NAFTA ARBITRATION UNDER THE UNCITRAL ARBITRATION RULES
AND THE
NORTH AMERICAN FREE TRADE AGREEMENT

INTERNATIONAL THUNDERBIRD GAMING CORPORATION

Claimant

versus

THE UNITED MEXICAN STATES

Respondent

STATEMENT OF REPLY OF CLAIMANT INTERNATIONAL THUNDERBIRD GAMING CORPORATION

9 February 2004

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I.

INTRODUCTION AND REVIEW OF MEXICO'S PARTICULARIZED STATEMENT OF DEFENSE.

A. Introduction.

In 2001, Mexico forcibly seized, closed and sealed Thunderbird's EDM investment enterprises. In doing so, Mexico reneged upon promises and assurances made to Thunderbird concerning the operation of those enterprises. Thunderbird's skill machine facilities remain closed and under government seizure. Mexico destroyed investment enterprises worth tens of millions of dollars. At the same time, it provided, *and still provides*, more favorable treatment to its own investors undertaking identical investment activities. Mexico arbitrarily and unjustifiably discriminated against a foreign investment. Mexico breached its treaty obligations under NAFTA Article 1102, 1105, and 1110.

In its Particularized Statement of Claim ("PSoC"), Thunderbird made a strong case in support of these claims. That case was supported by multiple, detailed declarations from the principal participants in the Thunderbird EDM investments, including not only Thunderbird/EDM representatives but also Thunderbird's principal attorney in Mexico, Luis Ruiz de Velasco of Baker & McKenzie, and Jorge Montano, former Mexican Ambassador to the United States and the United Nations and member of Mexico's NAFTA negotiating team. Thunderbird's case was supported by thousands of pages of records pertaining to the EDM investments. In response to Mexico document requests, Thunderbird provided substantial additional documentation pertaining to Thunderbird and the EDM enterprises. Thunderbird approached the present proceedings with the same transparency which underscores its business practices and which characterized the establishment and operation of its EDM operations in Mexico. Thunderbird made its *prima facie* case of multiple NAFTA treaty breaches by Mexico.

In its Statement of Defense ("SoD"), Mexico avoids any significant consideration of Thunderbird's evidence. In fact, Mexico largely ignores Thunderbird's evidentiary showing. It presents little, if any, rebutting evidence of its own. Instead, Mexico presents a defense based upon factual misrepresentations, unsubstantiated assertions and misleading arguments. In the absence of evidence to refute Thunderbird's claim, Mexico attempts to cloud the issues through misdirection and misrepresentation.

Thunderbird made its *prima facie* case that Mexico breached its NAFTA treaty obligations. Mexico has not met its burden to rebut Thunderbird's showing. Claimant respectfully asserts that an award of damages in the full restitution value of each of Thunderbird's EDM investment enterprises is warranted by the facts, supported by treaty standards and just under guiding NAFTA principles.

B. Mexico's Attempt to Recast the Issues and Avoid Application of Treaty Standards.

In its PSoC, Thunderbird describes in detail the basis of its claims and the precise questions presented to the Tribunal for consideration under Articles 1102, 1105 and 1110. For the most part, Mexico does not dispute the applicable NAFTA standards. Instead, it attempts to recast the argument in a manner designed to avoid application of those standards.

Mexico repeatedly attempts to recast Thunderbird's claim as being based upon the assertion that the EDM skill game operations were legal under Mexican law:

> "The claimant is basing its case on the fact that the machines it operated in the establishments at Nuevo Laredo, Matamoros and Reynosa (and those it claimed to operate in other locations) were permitted by the Federal Law on games and Raffles, or rather, that they were permitted by SEGOB as machines of "ability and skill" which demonstrates the legitimacy of its operations."[1]

With these and other similar statements, Mexico attempts to recast the argument and place the burden upon the claimant to *affirmatively prove the legality* of its skill machine operations. No such burden is placed upon Thunderbird either under the facts of this case or under applicable NAFTA standards. Thunderbird's EDM enterprises operated in an open and transparent fashion for a collective 29 months with the knowledge and support of Mexican state and local authorities. Moreover, Thunderbird's development efforts to expand in at last three other cities in Mexico were based solely upon Mexico's "blessing" of the existing operations. Thunderbird opened and operated its EDM facilities only after securing prior government assurances that its proposed operations were not

[1] SoD, Para. 19(a)

prohibited under Mexican law.[2] Mexico then reversed course. It closed the down the EDM facilities and thwarted Thunderbird's development efforts to expand, claiming the skill machines were illegal. It is Mexico that claims the skill machines were illegal. It is Mexico that claims such illegality warranted the confiscatory actions its took against the EDM enterprises. It is Mexico that bears the burden to justify its seizure of the EDM facilities.

Mexico had only two alternatives in these proceedings: (1) present the domestic legality question squarely before the Tribunal for its *de novo* determination, irrespective of what happened in Mexico administratively or in the courts or (2) assert that the Tribunal must defer to Mexico's post facto assurance that Thunderbird was acting illegally, ignoring the circumstances underlying how the investments were treated by Mexican officials or any real consideration of whether that treatment fell below the standard of "fair and equitable treatment" required by the NAFTA.

Mexico's rejection of the first alternative and unconditional acceptance of the second alternative is clearly stated as follows:

> "For this reason, Mexico respectfully considers it inappropriate for the Tribunal itself to be given the task of carrying out an analysis to determine whether the games operated by EDM constitute, under Mexican law, legal games of ability and skill or prohibited games of chance or gambling games. Furthermore, the Tribunal should not ignore the fact that this question has been clearly answered in the judgments of the Mexican Federal courts in respect of the actions brought by EDM. As will be explained below, this Tribunal does not have the jurisdiction to act as a Court of Appeal in respect of judgments of national courts."[3]

Thus, Mexico wishes to rely upon the alleged illegality of the skill machine operations as the basis for seizing Thunderbird's investment enterprises. Yet, it does not want an independent, *de novo*, review by the Tribunal of the illegality determination. Instead, it wants the Tribunal to simply defer to

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[2] To this day, Mexico has presented no evidence that the EDM machines were being operated in a manner inconsistent with the August 15, 2001 opinion letter. Mexico presents no evidence on this issue in its SoD.

[3] PSoD, Para. 94.

Mexico's post-facto characterization of the outcome of its administrative and legal processes on the issue of illegality. In doing so, it seeks to (1) recast the issues before the Tribunal so as to avoid any scrutiny of its arbitrary conduct towards Thunderbird and (2) make it impossible for claimant, much less any other NAFTA claimant, to enforce treaty obligations of "fair and equitable treatment" undertaken by the parties under the NAFTA. Simply put, Mexico wishes to "stack the deck" against Thunderbird in clear contravention of the obligations it accepted under the NAFTA.

Thunderbird agrees that it is not for this Tribunal to analyze and independently determine whether the EDM skill machines were legal or illegal under Mexican law. That would not be the proper function of a NAFTA Tribunal under these circumstances. However, the Tribunal also cannot do what Mexico asks it to do - simply defer to determinations made by Mexico's so-called "competent authority" without consideration of the facts and circumstances underlying those determinations. Mexico's *entire defense* is based upon this premise. It advocates complete deference to its administrative and judicial processes, but ignores the substantial evidence establishing the arbitrary and discriminatory means by which such processes were used against Thunderbird and its EDM enterprises.

As applied in this case, this approach would allow Mexico to avoid the consequences of its clear treaty violations. Numerous witnesses provided statements describing the arbitrary and discriminatory July 10, 2001 administrative hearing before Guadalupe Vargas. The denial of justice and abuse of rights suffered by Thunderbird and the EDM enterprises at that hearing are detailed at pages 85 through 97 of Thunderbird's PSoC. Mexico does not directly address the testimony of these witnesses concerning these proceedings. At paragraph 433 of its SoD, Mexico does generally deny Thunderbird's factual description of the hearing. But, it submits no evidence which contradicts Thunderbird's evidence on this point.[4] Even Alberto Alcantara *[R-0053]*, who was present at the hearing, fails to directly address Thunderbird's evidence on the arbitrary and unjust nature of these proceedings.

[4]Pointedly missing from Mexico's defense is <u>any</u> declaration testimony from Guadalupe Vargas. Without directly addressing his alleged actions at the hearing, Mexico argues that Guadalupe Vargas played a "minor role". Rather, Mexico asserts that Aguilar Coronado personally presided over the hearing. This is a false statement. Aguilar Coronado was not present. *[Watson, para. 38, Velasco, para. 18, Gomez, para. 23, Montano, para. 17, Reply-Watson, para. 1]* Mexico presents <u>no</u> declaration testimony from Aguilar Coronado attesting to his presence or participation at the hearing. Mexico's effort to misrepresent this fact underscores the egregious nature of the proceedings before Guadalupe Vargas.

If the facts presented on this issue by Thunderbird are believed, there is no doubt that the conduct of these proceedings failed to accord Thunderbird and its EDM enterprises the "fair and equitable treatment and full protection and security" required by Article 1105. Yet, Mexico would have the Tribunal avoid any factual scrutiny of the nature and conduct of this administrative proceeding and simply defer to the determination made at the proceeding and reviewed by the Mexican courts, no matter how flawed that determination may have been. How such a hearing, or any judicial review upholding a determination arising from such a hearing, could *under any circumstances* be deemed to have accorded the investor "fair and equitable treatment" is clearly subject to serious question. Mexico seeks to avoid any consideration by the Tribunal of just such questions.

Thunderbird agrees that Mexico may regulate its country as it sees fit. But, Mexico obligated itself under the NAFTA to compensate investors if the means by which it regulates is found to have violated the standards enumerated in Chapter 11. Under the NAFTA, Thunderbird's investments were owed certain standards of fair treatment by Mexico. Thunderbird's investments were owed treatment as good as that received by domestic investors undertaking the same activities. Thunderbird's investments were owed basic procedural fairness. In its SoD, Mexico devotes little time to, and submits essentially no evidence upon, these fundamental questions. Instead, it seeks to change the question and avoid scrutiny of its actions.

The Tribunal's role in these proceedings is clearly not to independently determine whether the EDM skill machines are in fact legal, or illegal, under Mexican law. Nor is it's role to simply defer to Mexico in its determinations on that point. The Tribunal's role, as clearly articulated in Chapter 11, is to decide, based upon the facts before it, whether Mexico breached its NAFTA obligations in the manner in which it treated Thunderbird's investments. This includes determining (1) whether domestic investors have been treated better than Thunderbird's EDM investments; (2) whether Thunderbird's EDM investments have been accorded fair and equitable treatment; (3) whether Thunderbird reasonably relied, to its detriment, on government assurances; and, (4) whether compensation is owed by Mexico for expropriation of Thunderbird's EDM investments.

C. Mexico's Failure to Factually Rebut Thunderbird's Claims.

Per agreement of the parties, these proceedings are being conducted in accordance with the IBA Rules of Evidence. These rules provide detailed requirements for the taking of evidence and the conduct of an evidentiary hearing. Procedural Order No. 1 provides an equally-detailed procedure for the production of evidence and the taking of witness testimony. These references underscore the obvious point that this is an *evidentiary proceeding*. The Tribunal will, and may only, make its determination based solely upon the evidence presented by the parties.

