¶ 118 and *Feldman* Award, ¶ 194.

> Except for the matters covered in Chapter Nineteen (Review and Dispute Settlement in Antidumping and Countervailing Duty Matters) and as otherwise provided in this Agreement, the dispute settlement provisions of this Chapter shall apply with respect to the avoidance or settlement of all disputes between the Parties regarding the interpretation or application of this Agreement or wherever a Party considers that an actual or proposed measure of another Party is or would be inconsistent with the obligations of this Agreement or cause nullification or impairment in the sense of Annex 2004.
>
> [Emphasis added]

383. The GATT 1947's dispute settlement procedure (which was in force when NAFTA was being negotiated) had encountered serious efficiency-related problems because it was based on a consensual agreement between the Contracting Parties, including any would-be respondent, and because the procedure was not automatic. Palmeter and Mavroidis describe the problems in the following terms:

> Dispute settlement under GATT was handicapped, however, by the requirement of Article XXIII that all matters be decided, and all action be approved, by the CONTRACTING PARTIES. GATT, in legal form, was a contract —a multi-party contract— and any decision to amend, modify, or interpret that contract required the consent of all of the parties. In practice, this meant that the losing party in a dispute settlement proceeding not only could refuse to agree, and therefore "block" the adoption of an adverse report, it could even refuse to agree to the very establishment of a panel, thereby avoiding even the embarrassment of a panel proceeding.
>
> Adverse GATT panel reports indeed were blocked by losing parties. In fact, parties who anticipated losing sometimes even blocked the establishment of a panel. It is a tribute to the system and the degree to which the parties valued it that blocking of both the establishment of panels and the adoption of their reports did not occur more often than they did. In fact, Prof. Hudec's study shows that from 1947 to 1992, the losing party eventually accepted the results of an adverse panel report in approximately 90 percent of the cases. Still, blocking was a problem and seemed to be occurring with increasing frequency in the 1980s…[293]
> [Emphasis added.]

384. The way in which the GATT operated had been widely criticized, particularly by the United States. Like all GATT Contracting Parties in the Uruguay Round of Multilateral Trade Negotiations (the round that led to the creation of the WTO), the NAFTA Parties wanted to correct

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[293] David Palmeter and Petros Mavroidis, *Dispute Settlement in the World Trade Organization, Practice and Procedure* (Second ed., Cambridge University Press, 2004), p. 9. Mexico initiated two cases within the framework of the GATT 1947: one on antidumping quotas imposed by the United States to the Mexican cement imports and another on restrictions adopted by the United States against imports of Mexican tuna. Both Panels resolved the dispute in favor of Mexico, but the United States blocked the adoption of their decisions.

these deficiencies. The GATT Contracting Parties cured this problem in the WTO's *Dispute Settlement Understanding* (the "DSU"*)*. As Professor John H. Jackson noted:

> …This text [the DSU] solves many of the issues that have plagued the GATT dispute settlement system, although not all of them. It accomplishes the following:
>
> 1) It establishes a unified dispute settlement system for all parts of the GATT/WTO system, including the new subjects of services and intellectual property. This, controversies over which procedure to use will not occur.
>
> 2) It reaffirms the right of a complaining government to have a panel process initiated, preventing blockage at that stage.
>
> 3) It ingeniously establishes a new appellate procedure which will substitute for some of the Council approval process of a panel report and overcome blocking.[294]
>
> [Emphasis added.]

385. The NAFTA Parties also sought to establish a dispute settlement procedure that would allow a complainant to have an arbitral panel appointed to prevent or resolve "all controversies" that arose between them "relating to the application or the interpretation" of the Treaty[295], even if one of the Parties objected or was reluctant to participate.

386. Specifically, NAFTA's Article 2009 states:

> **Article 2009: Roster**
>
> 1. The Parties shall establish by January 1, 1994 and maintain a roster of up to 30 individuals who are willing and able to serve as

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[294] John H. Jackson, "The Uruguay Round and the Launch of the WTO: Significance & Challenges," in Terence P. Stewart, The World Trade Organization: Multilateral Trade Framework for the 21st Century and U.S. Implementing Legislation, p. 14. See also Andreas F. Lowenfeld, "Remedies Along with Rights: Institutional Reform in the New GATT," Am. J. Int. L., Vol. 88, No. 3, (July 1994), 477 at pp 479-480: "…it was possible for the losing party before a GATT dispute panel to block adoption of a panel report, and this happened not infrequently. Indeed, in some instances a contracting party was able to block, or. at least delay, appointment of a panel in the first place… At some stage during the Uruguay Round, agreement was reached by the European Community and the United States to commit themselves completely to the panel process. Establishment of a panel could not be blocked, and panel decisions would go into effect automatically within sixty days, unless disapproved by consensus." [Emphasis added.] See also Andreas F. Lowenfeld, "Dispute Settlement in the WTO" p. 153, where having described the appointments process under the WTO Dispute Settlement Understanding, it is noted: "Thus it is not possible for the respondent state to prevent or delay establishment of a panel, even if its position could command a majority of other member States." The author later points out that: "Clearly the effort, which has not been wholly successful, is to avoid some of the delaying tactics through objection to panelists that plagued the GATT disputes process in the 1970s and 1980s." At p. 161.

[295] See NAFTA Article 2004.

panelists. The roster members shall be appointed by consensus for terms of three years, and may be reappointed.

2. Roster members shall:

(a) have expertise or experience in law, international trade, other matters covered by this Agreement or the resolution of disputes arising under international trade agreements, and shall be chosen strictly on the basis of objectivity, reliability and sound judgment;

(b) be independent of, and not be affiliated with or take instructions from, any Party; and

(c) comply with a code of conduct to be established by the Commission.

387. If the disputing Parties were unable to settle their dispute after having exhausted the technical consultation and FTC stages[296], either one could request the establishment of an arbitral panel. The disputing Parties would then proceed to constitute a panel by appointing the panelists

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[296] The relevant sections of NAFTA are:

Consultations

Article 2006: Consultations
1. Any Party may request in writing consultations with any other Party regarding any actual or proposed measure or any other matter that it considers might affect the operation of this Agreement.

….

Initiation of Procedures

Article 2007: Commission - Good Offices, Conciliation and Mediation

1. If the consulting Parties fail to resolve a matter pursuant to Article 2006 within:
(a) 30 days of delivery of a request for consultations,
(b) 45 days of delivery of such request if any other Party has subsequently requested or has participated in consultations regarding the same matter,
(c) 15 days of delivery of a request for consultations in matters regarding perishable agricultural goods, or
(d) such other period as they may agree,
…
Panel Proceedings

Article 2008: Request for an Arbitral Panel

1. If the Commission has convened pursuant to Article 2007(4), and the matter has not been resolved within:
(a) 30 days thereafter,
(b) 30 days after the Commission has convened in respect of the matter most recently referred to it, where proceedings have been consolidated pursuant to Article 2007(6), or
(c) such other period as the consulting Parties may agree,
any consulting Party may request in writing the establishment of an arbitral panel. The requesting Party shall deliver the request to the other Parties and to its Section of the Secretariat.
2. On delivery of the request, the Commission shall establish an arbitral panel….

in accordance with the following procedure: First, the Parties would endeavor to designate the panel's president by mutual agreement within 15 days. Lacking any agreement in this regard, the disputing Party chosen by lot would then have 5 days to select an individual who was not a citizen of that Party to act as president. Following the president's appointment, each disputing Party would have 15 days to designate two panelists of the other Party's nationality.[297]

388. Given the experience with GATT 1947, NAFTA's negotiators anticipated the possibility that a Party might refuse to designate panelists and established in Article 2011(1)(d) a provision that would allow the procedure to continue automatically in the face of a refusal:

> If a disputing Party fails to select its panelists within such period [15 days of the delivery of the request for the establishment of the panel], they shall be selected by lot from the roster members who have the other disputing Party's citizenship.

389. What the negotiators did not anticipate was that one of the Parties would refuse to appoint panelists to the extent of ordering the agency in charge of administering the proceeding – a dependent agency – to abstain from doing so and that it would subsequently refuse to establish the roster contemplated in Article 2009, which proved to be the system's Achilles heel. The practice derived from NAFTA Chapter Twenty has demonstrated that not only does no mechanism exist to appoint panelists automatically when faced with the reluctance of one of the parties, but also that any panelist should be appointed by agreement of the two Opposing Parties, that is, the appointment of panelists by one Party should have the consent of the other. Unlike the multilateral system, where even under the old GATT an affected Party was able to exert pressure with other Contracting Parties, under the NAFTA, being a three Party agreement, Mexico was unable to build a State coalition to pressure the United States into agreeing to submit to the dispute settlement proceeding.[298]

390. Since NAFTA's entry into force, the Parties have requested the establishment of a Chapter Twenty arbitral panel on four occasions. The only panel that has not been appointed so far is the panel requested by Mexico to resolve the U.S. sugar market access dispute. Of all four claims, this has been the only one that has not been submitted and heard by an impartial body.[299]

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[297] NAFTA, Article 2011.

[298] In 1988 the United States imposed sanctions against Brazil supposedly on the ground that Brazil failed to afford patent protection for pharmaceuticals. Brazil sought to settle this through the dispute settlement procedure against the United States, arguing that the United States imposed unilateral sanctions that were illegal under GATT. Brazil initiated a complaint proceeding under GATT in August 1988, but the United States blocked appointment of the panel for half a year, backing down only after more than 60 countries (parties to the agreement) expressed their support for the request for a panel. Disagreement about the composition of the panel and its terms of reference delayed its actual establishment until September 1989. Eventually, the United States lifted the sanctions upon agreement that Brazil would modify its legislation and withdrew its complaint. See Andreas F. Lowenfeld, 1994. Remedies Along With Rights: Institutional Reform in the New GATT, Am. J. Int. L., Vol. 88, No. 3, (July 1994), p. 477, footnote No. 7.

[299] In the other three proceedings, the Parties to NAFTA managed to establish the panels: Tariffs applied by Canada to certain US-origin agricultural products (CDA-95-2008-01), U.S. safeguard action taken on broom corn brooms from Mexico (USA-97-2008-01), and Cross-Border Trucking Services and Investment (USA-98-2008-01).

391. Mexico has already addressed the United States' acknowledgement that a legal dispute exists between it and Mexico and that Mexico completed all necessary steps to have the Panel established. The United States' recognition is that "…the dispute Mexico has brought against the United States under NAFTA (regarding the U.S. tariff-rate-quota on Mexican sugar) is presently in the panelist selection stage."[300]

392. Mexico's request is indeed outstanding; however, Mexico does not share the U. S. characterization. Mexico does not agree with the suggestion that both countries are currently actively working on panelist selection or that they had been occupied with this procedure following Mexico's frustrated efforts in 2000. The United States imposed its unilateral interpretation of the NAFTA and persistently refused to submit to an impartial body. In Mexico's view, the United States planned it in such a way that its restrictions had their greatest impact on the Mexican industry.

393. The pernicious effects of the U.S. refusal to submit to dispute settlement goes beyond the impact on the Mexican sweetener market. It has thwarted the dispute settlement procedure established in Chapter Twenty of the NAFTA. Since Mexico's request on 17 August 2000, none of the Parties to the Treaty has even tried to submit a request for consultations.

2. The measures taken by Mexico are legitimate countermeasures

a. Introduction

394. Mexico has a fundamental defence to the claim which will be set out in this Part. The defence has both jurisdictional and merits elements going to the relationship between Mexico's legal right to protect its interests under the NAFTA and at customary international law and Cargill's claim against a measure that was aimed at the State of which it is a national and which does not refer directly to the Respondent.