Thunderbird submitted substantial evidence in support of its PSoC. Thunderbird submitted numerous detailed declarations from the individuals principally involved in the establishment and operation of the EDM entities, as well as in the events surrounding the seizure of the EDM entities and the post-seizure activities. Thunderbird submitted thousands of pages of documents and records supporting its NAFTA claims. Thunderbird made its *prima facie* showing of NAFTA treaty violations. The burden shifted to Mexico to rebut Thunderbird's evidentiary showing.

In its SoD, Mexico does not sustain that burden. Mexico presents little evidence refuting the principle elements of Thunderbird's claim. In fact, essentially all of the material factual elements of Thunderbird's case are admitted or left un-rebutted by Mexico's defense. At pages 96 through 116 of the SoD, Mexico presents a paragraph-by-paragraph response to Thunderbird's Statement of Facts set forth at pages 3 through 34 of the PSoC. A review of this paragraph-by-paragraph response shows that little of the evidence presented by Thunderbird is actually rebutted by Mexico. Substantial portions of Thunderbird's Statement of Facts are admitted by Mexico. Other portions are generally denied but not contradicted by rebutting evidence. A bare denial has no evidentiary value. It is of no help to the Tribunal in its consideration of Thunderbird's claims. Mexico has the burden to produce evidence, not simply to deny Thunderbird's factual assertions. Mexico has failed to meet its burden to produce evidence.

Thunderbird's claim center largely around three events: (1) issuance of the August 15, 2001 opinion letter addressing EDM's proposed skill machine operations; (2) the February, 2001 closure of the Nuevo Laredo facility by Guadalupe Vargas; and, (3) the July 10, 2001 administrative hearing before Guadalupe Vargas. Thunderbird's evidentiary showing on these events is largely admitted or left

uncontradicted by Mexico.

As to facts surrounding the August 15, 2000 opinion letter, Mexico admits that the August 3, 2000 solicitud was a formal request to Mexico concerning the proposed skill machine operation, that the solicitud notified Mexico of EDM's intention to operate 2000 machines at various locations in Mexico and that it identified the precise make and model number of machines to be used. *[SoD, Pages 105-106.]* Mexico admits that August 3, 2000 solicitude was a direct request to the Director General of Gobernacion for official opinion that the identified machines were not prohibited by Mexican law. *[SoD, Page 106]* Mexico admits that on August 15, 2000, Gobernacion issued the official opinion letter and that it was signed by the official in charge at the highest level of the Mexican government with direct authority over gaming. *[SoD, Page 106]* Mexico makes a considerable effort to parse the words of that letter and reformulate its meaning. But, Mexico does not dispute that the letter was solicited from the appropriate Mexican authorities, that it was solicited with respect to the proposed operation of identified skill machines, that it was solicited and issued as an official opinion from SEGOB that the identified machines were not prohibited by Mexican law and that it was issued by the Mexican official with direct authority over such activities. Finally, Mexico does not dispute the text of the August 15, 2000 opinion letter offered as evidence.

As to the February, 2001 closure of the Nuevo Laredo facility, Mexico admits that Guadalupe Vargas closed the facility after conducting a " visual inspection" of the operation. *[SoD, Para. 415.]* In that regard, it is again noted that Mexico has never presented evidence that Guadalupe Vargas had the requisite knowledge to discern the operational differences between skill machines and traditional slot machines. In fact, there is no evidence that *anybody* on behalf of Mexico *ever* undertook to actually critically analyze the operation of EDM's skill machines. The only expert evidence obtained on that point by anyone associated with Mexico was the analysis obtained by the PGR attesting that the machines were in fact skill machines and not games of chance[5].

This lack of requisite knowledge on Guadalupe Vargas' part to discern the difference between a legal skill machine and an illegal slot machine is critical. In late December, 2001, Mexico attempted

[5]That report, obtained by an agency of the Mexican government itself, was summarily rejected as evidence in the October 10, 2002 administrative findings and order.

to close two skill machine operations located in Matamoros, in the state of Tamalupis. The Mexican national operator challenged that closure in the Mexican courts. The appellate court upheld that challenge and overturned the closure. *[Reply-Navarro Velasco; Ex. C-96]* In its opinion, the Sixth District Court of Matamoros held that the closure was illegal in part because the government officials who carried out the inspection and closure did not have the requisite knowledge to determine whether the subject machines were in fact illegal. The Court noted that such technical knowledge was critical,

> "... since it may happen that persons totally ignorant on the subject had determined the electronic and material operation of video machines, that at least from the view of the expert technician designated by this court are those that the claimant identifies as of ability and skill." *[Reply-Navarro Velasco; Ex. C-9; English Translation]*.[6],[7]

Guadalupe Vargas' subjective statements that the EDM machines were illegal "slot machines" are well-documented by Thunderbird. *[PSoC, Page 17, 18-19 and 25 and evidence cited therein]*.The lack of any evidence that Guadalupe Vargas had any understanding or knowledge concerning the operation of skill machines is critical to the Tribunal's application of the Article 1105 "fair and equitable treatment" standard.

As to the July 10, 2001 administrative hearing, Mexico does not rebut Thunderbird's factual assertions that at the time of the hearing it presented various items of evidence attesting to the legality of the EDM skill machines *[SoD, page 116]*. Mexico does not dispute that evidence included a sworn expert report procured for the PGR attesting that the EDM machines were legal skill machines, and declarations and testimony from various experts. *[SoD, pages 115-116]* Mexico admits that all of

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[6]This case runs directly counter to Mexico's assertion that while domestic skill machine operations remain open, there has been no definitive determination as to their permanent right to so operate. There was no appeal. This decision is a final and binding determination of the domestic investor's right to operate skill machines. The Reflejos skill machine facilities in Matamoros which are the subject of this ruling are open and operating under the full protection of Mexican law. *[Reply-Gilberto Vazquez Cuevas, paras. VI, VII (2); Reply-Velsaco Navarro; Ex C-96]*

[7]References to declarations shall state the last name of the declarant and the numbered paragraph. For example, a reference to paragraph 6 of the "DECLARATION OF ALBERT ATALLAH IN SUPPORT OF PARTICULARIZED STATEMENT OF CLAIM OF CLAIMANT INTERNATIONAL THUNDERBIRD GAMING CORPORATION" will be stated as follows: "Atallah, para. 6". Declarations submitted with the SoR will include the designation "Reply"; for example, "Reply-Atallah, para 5" . All declarations supporting the PSoC are located in Binder C-II. All declarations supporting the SoR are located in Binder C-XII along with this SoR. References to exhibits shall state the abbreviation "Ex." and exhibit number. For example, a reference to Exhibit 6 will be stated as follows: "Ex. 6". All Exhibits supporting the PSoC are located in Binders C-III through C-XII and arranged in numerical order. All Exhibits supporting the SoR are located in Binder C-XIII.

Thunderbird's evidence presented at the hearing was excluded because it was allegedly provided in photostatic copy form as opposed to original documents.[8] *[SoD, page 121]* Mexico admits that declarations provided by Thunderbird/EDM at the hearing were excluded because they were offered in English and because they were offered by employees of Thunderbird. *[SoD, page 121]* Mexico admits the sworn PGR report attesting to the legality of the machines was excluded because it was a "private document" and not a "public document". *[SoD, page 121]* Significantly, Mexico offers no evidence refuting the following factual assertion:

> "Further, there is no evidence cited in the administrative findings and order that the machines were any different than those specifically identified in, or operated in any manner different from that described in, the original August 3 solicitud in response to which the August 15 official opinion letter was issued." *[SoD, Page 121.]*

In support of its SoD, Mexico submits only two witness statements: those of Barragan and Alacantara. In his declaration, Alcantara addresses the administrative and legal efforts undertaken by the Mexican government with respect to Thunderbird's EDM operations. The declaration of Barragan describes the interiors of the EDM facilities as seen during inspections in November, 2003 and authenticates certain damage graphics.[9] Neither of these declarations even attempts to meet Thunderbird's factual showing.

This an evidentiary process. The Tribunal's determinations will be properly based only upon the evidence before it. Thunderbird has supported its case with a significant factual showing. Mexico offers little evidence in its response and does not refute the essential factual elements of Thunderbird's case. While the Tribunal must determine whether the facts offered by Thunderbird warrant a finding that Mexico breached its NAFTA obligations, the facts themselves are largely not in dispute.

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[8]The factual assertion that Thunderbird and EDM presented anything other than original documents at the hearing is simply false. Original documents were provided. *[Velasco, para. 18; Watson, para. 39]* Further, participants at the hearing on Thunderbird's part recall no issue over the admissibility and consideration of Thunderbird's evidence. *[Watson, para. 39; Velasco, para. 18]*

[9]Mexico does not even submit a witness statement bearing upon damages from any representative of FinBridge Consulting, its damage consultant. It is unclear how Mexico intends to present its damage case at the merits hearing without an identified witness or offered written testimony from that witness. Procedural Order No. 1 requires ("..shall..") the parties to submit witness statements along their respective PSoC and SoD.

D. Mexico's Attempt to Misrepresent the Facts and Mislead the Tribunal.

In a clear effort to mislead the Tribunal, Mexico repeatedly misstates and misrepresents the facts. Thunderbird will not detail each such instance. The examples stated below are particularly egregious and go to the heart of Mexico's factual defense. Nevertheless, claimant respectfully suggests that the Tribunal closely scrutinize Mexico's claims and assertions and the evidence cited as supporting such claims and assertions. Thunderbird invites and respectfully expects the same scrutiny of its own arguments and evidentiary showing.

1. Mexico's False Assertion that Thunderbird "Exported"Illegal Gaming Activity to Mexico.

In the opening paragraph of SoD, Mexico attempts to create the false theme of habitual illegal activity on the part of Thunderbird. This theme is later stated at paragraph 10 of the SoD.

> "Therefore, the case before the Tribunal is one in which the claimant is dedicated to an activity, which is highly regulated, and to a large extent prohibited, throughout the world. The claimant instigated an incursion into Mexico, having been forced to abandon its operations in the United States, initiating the same activities in Mexico, which had previously been declared to be illegal in the jurisdictions in which they had been operating."

This statement is a complete fabrication unsupported by any evidence. The activities undertaken by Thunderbird in Mexico are not to a large extent prohibited throughout the world. Thunderbird did not enter into Mexico after having been forced to abandon its operations in the United States. Thunderbird did not undertake the same activities in Mexico that it had undertaken in the United States. None of the machines which were operated at Thunderbird's EDM Enterprises had ever been declared illegal in the United States. In fact, the machines operated at the EDM facilities were distinct to the Mexico market. *[Reply-Atallah, para. 12; Reply-McDonald, paras. 8-13; Reply-Carson, para. 7-9]*

2. Mexico's False Assertion that Thunderbird Operated "Slot Machines" in Mexico.

Throughout its SoD, Mexico repeatedly states that Thunderbird undertook to operate "slot machines" in Mexico. The term "slot machines" is used no less than 35 times in the SoD. Yet there is *no evidence offered, nor has there ever been any evidence offered*, that Thunderbird operated slot

machines in its EDM facilities. This is not a matter of simple labeling. There is a clear and important distinction between the operation of skill machines and the operation of traditional slot machines.