395. The Tribunal will recall that after the tax was imposed, the United States sought consultations with Mexico within the WTO on the measure that is now the subject of this claim. When those failed to resolve the dispute it, requested a WTO panel to examine its claim that the tax violated Article III of the GATT 1994. The WTO Panel was duly constituted. Mexico submitted to its jurisdiction.

396. In the WTO proceeding, Mexico explained the origins of the sweeteners dispute between both countries and its current status; the United States' obstruction of the dispute settlement mechanism by refusing to name panelists, and even instructing its National Section of the NAFTA Secretariat, which administers the proceeding, to refrain from doing so; and Congress' decision to restore the *status quo ante* in the hopes of preserving the sugar industry's existence pending a resolution of the NAFTA dispute.

397. Mexico's adoption of countermeasures is inextricably linked to the controversy between Mexico and the United States in the context of the NAFTA. Mexico acknowledged this fact to the

[300] See Answers of the United States to Questions of the Panel in Relation to the First Substantive Meeting with the Parties, answer to question number 7, p.9, Exhibit R 50.

WTO Panel and noted that the Panel had no jurisdiction to resolve it. Mexico requested the Panel to make a series of findings of fact and to recommend the parties to submit to NAFTA's dispute settlement procedure. Although Mexico explained to the Panel that, under the circumstances surrounding the dispute, the tax was justified under customary international law, it indicated it would not invoke this argument before the WTO for a number of reasons.

398. First, in Mexico's view, Article XX(d) of the GATT 1994 fully justified the adoption of the tax under the WTO. The fact that the Panel ultimately ruled against Mexico does not affect Mexico's rights and the legitimacy of its actions under the NAFTA or other rules of international law. The Panel's decision is strictly circumscribed to the scope of the WTO, as the Panel itself recognized in its final report:

> …any findings made by this Panel, as well as conclusions and recommendations in the present case, only relate to Mexico's rights and obligations under the WTO covered agreements, and not to its rights and obligations under other international agreements, such as the NAFTA, or other rules of international law.[301]

399. Mexico also acknowledged that, although the Panel was capable of learning the facts concerning the NAFTA dispute and issuing recommendations in this regard, given the limited nature of its mandate, it was not the ideal body to resolve the dispute, specially considering the fact that Mexico was facing other international proceedings related to the same measure and that it could not risk undermining its position. Mexico did, however, in response to a question from the Panel, sketch out the basis for its countermeasures defence under the applicable rules of international law, while noting that it was not asking the Panel to decide that issue.

400. Mexico believes that this response and the evidence of the pre-existing NAFTA dispute and Mexico's inability to compel the United States to submit to NAFTA dispute settlement is what led the Panel to hold that Mexico's tax was an international countermeasure. To Mexico's knowledge, this is the only GATT or WTO panel to have ever characterized an internal tax as an international countermeasure.

401. The essential basis for the tax's not being accepted as justified under GATT Article XX(d) is that due to its inherent uncertainty, the countermeasure could not be said to "secure compliance" within the meaning of that GATT exception, which is oriented to enforcement measures (*i.e.*, police powers) under domestic law. The Panel's central findings on Article XX(d) and the use of countermeasures can be found at paragraphs 8.178 *et seq.* of its Final Report:

> 8.178 The identification of the phrase "to secure compliance" with the notion of enforcement has important implications for the arguments presented by Mexico. The context of Mexico's action is essentially international. Countermeasures have an intrinsic inter-state character, and there is no concept of private action against a state being justifiable on this basis. On the other hand, the notion of enforcement contains a concept of action within a hierarchical structure that is associated with the relation

301 *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R, 8 August 2005, ¶ 7.15 (hereinafter "WTO Panel Report"). Exhibit R 49.

> between the state and its subjects, and which is almost entirely absent from international law (action under Chapter VII of the United Nations Charter is arguably an exception, but it has no relevance in the present dispute). The possibility for states to take countermeasures, that is to try by their own actions to persuade other states to respect their obligations, is itself an acknowledgement of the absence of any international body with enforcement powers. In contrast to this, the capacity to enforce laws and regulations through the use of coercion, if necessary, is perhaps most important of the features that distinguish states from other kinds of bodies.
>
> 8.179 The examples provided in Article XX(d) serve to reinforce the conclusion that this provision is concerned with action at a domestic rather than international level. Customs, monopolies, patents, trade marks and copyrights, and deceptive practices are essentially aspects that are regulated under domestic law…
>
> 8.180 The Panel will return to the notion of enforcement in its discussion of "laws or regulations", but before leaving the current topic it is worth noting that the Draft Articles on *Responsibility of States for internationally wrongful acts* adopted by the International Law Commission did not speak of enforcement when addressing the use of countermeasures. Rather, paragraph 1 of Article 49 states that "[a]n injured State may only take countermeasures against a State which is responsible for internationally wrongful act in order to induce that State to comply with its obligations under Part Two." Nor is the notion of enforcement used in the Commentary on the articles, except in regard to procedures within the European Union, which because of its unique structures and procedures is obviously a special case.
>
> 8.181 For these reasons the Panel concludes that the phrase "to secure compliance" in Article XX(d) does not apply to measures taken by a Member in order to induce another Member to comply with obligations owed to it under a non-WTO treaty. [302]
>
> [Emphasis added; footnotes omitted.]

402. The Panel noted that the use of countermeasures in accordance with international law does not fit within the concept of "to secure compliance" contained in Article XX(d):

> 8.184 The question of whether the measure identified by Mexico is designed to secure compliance is therefore one must be addressed by the Panel. The considerations that influenced the Panel in reaching a conclusion regarding the phrase "to secure compliance" are also relevant in answering this question.
>
> 8.185 The Panel additionally notes that, when enforcement action is taken within a Member's legal system there will normally be no doubt, provided the action is pointed at the right target, that it will achieve that target. At

[302] *Id.,* ¶¶ 8.178-8.181.

> least, there is no systemic problem in arriving at that conclusion, because the State by its very nature is usually in a position to achieve that enforcement, through the use of coercion, if necessary. However, the situation is quite different when one considers international relations. Mexico argues that its tax measures are designed to secure compliance by the United States with obligations Mexico considers the United States to have under the NAFTA. Regardless of the issue of Mexico's actual intentions regarding its measures, the effectiveness of those measures in achieving their stated goal -- that of bringing about a change in the behaviour of United States -- seems to the Panel to be inescapably uncertain.
>
> 8.186 In this regard, Mexico has not explained how its measures will make any significant contribution to securing compliance on the part of the United States, and much less how they will perforce bring about a change of conduct on the part of United States. Mexico has claimed only that they have had the effect of "attracting the attention" of the United States. Attracting attention of the Member is not equivalent to securing compliance of that Member with a law or regulation. Even conceding that the measures may have "attracted the attention of the United States", at most this would imply the beginning of a process between the parties with uncertain results. The Panel mentions these considerations principally in order to reinforce its conclusion that the outcome of international countermeasures, such as those adopted by Mexico, is inherently unpredictable, and that they are therefore not eligible to be considered as measures "to secure compliance" within the meaning of Article XX(d). However, even if the assumption were to be made in the abstract that international countermeasures are potentially capable of qualifying as measures designed to secure compliance, the Panel's conclusion would be that Mexico has not established that its measures contribute to securing compliance in the circumstances of this case.
>
> ...
>
> 8.188 As indicated by the [WTO] Appellate Body, measures that are of uncertain outcome do not qualify as reasonably available alternatives when considering whether a measure is necessary to secure compliance with a law or regulation. Following a similar rationale, in order to qualify as a measure "to secure compliance", it would seem that there should be a degree of certainty in the results that may be achieved through the measure. Such certainty is inherently absent in the case of international countermeasures.[303]
>
> [Italics in original; emphasis added.]

403. Finally, with respect to its interpretation of the expression "laws and regulations" used in Article XX(d), the Panel held:

303 Ibid., ¶¶ 8.184 – 8.186 and 8.188. Exhibit R 49.

> 8.197 … the Panel observes that, even if it were to assume that the expression "laws or regulations" in Article XX(d) could include international agreements such as the NAFTA, it would in any event conclude that, on the facts of this case, because of the uncertainty of their consequences, the challenged measures are not designed "to secure compliance with laws or regulations which are not inconsistent with the provisions" of GATT 1994.[304]

404. The key point is that legality of the measure under the NAFTA and other rules of international law is a separate issue, over which the WTO panel lacked jurisdiction and made no findings.

405. The legal implications of Mexico's countermeasure for the purposes of NAFTA can be summarized simply: By virtue of NAFTA's character as an international treaty, the Chapter Eleven obligations (and the balance of the NAFTA) are owed by Mexico to the United States and *vice versa*. Cargill has standing to submit a claim to arbitration only because it is a U.S. company;[305] however, that procedural right does not modify the nature of other rights and obligations contemplated in the NAFTA, such as the rights and obligations of the States *vis-à-vis* each other. For that reason Cargill cannot have greater rights than the United States itself holds under the NAFTA.[306] Section B of Chapter Eleven confers a procedural right of access for an investor of a Party to enforce a limited number of obligations of the NAFTA that, in the absence of that right, would be available only to the corresponding State Party.

406. Furthermore, the investment protection provisions in Chapter Eleven are not intended to constitute a self-contained regime established for the sole benefit of investors and without regard to broader legal issues and disputes arising under the NAFTA. Whatever the position with the WTO agreements, Chapter Eleven is part of a broader trilateral agreement (with many bilateral aspects), and it should be read as a whole. In effect, Chapter Eleven expressly states that. Article 1112, "Relation to Other Chapters", subordinates it to other chapters in the event of an inconsistency between them: "In the event of any inconsistency between this Chapter and another Chapter, the other Chapter shall prevail to the extent of the inconsistency." The investment chapter is thus subordinate to any inconsistency with another chapter. Article 1115 also confirms that the investor-State arbitral mechanism established in Section B is "[w]ithout prejudice to the rights and obligations of the Parties under Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures)." [Emphasis added]

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304 Ibid., ¶ 8.197

305 Articles 201, 1116, 1117 and 1139 of the NAFTA.

306 As noted by Patrick G. Foy, Q.C., "Although Chapter 11 allows an investor direct access against a Party for damages claims, and does not procedurally require the exhaustion of local remedies or the interposition of his government in order to espouse a claim, an investor still has no valid claim unless he can establish state responsibility of a Party. The investor may be the claimant in procedure, but in substance, the investor is asserting the right of his Party to obtain compliance of the other Party with the obligations set out in Section A of Chapter 11." "Effectiveness of NAFTA's Chapter 11 InvestoR State Arbitration Procedures", Proceedings of the 31st Annual Conference of the Canadian Council on International Law, October 2002, p. 21, p. 51. This is quoted with approval by Pepall J. in *Council of Canadians et al. v. Her Majesty in Right of Canada, as represented by the Attorney General of Canada*, Ontario Superior Court of Justice, File No. 01-CV-208141, 8 July 2005, ¶ 41.

407. In the present context:

- those rights include Mexico's undisputed right to have a Chapter Twenty Panel hear its grievance, which right has been denied, and in respect of which Mexico has taken a countermeasure; and
- those obligations include the United States' obligations to allow Mexican sugar to access its market under the NAFTA[307] and to submit to the dispute settlement procedure contemplated in Chapter Twenty, both of which have been violated to the detriment of Mexico.

408. The Tribunal must therefore consider the interaction between: (i) the United States' obstructing Mexico's access to the dispute settlement proceeding to resolve a legitimate grievance; (ii) Mexico's countermeasures aimed at rebalancing its market and inducing the United States to resolve its grievance; and (iii) Cargill's attempt to invoke Section B to challenge that countermeasure.

b. The imposition of the tax was a lawful countermeasure at customary international law

(1) Lawful countermeasures preclude state responsibility

409. As the International Law Commission's Articles on State Responsibility note in Chapter V, "Circumstances Precluding Wrongfulness", Article 22, "Countermeasures in respect of an internationally wrongful act", provides that:

> The wrongfulness of an act of a State not in conformity with an international obligation towards another State is precluded if and to the extent that the act constitutes a countermeasure taken against the latter State in accordance with Chapter II of Part Three.