> "Skill games" or "skill machines" are commonly understood in the international gaming industry as differing from slot machines in that the skill machine player is able to start and stop the activity at play, to make decisions about which games and which symbols to hold, and to effect, through his skill and dexterity, the outcome of the game. None of these elements are present in a "slot machine". There, the player simply pulls the handle and waits to see if he has won anything. Further, in the international arena of gaming activities, there is a clear distinction between traditional "casinos" and video gaming parlors. *[Atallah, para. 14; McDonald, para. 10, 11; Ex 69, Maida Dec.]*

While Mexico denies this statement of the distinction between skill and slot machines, it submits *no evidence* rebutting it. *[SoD, Page 98]* In fact, this operational distinction between slot machines and skill games is addressed in a consistent manner in the August 15, 2002 opinion letter based upon which Thunderbird proceeded with its EDM investments. In relevant part, the letter stated as follows:

> In this light, it is important to clarify that, if the machines that your representative exploits operate in the form and conditions stated by you, this governmental entity is not able to prohibit its use, in the understanding that the *use of machines known as "coins-swallowers," "token-swallowers" or "slot machines," in which the principal factor of the operation is luck or gambling and not the user's ability of skillfulness as* you stated, could constitute any of the hypothesis described under the Federal Law of Games and Sweepstakes, with the corresponding legal consequences that may be derived therefrom, under article 8 of such law. *[Ex. 17; Velasco, para.7; Watson, para. 16; Atallah, para. 17; English Translation]*

The letter stated that if the skill machines are used in the manner described by EDM in the August 3 solicitud, the government could not prohibit their use. The letter then warned EDM that use of machines known as "coin swallowers", "token-swallowers" or "slot machines" would be subject to regulation. The letter then defined those regulated machines as those in which the*"principal factor of the operation is luck or gambling and not the user's ability of skillfulness"*. This description of the operational

characteristics of a "slot machine" is consistent with Thunderbird's statement above.

There is no evidence that Thunderbird and its EDM entities operated machines in which the "principal factor of the operation was luck or gambling and not the user's ability of skillfulness". There is no evidence that Thunderbird and its EDM entities operated machines in any manner violative of the directives of the August 15, 2000 opinion letter.

Mexico's approach throughout this entire course of events, including the initial seizure of Nuevo Laredo, the time period leading to the July 10, 2001 administrative hearing, the July 10, 2001 hearing itself, the October 10, 2002 administrative findings, the final closures of Nuevo Laredo, Matamoros and Reynosa and in its present defense of the Thunderbird claim has been to repeatedly characterize the EDM machines as "slot machines" without offering a shred of evidence to support that characterization. Mexico's purpose in doing so is obvious: the subjective characterization of the machines as "slot machines" leads to the pre-determined conclusion that the machines are illegal.

When Guadalupe Vargas shut down the Nuevo Laredo facility for the first time he stated: *"what I see before me are slot machines."* When Guadalupe Vargas wrote to de Vaca explaining the closures he stated: *". . .we had found 120 betting machines, known as "slot machines", operating without the authorization of the Secretary of the Interior."* At the administrative hearing, and without having undertaken any review of the available evidence, Guadalupe Vargas stated: *"These are slot machines and nothing else."* Extending these purely subjective and uninformed opinions into these proceedings, Mexico states in its SoD:

> The Tribunal may appreciate that the operations of EDM are in fact no different from the operation of typical slot machines; the way in which the machines are arranged is identical to the typical arrangement of slot machines in casinos; the establishment has a "cage" in which the players can exchange pesos for dollars to deposit in the machines and where they can exchange the credits won for cash; the game consists of depositing cash and starting the movement of video "reels" which have to be stopped to achieve predetermined combinations of shapes; each machines showed the probabilities and prizes associated with each of the different combinations; if the player won, he obtained credits which he could use to continue playing or which he could exchange for dollars

> in cash; the amounts deposited in the machines, less the amount paid out in dollars, constituted the company's earnings. The respondent took photos of the "a Mina de Oro" establishment in Nuevo Laredo and of the games in this establishment, during its visit of 5th November 2003. *[SoD, para. 3]*

As *evidence* of this statement, Mexico refers to photographs of the interior of "La Mina de Oro" and the skill machines located therein. *[R-0001]* Needless to say, these photographs establish little, if anything, about the actual operation of the EDM machines and the gaming software installed in them. *[Reply-McDonald, paras. 8-14; Reply-Watson, para.2]*

Mexico's constant refrain that Thunderbird and its EDM enterprises operated "slot machines" is false. It is not now, and never has been, supported by evidence. Whatever its true motives were, Mexico used that falsehood as pretext to seize Thunderbird's EDM investments. It is now using that falsehood as a means to confuse the issues and attempt to mislead the Tribunal.

3. Mexico's False Assertion that Aguilar Coronado was Present at the July 10, 2001 Administrative Hearing.

In its Statement of Facts, Thunderbird stated the following with respect to the July 10, 2001 hearing:

> The hearing took place on July 10, 2001 at the offices of Director de Juegos y Sorteos in Mexico City. Gobernacion was represented by Guadalupe Vargas and Mr. Alcantara, one of the general counsels of Gobernacion in charge of the Ampara proceedings. No other representatives of Gobernacion were present. A stenographer was present. Thunderbird was represented by Peter Watson, Jorge Montoyo, Mauricio Gauralt, Carlos Gomez and Luis de Ruiz Velasco of Baker & McKenzie. The meeting was presided over by Guadalupe Vargas, the same individual who had previously closed down the Nuevo Laredo. *[Watson, para. 38; Velasco, para. 18 ; McDonald, para. 16; Atallah, para. 51, 52; Gomez. para. 23]*.
>
> Guadalupe Vargas looked at the materials for a matter of seconds. He threw the booklet off to the corner of the desk and said "this is just a thesis, and means nothing". Throughout the hearing, Guadalupe Vargas exhibited a prejudice towards the foreign

investment. He was "nasty and disrespectful" of the Thunderbird representatives. Although the Thunderbird representatives explained and demonstrated everything possible to Guadalupe Vargas, he, from the beginning of the hearing until the end, steadfastly represented that the machines were "slot machines" and nothing else. Guadalupe Vargas had clearly made up his mind long before the hearing and nothing Thunderbird could say would change his personal opinion regarding the operation of the machines. Gobernacion presented no evidence at the hearing relating to the operation of the machines, no evidence that the machines were being operated in a manner different than as represented in the August 3 solicitud, and no evidence establishing in any respect that the machines were anything other than legally-operating skill machines. More simply stated, Gobernacion presented no evidence. *[Watson, paras. 38,39, 45; Velasco, para. 18; Montano, para. 17; Gomez, para. 24]"*

Thunderbird argued that these actions by Guadalupe Vargas acted to deny Thunderbird and the EDM enterprises the "fair and equitable treatment" required by the NAFTA. Thunderbird also argued that the October 10, 2001 administrative findings further evidenced the lack of "fair and equitable treatment" in that they were signed by Aguilar Coronado, an individual who was not present at the hearing. *[PSoC, pages 95-95]*

In response to these assertions, Mexico resorts to an outright fabrication. Mexico presents no evidence which directly contradicts Thunderbird's factual assertions about the conduct of the hearing. Mexico simply states that Guadalupe Vargas had "a very limited role" and "did not take any active part in the hearing." *[SoD, paras. 433, 434]* Mexico makes the claim that Aguilar Coronado was in fact present at, and presided over, the hearing. *[SoD, Paras. 430,433]* This claim is false representation made to the Tribunal. Numerous witnesses present at the hearing attested to the fact that only Guadalupe Vargas and Alcantara were present at the hearing on behalf of Gobernacion.

Peter Watson stated *under oath* as follows:

"On the day of the hearing, we were crowded into a small room with Mr. Alcantara, Guadalupe Vargas and a stenographer. Guadalupe Vargas presided over the hearing. Present for Thunderbird were myself, Carlos Gomez, Kevin McDonald, Lozano (an

expert who testified), Francisco Ortiz Ambassador Montano and Attorney Luis Ruiz de Velasco. I handed Guadalupe Vargas a booklet containing our expert affidavits, the PGR sworn response, documents and proofs. He looked at the first page for less than five seconds, and the last page for less than five seconds. He threw the booklet off to a corner of the desk and said "this is just a thesis, and means nothing."

[Declaration of Peter Watson in support of PSoC, Para. 38]

Attorney Luis Ruiz de Velasco of Baker & McKenzie stated, *under oath*, as follows:

"The hearing took place at the offices of Juegos y Sorteos in Mexico City on July 10, 2001. At such meeting, Gobernacion was represented by Mr. Guadalupe Vargas (the director of "Juegos y Sorteos") and by Mr. Alcantara (one of the general counsels of Gobernacion in charge of the "amparo" proceedings). Thunderbird was represented by Messrs. Watson, Montaño, Girault, Gomez and myself. Thunderbird also brought two experts and a skill machine for demonstration. In addition, Thunderbird brought all documents, proofs and evidences supporting the operation of these machines. These documents were all presented as originals and there was no issue raised at the hearing at propriety or admissibility of any of Thunderbird's offered evidence. Included with the evidence was a written expert opinion issued at the request of an inside officer at Gobernacion stating that, in accordance with the details of the machines, they should be considered as skill machines. The hearing was only a formality to this proof by Gobernacion itself that it was in compliance with the procedure established in the law. Although we explained and demonstrated everything possible to the director, he, at the beginning of the hearing until the end, represented that Thunderbird's machines were "slot machines and nothing else"."

[Declaration of Luis Ruis de Velasco in support of PSoC, Para. 18]

Attorney Carlos Gomez stated, *under oath*, as follows:

In June 2001, Mr. Ruiz Velasco was informed about a hearing so that Entertainmens could officially present all and any elements to prove that legal operation of the skill machines. Thus, Mr. Ruiz Velazco attended such hearing with a file including

documentary evidence, public and private, as well as testimonial evidence. A physical demonstration of the skill machine operation system was carried out in such hearing. The hearing took place on July 10, 2001; Mr. Jose Guadalupe Reyes and Mr. Alcantara (counselors of the Ministry of the Interior) attended this hearing representing the Games and Drawings Directions. Entretainmens and Thunderbird were represented by Mauricio Girault, Luis Ruiz de Velazco, Peter Watson and the Ambassador Jorge Montano and myself."

[Declaration of Carlos Gomez in support of PSoC, Para. 23.]

Ambassador Jorge Montano stated, *under oath*, as follows:

"The officer in charge of the hearing Mr. Jose Guadalupe Vargas, a former police chief in the city of Guanajuato had a prejudice attitude against foreign investors. He was nasty and disrespectful with everybody, using the expression "maquinas tragadolares" meaning they were using a foreign currency, forgetting the fact that dollars and peso are common use in both sides of the border."

[Declaration of Jorge Montano in support of PSoC, Para. 17]

In an additional statement submitted with this SoR, Peter Watson stated, *under oath*, as follows:

That the assertion that Mr. Umberto Aguilar attended the administrative hearing in this matter is patently false. He neither attended, nor did he ever appear. The only representatives of the Mexican Government present on that date were Mr. Jose Guadalupe Vargas, who conducted the so-called hearing, and his attorney Mr. Alcantara, and a secretary who typed some sort of summary (not verbatim) of the proceeding. If Mr. Aguilar signed a document representing a transcript of the proceedings, he must have done so afterwards, because he was not present for even one second during those proceedings, and any assertion to the contrary by SEGOB under oath would constitute perjury.

[Declaration of Peter Watson in support of SoR, Para. 1]

These declarations present substantial evidence of Aguilar Coronado's absence from the hearing.

Aguilar Coronado did not submit a declaration attesting to his presence. Attorney Alcantara was present at the July 10, 2001 hearing representing Mexico. His declaration testimony neither confirms nor denies that Aguilar Coronado was present at hearing.

> "The hearing referred to took place on 10th July 2001. I took part in the said hearing on behalf of the Legal Affairs Unit of the Interior Secretariat. Entertainmens' legal representative appeared at the hearing. He offered various pieces of documentary evidence, presented witnesses, and brought a machine so that the authorities could inspect it. The representative of Entertainmens also presented pleadings (arguments in support of his testimony). The participation of the Interior Secretariat was at all times in accordance with the provisions of the Federal Law of Administrative Proceedings, and followed the rules established by said law and the Federal Code of Civil Proceedings, and not the wishes of the authority. This was confirmed in the minutes of the hearing, which were prepared while the hearing was still in progress, and was signed in the end by all the participants." *[R-0047]*

In light of the emphasis placed upon this issue by Thunderbird in its PSoC, the absence of a witness declaration from Aguilar Coronado and Alcantara's failure to directly address the issue are highly relevant.

Mexico refers to as single document *[R-0047]* as proof of Aguilar Coronado's presence at the hearing In the absence of witness testimony from Aguilar Coronado, which could be subjected to cross-examination, that single document has little no evidentiary value. In fact, the document bears a signature by Aguilar Coronado that could only have been added *after the fact*, given his absence from the hearing. Mexico has fabricated a story in an effort to deflect scrutiny of Guadalupe Vargas's egregious conduct at the July 10, 2001 hearing.

4. Mexico's False Assertion that EDM Commenced its Skill Machine Operations before Securing the August 15 Gobernacion Opinion Letter.

Thunderbird argues that it relied to its detriment upon the August 15, 2000 opinion letter addressing EDM's intended operation of skill machines. In its defense, Mexico argues that Thunderbird did not reasonably rely upon the opinion letter. As evidence, Mexico cites to Thunderbird's preparations

to open undertaken before the issuance of the August 15, 2000. Thunderbird concedes that it made preparations to operate before securing approval from the Mexican government. Thunderbird itself detailed those efforts at pages 6 through 8 of its PSoC. But, Mexico goes further and claims that EDM Matamoros facility was already in operation at the time of the August 3, 2000 solicitud. [SoD, paras. 169, 405] This is another misrepresentation.

Multiple witnesses attested to the fact that Matamoros did not open until after EDM received the August 15, 200 opinion letter approving the skill machine operations. *[Watson, paras. 17 and 18; Velasco, Paras. 7 through 10; Atallah, para. 18 and 19.]*. In his supplemental declaration filed in support of this statement of reply, Albert Atallah addresses this issue as follows:

> In the case of the Mexico investment, the company determined that due to uncertainty in the law the best course of action was to approach Gobernacion with complete transparency. The investors that Thunderbird solicited for this venture would accept nothing less than that approach to become silent partners in the venture. The company prepared itself to commence operations in Mexico but was firmly committed that if Gobernacion did not provide the assurance through its letter of August 15, 2000, the company would not have opened its doors for business. This decision to seek Gobernacion's approval was well thought out and very deliberate. Management understood the risk that if Goberncaion's response to our petition was negative, we would never have pursued the business opportunity in Mexico

Mexico's assertion that Thunderbird's EDM facility at Matamoros was already operating as of August 3, or anytime prior to the August 15 opinion letter, is false.

5. Mexico's False Assertion that It has Closed Down all Similar Gaming Facilities.

Mexico states as follows at paragraph 58 of its SoD:

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

This statement is false. Numerous domestic skill machine facilities remain open and operating, including Guardia's "Club 21" and the Reflejos facilities.

a. Guardia – "Club 21" in Mexico City.

Guardia's "Club 21" located in Mexico City remains open and operating with as many as 70 machines. Those machines accept U.S. dollars and pay out dollars as prizes. *[Reply-C. P. Luis Arredondo Cepeda Y Torres, para VII]*

Further, Club 21 and other Guardia skill machine facilities remain open and operating in a very public fashion. In recent Mexican publication, Mileno, Guardia, referred to in the article as "Lord of the Casinos", spoke of his "nationwide betting centres" operating "machines of skill and ability". Guardia further spoke of a favorable ruling from the Supreme Court of Justice that allows him to operate "skill machines" without problems. The article features color photographs of rows of skill machines in a Guardia facility. *[Ex. C-97]*

b. Reflejos in Rio Bravo

In its SoD, Mexico stated the following with respect to the Reflejos skill machine in Rio Bravo, Tamaulipas:

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

This is not true. The Reflejos skill machine facility in Rio Bravo remains open and operating. *[Reply-Notary Declaration re Reflejos in Rio Bravo]*

c. Reflejos - Two Facilities in Matamoros

In addition to the Rio Bravo facility, Reflejos is operating two additional skill machine facilities in Matamoros, the same location where seized and closed a Thunderbird/EDM facility . The first facility located at Centro Comercial So – Riana Lauro Villar. Ubicado en Av. Lauro Villar y Accion Civica. This facility is open and operating with as many as 40 skill machines. These machines accept U.S. dollars and pay out dollars. *[Reply-Gilberto Vazquez Cuevas, paras. VI, VII]*

The second facility in Matamoros is located at Centro Comercial Soriana Plaza Fiesta, ubicado en Avenida – Pedro Cardenas y Boulevard Manuel Cavazos Lerma. This facility is open and operating with as many as 70 machines. *[Reply-Gilberto Vazquez Cuevas, paras. VI, VII]*[10]

These first of these facilities is open and operating *under full protection of Mexican law.* In December 2001, Mexico attempted to close this facility. The Mexican national operator challenged the closure. The Sixth District Court of Matamoros, upheld that challenge and overturned the closure. There was no appeal. That decision is a *final and binding determination by a Mexican court of the domestic investor's right to operate skill machines.[Reply-Navarro; Ex.C-96]*

This case is directly counter to Mexico's claim that while domestic skill machine operations remain open, there have been no definitive determinations as to their permanent right to so operate *["None of these judgments were concluded definitively"; SoD, para. 9]* This case also seriously undercuts Mexico's assertion that it has uniformly accorded skill machine operators, domestic or foreign, that same treatment - that it has uniformly acted to shut them down. In this instance, Mexico did not appeal and allowed the decision to become a final judicial determination of a Mexican national investor's right to operate skill machines. At the same time it was doing so, it was actively opposing Thunderbird's effort to operate in Mexico and pursue its remedies under NAFTA.

d. Bella Vista Entertainment Center in Monterey

A large skill machine facility, El Centro de Entretenimiento Bella Vista, in Monterey, one of the location where Thunderbird and its controlled EDM-Monterey was preparing to open a facility. This facility is located at la Avenida Jorge del Moral s/n, en la Colonia Lomas del Roble en el Municipio de San Nicolas de los Garza, Nuevo Leon. The facility operates at least *426 video skill machines*. The entrance to the center contains the rules of play and specifically states that the customers will be playing "video machines using the player's skill and ability". *[Reply-Jesus de la Rosa Buenrostro]*

Mexico is not being complete or honest in its statements concerning the skill machine facilities presently open and operating domestically and concerning the actions it has taken against such domestic operations.

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[10]Note that two declarations are submitted with the SoR from Gilberto Vazquez Cuevas, one for each of the Reflejos facilities in Matamoros.

6. The Finbridge Report's Inaccurate Representation of the EDM Operations.

Mexico submits the Finbridge Consulting report *[R-0055]* in support of its SoD. That report presents a grossly inaccurate and misleading portrayal of the EDM operations. The declaration of Booker T. Copeland submitted with this SoR addresses in detail the factual inaccuracies of the report.

E. Mexico's Unfounded Attack upon the Integrity of Thunderbird's Business Practices.

Throughout its SoD, Mexico emphasizes the false theme of habitual illegal activity on the part of Thunderbird which it attempted to export to Mexico. This theme is reflected in the following allegation located at paragraph 126 of the SoD.

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

This allegation is without factual basis. It is unfounded. It is false. Rather than meet the evidence presented by Thunderbird, Mexico feels compelled to slander the integrity of the claimant. As set forth in the supplemental declarations of Albert Atallah, General Counsel of Thunderbird and Booker T. Copeland, Chief Financial Officer of Thunderbird, filed in support of this reply, Thunderbird is successfully doing business and undertaking gaming activities in several Latin American countries with the full participation and assistance of the host governments. Mexico failed to mention these successes in its attempted indictment of Thunderbird's business practices.

Further, as addressed in Mr. Atallah's supplemental declaration, Thunderbird's involvement in the California Indian gaming market and its past gaming activities in the United States, and elsewhere, serve only to emphasize the notions of transparency and accountability central to all of Thunderbird's business operations.

Thunderbird approached it investment activities in Mexico with the same notions of transparency and accountability. Rather than pursue an aggressive, confrontational course of action with respect to its intended skill machine operations, Thunderbird voluntarily approached the Mexican

government and sought prior approval of its operations. No matter how Mexico parses the words of the August 3 solicitud and the August 15 opinion letter, no matter how Mexico misrepresents the facts of this case, it cannot deny that Thunderbird openly approached Mexico with its intended plans. In fact, Thunderbird had much to lose in doing so. If the Mexican government had rejected Thunderbird's intended operations, Thunderbird could only proceeded with skill machine operations in open defiance of the government's determination. Thunderbird's voluntary approach to the Mexican government to seek prior approval of its intended operations is consistent with the transparent manner it which it has always dealt with host governments. Mexico's allegations of a pattern of illegal business activity on the part of Thunderbird are false and unfounded. They serve no purpose other than to deflect scrutiny of Mexico's own actions taken in violation of its NAFTA treaty obligations.

II.

THUNDERBIRD MAY PROPERLY PROCEED UNDER ARTICLE 1117 BECAUSE IT "OWNS OR CONTROLS" THE EDM ENTITIES.

In its SoD, Mexico raised a "preliminary argument" concerning Thunderbird ability to proceed under Article 1117 of the NAFTA. The crux of Mexico's "preliminary argument" can be found at Paragraph of the SoD. Mexico alleges that Thunderbird failed to provide sufficient evidence to demonstrate that it owns or controls the EDM investments. Procedural Order No.4 denied Mexico's request for bifurcation of this issue, holding that the issue appeared to be interwoven with the facts of the merits. Procedural Order No. 4 invited the parties to address the Preliminary Question in their submissions with specific reference to the facts and the law in light of Article 1117 of the NAFTA.