410. Lawful countermeasures preclude wrongfulness and play an essential role in contemporary international law.

411. As Mexico already explained, the NAFTA Parties assumed rights and obligations towards each other, not toward the nationals of another Party, to which the Treaty only confers a procedural right of action. Nationals of a Party[308] cannot exert a right that the Party itself does not have. Since a legally adopted countermeasure by a Party precludes any wrongfulness, and thus, exempts it of any responsibility, it would be absurd for a person of the Party against which the countermeasure is taken to successfully challenge it. A legitimate countermeasure against the United States is necessarily legitimate against United States' nationals. Otherwise, United States' nationals would have greater rights than United States, and Mexico's legitimate right to adopt

[307] Mexico recognizes that this Tribunal has no jurisdiction to determine the merits of the dispute between Mexico and the United States over sugar market access arising under Chapters Three, Seven and Twenty of the Treaty.

[308] See Article 201 of the NAFTA.

countermeasures in accordance with international law would be nullified. This outcome is not only illogical, but would seriously constrain the States' basic rights under international law.

412. Moreover, when the disputing NAFTA Parties do submit to the NAFTA's dispute settlement procedure, if a arbitral panel determines that the challenged measure is in violation of the Treaty and the losing Party refuses to comply with its obligations, the affected Party can legitimately suspend benefits to the recalcitrant Party. The NAFTA does not impose a limit on the rights of a Party to suspend benefits to the other Party, but requires only that they not be manifestly excessive. In other words, the losing Party cannot object to the measures adopted by the Party affected by the violation nor can it object to the sector to which they have been applied. It can only challenge any lack of proportionality. In such a case, an investor of the recalcitrant Party affected by the legitimate suspension of benefits would not be able to successfully challenge such measures through a Chapter Eleven proceeding. Otherwise, the fundamental right established in Chapter Twenty to maintain the equilibrium of what had been negotiated in the Treaty would be undermined.

413. When a Party, in addition to violating the Treaty, refuses to submit to dispute settlement, which implies in itself a more serious second violation, that Party loses the right to object to actions taken by the adversely affected complaining Party and extinguishes any right its nationals –the nationals of the obstructing Party- could have to challenge them. Otherwise, there would be the odd and most unattractive situation of a Treaty operating entirely to the benefit of one Party and its nationals and not to the benefit of the other Party at all.

414. If the countermeasure is lawful, there is no wrongfulness , and Mexico cannot incur State responsibility. If the measure taken by Mexico is justified at international law, Mexico has a complete defence to the claim: The Tribunal must determine the inadmissibility of the claim and dismiss it in its entirety.

(2) The NAFTA Parties agreed on the central importance of effective state-to-state dispute settlement

415. To understand the legal basis for Mexico's countermeasure, is necessary to appreciate the central importance of the NAFTA dispute settlement mechanism. The Parties' intention was to establish a treaty that would lead to harmonious and better trade relations between them. They recognized that disputes would inevitably arise but that they should be resolved on an amicable and reasonably prompt basis. Nevertheless, they established a procedure with specific rules in case no prompt solution was possible via consultations or negotiations.

416. Article 2003, "Cooperation" stipulates:

> The Parties shall <u>at all times</u> endeavor to agree on the interpretation and application of this Agreement, and <u>shall make every attempt</u> through cooperation and consultations to arrive at a mutually satisfactory resolution of any matter that might affect its operation.
>
> [Emphasis added]

They also agreed that dispute settlement rules would apply to "the avoidance or settlement of *all* disputes… regarding the interpretation or application of …[the] Agreement *or* whenever a Party considers that an actual or proposed measure of another Party is or would be inconsistent with the obligations of [the] …Agreement or cause nullification or impairment…" (Article 2004, Emphasis added).

417. In the context of another Chapter Eleven claim, the United States described Chapter Twenty in the following terms:

> …The Chapter Twenty mechanism has an unusually broad reach: it applies to all disputes concerning "the interpretation or application of this Agreement or wherever a Party considers that an actual or proposed measure of another Party is would be inconsistent with the obligations of this Agreement.[309]
>
> [Emphasis added.]

It should be noted that the dispute settlement mechanism is available to resolve existing controversies or prevent possible future disputes.

418. Chapter Twenty is premised on a collective commitment by the three Parties to cooperate in good faith in resolving disputes. However, if a dispute cannot be resolved in an amicable fashion, the Chapter contemplates a dispute settlement stage and gives the Parties the option to resort to an independent and impartial panel to which jurisdiction they must submit.

419. According to the rules on treaty interpretation, Chapter Twenty is to be interpreted in light of the Treaty's object and purpose. The NAFTA's preamble speaks of the Parties' resolution to, among other things:

> "STRENGTHEN the special bonds of friendship and cooperation among the three Parties";
>
> "CREATE an expanded and secure market for the goods … produced in [the Parties'] territories"; and
>
> "ESTABLISH clear and mutually advantageous rules governing their trade".
>
> [Capital letters in the original]

420. Article 102 elaborated on the preambular intentions as *inter alia*:

> (a) to eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
>
> (b) promote conditions of fair competition in the free trade area…;

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309 Objection to Jurisdiction of Respondent United States of America in *Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc., v. United States of America*, http://www.state.gov/documents/organization/42165.pdf

> (e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
>
> (f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.
>
> [Emphasis added]

421. The United States has emphasized the importance of effective resolution of disputes under the Treaty:

> *The final element of the Vienna Convention's cardinal rule of treaty interpretation focuses on the treaty's object and purpose. NAFTA Article 102 states in pertinent part as follows:*
>
> *The objectives of this Agreement, as elaborated more specifically through its principles and rules, ... are to:*
>
> *(c) create effective procedures ... for the resolution of disputes.*
>
> *As demonstrated below, a review of the NAFTA's various rules for dispute resolution reveals an overriding concern with promoting effective dispute resolution procedures and avoiding the inefficacies that result from redundant proceedings between the same parties before different dispute resolution panels...*[310]
>
> [Italics in original.]

422. Chapter Twenty does not permit a respondent to refuse to resolve a dispute nor does it allow it to block the dispute settlement procedure.[311] A Party cannot decline to participate in dispute settlement because it would prefer not to have its measures scrutinized.

423. This inability to "self-judge" the merits of another Party's complaint makes eminent sense (and no less sense under Chapter Twenty than Chapter Eleven): if it were left to potential respondents to determine whether or not to submit to a panel, they would be tempted to refuse to submit in all cases except those in which they considered they faced no significant risk.

(3) Customary international law coexists with the NAFTA

424. Unlike under the WTO, the NAFTA Parties did not renounce their rights at customary international law to impose countermeasures in response to the wrongful act of another Party.[312]

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[310] Ibid., p. 26

[311] In this sense, the NAFTA differs from the old GATT, according to which access to the dispute settlement procedure is based on a consensual agreement by the Contracting Parties, including the Respondent Party; and even in the that case, the United States stated that it had the right to respond to protect its rights.

Although the NAFTA Parties established a dispute settlement procedure that regulates their rights even where a Party refuses to comply with its obligations under the Treaty after exhausting the dispute settlement procedure, the right to take countermeasures is pertinent when a Party blocks the other's access to such a mechanism.

425. The United Sates has generally been a strong proponent of this view. Mexico has already adverted to criticisms of the old GATT dispute settlement system due to the ability of recalcitrant respondent States' to block its operation. The United States repeatedly criticized such behavior – notwithstanding that the United States itself engaged in it.[313]

426. At a GATT Council meeting in 1989, for example, the United States insisted on its right to take action when another State impeded the operation of a treaty's dispute settlement mechanism:

> Wherever it could, the United States would challenge unfair practices under the dispute settlement provisions of the General Agreement or the Tokyo Round Codes, <u>but where other contracting parties prevented or impeded that process</u> or blocked efforts to ensure that their practices were covered by multilateral disciplines, <u>the United States would act to protect its interests. If such action was considered unilateral, it should be nevertheless recognized as perfectly justifiable, responsive action necessitated by the failure of bilateral or multilateral efforts to address a problem</u>.[314]
>
> [Emphasis added.]

427. Indeed, prior to the WTO's entry into force, the United States took unilateral retaliatory action against other States when efforts to resolve disputes over U.S. grievances through a non-binding multilateral dispute settlement system failed.[315]

428. There was agreement in the WTO *Understanding on Rules and Procedures governing the settlement of disputes* that regulate the *Dispute Settlement Understanding* (the DSU) that no WTO Member would make a unilateral determination of WTO rights and obligations (the United States' practice under the GATT of 1947). It requires the members to submit to the dispute settlement mechanism. The *quid pro quo* was the automaticity of the mechanism (*i.e.*, no blocking of panels

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[312] A principle of customary international law should not be held to have been modified in the absence of words making clear the intention to do so. See the *Loewen* Award on the Tribunal's competence and jurisdiction, at ¶ 73. http://www.state.gov/documents/organization/3921.pdf

[313] See ¶¶ 383 and 384 of this submission.

[314] GATT document C/163 of 16 March 1989, p. 4. Exhibit R 103.

[315] A case in point is the pre-WTO dispute between the United States and the European Communities concerning the EC ban on the importation and sale of animals, and meat derived from animals, that had been administered certain hormones for growth promotion purposes. *See European Communities - Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/R/USA, Report of the Panel, adopted on 13 February 1998, ¶¶ 2.34, 2.35.

or of the adoption of final panel and Appellate Body reports unless there was a consensus, including that of the Member who received the favorable judgment).[316]

429. During the WTO proceeding initiated by the United States in regard to the same measure that is the subject of this claim, Mexico directed the United States to its statement to the GATT 1989 Council and requested it to confirm whether it was still of the view that a legal right to retaliate existed when another State blocked its access to the mutually agreed-upon bilateral dispute settlement. The United States did not repudiate its earlier statement.[317]

430. Today the NAFTA works like the GATT 1947 dispute settlement procedure operated. Therefore, the legal basis for acts justified by the United States as "perfectly justifiable, responsive action necessitated by the failure of bilateral... efforts" to address a problem is no different to that of Mexico's countermeasure in this case.

(4) The United States has also used countermeasures to induce other states to submit to dispute settlement

431. In the *Air Services Agreement arbitration*, the United States justified countermeasures imposed to induce France to submit to dispute settlement.[318] The United States considered France to be in breach of a bilateral air services agreement (which adversely affected Pan Am) and while it consulted with France it simultaneously imposed countermeasures on France by restricting Air France's ability to fly to Los Angeles. This was done in advance of agreeing to submit to arbitration. France subsequently contested the countermeasures' legality. However, the tribunal ruled that the U.S. was fully within its rights to take action that was not "clearly disproportionate" to the harm suffered by its interests.

432. It supported its argument that performance of treaty rights may be temporarily suspended by referring to Article 27 of the 1935 Harvard *Draft Convention on Law of Treaties*, which provided that:

> (a) If a State fails to carry out in good faith its obligations under a treaty, any other party to the treaty, acting within a reasonable time after the failure, may seek from a competent international tribunal or authority a

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316 See Articles 6 and 17 of the DSU.