A. Applicable Law - Ownership or Control under Article 1117.

There is no dispute between the parties as to the meaning of Article 1117. In its PSoC, Thunderbird stated as follows:

> Under Article 1117, a claim can only be made by a NAFTA Investor in respect of the investment enterprise owned or controlled by an investor of a NAFTA Party. The Matamoros, Nuevo Laredo and Reynosa investment enterprises were all owned, in part, or controlled, completely, by Thunderbird. *[PSoC, Page 44, Lines 8-12]*

In its SoD, Mexico states as follows:

> Under special circumstances, Article 1117(1) allows a claim derived in the name of a company which is an artificial person of the State where the investment was made. An investor of one Party may present a claim in representation of a company of the other Party, if the company is an artificial person, and the investor owns or controls the company, directly or indirectly. *[SoD, Para. 263]*

Mexico does not dispute that Thunderbird, a Canadian corporation, qualifies as an "investor of a Party". Mexico concedes that EDM[11] is an "artificial person of the State where the investment was made", i.e, Mexico. *[SoD, Para. 268]*

Thus, application of Article 1117 turns only on the question of whether Thunderbird owns or controls, directly or indirectly, the EDM enterprises.

For its part, Thunderbird does not claim that it owned more than 50% of certain EDM's (i.e. Nuevo Laredo, Matamoros & Reynosa) during the relevant times. Rather, it does claim to have held a significant level of ownership in all of the EDM's and to have exercised complete control over all of them at all relevant times. Thus, the question for this Tribunal to determine as regards to Thunderbird's ability to proceed under Article 1117 is *whether Thunderbird directly or indirectly controlled the EDM's at the relevant times.*

As demonstrated by the practice of the Iran-US Claims Tribunal ("I-USCT"), claims may be made on behalf of corporations incorporated in a Respondent State by citizens of a qualifying claimant state if it can be shown that their ownership interests were sufficient to control the corporation. A majority interest is not necessarily required to found a claim.[12] The NAFTA similarly provides that an investor may make a claim if it "controls directly or indirectly" the investment enterprise harmed by the breach of a Chapter 11A provision. The NAFTA accordingly reflects the on-going doctrinal development of the concept of "control" in respect of eligibility to bring a claim. The jurisprudence of the I-USCT is instructive in understanding the meaning of "controls directly or indirectly" within the

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[11] Presumably referring to all the EDM entities on behalf of whom Thunderbird proceeds.

[12] See, e.g.: Article VII(2) of the *Claims Settlement Declaration*.

context of Article 1117.[13]

According to I-USCT authorities, "control" could be achieved in a number of ways. For example, one tribunal suggested that "... the ultimate beneficial ownership required to "control" [a] subsidiary may be as low as 25 per cent."[14] In another case, it was noted that control could be demonstrated – as a matter of fact – regardless of the number of shares held by a claimant. In that case (*Alcan*), the claim was made by the US national shareholders of a Canadian corporation. Under Article VII(2) of the *Claims Settlement Declaration*, these shareholders needed to prove that they were in "control" of Alcan's Iranian subsidiary in order to bring a claim. On the meaning of the word "control" the Tribunal stated:

> That the ownership interests of the shareholder-claimants who are United States nationals were, collectively, sufficient to control a corporation at the time the claim arose may be demonstrated in several ways. It may be shown that, at the appropriate time, such shareholders controlled the corporation in fact, regardless of the total proportion of their shares. Although it may be shown that such shareholders had sufficient voting strength or the right to assert control, this would generally require ownership of 50 per cent or more of the shares.(emphasis added)[15]

Commenting on the *Alcan* award, Professor Mapp wrote:

> The situation envisaged by the *Alcan* case primarily applies to subsidiary corporations incorporated overseas, and to overseas corporations where the controlling interest is owned by United States nationals. Nevertheless the possibility arises that United States nationals may make a claim by virtue of having a minority, but controlling, shareholding

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[13] Rodolf Dolzer, Margaret Stevens, *Bilateral Investment Treaties* (1995) at 38-42. For a discussion of the origins of the concept of the control test, see Georg Schwarzenberger, *International Law* (3rd ed.)(1957) 402-406, in particular with respect to his comments on the case of *Certain German Interests in Polish Upper Silesia (1926)* ICJ Reports 1955 which suggests that fundamentally the control of the Board of Directors, and hence management, by shareholders is evidence of control of the corporation. This point particularly addressed the possibility that shares would be distributed among a large number of persons.

[14] Wayne Mapp, *The Iran-United States Claims Tribunal- The First ten years, 1981-1991* (1993) at 92.

[15] (1983) 2 Iran-U.S.C.T.R. 294 at 297. In *Alcan*, because shares were held widely and were not part of what could be termed a controlling block, the Tribunal held that insufficient proof was provided such that even if US nationals did hold 50% or more of the shares that such nationals were not in a position to control the company.

in a corporation incorporated in the United States.[16]

In *Myers*, a Canadian enterprise ("Myers Canada") was established by the same four brothers who owned and controlled the Ohio-based S.D. Myers, Inc. ("SDMI"). SDMI did not own a single share of Myers Canada. Nonetheless, SDMI brought the claim; not the brothers. Canada argued that because SDMI did not own any amount of Myers Canada, it could not succeed in its NAFTA claim. Canada made this argument despite significant evidence that SDMI did – as a matter of fact – control Myers Canada. The Tribunal rejected Canada's argument, finding that SDMI did exercise control over Myers Canada and therefore meet the requirements of "investor" and "investment" under Article 1116. The Tribunal stated as follows:

> 227. At the relevant time Myers Canada was undoubtedly an "enterprise", but Canada submitted that it was not owned or controlled directly or indirectly by SDMI. This is because the shares of Myers Canada were owned not by SDMI, but equally by four members of the Myers family. They also owned the shares in SDMI, but in different proportions. As noted previously, Mr. Dana Myers owned 51% of that company. His was the authoritative voice in SDMI and the evidence of his brother, Mr. Scott Myers, was that Dana Myers was the authoritative voice in Myers Canada.
>
> 228. Mr. Dana Myers explained the basis on which the Claimant carried on its international operations at the relevant time:
>
> > "Q. Now, just to return for a moment, and I understand it was in your capacity as an official with SDMI that you were involved in the operations in Australia, Saudi Arabia and MEXICO. And I wanted to clarify from what perspective you were operating in this sense: Were you providing direction as the Chief Executive of SDMI or were you providing direction as an officer of those companies in those locations?
> >
> > A. Okay. Here"s how we operate. S. D. Myers was the big portion of our business. We were trying to expand into other countries, and so we would set up these other companies because it's better to have a local presence in these companies' countries. I'm sorry. Specifically, I think it was my position as President of S.D. Myers, Inc. that I exercised control over all these other places because all these other places were basically just an offshoot or an outpost of S.D. Myers, Inc. to do business around the world.

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[16] Mapp at 97.

Q. Now, but in each of those cases, they were corporations with their own directors and their own shareholders?

A. Correct.

Q. And their own corporate officers?

A. Correct.

Q. Were you a corporate officer of any of those concerns in Australia?

A. Yeah. Yes.

Q. And the same is true of Saudi Arabia and MEXICO?

A. Yes, yes.

Q. All right. Now you also told us, I believe it was in connection with MEXICO, but it may have been in connection with Saudi Arabia, as well, that you signed some papers.

A. Okay.

Q. in respect of those operations? Were those papers that related to your arrangement with individuals within those companies or those countries, rather, for the delivery of PCB disposal services?

A. No. What it would have been was we had 51 per cent. My brothers and I had 51 per cent of the operation in MEXICO and the Mexican owner had 49 per cent. So we had a document that laid out what he was going to provide and what we were going to provide.

Q. And that's what you would characterize as a joint venture, a joint venture agreement?

A. Yes.

Q. Did you have a similar agreement in respect of Australia?

A. At the beginning, because we were dealing with a guy named Neil Richter and I forget the other guy's name. So we had something. Then we bought them out and then basically there wouldn't have been an agreement because it was just all within the family.

Q. So, in fact, in Australia, you did as well have

A. To begin with.

Q. a joint venture agreement?

A. For a year or two.

Q. All right. And that document set out the respective responsibilities and obligations of the participants?

A. Correct.

Q. And indicated the extent to which they would share in the success of the venture?

A. Correct.

Q. Now, in respect of Myers CANADA, was there such a document ever signed by you or anybody else for your company?

A. Because it was all in the family, no."

229. Taking into account the objectives of the NAFTA, and the obligation of the Parties to interpret and apply its provisions in light of those objectives, the Tribunal does not accept that an otherwise meritorious claim should fail solely by reason of the corporate structure adopted by a claimant in order to organize the way in which it conducts its business affairs. The Tribunal's view is reinforced by the use of the word "indirectly" in the second of the definitions quoted above.

230. The uncontradicted evidence before the Tribunal was that Mr. Stanley Myers had transferred his business to his sons so that it remained wholly within the family and that he had chosen his son Mr. Dana Myers to be the controlling person in respect of the entirety of the Myers family's business interests.

231. On the evidence and on the basis of its interpretation of the NAFTA, the Tribunal concludes that SDMI was an "investor" for the purposes of Chapter 11 of the NAFTA and that Myers Canada was an "investment".

As in the *Myers* claim, Thunderbird has brought a claim supported by a substantial evidence that it, *as a matter of fact*, controlled all of the EDM investments involved in its claim. The fact that it has brought its claim under Article 1117, rather than Article 1116, is immaterial on this point. The provisions contain identical wording requiring direct or indirect ownership or control.

B. Evidence of Thunderbird's Control of the EDM Enterprises.

In its PSoC, Thunderbird presented substantial evidence that the EDM enterprises were all owned, in part, and controlled, completely, by Thunderbird. *[Atallah declaration in support of PSoc,*

paras. 15 -42; PSoC Exhibit Nos. 11-14, 27-29, 31, 34-35, 37, 39, 42-45, 48-50, 52-53, 55-57] In support of this SoR, Thunderbird submits multiple additional declarations from investors in the various EDM entities. These investors state, under oath, that they were and are passive investors in the EDM enterprises, that Thunderbird was the owner of a significant equity interest in the EDM enterprises and, finally, that they relinquished control of their EDM investments and of the operations of the EDM entities to Thunderbird. *[Reply Declarations of Monaldo, Watson, Berger, Aquilino De Le Guardia, Bennett, Carlos De La Guardia, Harari, Girault, Rudd, , Snow, Strunz]* Thunderbird also submits the supplemental declaration of Steven Sawin, the manager of the Nuevo Laredo, Reynosa and Matamoros facilities attesting to Thunderbird's complete control over the operation of those EDM entities. *[Reply Sawin]* Thunderbird has more than met its burden to establish its standing to proceed under Article 1117 of the NAFTA.

C. The Remaining EDM Enterprises.

Thunderbird is also proceeding under Article 1117 on behalf of Entertainmens de Mexico Puebla S. de R.L. de C.V. ("EDM-Puebla"), Entertainmens de Mexico Monterey S. de R.L. de C.V. ("EDM-Monterey") and Entertainmens de Mexico Juarez. S. de R.L. de C.V. ("EDM-Juarez"). Concurrent with the filing and service of the PSoC, Thunderbird provided waivers under Article 1121 2.(b) for these entities.