317 As Mexico pointed out to the WTO Panel: "In Mexico's view, the United States wants to preserve its ability to impose countermeasures when it is in the position of being the complainant rather than the obstructing respondent in other disputes under the NAFTA or in other contexts. If this is not so, why did the United States not simply state that it disagrees with Mexico's statement [that countermeasures may be taken under the NAFTA where a Party blocks access to dispute settlement? Why did it not repudiate the view expressed in the quotation cited at paragraph 126 of Mexico's First Written Submission? Why did it not try to explain why, when its Cabinet secretaries signed an agreement promising not to take countermeasures inconsistent with the GATT or the NAFTA for a period of twelve months, the term "countermeasures" as used there did not really mean countermeasures as discussed by Mexico in this case? …" *Mexico – Tax Measures on Soft Drinks and other Beverages*, Mexico's Comments on the Answers of the United States to the Second List of Questions Posed by the Panel, comment on U.S. response to Question 58. Exhibit R 104.

318 *Air Services Agreement* Arbitration Award, at ¶ 12. Exhibit R 105.

> declaration to the effect that the treaty has ceased to be binding upon it in the sense of calling for further performance with respect to such State.
>
> (b) Pending agreement by the parties upon and decision by a competent international tribunal or authority, the party which seeks such a declaration may provisionally suspend performance of its obligations under the treaty *vis-à-vis* the State charged with failure.
>
> (c) A provisional suspension of performance by the party seeking such a declaration will not be justified definitively until a decision to this effect has been rendered by the competent international tribunal or authority.[319]
>
> [Emphasis added.]

433. The United States also directed the tribunal to the drafters' commentary on Article 27. The commentary is particularly relevant to the sugar market access dispute between Mexico and United States:

> It is apparent, therefore, that it might frequently be within the power of the state alleged to have committed the breach to prevent or delay submission of the matter to an international tribunal or authority simply by neglecting or refusing to agree upon any such tribunal or authority, or by denying that tribunals or authorities which it already had agreed upon for certain purposes possess jurisdiction to make the sort of declaration referred to in this article. Furthermore, even after the states concerned have agreed upon a competent international tribunal or authority, a considerable time will necessarily elapse before it can render its decision. In consideration of these facts, and in view of the further fact that continued performance of its obligations under a treaty *vis-à-vis* a state charged with breach thereof might prove costly or even involve irreparable damage to the state seeking the declaration, if the decision is ultimately in its favor, it seems only reasonable to permit the latter state to suspend the performance of its own obligations under the treaty *vis-à-vis* the state charged with failure pending agreement upon a competent international tribunal or authority, and pending final decision by such authority.[320]
>
> [Emphasis added.]

434. The tribunal found that the United States' countermeasure was justifiable at customary international law.[321]

435. The award is particularly relevant because the facts of that case were far less egregious than the facts of Mexico's claim on the sugar market access, yet the United States' rationale for its

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319 Draft Convention on the Law of Treaties of 1935. Exhibit R 106

320 Department of State, Office of the Legal Adviser, Digest of United States Practice in International Law, 1978, page 775. Exhibit R 107.

321 *Air Services Agreement Arbitration* (United States v. France), RIAA XVIII, p. 146 (1979). Exhibit R 105.

countermeasures was similar to Mexico's rationale here. The Tribunal can appreciate the parallels and relevant findings:

> *First*, as in the instant case, the U.S. measures were taken to protect the interest of its industry and induce France to submit to dispute settlement under the applicable treaty.
>
> However, unlike the instant case, the United States adopted countermeasures notwithstanding that the treaty required the Parties to negotiate in good faith to try to find a solution to the dispute. The Tribunal determined that the use of countermeasures was legal in that case and France agreed to submit the dispute to an international tribunal. Unlike the United States in this case, France did not drag the dispute on for over seven years (in the WTO proceeding, the U.S. claimed that both countries were "presently in the panelist selection stage" this statement prompted the panel to ask how long NAFTA panels usually take to be established.)[322]
>
> *Second*, the tribunal ruled that it only required to be satisfied with a "very approximative appreciation" of the proportionality of the measures, and refused to find that the they were not "clearly disproportionate" in comparison to France's measures which gave rise to the dispute.[323]
>
> In this case, Mexico's countermeasure was tied to the specific sector in which the dispute arose and was clearly proportionate.
>
> *Third*, the tribunal considered that in addition to the commercial issues at stake, systemic issues arising under the treaty were also relevant to its consideration of the countermeasures.[324]
>
> Just as the U.S. had a systemic interest in the operation of certain technical terms of the *Air Services Agreement* , Mexico has a systemic and broader interest in ensuring the correct operation of the dispute settlement mechanism, which is a pillar in the operation of the Treaty.
>
> *Fourth*, the aim of countermeasures "is to restore equality between the Parties and to encourage them to continue negotiations with mutual desire to reach an acceptable solution." The United States added "the United States countermeasures restore in a negative way the symmetry of the initial positions."[325]

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322 Answers of the United States to Questions of the Panel in Relation to the First Substantive Meeting with the Parties, p. 9. Exhibit R 11. Answers of the United States to Questions of the Panel in Relation to the Second Substantive Meeting with the Parties, pp. 31 and 32. Exhibit R 110.

323 *Air Services Agreement Arbitration* Award, at ¶ 83. Exhibit R 105.

324 Ibid.

325 Ibid., ¶ 90.

> This is precisely what Mexico sought to do. The Mexican measure restored in a negative way the symmetry of the initial positions.
>
> *Finally*, the tribunal emphasized the importance of accompanying countermeasures with "a genuine effort at resolving the dispute" but found it impossible "to lay down a rule prohibiting the use of countermeasures during negotiations… especially where such countermeasures are accompanied by an offer for a procedure affording the possibility of accelerating the solution of the dispute".[326]
>
> Mexico has repeatedly sought a solution, including by negotiations, as demonstrated by the various meetings and efforts taken at various levels during several years.

436. The essential finding of the tribunal was that:

> 81. … If a situation arises which, in one State's view, results in a violation of an international obligation by another State, the first State is entitled, within the limits set by the general rules of international law pertaining to the use of armed force, to affirm its rights through "countermeasures".[327]

437. This remains an accurate statement of the law.[328]

438. The *Air Services Agreement* Award's continued vitality[329] and the United States' own statements confirm that at customary international law a State has the right to protect its interests when international disputes arise and particularly when the respondent State obstructs a treaty's dispute settlement mechanism.

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326 Ibid., ¶ 91.

327 Ibid., ¶ 81.

328 *Draft Articles on States Responsibility: Comments of the Government of the United States of America*, 22 October 1997. The United States Department of State considered the *Air Services Agreement* Award to be an excellent statement of the law in 1997 when it provided the United States' comments on the then-draft Articles on State Responsibility under consideration by the ILC: "The United States agrees that under customary international law an injured State takes countermeasures "in order to induce [the wrongdoing State] to comply with its obligations". *See* Draft Article 47(1). See also *Case Concerning the Air Services Agreement of March 27, 1946 Between the United States of America and France*, 18 R.I.A.A. 417, 443 (1978) [hereinafter *Air Services Case*] stating that an injured State "is entitled … to affirm its rights through 'countermeasures'"). In a six page discussion of countermeasures, the State Department cited the *Air Services Arbitration* award with approval no less than nine times, six times more than the next most frequently cited case (*Case Concerning the Gabcikovo-Nagymaros Project*). The award was cited for the right to impose countermeasures during negotiations and in support of the principle that they should be compared to the act motivating them and that there should be some degree of equivalence with the alleged breach. Exhibit R 105.

329 The International Law Commission recognized the award's authoritativeness in its articles on countermeasures and commentary thereon. *See* James Crawford, The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries (Cambridge University Press, 2002) Part Three, Chapter II.

(5) The United States has taken actions to reestablish the balance of concessions and recognized the right to take countermeasures under the NAFTA

(a) Imposing new tariffs on refined sugar from Canada

439. In Chapter 7 of the FTA, which was incorporated into the NAFTA, Canada and the United States agreed on certain tariffs on certain agricultural products, but also agreed to maintain import quotas. Following the Uruguay Round, Canada converted its quantitative restrictions into tariffs and raised its tariffs on certain agricultural products on an MFN basis. Canada applied its new tariffs to the imports of United States-originating agricultural products. The United States complained that this was contrary to NAFTA's Article 302, which prohibits a Party from increasing any existing customs duty on an originating good. It initiated the dispute settlement procedure contemplated in Chapter Twenty of the NAFTA. Canada and the United States failed to resolve the matter through consultations conducted under Article 2006 of the Treaty, nor at the FTC level under Article 2007. The United States requested then the establishment of a panel. The panel was duly constituted −after approximately six months.

440. Prior to the hearing, the United States took similar action as the Canadian action of which it complained; that is, it adopted certain measures to balance the situation. The United States raised tariffs on refined sugar from Canada.

441. Canada pointed out to the Panel that the United States had taken the same action as Canada (albeit on different products). The Panel recorded the parties' submissions in this regard:

> 57. Canada also directs attention to the fact that the United States, while challenging the legitimacy under the NAFTA of certain Canadian tariffs on over-quota agricultural imports, is applying "exactly the same type of measure as it impugns on over-quota quantities of certain Canadian agricultural products".
>
> …
>
> 151. The Panel is also referred to practice of the Parties in the context of the Uruguay Round. In particular, Canada emphasizes the United States own adoption of tariffs on over-quota imports of agricultural products and their application to Canada –a position seemingly at variance with that being advanced by the United States under the NAFTA against Canadian over-quota tariffs applying to the United States.
>
> 152. The Panel notes that even before Canada indicated that it was going to tariffy, the United States had submitted draft schedules to the Uruguay Round under which it was apparent that the United States would apply over quota tariffs to Canada in respect of certain products. Moreover, the United States made no objection to the Canadian tariff schedule filed under the *WTO Agreement on Agriculture*. In neither instance did the United States reserve its position with respect to the interpretation of FTA Article 710 or make it clear that its actions were "without prejudice" in

> respect of its disagreement with Canada over the effect of NAFTA Article 302(1). However, the Panel also notes that the United States explains that its conduct in establishing over-quota tariffs was a response to action taken by Canada. The Panel observes that all of this conduct occurred after 1991 by which time the Parties had identified a difference between them over the consequences of tariffication for their rights and obligations under the NAFTA.[330]
>
> [Italics in the original; emphasis added.]

(b) Recognition of the right to take countermeasures

442. In the context of another dispute over the allegedly unfair treatment that Canada gave to U.S. wheat, the Ministries of both countries entered into a Memorandum of Understanding (MOU) signed on 20 September 1994 (nine months after NAFTA's entry into force and shortly before the WTO entered into force).[331] The MOU recorded that for a period of 12 months, the United States intended to apply a new schedule of tariffs on wheat imports from Canada. Mexico understands that the NAFTA preferential tariff was applicable to only a limited volume of imports of wheat from Canada. In this way, the MOU recorded the United States' decision to impose import restrictions that were not authorized by the NAFTA.

443. In paragraph C of that agreement, the parties stated:

> C. Canada reserves the right to challenge the U.S. measures referred to in part B above, in either the NAFTA or the GATT or both. However, Canada will not request that a NAFTA or GATT panel or working party be convened in respect of the aforementioned U.S. measures during the 12-month period beginning September 12, 1994, to allow the aforementioned Joint Commission on Grains to complete its work and the two governments to consider its findings and recommendations. Further, during this period, neither country will take countermeasures inconsistent with the NAFTA or the GATT.
>
> [Emphasis added.]

444. The MOU shows that both of Mexico's NAFTA partners contemplated that countermeasures "inconsistent with the NAFTA or the GATT" could be imposed within the framework of their legal relations. Otherwise, they could not have agreed not to take those countermeasures during the 12-month period.

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[330] *In the Matter of Tariffs Applied by Canada to Certain U.S.-Originating Agricultural Products*, Report of the Panel, CDA-95-2008-01, 2 December 1996, ¶¶ 57, 151-152. http://www.nafta-sec-alena.org/app/DocRepository/1/Dispute/english/NAFTA_Chapter_20/Canada/cb95010e.pdf

[331] Memorandum of Understanding between the United States and Canada, signed by USTR Michael Kantor and Secretary of Agriculture Michael Espy for the United States and Minister of International Trade Roy MacLaren and Minister of Agriculture Ralph Goodale for Canada. Exhibit R 109.

445. Thus, in other instances under the NAFTA, the United States has claimed the legal right to take action of the type that Mexico took in this case.

446. In the WTO case, the United States was repeatedly asked by both Mexico and the Panel for its views as to the legality of countermeasures under the NAFTA. It was also given the opportunity to comment on Mexico's analysis and others to deny its relevance to the WTO case. Although United States denied any NAFTA violation, the most the United States would venture was that Mexico's defence was "complex".[332] In particular, notwithstanding repeated requests from Mexico to either confirm the continued validity of its earlier statements or actions or to repudiate them, the United States:

- did not repudiate its 1989 statement to the GATT Council claiming the right to take unilateral action;
- did not repudiate its justification of countermeasures in the *Air Services Agreement arbitration*;
- did not disavow its reliance on the 1935 Draft Harvard Convention;
- did not disavow any of its statements defending the use of countermeasures made in the course of commenting on the ILC's Draft Articles on State Responsibility.

447. At customary international law, an injured State has the legal right, under certain conditions, to take action to redress such a situation. As the *Air Services Agreement* tribunal noted, the aim of countermeasures "is to restore equality between the Parties and to encourage them to continue negotiations with mutual desire to reach an acceptable solution. …the United States countermeasures restore in a negative way the symmetry of the initial positions."[333] This is precisely what Mexico sought to do. The measures adopted return the sweeteners trade to the *status quo ante*, and have the aim to induce the United States to submit to the NAFTA dispute settlement mechanism in compliance with its obligations or to negotiate in good faith to arrive at a mutually satisfactory solution.

448. Mexico's many efforts to find a resolution of the dispute also support the legality of the adopted countermeasures. As mentioned already, the *Air Services Agreement* tribunal emphasized the importance of accompanying countermeasures with "a genuine effort at resolving the dispute" but found it impossible "to lay down a rule prohibiting the use of countermeasures… especially where such countermeasures are accompanied by an offer for a procedure affording the possibility of accelerating the solution of the dispute".[334] Mexico's efforts to resolve the dispute over the years before taking countermeasures were unsuccessful, and are still unsuccessful even after taking countermeasures.

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[332] Comments by the United States on Mexico's answers to the first series of questions by the Panel. Exhibit R 110.

[333] Air Services Agreement Arbitration Award, at ¶ 90. Exhibit R 105

[334] Ibid., ¶ 91.

449. In contrast with the United States' position in the *Air Services Agreement* case, in the present case:

- Mexico adopted the measure at issue only after having exhausted unsuccessfully all other efforts;
- during that period of time, the Mexican sugar sector suffered injury as a result of the United States' denial of the negotiated access to its market, while HFCS continued to gain market share in Mexico −in fact, the government of Mexico was forced to expropriate nearly half of the sugar mills in Mexico because their financial situation put the sugarcane harvest at risk and with it, social stability;
- in no case can it be said that, in accordance with any objective parameter, Mexico's countermeasures came close to being "clearly disproportionate";
- Mexico was at all times willing to submit the whole dispute with the United States to the dispute settlement proceeding under the NAFTA;
- the U.S. government acknowledged, through the USDA and the USTR, − even during the WTO proceeding - that Mexico disputes the legality of the restrictions imposed on Mexican sugar access to the U.S. market; that Mexico's request for the establishment of a panel under Chapter Twenty was still outstanding, but the Panel had not been established
- the USDA reports demonstrate that the U.S. government was aware at all times of the adverse effects and damage that its actions and omissions have caused to the Mexican industry.

(6) Customary international law gives the aggrieved state considerable discretion to formulate a countermeasure

450. Customary international law gives the aggrieved State wide discretion to formulate countermeasures. As the ILC's Articles on State Responsibility note:

> 2. Countermeasures are limited to the non-performance for the time being of international obligations of the State taking the measures towards the responsible State.
>
> 3. Countermeasures shall, as far as possible, be taken in such a way as to permit the resumption of performance of the obligations in question.[335]

451. Mexico's measure is aimed at the United States, with the purpose of restoring the balance in the Mexican sweetener market that exited prior to the NAFTA's entry into force. Between 1997 and 2001 approximately 2.7 million tones of HFCS were consumed in Mexico. Approximately 95% were imported from the United States. U.S. investments of U.S. investors in Mexico produced over 1.5 million tones and the majority was produced from corn imported from the

[335] Articles on the Responsibility of States for International Wrongful Acts, Article 49, p. 361. Exhibit R 111.

United States duty-free under the NAFTA. The tax was a temporary measure that responded to the lack of a solution that allows bilateral trade under conditions that maintain the balance negotiated in the NAFTA until the Parties arrive at a mutually agreed solution.

452. The ILC's Commentary to Article 49 stated:

> (4) A second essential element of countermeasures is that they "must be directed against" a State which has committed an internationally wrongful act and which has not complied with its obligations of cessation and reparation under Part Two of the present articles. The word "only" in paragraph 1 applies equally to the target of the countermeasures as to their purpose and is intended to convey that countermeasures may only be adopted against a State which is the author if the internationally wrongful act. Countermeasures may not be directed against States other than the responsible State. In a situation where a third State is owed an international obligation by the State taking countermeasures and that obligation is breached by the countermeasure, the wrongfulness of the measure is not precluded as against the third State. In that sense the effect of countermeasures in precluding wrongfulness is relative. It concerns the legal relations between the injured State and the responsible State.
>
> (5) This does not mean that countermeasures may not incidentally affect the position of third States or indeed other third parties. For example, if the injured State suspends transit rights with the responsible State in accordance with this Chapter, other parties, including third States, may be affected thereby. If they have no individual rights in the matter they cannot complain. Similarly, if, as a consequence of suspension of a trade agreement, trade with the responsible State is affected and one or more companies lose business or even go bankrupt. Such indirect or collateral effects cannot be entirely avoided.[336]
>
> [Emphasis added.]

453. Beyond these basic limits[337], and subject to the requirements of proportionality, a State is free to choose which countermeasures to take. The ILC Commentary confirms this; indeed, it expressly contemplates the suspension of the performance of a trade agreement as an example of a countermeasure.

454. Finally, Mexico notes that the United States and Mexico agreed to a balanced, partial resolution of their dispute. The principal example is a memorandum of understanding on sugar-

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[336] See Crawford, The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries: Comment on Article 49, p. 363. Exhibit R 112

[337] According to Article 50 of the Articles on State Responsibility, there are four categories of fundamental substantive obligations which may not be affected by countermeasures: a) the obligation to refrain from the threat to use of force as embodied in the Charter of the United Nations, b) obligations for the protection of fundamental human rights, c) obligations of humanitarian character prohibiting reprisals and d) other obligations under preremptory norms of general international law, p. 367. Exhibit R 111.

HFCS trade proposed by the United States coincidentally during the week that the *CPI* claim was being heard.

455. During the week of the *CPI* hearing, the United States approached Mexico with an offer to settle certain aspects of the sweeteners dispute for the balance of the 15 year transition period. Mexico believes that the U.S. made this proposal because Mexico made it clear that it would bring itself into compliance with the WTO Panel ruling but it would maintain a NAFTA-inconsistent countermeasure until such time as the U.S. came to the table.

456. On 31 December 2007, the transition period will conclude and the two Parties will have created a customs union for trade in sweeteners. The U.S. proposed a series of measures that would move the Parties closer to this position. The Parties agreed to an exchange of letters, dated 27 July 2006, setting out understandings "which are intended to promote an orderly transition to the elimination of tariffs on sugar and syrup goods and HFCS goods."[338]

457. The Parties established a "one-for-one" market access agreement: for the marketing year beginning 1 October 2006. Essentially, the United States will award a quota of 500,000 tons of Mexican sugar, spread out in three marketing years until 1 January 2008 (the current marketing year, which begins in October 2006 and the first three months which start in October 2007). Mexico agreed to grant a reciprocal quota of 500,000 metric tons in the same period.[339]

458. The amount of duty-free access that the United States agreed to provide to Mexico for the balance of the 15 month transition period is greater than it has hitherto been willing to grant, and the agreement also recognizes a one-to-one relationship between U.S. exports of HFCS and Mexican exports of sugar to the U.S. Mexico considers the agreement as a recognition by the United States of the need to resolve Mexico's sugar market access grievance for the balance of the transition period.

459. The understanding also recorded that the Parties submitted a joint letter to the WTO's Dispute Settlement Body expressing their agreement that Mexico shall eliminate the tax measures that were challenged by the U.S. at the WTO.[340]

460. Both Parties also agreed to a "standstill" clause. Neither will adopt, directly or indirectly, restrictions to bilateral sweetener trade that are not contemplated in the July 27 agreement and in other future agreements.[341]

461. Finally, of relevance to the present case, paragraph 8 of the understandings stated that:

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338 Letter from the United States Trade Representative to Undersecretary for International Trade Negotiations Angel Villalobos Rodriguez, dated 27 July 2006. Exhibit R 113.

339 Ibid., ¶¶ 1-2. The agreement also provides for an additional 21,774 tons of Mexican sugar to be imported into the United States during the 2005 marketing year, which is equivalent to the 7,258 tons of HFCS per year that Mexico will allow to be imported from the United States during each of the marketing years 2005 and 2006, and the first quarter of marketing year 2007.

340 *Id.*, ¶ 6.

341 *Id.*, ¶ 7.

> Mexico and the United States recognize that there are ongoing disputes concerning trade in sweeteners, which have not been resolved, and that this agreement contributes to finding a resolution to those disputes. Mexico and the United States further recognize that this agreement will facilitate an orderly transition to full tariff elimination on sugar and syrup goods and HFCS goods on January 1, 2008. Mexico and the United States shall continue to consult on trade in sweeteners with a view toward facilitating that transition, further liberalizing trade in such goods, and making progress on the issues underlying those disputes.

462. Accordingly, Mexico has a complete defence on the countermeasures ground alone, and the claim should be dismissed in its entirety by the Tribunal.

IV. RESPONSE TO THE CLAIM FOR DAMAGES

A. Jurisdictional issues applicable to damages

463. As explained in Section III. A:

a) the Tribunal lacks jurisdiction to consider the claim for profits (or net cash flow) allegedly lost by Cargill on HFCS that would have been produced at facilities in the United States and exported to Mexico – only the claim for profits (or net cash flow) allegedly lost by Cargill de Mexico as a distributor of HFCS in Mexico may be considered by the Tribunal;

b) the Tribunal lacks jurisdiction to consider any claim arising from the imposition of antidumping duties – as will be explained below, the entire claim for damages rests on the assumption that the antidumping duties never existed; and

c) finally, the Tribunal lacks jurisdiction to consider any claim arising from the alleged breaches of Article 1103 and 1105.

B. Applicable jurisprudence

1. Article 1110

464. There is a fundamental difference between the assessment of compensation payable for a breach of Article 1110 and the assessment of damages payable for a breach of other substantive obligations under Section A of Chapter Eleven.

465. Article 1110(2) prescribes the measure of compensation payable for a breach of article 1110(1). This requirement has been consistently confirmed by tribunals established under the NAFTA.

466. In *Metalclad*, the tribunal held:

> NAFTA, Article 1135(1)(a), provides for the award of monetary damages and applicable interest where a Party is found to have violated a Chapter Eleven provision. With respect to expropriation, NAFTA, Article 1110(2) specifically requires compensation to be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place. This paragraph further states that "the valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value".[342] [Emphasis added.]

467. The *Feldman* tribunal took the same view:

[342] Metalclad Corporation v. United Mexican States, Award, 30 August 2000. ¶ 118.