In regards to Article 1117, Mexico does not dispute that each of these EDM entities is an "artificial person of the State where the investment was made", i.e, Mexico. Further, Thunderbird presented evidence that it owned, in part, and controlled, completely, each of these entities. *[Atallah declaration in support of PSoC, paras. 38 -46; PSoC Exhibit Nos. 48-50, 52-53, 55-57]* Thunderbird clearly may proceed under Article 1117 on behalf of EDM-Puebla, EDM-Monterey and EDM-Juarez.

Rather than address the merits of Thunderbird's claim on behalf of these entities, Mexico asserts that the Tribunal should simply not consider them because Thunderbird did not timely submit waivers on behalf of these entities in accordance with Article 1121. It is undisputed that Thunderbird submitted appropriate waivers on behalf of these entities on August 15, 2003 concurrent with submission of its PSoC. Thunderbird clearly complied with the requirements of Article 1121.4.

What Mexico appears to be arguing, though it is not clearly stated, is that because Thunderbird did not submits these waivers along with the original "Notice of Arbitration and Statement of Claim" provided to Mexico in August, 2002, the submission of waivers concurrent with the PSoC is inadequate. This argument is in stark contrast to the position taken by Mexico at the preparatory conference, and prior thereto, that the August, 2002 "Notice of Arbitration and Statement of Claim" was not submitted in compliance with the NAFTA requirements, did not serve to invoke jurisdiction under the NAFTA and did not properly act to initiate the arbitration process. In fact, Mexico refused to respond to the August 2002 "Notice of Arbitration and Statement of Claim" in the manner dictated by the NAFTA because Mexico asserted it did not comply with the NAFTA requirements. *Now*, Mexico seeks to refer back to the same document and claim that it amounted to "the submission of a claim to arbitration" under Article 1121.

Mexico raised its concerns about the inadequacy of the August, 2002 "Notice of Arbitration and Statement of Claim" at the preparatory conference. The Tribunal also had concerns about the sufficiency of the original statement of claim based upon the lack of specificity and annexed evidence. The Tribunal pointed out that:

> "Now in practice, a statement of claim is usually a rather extensive document, and also practices in most cases that at least under the UNCITRAL rules, that most of the documents on which the claimant relies are attached to the statement.
>
> Now, your Notice of Arbitration, which is also labeled statement of claim, is a rather short form statement of claim." *[Transcript, Page 90-91]*

The Tribunal then suggested that the parties in essence, start over, with the submission of a new and fully-particularized statement of claim. *[Transcript, Page 94-97]* Mexico agreed with that approach. *[Transcript, page 97-98]* The Tribunal then ordered the parties to so proceed, over the objections of claimant. *[Transcript, Page 98-99]*

Mexico now wants to revert back to the original statement of claim which, at least until now, it has asserted was inadequate and insufficient to invoke NAFTA, to argue that it fixed the time for submission of 1121 waivers. If the statement of claim was insufficient *then* to invoke NAFTA jurisdiction, how can it be used *now* as a basis to invoke a waiver provision based upon the submission

of a NAFTA claim?

Thunderbird has fully complied with Article 1121. It submitted appropriate waivers concurrent with submission of its PSoC. There is nothing in the record to suggest that parties, or the Tribunal, intended that the submission of the PSoC under Procedural Order No. 1 was not to be deemed "the submission of a claim to arbitration" under Article 1121. It is starkly inconsistent for Mexico to now argue to the contrary.

Moreover, Mexico's argument on Article 1121 is over-literal interpretation of Article 1121 which has been consistently rejected by other NAFTA tribunals.

The Mondev Tribunal, which counted Judge Schwebel and Professor Crawford among its members, stated that:

> "International law does not place emphasis on merely formal considerations, nor does it require new proceedings to be commenced where a merely procedural defect is involved."[17]

In the Ethyl Claim, the Tribunal considered the timing set out in Article 1121 to be "procedural" rather than "jurisdictional" in nature. In that case, Canada had argued that the claim should be dismissed because the arbitration was launched before the measure came into force. Because there was no measure at the time the arbitration was commenced, Canada reasoned that the waivers were ineffective by the time the measure came into force. The Tribunal dismissed this argument by noting that an investor effectively waives its rights to pursue remedies elsewhere from the moment it commences an arbitration, regardless of whether any formal, procedural requirement for the submittal of an actual waiver letter exists.[17]

In the *Pope & Talbot* claim, respondent raised an argument very similar to the one raised here by Mexico. Long after the arbitration had been commenced, the investor submitted a waiver on behalf of a subsidiary for whom it planned to seek consequential losses. A waiver had not been provided at the outset of the arbitration because the subsidiary did not suffer harm or damage as the direct result of an alleged NAFTA breach. The subsidiary operated a pulp and paper mill that was not subject to the

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[17] *Mondev* Award, at para. 86.
[17] *Ethyl* Award on Jurisdiction, at para's. 58-59.

lumber quota regime upon which Pope's claim was founded. It's losses allegedly stemmed from the fact that pulp prices were negatively affected by the imposition of the quota regime. In addition to arguing that claims could not be made under Article 1116 for consequential losses suffered by an investor, Canada argued that the waiver submitted on behalf of this subsidiary was ineffective because it was provided long after the notice of arbitration had been filed – i.e. more than three years from the date upon which the measure came into force, thus violating the time limits imposed in Article 1116.

In dismissing these arguments in their entirety, the *Pope* Tribunal cited the result in the *Ethyl* case with approval, noting that through the commencement of arbitration an investor will generally be deemed to be bound by a constructive waiver of its rights to pursue the same remedy elsewhere.[18] More importantly, however, the *Pope* Tribunal went on to suggest the following:

> In any case, there is nothing in Article 1121 preventing a waiver from having retroactive effect to validate a claim commenced before that date. The requirement in Article 1121(3) that a waiver required by Article 1121shall be included in the submission of a claim to arbitration does not necessarily entail that such requirement is a necessary prerequisite before a claim can competently be made. Rather it is a requirement that before the Tribunal entertain the claim the waiver shall have been effected.[19]

The very same reasoning should be applied in this case. The waivers were effective before the Tribunal received the PSoC and they have remained so to this day. None of these EDMs have commenced actions in breach of the Article 1121 waiver, and no plans exist to do so. Mexico's Article 1121 argument concerning these three enterprises should be rejected in its entirety.

III.

MEXICO'S ARGUMENTS CONCERNING THE REGULATION OF "SO-CALLED MACHNIES OF ABILITY AND SKILL" AND THE GAMES OPERATED BY EDM LACK EVIDENTIARY SUPPORT AND ARE LARGELY IRRELEVANT.

In Section III of its SoD, Mexico presents a long dissertation on the laws of North Carolina, Texas and California, and upon legislation applicable to Indian reservations in California. The apparent

[18] *Pope & Talbot* v. *Canada*, Award on the "Harmac Motion," (24 February 2000) at para's. 13-17.
[19] Ibid, at para. 18.

purpose of this dissertation is to lay the groundwork for an argument that the skill machines operated in the EDM facilities are of a type declared illegal in these jurisdictions.

It is striking to note that application of the laws of these various jurisdictions *as presented by Mexico* largely concern the varying degrees of skill and ability required in the operation of a machine so as to render its operation legal. These discussions are not inconsistent in any respect with the statements made by Thunderbird to Mexican authorities or the positions taken by Thunderbird in the seizure and post seizure periods. It is unclear what relevance this discussion has to the issues before the Tribunal or in what respect it assists the Tribunal in making its determinations as to whether Mexico breached treaty obligations. The discussion is largely off-point. The arbitrary application, or misapplication, of Mexican law to the EDM operations is the heart of this dispute.

In fact, what is also striking about this portion of Mexico's SoD is the lack of any significant discussion of *Mexican law* as it applies to the operation of skill machines. At paragraphs 20 and 21 of the SoD, Mexico recites a statement concerning Thunderbird's "understanding" of the law of Mexico as it applies to the operation of skill machines. Mexico also refers to the declaration provided by James Maida at the July 10, 2001 hearing wherein Maida provided a description of the operation of skill games. In the description, Mr. Maida described the game of skill as one in which the player can affect the result of the game, in which the player's ability is a determining factor in the outcome of the game and in which the game requires the player to take significant decisions. Maida concluded that he understood that Mexican law did not prohibit "games involving the users ability and skill". Mexico chides Thunderbird for these statements, stating that "Mexican law does not support these conclusions." *[SoD, para. 21]*

Yet, the SoD contains *no discussion* of Mexican law as it applies to the operation of skill machines. In fact, respondent concedes that Mexican law "does not refer to games of "ability and skill" or of the extent to which chance may be involved." *[SoD, para. 36]* Mexico concedes that its statutory law gives no direction whatsoever as to the circumstances under which skill machines may be regulated.

It is within this legal context that Thunderbird approached the Mexican government to address its intended operation of skill machines. Thunderbird sought direction from the Mexican government.

Thunderbird got that direction in the form of the August 15, 2000 opinion letter which made a clear distinction between skill machines which were not prohibited and "slot machines" which were. Thunderbird relied upon that letter in proceeding with its investments. It is unclear what relevance the laws of Texas, California and North Carolina, or the history of Indian gaming in California, have to the Tribunal's consideration of these essential facts.

In Section IV of its SoD, Mexico presents a purported review and analysis of the games operated by the EDM entities; specifically, the "eight-liner" game, the "Fantasy Five" game and video poker games. Mexico summarizes this review and analysis as follows:

> In summary, the establishments of EDM operated the following gambling machines:
>
> - "eight-liner" which have been determined as gambling machines in the states of North Carolina and Texas.
> - "Bestco", "Fantasy Five" and "reel game" which have been classified as gambling machines by the National Indian Gaming Commission; and
> - video poker, which the courts of North Carolina and California have found to be gambling machines
>
> *[SoD, para. 68]*

To support this conclusion[20], Mexico cites two Texas cases addressing an "eight-liner" game, an National Indian Gaming Commission decision addressing a "Fantasy Five" reel game and California Attorney General Opinion addressing video games.

This entire analysis is based upon the faulty presumption that the specific games addressed by these various authorities were the same specific games in operation at the EDM facilities. But, there is no evidence offered to support this presumption. For example, there is no evidence offered to support the assertion that the "eight-liner" game addressed in the Texas cases operated the same as, or even in a fashion similar to, the eight-line games operated at the EDM facilities. Without such evidence, this entire comparative analysis is meaningless.

[20] Again, it is unclear exactly what bearing this analysis, even if presumed valid for the purposes of argument, has on the issues before the Tribunal. Mexico wasn't relying upon a decision of the National Indian Gaming Commission or California Attorney General when it seized the EDM facilities. Nevertheless, the analysis lacks evidentiary support and is based upon a faulty factual premise.

This analysis is based upon the faulty premise that a "Fantasy 5" or "eight liner' game in one jurisdiction (for example, Texas or North Carolina) is identical to and operates the same as a "Fantasy 5" or "eight liner" game in another jurisdiction (for example, Mexico). As set forth in the declaration of Kevin McDonald[21] submitted with this SoD, the precise operation of the machines is largely the function of the software and not the outward physical appearance or the identifying name.