> The Tribunal, first, observes that under NAFTA Article 1117(1) (as well as Article 1116(1) an investor of a Party on behalf of an enterprise may submit to arbitration a claim that the other Party violated, among other provisions, the obligation to accord national treatment under NAFTA Article 1102 and, therefore, "that the enterprise has incurred loss or damage by reason of, or arising out of, that breach". NAFTA provides no further guidance as to the proper measure of damages or compensation for situations that do not fall under Article 1110 (expropriation); the only detailed measure of damages specifically provided in Chapter 11 is in Article 1110(2-3), "fair market value", which necessarily applies only to situations that fall within that Article 1110. It follows that, in the case of discrimination that constitutes a breach of Article 1102, what is owed by the responding Party is the amount of loss or damage that is adequately connected to the breach. In the absence of discriminations that also constitutes indirect expropriation or is tantamount to expropriation, a claimant would not be entitled to the full market value of the investment which is granted by NAFTA Article 1110. Thus if loss or damages is the requirement for the submission of a claim, it arguably follows that the Tribunal may direct compensation in the amount of the loss or damage actually incurred.[343] [Emphasis added.]

468. It is clear that Article 1110 is confined, by its own terms, to compensating investors in circumstances where an investment has been taken, or effectively taken, by the actions of the host state. It does not stipulate payment of compensation for lesser forms of injury as, for example, in the case of the terms of reference of the Iran-U.S. Claims Tribunal which required compensation for expropriation and other measures affecting property rights. Nor does it stipulate payment of compensation for diminution in value of an investment caused by the actions of the host state. Article 1110(2) contemplates only payment of the fair market value of an expropriated investment, assessed immediately before the expropriation date.

2. Articles 1102 and 1106

469. The Claimant contends that compensation for damages derived from "non-expropriation violations of NAFTA" should "as far as possible, wipe out all of the consequences of the illegal act and re-establish the situation which would, in all probability have existed, if the act had not been committed".[344]

470. NAFTA tribunals have tended to point to Article 1116 and 1117, which enable investors to submit claims for "loss or damage by reason of, or arising out of" a breach of Section A of Chapter Eleven. Thus, the tribunal in *S.D. Myers, Inc v. Government of Canada*, cited by the Claimant for its reference to the *Chorzów Factory* case, correctly observed:

> …damages may only be awarded to the extent that there is a sufficient causal link between the breach of a specific NAFTA provision and the loss sustained by the investor. Other ways of expressing the same concept

343 Marvin Roy Feldman v. United Mexican States, Award, 2 December 2002, ¶ 194.

344 Memorial, ¶ 300, 301.

> might be that the harm must not be too remote, or that the breach of the specific NAFTA provision must be the proximate cause of the harm.[345]

471. The Claimant seeks to recover the "lost net cash flow that Cargill and Cargill de Mexico would have garnered" but for the alleged breach of Article 1102 and 1106. Mexico does not dispute that lost net cash flows could be an appropriate valuation criterion in a particular case, provided that the tribunal is not required to engage in speculation to assess future cash flows. This position was embraced by the *Metalclad* tribunal which decided that a period of two to three years of profitable operations is required before a discounted cash flow (DCF) valuation could be considered reliable.

> 119. Normally, the fair market value of a going concern which has a history of profitable operation may be based on an estimate of future profits subject to a discounted cash flow analysis. *Benvenuti and Bonfant Srl v. The Government of the People's Republic of Congo*, 1 ICSID Reports 330; 21 I.L.M. 758; *AGIP v. The Government of the People's Republic of Congo*, 1 ICSID Reports 306.
>
> 120. However, where the enterprise has not operated for a sufficiently long time to establish a performance record, or where it has failed to make a profit, future profits cannot be used to determine the going concern or fair market value. In *Sola Tiles, Inc v. Iran* (1987) Iran-U.S.C.T.R. 224, 240-42; I.L.R. 460, 480-81, the Iran-U.S. Claims Tribunal pointed to the importance in relation to a company's value of "its business reputation and the relationship it has established with its suppliers and customers". Similarly, in *Asian Agricultural Products v. Sri Lanka* (4 ICSID Reports 246 (1990) at 292) another Tribunal observed, in dealing with the comparable problem of the assessment of the value of goodwill, that its ascertainment "requires the prior presence on the market for at least two or three years, which is the minimum period needed to establish continuing business connections". [346]

472. A further limitation on the use of a DCF valuation to assess going concern value is the requirement to account for all negative contingencies that may affect the price a prospective buyer would be willing to pay, as articulated by in *Phillips Petroleum v. Iran*: "any … analysis of a revenue-producing asset … must involve a careful and realistic appraisal of the revenue producing potential of the asset over the duration of its term" and "must also involve an evaluation of the effect on the price of any other risks likely to be perceived by a reasonable buyer at the date in question…."[347]

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345 Second Partial Award, 21 October 2002, at paragraph 140. (Note that this Award is under judicial review on the grounds, *inter alia*, that the Tribunal exceeded its jurisdiction by combining losses the claimant suffered in it its capacity as a cross-border service provider with damages suffered in its capacity as investor.)

346 *Metalclad* Award, ¶¶ 119-120.

347 *Phillips Petroleum Co. vs. the Government of Iran*, et. al., Award No. 425-39-2 (29 June 1989), 21 Iran – U.S.C.T.R. 79, 124, Id,. ¶ 111.

473. The International Law Commission has noted that international tribunals "have been reluctant to provide compensation for claims with inherently speculative elements."[348] In his separate opinion on the issues at the quantum phase of in *CME v. The Czech Republic*, Professor Brownlie concurred: "The principle denying recovery for speculative damages has long been recognized in the practice of international tribunals."[349] There is considerable support for this conclusion. The Iran-U.S. Tribunal stated in *Amoco v. Iran*:

> One of the best settled rules of the law of international responsibility of States is that no reparation for speculative or uncertain damage can be awarded. This holds true for the existence of the damage and of its effect as well. Such a rule, therefore, applies in the case of unlawful expropriation. *A fortiori*, the reasoning on which it rests must also apply in the case of compensation for a lawful expropriation. It does not permit the use of a method which yields uncertain figures for the valuation of damages, even if the existence of damages is certain.[350]

474. In the *Chorzów Factory* case, on which the Claimant relies, the Permanent Court of International Justice concluded that the damages alleged to have been caused by injurious competition "would come under the heading of possible but contingent and indeterminate damage which, in accordance with the jurisprudence of international tribunals, cannot be taken into account."[351]

475. In this context, while recognizing the validity of certain valuation methods that factor in different elements of risk and probability, such as the DCF method, international tribunals have exercised caution because "[t]he method analyses a wide range of inherently speculative elements, some of which have a significant impact upon the outcome (e.g. discount rates, currency fluctuations, inflation figures, commodity prices, interest rates and other commercial risks)."[352]

476. Mexico submits that the jurisprudence cautioning against speculation in assessing going concern value for the purposes of an expropriation claim applies equally to any assessment of damages that relies on future profits claimed as damages for breach of Article 1102. This was reflected in the approach taken in *S.D. Myers* – cited in the Memorial for the proposition that loss of anticipated profits can form the basis of an award of damages for breach of Article 1102 –

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[348] International Law Commission, Report of the International Law Commission on the work of its Fifty-third session, p. 277, Exhibit R 135.

[349] *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, Separate opinion on the issues at the quantum phase, ¶¶ 66 et seq.

[350] *Amoco International Finance Corporation v. Islamic Republic of Iran*, Partial Award of 14 July 1987, 27 I.L.M. 1320 (1988), ¶ 238.

[351] *Case concerning the factory at Chorzów* (Claim for indemnity) (The merits), Judgment No. 13 of 13 September 1928, Publications of the Permanent Court of International Justice, Collection of Judgments, Series A.-No. 17, p. 57.

[352] Report of the International Law Commission on the work of its Fifty-third session, p. 276. Exhibits R 135.

where the tribunal expressly cautioned against the use of speculative profits as a measure of compensation.[353]

477. A full review of the facts in that case[354] reveals that S.D. Myers, Inc. (SDMI) had been "an industry leader in the remediation of PCB-contaminated waste material in the USA"[355] for several years when it obtained permission from the U.S. Environmental Protection Agency to import PCB waste from Canada for destruction at its facility in Ohio. It also had "an excellent record of profitability, and an outstanding record of passing audits by regulators and customers"[356] when Canada imposed an export ban on PCB waste which remained in place for 14 months.

478. With the assistance of its Canadian affiliate, Myers Canada, SDMI had secured 107 orders and 833 bids and quotes having a total value of 104 million dollars[357] which it was ready to perform but for the export ban. In awarding damages, the tribunal carefully assessed appropriate success rates on the orders, bids and quotes to calculate the number of contracts that would have been performed, taking suitable reductions for likely price degradation and other effects of competition, even though SDMI was found to have had a significant timing advantage over its American competitors and a substantial price and location advantage over its Canadian competitors[358]. In the result, the tribunal awarded slightly more than 6 million dollars on SDMI's orders, bids and quotes of 104 million dollars[359].

479. The Claimant here urges the Tribunal to award damages of $123.81 million dollars – $57.9 million dollars for loss allegedly suffered by Cargill de Mexico plus $65.9 million for loss allegedly suffered by Cargill in the United States – on fundamental assumptions concerning (i) the projected size of the Mexican HFCS market; (ii) Cargill de Mexico's projected market share: and (iii) the prices that it says would have prevailed during the relevant period that are wholly speculative if not grossly exaggerated.

480. In the section that follows Mexico will present a comparative analysis of the valuation evidence adduced by the parties in this proceeding. However, Mexico respectfully submits that in determining what revenues Cargill de Mexico would have enjoyed in the absence of the tax, the Tribunal must also consider the negative effects the continuing sweeteners dispute between Mexico and the United States would have had on Cargill de Mexico's market share, its ability to import HFCS from the United States, and its profit margins.

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353 Indeed, the *Myers* tribunal expressly cautioned against the use of speculative profits as a measure of compensation: see Second Partial Award, ¶¶ 156 and 173.

354 Ibid.., pp. 17-19, 41-73.

355 Ibid., ¶ 83.

356 Ibid., ¶ 181.

357 These prospective Canadian customers had a legal obligation to either store or dispose of their stockpiles of PCB waste in a manner approved by prevailing environmental laws and regulations. They were motivated to dispose of their PCB's when the opportunity presented itself. *Id*., ¶ 198.

358 Ibid., ¶ 197-208 and 249-281.

359 Ibid., ¶ 300.

C. Deficiencies in the Claimant's evidence

1. Failure to prove damages for alleged breach of Article 1110.

481. The Claimant has not adduced evidence of the fair market value of Cargill de Mexico or the Tula distribution facility (or any other investment that Cargill owns or controls in Mexico) immediately prior to the presumed date of expropriation, or on any date. Rather, its damages expert, Navigant Consulting, Inc. (Navigant) has limited its assessment to an estimate of the lost net cash flow that Cargill and Cargill de Mexico would have earned "but for" what it describes variously as the "actions" and/or the "interference" of the Mexican government between 1 January 2002 and 31 December 2007.

2. Reliance on demonstrably incorrect assumptions as to market size, market share and price

a. Presumed non-existence of the antidumping duties

482. The Navigant report is ambiguous in its description of the measures which are alleged to have caused Cargill and Cargill de Mexico to suffer loss of net cash flow. It describes in detail the effects of the three measures that the Claimant describes collectively as "Mexico's anti-HFCS measures" (the antidumping duties, the IEPS and the permit requirement) but it does not explain how the effect of each of these measures relates to the lost cash flow that Cargill or Cargill de Mexico would have enjoyed "but for Mexico's actions".

483. Although Navigant states "[w]e have been advised by Counsel that Cargill cannot claim direct losses incurred as a result of the unlawful anti-dumping duties imposed by Mexico",[360] upon close examination of the Navigant Report it is evident that Navigant has made projections as to the size of the HFCS market from 2002 to 2007 and Cargill de Mexico's market share as if the antidumping duties had never been imposed. In other words, the damages assessment has been calculated on the basis of what Cargill and Cargill de Mexico would have earned from 2002 to 2007 (inclusive) "but for" the effects of the antidumping duties as well as the effects of the IEPS and the permit requirement.

484. This assumption has not been disclosed in a forthright manner. Paragraphs 73 to 79 are reproduced for the convenience of the Tribunal:

> *A. Forecast of the Mexican HFCS Market*
>
> 73. In order to establish Cargill's losses, it is first necessary to develop a forecast of the Mexican HFCS market absent Mexico's interference. To develop this "But For Mexican HFCS Market," we relied upon the adoption curve of HFCS in the U.S. market as a guide. We believe the evolution of HFCS in the U.S. market is a useful guide to project how HFCS would have evolved in the Mexican market for the following reasons:

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[360] Navigant Report, ¶ 69.

[List of reasons omitted.]

74. The majority of the initial growth in Mexican HFCS sales was expected to result from soft drink customers converting to HFCS-55 and HFCS-42 from sugar for their sweetener needs. This aspect of the Mexican market differed from the U.S. experience. In the U.S. HFCS-42 was introduced first and was not fully adopted by the soft drink industry because it was not sweet enough for use in colas. Only after developing the sweeter HFCS-55 product some 4 or 5 years later did the U.S. industry adoption rate accelerate to nearly 100 percent HFCS use. Although both HFCS-42 and HFCS-55 were available to the Mexican market at the same time, we have not made any adjustments to the U.S. adoption curve to account for this factor. As such, we believe the U.S. adoption rate curve would yield a conservative adoption rate curve for Mexico.

75. As in the U.S. market, HFCS was also expected to displace sugar as an ingredient in nonbeverage products where it was a viable substitute in Mexico as well. However, the U.S. adoption rate of HFCS in the non-beverage segment did not track the adoption rate in the beverage segment largely because HFCS is not a viable replacement for sugar in some products. In light of the differences, we separated the U.S. industrial sweetener market into two segments, beverage and non-beverage, and constructed an adoption rate curve for each segment. Data published by the United States Department of Agriculture ("USDA") was relied upon to construct the U.S. adoption rate curves for each segment. USDA data was also relied upon to establish the demand (i.e., consumption) for these two segments of the Mexican industrial sweetener market in each year of our forecast.

76. To construct the adoption rate curve for the Mexican beverage segment, we utilized 1992 as the starting point for the Mexican market. The starting point for the U.S. market was set at 1974, thus creating an 18 year lag. To test this lag and the "fit" of our adoption rate curve, we compared the actual adoption rate of HFCS in the Mexican beverage segment in 1997 to the actual adoption rate of HFCS in the U.S. beverage segment in 1979 (i.e., 18 year lag). HFCS constituted 21.38 percent of the industrial sweetener consumption in the Mexican beverage segment in 1997. Similarly, HFCS constituted 21.81 percent of the industrial sweetener consumption in the U.S. beverage segment in 1979. Thus, we deemed our U.S. adoption rate curve to be appropriately applied to the Mexican market. See Figure 7 below for a diagram of the U.S. adoption rate curve in the beverage segment as we have applied it to the Mexican market. See Appendix 9 for more detail.

[Figure 7 omitted.]

77. As Figure 7 demonstrates, the Mexican adoption rate curve is curtailed beginning in 2002 as compared to the U.S. curve. We limited the penetration of HFCS in the Mexican beverage segment to 80 percent to

> account for the fact that Pepsi was a fairly large investor in the sugar industry. Although HFCS would be a cheaper sweetener and lead to higher profit sales for Pepsi, we conservatively limited the adoption to account for the risk that Pepsi might not fully switch to HFCS given its investment in Mexican sugar.
>
> 78**.** We followed the same methodology when we constructed the adoption rate curve for the Mexican non-beverage segment. However, we deemed it more appropriate to incorporate a lag of 21 years rather than 18 years. This lag appears appropriate because the HFCS adoption rate for the Mexican non-beverage segment was 10.30 percent in 1997 while the adoption rate for the U.S. non-beverage segment was 10.36 percent in 1976. See Figure 8 below for a diagram of the U.S. adoption rate curve in the non-beverage segment as we have applied it to the Mexican market. <u>See Appendix 9 for more details</u>.
>
> [Figure 8 omitted.]
>
> 79. Aggregating the adoption data from both segments, the Mexican industrial sweetener market, and HFCS's share of that market, was projected to develop as set forth in Table 3 below. <u>Our market projections estimate that absent Mexico's interference in the sweetener market. HFCS would have constituted 54.55 percent of Mexico's total industrial sweetener consumption by 2002 and 58.32 percent by 2007</u>.
>
> [Emphasis added, footnotes omitted.]

485. Appendix 9, which purportedly contains "more details", is entitled "Mexican Industrial Sweetener Market Actual and Projected". The following explanatory note appears in very small print:

> *(All assumptions and projections are in italics.)* [Italics in the original.]

486. An examination of the figures in italics in Appendix 9 reveals that Navigant has projected HFCS and sugar consumption <u>beginning in 1998</u>, with the result that the projected HFCS consumption for 2002, the first year the IEPS tax was in effect, is 275% greater than the amount of HFCS actually consumed in 2001, the year before the tax was imposed.[361] By doing this, without expressly saying so, Navigant has eliminated what it contends were the market restricting effects of the antidumping duties.

487. Navigant made a similar assumption (without express disclosure) in projecting Cargill de Mexico's market share. At paragraphs 80 and 81 of its report, Navigant postulates that when the IEPS was imposed Cargill would have had the 26.53% market share it claims to have held in 1997 before the antidumping duties were put in effect. It is acknowledged by the Claimant that the antidumping duties were not removed until May of 2002.[362] Cargill could have not have regained

361 Exhibit R–02 , PRA Report, ¶ 52.

362 Memorial, ¶ 100.

any of its former market share until then and, in any case, it would have had to compete with ALMEX and CPIngredientes to gain back any market share. Navigant, without saying so, has also eliminated the effects of the antidumping duties for the purposes of its market share assumption.

488. It is plain to see that Navigant's entire damages assessment is based on the faulty premise that the size of the Mexican HFCS market would have been nearly triple what it actually was when the IEPS went into effect and that Cargill de Mexico would have supplied more that a quarter of that market at times when it could not have supplied any HFCS, the Navigant Report should be rejected in its entirety.

b. Market size

489. Navigant's market size assumptions suffer from a further flaw. Its predictions as to market growth are based on the premise that, but for the IEPS (and the antidumping duties, as noted above), the Mexican market would have followed the same "HFCS adoption curve" that was experienced in the United States in the1970's and 1980's, with the expectation that the two largest consumers of HFCS-55, the bottlers of Coca Cola and Pepsi Cola, would quickly convert to 100% HFCS (with the possible exception of certain Pepsi bottlers that were vertically integrated with sugar mills).[363]

490. The fallacy in this hypothesis is the fact that socio-economic conditions in Mexico pertaining to the sugar industry in 2001-2002 were in no way comparable to those in the United States in the 1970's and 1980's. The Mexican sugar industry was in crisis as a result of recurring production surpluses which could not be exported to the United States or sold profitably to the world market.[364] There was a serious and worsening socio-economic problem that threatened the livelihood of hundreds of thousands of Mexicans employed in the industry as cañeros and sugar mill workers who, although they live in poverty, are highly organized, politically vocal and fully capable of engaging in disruptive measures.[365]

491. It cannot be presumed that responsible licensed users of the Coca Cola or Pepsi brands, who undoubtedly place a high value on their brands' public image, would choose to act solely on the basis of price to substitute HFCS for sugar, if that meant large scale displacement of Mexican workers and widespread social unrest. Indeed, the evidence of Mexico's Coca Cola and Pepsi bottlers is precisely to the contrary. They were not then inclined, and are still disinclined, to move beyond a maximum level of 50% HFCS.

492. The first example is FEMSA, to whom the Claimant repeatedly refers, the largest Coca Cola bottler in Latin America. FEMSA states that, bearing in mind the importance of the sugar sector to the social development of the country and the number of people who rely on it for their livelihood, it has continuously maintained a policy of using sugar and HFCS in equal quantities

[363] Navigant Report, ¶¶ 73-77.

[364] As shown in paragraph 54 of the facts, any sales from the Mexican market to the "world market" would be made at a loss.

[365] Counter-Memorial, ¶ 123, See also Exhibit R–01D, Witness Satement of Ángel Villalobos, ¶ 17 and Exhibit R 01B, Witness Statement of Gabriel Ramírez Nambo ¶ 7.

(50/50) since before the IEPS was imposed and expects to maintain that policy for the foreseeable future now that the tax as been eliminated.[366]

493. FEMSA produces 30% of all soft drinks (all varieties) sold in Mexico. As FEMSA has had an *amparo* against the application of the IEPS since November 2003,[367] the fact that it continues to maintain its policy of using sugar and HFCS in a 50/50 mix clearly to the contrast between the situation that has prevailed in Mexico since the late 1990's and that which existed in the United States thirty years ago.[368]

494. The second example is GEUPEC, the second largest Pepsi Cola bottler in Mexico, which has never used HFCS and has no plans to use it. GEUPEC's quality control manager explains that this decision was taken in part because of concern for consumer taste preferences and in part because of socio-economic and socio-political considerations and the prospect of attracting negative publicity for the brands that the company represents.[369]

495. Finally, it bears noting that the Claimant's contemporaneous records, produced in response to the Respondent's request for production of documents, are consistent with what FEMSA has reported. A selection of these internal emails and memoranda is can be found in paragraph 59 of the PRA Report. It is obvious that the Mexican bottling industry was following a cautious course of action.

496. In the result, even if all Coca Cola and Pepsi Cola bottlers, including GEUPEC and any others that are not using HFCS at this time, were to use 50% HFCS in their non-dietetic cola products, the market penetration for HFCS could only reach 65%, and it would be much less than that as long as GEUPEC and Pepsi bottlers affiliated with sugar mills maintain a sugar only policy. [370]

c. Market share

497. In addition to Navigant's problem that the antidumping duties would have prevented Cargill de Mexico from regaining its market share until after their removal in May 2002, it would be unrealistic to expect that Cargill de Mexico would have quickly regained market share from its competitors, CPIngredientes and ALMEX, both of whom produce HFCS in Mexico. Simply put, they had a better grip on the market as a result of Cargill's four year absence since the final anti-dumping duties were imposed in 1998.

498. Common sense dictates that it would have taken time for Cargill de Mexico to start taking away business from its competitors. There would have been a waiting period for the competitors' supply contracts with major customers to begin to expire, and Cargill would have had to price

366 Exhibit R – 118. FEMSA letter to the Secretariat.

367 Memorial, ¶ 153.

368 Ibid.

369 Exhibit R 01B, Witness Statement of Gabriel Ramírez Nambo.

370 Exhibit R–02, PRA Report, ¶¶ 61-62.

aggressively in order to take business away from them. This would have the effect of stimulating price competition among the three suppliers with a consequential downward movement in prices.