9. The Government of Mexico's brief refers to certain statements made by me and also refers to various manuals that were apparently found in the EDM operations. The references made in the brief to the "4205 board" as described in the various Thunderbird and SCI manuals are generic descriptions for the electronic board that is found in all forms of entertainment or gaming machines, including skill game machines or slot machines. The 4205 board is the "brains" of the machine. This board controls various functions of the machine, including the bill acceptor or voucher that the player uses to begin playing, the video display, the buttons that the player presses, the pay out with either a hopper in which coins are dispensed or a printer in which a voucher is printed. The 4205 board, just like any electronic board within a machine, does not determine whether a machine is either a slot machine, video gaming terminal, video lottery terminal or skill game. In the case of a skill game, just as in any other of these entertainment machines, the 4205 board contains a chip that allows the player to interact with the game and that chip is inserted onto the 4205 board and acts as the software for the board.

10. Mexico refers to games that were supplied to the Mexico operations as games that had been utilized by Thunderbird in various jurisdictions, including California. This statement is not true. The games that were sold to the EDM operations either by SCI, Bestco or Summit were all games that were created for the Mexico market following Thunderbird's submittal of its petition to Gobernacion and Gobernacion's August 15, 2000 reply.

[21] Note that two declarations are submitted with the SoR from Kevin McDonald, one addressing reliance issues as an investor and the other addressing the above-referenced technical issues.

11. The Mexico brief also describes various games that Mexico refers to as "illegal games" in California, Texas and North Carolina. These games as described by Mexico in its brief, stand on their own. The games that I sold to the EDM operations are unique and distinct from the games that Mexico claims were rendered illegal.

12. Although the games as described by Mexico have names that are similar to the names of the games that were located in the Mexico operations, that reference does not determine whether the game is a game of skill or chance. For example, in certain jurisdictions the game of "Fantasy 5" or "Eight Liners" may be a game of chance. That same name was attached to games in the EDM operations but the determinative factor of "skill" is a function of the players abilities and interaction with games software.

It is important to point out that the fact the operation of the machines is controlled in large part by the software installed was addressed in the PGR report presented to Guadalupe Vargas at the July 10, 2001 administrative hearing. *[Ex. 69 a]* That certified expert report obtained at the request of the Procuraduria General de la Republica ("PGR") concluded that the EDM machines *"only involve ability and skill, by reason of the fact that their components known as "logic boards" (tables or cards of logic) do not contain circuits which randomly control the results, that is to say they are machines for games of ability and skill."* That report, along with Thunderbird's other evidence attesting to the legal operation of its facilities, was arbitrarily rejected by Guadalupe Vargas at hearing and excluded in the subsequent administrative order.

At pages 32 through 33 of its SoD, Mexico argues that Thunderbird introduced gaming machines into Mexico that it used in the United States. The relevance of this argument is unclear. Further, the argument is based upon same faulty premise addressed above - that machines described in old Thunderbird manuals are the same machines operated at the EDM facilities. There is no evidence supporting that premise. Mexico further bases its argument upon an internal memo purportedly linking some machines returned from a California Indian Tribe and machines intended to be refurbished for the Mexican market. There is no evidence that the returned Indian games were the same as the games intended to be refurbished for the Mexican market or that it mattered if they were. There is no evidence

that such re-furbished machines were in fact provided to the Mexico operations. The evidence cited *[Exhibit C-63]* refers to the proposed skill machine facility in Puerto Vallarta which admittedly never opened.

IV.

THUNDERBIRD REASONABLY RELIED TO ITS DETRIMENT UPON PRIOR GOVERNMENT ASSURANCES CONCERNING ITS ABILITY TO OPERATE IN MEXICO.

In its PSoC, Thunderbird established that it reasonably relied upon the Mexican government's August 15, 2000 opinion letter in pursuing its EDM investments in Mexico. There are few factual disputes concerning the August 15, 2002 letter and its issuance. Mexico does not dispute that the letter was solicited from the appropriate Mexican authorities, that it was solicited with respect to the proposed operation of identified skill machines, that it was solicited and issued as an official opinion from SEGOB that the identified machines were not prohibited by Mexican law and that it was issued by the Mexican official with direct authority over such activities. Finally, Mexico does not dispute the text of the August 15, 2000 opinion letter offered as evidence.

In its SoD, Mexico argues, again with little evidentiary support, the Thunderbird did not in fact rely upon the August 15, 2002 opinion letter and, for that and other asserted reasons, did not have a reasonable expectation of a right to operate in Mexico. Included in that argument is the notion that the EDM Nuevo Laredo was open and operating before the August 15, 2002 letter. That factual misrepresentation was addressed earlier.

Thunderbird provided ample evidence of it's reasonable reliance upon the August 15, 2000 SEGOB letter in its PSoC. *[PSoC, Section VI B 1and evidence cited therein]*. Thunderbird presents additional evidence of its reliance of the letter along with this SoD. Thunderbird presents numerous declarations from investors in the EDM enterprises. *[Reply Declarations of Monaldo, Watson, Berger, Aquilino De Le Guardia, Bennett, Carlos De La Guardia, Harari, Girault, Rudd, , Snow, Strunz]* Each such investor attest, under oath, that he reviewed the August 15, 2002 letter and relied heavily upon it in considering the EDM investment. Each such investor states under oath that but for that letter, he

would not have invested in the EDM enterprises. As an example, investor Frank Bennett states in his declaration as follows:

> Included in documentation and discussion with ITGC concerning the proposed investment in the Mexico Skill Machine Operation was Thunderbird's commitment to seek approval of that type of operation from the Mexico government. I understood and relied on ITGC seeking formal approval of the proposed skill machine operations from the Mexican government in order for ITGC to be certain it would proceed with the investment and operation. I further understood that Mexico responded with a letter dated August 15, 2000. I reviewed that letter in considering the investment. I understood from the letter that Mexico considered the skill machines to be operated by Entertainmens De Mexico to be legal under Mexico Law and not subject to Gobernacion's regulations. I relied heavily upon the August 15, 2000 letter from the Mexican government in considering and agreeing to invest money in the Mexico Skill Machine Operation. But for this approval of the proposed operation from the Mexican government, I would not have invested in the proposed skill machine operations and ITGC would not have proceeded with the investment and the operation.

Albert Atallah, Thunderbird's General Counsel, states the following on the issues of reliance:

> In the case of Mexico, the company determined that the best course of action concerning the skill machine operation was to approach Gobernacion on the basis of a petition describing our business plan with the same transparency as we conduct our business elsewhere. The investors that Thunderbird solicited for this venture would accept nothing less than that approach to become silent partners in the venture. The Company prepared itself to commence operations in Mexico but was firmly committed that if Gobernacion did not provide the assurance to operate the skill machine business through its letter of August 15, 2000, the Company would not have opened its doors for business. This decision to seek Gobernacion's approval was well thought out and very deliberate. Management understood the risk that if Gobernacion's response to our

petition was negative, we would never have pursued the business opportunity in Mexico. *[Reply-Atallah, para.20]*

In addressing the issue of Thunderbird's reasonable reliance on Mexican assurances, it is important to understand the context within Thunderbird initiated its investment activities in Mexico. While Mexican law purportedly prohibited games of chance, it did not, and still does not, prohibit other related activities. In Mexico, there were and still are bingo parlors, sports book operations where customers wager on sporting events and horse and dog racing operations with betting on race outcomes, jai lai with wagering, and various other gaming-related activities. There were and still are numerous skill machine operations at various locations in Mexico. *[Watson, para. 4, 7, 57; Velasco, para. 25; Montano, para.19; Luz A. Armas Sawin, para. 4,5, 6, 7; Sawin, para. 8; Dec. of Cepeda y Torres; Gomez, paras. 27-29; Exs. 82-85; Reply-C. P. Luis Arredondo Cepeda Y Torres; Reply-Gilberto Vazquez Cuevas (2)]* Mexico does not dispute these facts.*[SoD, Page 100]* In fact, Mexico points out in its SoD that a permit for activities such as cock fighting or horse racing may be obtained by presenting an official form, duly completed and signed, to the Director of Games and Raffles, together with the corresponding duty. *[SoD, Para. 29]*.

Further, at the time that Thunderbird was considering skill machine operations in Mexico, it understood that there had already been litigation between the Mexican government and Guardia over his skill machine operations and that Guardia had won an amparo allowing him to remain open and operating. *[Watson, para 7; Mitchell, para 11]* Neither Thunderbird's understanding at the time nor the fact of Guardia's prior litigation leading to issuance of an amparo are factually disputed by Mexico. *[SoD, Pages 98 through 99]*

Finally, Mexico statutory law gives no direction whatsoever as to the circumstances under which skill machines may be regulated. Mexico concedes that Mexican law "does not refer to games of "ability and skill" or of the extent to which chance may be involved." *[SoD, Para. 36]*

It is within this legal and factual context that Thunderbird approached the Mexican government to address its intended operation of skill machines. Seeking certainty as to the legality and propriety of its intended skill game operations, Thunderbird sought direction from the Mexican government.

Thunderbird got that direction in the form of the August 15, 2000 opinion letter.

Even disregarding for the purpose of argument all the evidence Thunderbird has submitted on the issue of reliance, the fact that Thunderbird approached the Mexican government *in and of itself* strongly supports the conclusion Thunderbird intended to rely upon the government's response. Mexico argues that Thunderbird would have proceeded with the investments *irregardless* of how the Mexican government responded. It argues that Thunderbird was relying upon its "partners" and lawyers, and not upon Mexico's assurances. But, the simple fact that Thunderbird sought such assurances by way of its August 3, 2002 solicitud completely undercuts such arguments. If Thunderbird was proceeding with the investments *irregardless of* the government's response, as Mexico now argues, why would Thunderbird have sought government assurances in the first place? In fact, Thunderbird had much to lose in doing so. If the Mexican government had rejected Thunderbird's intended operations, Thunderbird could only have proceeded with the investments in open defiance of the government's determination. Under such circumstances, Thunderbird would have been better off to simply open a skill machine facility and wait to see if and how the government responded. Thunderbird expressly rejected that approach and opted to openly approach the government with its intended investments. Seeking Mexican government assurances as to the propriety of its intended operation was no idle act for Thunderbird. It was the act upon which it proceeded with its investment activities in Mexico. Thunderbird sought certainty as to the legality and propriety of its proposed skill game operations before proceeding with significant investments in Mexico.

> "...We are requesting an opinion from this *Direccion General* so the entity I represent has the certainty that the commercial exploitation of video gaming machines for games of skill and ability is legal." *[August 3 solicitud ; Ex. 17,; English translation]*

Mexico's present argument that Thunderbird did not, in fact, rely upon the August 15, 2000 SEGOB letter lacks evidentiary support and makes little sense.