499. It is more realistic to expect that Cargill would have focused its efforts sales to new HFCS users. Indeed, in January 2005, the press reported FEMSA as saying that it would only use domestically produced HFCS in its products until such time as Mexican sugar production was below demand, so as not to upset the domestic sugar industry. [371]

500. For the purposes of its reassessment of the claim for damages using the Navigant model, PRA has assumed that it would take Cargill de Mexico about 18 months to win back a 26.53% market share, beginning in June 2002, had the IEPS never been imposed.[372] This is generous, considering that, when allocated HFCS quota pursuant to the 2005 Katrina Swap, Cargill elected to sell its quota to a competitor instead of attempting to re-enter the Mexican market itself.[373] Likewise, having been granted substantial HFCS import quota for 2006-2007, Cargill apparently elected to refurbish the Tula distribution facility with a view to opening it in a year's time.[374] It is thus apparent that re-entering the market in 2002 would have been much more difficult and time consuming than the Claimant would have the Tribunal believe.

d. Prices

501. Navigant's assessment of damages relies on estimated prices for HFCS in 2002-2007 to determine Cargill's alleged lost revenues. The price for 2002 is obtained by discounting the 2002 observed price for refined sugar in Mexico. For subsequent years Navigant assumes that the Mexican market would have tracked the U.S. market.

502. There are three fundamental flaws in Navigant's approach. First, by using the actual or observed price of refined sugar in Mexico in 2002, Navigant is incorporating the effects of the IEPS tax, which is exactly what it purports to avoid by using its "but-for" approach. Indeed, by eliminating HFCS consumption in the soft drink market, the IEPS tax increased demand for refined sugar, which in turn had the effect of increasing its price (this is acknowledged in the Navigant Report in ¶ 64). By using this higher sugar price, Navigant improperly incorporates the effects of the tax. It is also worth noting that in a truly "but-for" scenario sugar prices not only would <u>not</u> have increased, but almost certainly <u>would have</u> decreased (due to the excess supply), making refined sugar more competitive *vis-à-vis* HFCS.[375]

503. The second flaw is that the price estimate used by Navigant incorporates a premium for which it offers no explanation. The PRA report points out that that Navigant's price estimate for HFCS in Mexico is higher than the U.S. price plus transportation costs.[376] It is unlikely that,

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[371] Exhibit R – 119, email from Jonathan Drake dated 28 January 2005, Redweld 19.

[372] Exhibit R – 02, PRA Report, ¶ 79.

[373] Memorial, ¶ 175.

[374] Ibid., ¶ 179.

[375] For a more detailed explanation please refer to section C.5.3 of the PRA report (¶¶ 81-85).

[376] Ibid., ¶¶ 86-92.

absent the tax, Cargill would have been in a position to charge an additional premium, considering that its other two competitors (or three, if Tate & Lyle is considered separately from ADM) were also capable of exporting HFCS from the U.S. and were also local producer (and had a competitive advantage over Cargill in the form of lower freight and distribution costs). If competition of other U.S. HFCS producers is taken into account then prices would have moved towards the U.S. price plus reasonable transportation costs if not lower.

504. Third, Navigant also assumes that the Mexican market would have tracked the U.S. market as if they were fully integrated markets. This is untenable. It ignores, the fundamental differences that exist between the two markets, like the fact that Mexico is a sugar net surplus producer and the U.S. is a net importer and that a number of soft drink bottlers are integrated with sugar mills.

505. Finally, it bears noting that in 2001 Cargill was able to sell small amounts of HFCS 42 and HFCS 55 in Mexico notwithstanding the antidumping duties had not been removed, and therefore, prices for these two products prior to the enactment of the tax are available.[377] Navigant offers no explanation for not using these observed prices as the basis for its analysis.

506. In view of the foregoing, PRA estimates that HFCS prices used by Navigant are overstated by at least USD $0.72 per cwt, or 5%, assuming the price of sugar does not go down.

D. The proper measure of damages

507. Mexico has defended this claim on the primary ground that it has no liability to the Claimant for the alleged breaches of Articles 1102, 1103, 1105, 1106 and 1110, either because claims arising from the measure complained of (i.e. the antidumping duties and the permit requirement) are not within the Tribunal's jurisdiction, or on the basis of the substantive defenses described in Section III.B.

508. Mexico has defended this claim on the secondary ground that the IEPS and the permit requirement were countermeasures properly taken at international law which relieve Mexico of liability to Cargill and the other HFCS suppliers that contend they would have supplied HFCS to the Mexican soft drink bottling industry "but for" the IEPS and/ or the permit requirement.

509. If the Tribunal finds it necessary to consider awarding damages to the Claimant for any alleged breach of Section A of Chapter Eleven, Mexico respectfully submits that the considerations discussed below must be taken into account.

1. Effect of the permit requirement

510. The requirement for importers of HFCS produced in the United States to obtain an import permit was part of a discretionary TRQ regime which took effect on 1 January 2002. It was the countermeasure that the Executive saw fit to impose.[378] The aim of the Executive was to grant import quota on a ton-for-ton basis with quota granted by the United States for imports of

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[377] Ibid., ¶ 95.

[378] Counter-Memorial, ¶¶ 214-215.

Mexican sugar[379]. The efficacy of the scheme was never really tested until after the IEPS tax was the subject of *amparos* and the U.S. sought a partial settlement.

511. Mexico respectfully submits that, if the Tribunal agrees that claims arising from the permit requirement are not within its jurisdiction (either because it was trade in goods measure which does not fall within the scope and coverage of Chapter Eleven or because it was not properly submitted to arbitration) then the Tribunal cannot safely predict that Cargill de Mexico would have been able to import HFCS from the United States. In such case the proper measure of damages would be zero.

2. Avoidance of speculation

512. If the Tribunal is of the opinion that the permit requirement would not have impaired Cargill de Mexico's ability to import HFCS from the United States, it would be difficult for it to assess damages without engaging in speculation. Put another way, the Tribunal will have to assess damages by relying solely on factually solid, wholly predictable figures for market size, market share and price, an exercise that may prove elusive in the circumstances of this case.

513. First, the Tribunal would be faced with the fact, due to its four year absence, Cargill de Mexico had no recent track record as a supplier to the Mexican HFCS market prior to the implementation of the IEPS.

514. Second, given that Cargill de Mexico was not engaged in the HFCS business when the IEPS was imposed, the Tribunal must turn its mind how to assess what the Claimant really lost, which was the opportunity to compete for business in the market HFCS market following the removal of the antidumping duties.

515. Third, although the Claimant points to the benefits of using HFCS, both in terms of its physical properties and its lower cost, the Tribunal must take into account the many potential negative contingencies that would have confronted the Mexican soft drink industry "but for" the imposition of the IEPS, including the following:

- Would the cañeros and/or sugar mill workers engage in disruptive tactics, such as blockading the entrance to bottling plants?
- Would there be a consumer boycott of soft drinks containing HFCS in view of the widely held view in Mexico that the U.S. was seeking to deny Mexican sugar real access to its market while U.S. HFCS producers were shipping large volumes of product into Mexico?
- Would there be further government measures imposing limits on the availability or use of HFCS as a caloric sweetener, such as an agreement between Mexico and the Unites States imposing a quota on imports of HFCS and/or yellow corn?
- Would there be a voluntary restraint by bottlers which limited the use of HFCS?

[379] Exhibit R – 01A, Witness Statement of Luis de la Calle, ¶¶ 51-53.

516. Had any one or more of these contingencies occurred there is every possibility that there would have been either (i) little or no demand for HFCS beyond what CPIngredientes and ALMEX could have supplied though their local production facilities; or (ii) little or no ability to import HFCS from the United States due to new border measures imposed by Mexico or forming part of an agreement with the United States.

517. No one can safely predict what would have happened had the IEPS never been imposed, other than to say that there would have been a continuing crisis in the Mexican sugar industry (with the attendant socio-economic and socio-political problems described above) and there would have been a continuing trade dispute with the United States concerning market access for Mexican sugar under the Chapter Seven of NAFTA and the side-letters.

518. The PRA Report provides a re-assessment of damages based on the Navigant model but using assumptions as to market size, market share and price that it considers realistic, assuming there are no legal or practical impediments to Cargill de Mexico's ability to import HFCS from the United States and distribute it to customers in Mexico: Cargill de Mexico's net loss cash flow between 1 January 2002 and 31 December 2006 is estimated at $6.75 million dollars.[380]

3. Mitigation

519. The Claimant was able to take advantage of a market opportunity caused by the IEPS, namely the acquisition of 15% equity interest in Zucarmex, Mexico's third largest sugar producer, coupled with a distribution agreement naming Cargill de Mexico as the sole distributor of Zucarmex products for a period of five years.

520. The claim for damages rests solely on the contention that "but for" the IEPS, Cargill and Cargill de Mexico would have enjoyed increased net cash flows totaling $123.81 million dollars The Memorial and the Claimants' witness statements contend that, to the detriment of the HFCS industry, the IEPS put the Mexican sugar industry on a sound financial footing and saved it from financial ruin.[381] The Claimant cannot seriously contend that it should not be required to deduct from its claim the financial benefit it received – the net value of its investment in and distribution arrangement with Zucarmex – that was made possible because of the imposition of the IEPS.

521. In its request for production of the documents, the Respondent requested the Claimant to produce:

> financial records showing the amount of revenues and profits obtained by Cargill (from dividends or any other source) from its minority interest in Zucarmex between 2003 and 2006 (inclusive) and financial records showing the amount of revenues and profits that Cargill derived as a result of the commercialization agreement between 2003 and 2006 (inclusive).[382]

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[380] Exhibit R – 02 , PRA Report, ¶ 106.

[381] Memorial, ¶ 111, Meyer Expert Report ¶ 118, Navigant Report ¶¶ 64, 65.

[382] Mexico's Request for Production of Documents, Paragraph 20(b).

522. As explained in the PRA Report, the documents produced by the Claimant consisted only of Cargill de Mexico's audited financial statements which did not enable PRA to assess the economic benefit that Cargill derived from the Zucarmex investment and the distribution agreement.[383] However, it bears noting that Cargill itself estimated the distribution agreement to represent a benefit of $3.75 to $4 million dollars per year and to have a total value of $15 million dollars.[384]

523. The Respondent submits that the onus has shifted to the Claimant to make full disclosure of the economic benefit to Cargill and Cargill de Mexico of the Zucarmex investment and distribution agreement, failing which the Tribunal should infer that the benefit exceeds the amount of any loss or damages suffered by Cargill and/or Cargill de Mexico by reason of, or arising out of, any measure complained of in this proceeding.

4. Contributory fault

524. If the Tribunal is disposed to make any award of damages in favor of the Claimant, the Respondent submits that it should consider reducing such award to account for the role of the United States sweeteners industry in terms of preventing the timely resolution of the sweeteners dispute between Mexico and the United States.

525. As has been seen, the American Sugar Alliance, which included HFCS producers among its members, strenuously sought a renegotiation of the NAFTA's sweeteners' trade provisions that would have restricted Mexico's market access even further. Mexico does not know whether Cargill was a member of the ASA, but its fellow HFCS producers were. Moreover, even the CRA, in which Cargill actively participated, agreed to support a position that contradicted Mexico's existing NAFTA rights. Accordingly, Cargill cannot escape the fact that its industry was also at the root of the dispute and it should not now be heard to complain of a proportionate response by Mexico

5. Interest

526. There is no specific rate of interest stipulated in the NAFTA for damages arising from a breach of Article 1102 or 1106. However, Article 1110 of NAFTA provides the payment of interest in the following manner:

> 4. If payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.
>
> 5. If a Party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing

383 Exhibit R – 02 , PRA Report, ¶ 155.

384 *Id.*, ¶148.

> on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.

527. The Respondent considers that simple interest at the rate payable from time to time on U.S. Treasury Bills is a reasonable interest rate for an award denominated in U.S. dollars.

V. PETITION

528. For all of the foregoing reasons, the Government of Mexico maintains that the Tribunal should dismiss the Claimant's claim in its entirety, with corresponding order in costs.

All of which is respectfully submitted
for your consideration;

(signed in the original)
Luis A. González García
Director of Legal Consultancy and Negotiations
2 May 2007