A. Thunderbird's Experience in the Gaming Industry and its Expectations of a Right to Operate in Mexico.

At paragraphs 115 through 126 of the SoD, Mexico argues that the recent history of Thunderbird's operation in other countries is relevant to an evaluation of its reasonable expectations upon entering the Mexican market. Respondent then refers to a series of Thunderbird business operations in other jurisdictions and concludes that Thunderbird "appears to have consciously followed a business strategy which is against the law". This statement was addressed earlier in this SoR. The Thunderbird business operations cited by Mexico, as well as the Thunderbird's successful Latin American operations not mentioned by Respondent, are addressed in the declarations of Albert Atallah and Booker T. Copeland submitted with this SoR.

B. The Involvement of Oien, Ong, Aspe and Arroyo.

At paragraphs 130 and 131 of the SoD, Mexico addresses the involvement of Messrs. Oien and Ong arguing that Thunderbird relied upon them rather upon assurances from SEGOB in proceeding with its EDM investments. Mexico refers to certain "posturing" statements made by Thunderbird's General Counsel in response to demands for money. These statements are addressed in the declaration of Albert Atallah submitted with this SoD. These statements are hardly evidence that Thunderbird did not rely upon the government assurances it received from Mexico. As Respondent knows from its review of the Orange County Case file referred to in Footnote 131, no cross-complaint for fraud or misrepresentation was filed and Thunderbird ultimately settled the involved contract claim for full value. Further, Thunderbird's dealings with Oien and Ong predated any communications between Thunderbird and the Mexican government concerning skill machine operations.

At paragraphs 132 through 136, Mexico addresses the involvement of Messrs. Aspe and Arroyo and again, without evidentiary support, attempts to raise an implication of impropriety. The fee paid to Aspe and Arroyo for their work in helping to secure to the August 15, 2000 SEGOB letter was addressed in the declaration of Luis Ruiz de Velasco submitted in support of the PSoC. The involvement of Aspe and Arroyo was addressed in the declaration of Peter Watson and in the Velasco declaration. Mexico offers no *evidence* of impropriety.

Mexico attempts to raise a negative implication by asserting that Thunderbird "refused" to provide documents relating the involvement of Oien, Ong, Aspe and Arroyo. In fact, the Tribunal sustained objections by Thunderbird to requests by Mexico relating to these individuals as not being made in compliance the IBA Rules of Evidence. [*Procedural Order No. 3 and related submissions]*

C. Mexico's "Approval" of Thunderbird's Skill Machine Operations:

The August 15, 2001 Opinion Letter from Gobernacion.

Finally, Mexico argues that SEGOB did not "approve" the EDM operations by way of the August 15, 2000 letter. *[SoD, Para.]* Mexico points out that EDM did not apply for a permit, license or authorization to develop its operations. Claimant has never asserted that it obtained a government permit or specific formal authorization to operate with the August 15, 2002 letter. Further, use of the term "approval" by the parties is largely a matter of semantics. In the August 15, 2000 letter, Mexico advised Thunderbird/EDM that its intended operations were not prohibited by Mexican law. In light of the clearly-stated desire of Thunderbird/EDM to proceed with the intended operations, a responsive statement by the government that it could not prohibit the investment could hardly be deemed as anything other than an approval.

Whether the letter is characterized as an "approval" or a "government assurance", there can be little doubt that it was intended by Mexico, and understood by Thunderbird, to be a statement by the government of Mexico that the intended investment was not prohibited and could go forward without threat of government restriction or regulation.

Mexico also argues EDM "did not offer evidence, or present the machines to demonstrate their functioning, nor invite SEGOB to inspect the establishment where they were already in operation, or presented the operating manuals". *[SoD, Para.]* Needless to say, there is no evidence that SEGOB sought or even required such information to respond to August 3, 2000 solicitud. Further, In October, 2000, attorney Carlos Gomez requested permission from Gobernacion and the Department of Interior on behalf of a client other than claimant to operate skill machines. In response, Gobernacion, in a letter signed by the same individual who signed the August 15, 2000 opinion letter concerning Thunderbird's machines, requested specific information about the machines to be utilized, including make and model

numbers, methods of operation, and other detailed information. *[Gomez, paras. 3, 4, 5; Ex. 93]*. This was the *same exact information* provided by Thunderbird in its August 3, 2000 solicitud and in response to which Gobernacion opined that it did not have the authority to prohibit use of the machines. In both these cases, Gobernacion had sufficient knowledge and understanding of skill machines in order to assess their legality.

There is no evidence that Mexico sought information from Thunderbird that was not provided nor that it even required additional information to consider the legality or propriety of Thunderbird's proposed skill machine as presented in the August 3, 2000 solicitud. There is no evidence to suggest that Mexico did not fully understand what investment activities was being presented for consideration in the August 3, 2000 solicitud. In fact, in a later meeting with Peter Watson, Francisco La Bastida, under whom Antuano and Orozco Arceves served when the opinion letter was provided , acknowledged that he was aware of the solicitud and of the August 15, 2000 response. La Bastida stated that since there was already a successful skill operation in Mexico and a precedential court case, the August 15, 2000 letter was an appropriate response to the solicitud. *[Watson, para. 16]* Mexico has not disputed that fact of, nor the content of, this conversation.

V.

DOMESTIC SKILL MACHINE OPERATIONS REMAIN OPEN IN MEXICO UNDER PROTECTION OF LAW.

In its PSoC, Thunderbird argued that Mexico breached the "National Treatment" standard as follows:

> Application of the Article 1102 "National Treatment" standard is simple and straightforward under the facts of this case. Thunderbird's EDM enterprises were seized and closed because of the machines the facilities were utilizing. Mexico asserted Thunderbird's skill machines were illegal "cash slot machines" *[Ex. 70]*. Yet, domestic investors were, and are, open and operating essentially identical machines at locations in Mexico. Mexico breached its 1102 obligation of failing to provide claimant and its investments with treatment no less favorable than it provided to these domestic

investors. *[PSoC, page 52]*

Thunderbird then identified Guardia "Club 21" in Mexico City and the Reflejos skill machine operation as appropriate comparators.

Mexico does not dispute that these operations are appropriate comparators. Rather, it argues that they have been treated the same as Thunderbird's EDM enterprises because "it has closed down all premises which were either open or closed in which were found to be operating machines commonly known as slot machines, token machines, bill machine, or dollar machines, functioning in the same or a similar way as those operated by EDM in the establishments in Nuevo Laredo, Reynosa and Matamoros."

As set forth in Section I. D. 5. of this SoR above, this assertion is false. Numerous skill machines facilities of domestic investors remain open and operating under full protection of Mexican law.

Further, several of those skill machine facilities are open and operating in the *same locations* as were the Thunderbird EDM enterprises closed and seized by Mexico. Two Reflejos skill machine facilities are open and operating in Matamoros, the site of the EDM-Matamoros skill machine operation closed and sized by Mexico in October, 2001. In fact the Reflejos are open and operating in the location under a final and binding judicial determination of its right to operate skill machines. The Bella Vista Entertainment Center in Monterey is open and operating as many as 467 skill machines in an large facility. Thunderbird's EDM-Monterey was preparing to open a skill machine in Monterey.

Mexico has allowed, and is allowing, domestic investors to undertake the *very same investment activities* (the operation of skill machines) that Thunderbird was precluded from undertaking in *the very same locations* (Matamoros and Monterey) that Thunderbird was undertaking or sought to undertake such activities. This fact is highly relevant to the Tribunal's consideration of Thunderbird's claim that Mexico breached its Article 1102 "National Treatment" standard.

V.

LEGAL ARGUMENTS

A. The Import and Effect of Regulatory Action by a NAFTA Party Under Chapter 11.

At paragraphs 183 to 185 of its SoD, Mexico argues that it is entitled to regulate all investments as it sees fit. It also implies that different jurisdictions within the territory of a NAFTA Party may be subjected to different forms of regulation and it states that the NAFTA does not bind it to admit investments into its territory that it considers to be illegal. All three of these statements are correct and at the same time misleading.

Mexico is entitled to regulate in its territory as it sees fit, but it has promised to compensate investors under NAFTA Chapter 11 if the means by which it regulates is found to have violated the norms enumerated in Section A of NAFTA Chapter 11. Investments in different Mexican states may receive different regulation, but only if that different regulation emanates from the state level. Federal measures, such as the type at issue in this case, apply across the entire Mexican territory and – as NAFTA Article 1102(3) makes clear – the treatment provided under federal measures must be no less favorable to any investor or investment situated throughout Mexico's territory.

Finally, Mexico's third statement about illegality simply misses the point about the exercise required of a NAFTA Tribunal. The NAFTA Tribunal's task is not to determine whether a lost investment was illegal under domestic law; its task is to determine whether Mexico's treatment of an investment was contrary to international law (i.e. the obligations undertaken by Mexico when it ratified the NAFTA). Mexico cannot escape liability by designating an investment activity "illegal" after the fact. And Mexico is not the Soviet Union, circa 1970, where all investment activity required a license before it would be permitted.

With the NAFTA, Mexico threw open its doors to investment. And as signified by the August 15, 2000 opinion letter, Mexico opened its doors to Thunderbird – an investor that did perform its due diligence before any of the investments that it controlled commenced operations in Mexico. While Mexico is now entitled to change its mind, and prevent those investments from operating (even while "like" businesses stay open), it is not entitled to escape its obligation to pay compensation for doing so.

At paragraphs 186 to 194 of the SoD, Mexico argues that NAFTA Tribunals are not courts of appeal which can sit in judgment of domestic judicial decisions. As authority for this proposition, it cites cases such as *Loewen*, *Mondev* and *Azinian* – all of which involved judicial measures as the focal point of the investor's claim It does so despite its having provided this Tribunal with pages of unsupported facts designed to demonstrate that – despite manifest procedural flaws – its bureaucrats made the right decision on the merits of Mexican law. It does so because it expects this Tribunal to accept – without question – its assurance that only Mexico can say whether this decision was correct on the merits, even if it is doing so in a *post facto* manner obviously intended to escape liability under the NAFTA.

Mexico has taken this course – of stressing the obvious point that NAFTA tribunals are not appellate courts that can hear the merits of domestic judicial decisions – because its key defense in this case is to try to convince this Tribunal to abandon the terms of the NAFTA and re-establish an *exhaustion of local remedies rule* for all NAFTA claims. Faced with overwhelming evidence of arbitrary and inequitable treatment from senior SEGOB officials – none of whom have provided evidence to this tribunal – Mexico's strategy apparently is to fudge the evidence and change the applicable rules.

B. Mexico Breached the "National Treatment" Standard under NAFTA Article 1102 in its Destruction of the Thunderbird Investments.

Without justification, Mexico has accorded less favorable treatment to the Investor and its investments than that which has been provided to domestic investors and investments operating in like circumstances. Such conduct constitutes a *prima facie* breach of the national treatment standard, which is found in NAFTA Article 1102. Article 1102 provides, in relevant part:

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

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

3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

NAFTA Article 102(1) provides that "national treatment" is one of the "principles and rules" of the Agreement which must be used to "elaborate" the objectives of the NAFTA set out in Article 102(1). Those objectives include "the promotion of conditions of fair competition in the free trade area" and "to increase substantially investment opportunities in the territories of the Parties." Article 101(2) mandates that any interpretation and application of the NAFTA text must be undertaken "in light of" these objectives.

At pages 41 to 52 of the PSOC, Thunderbird sets out the three-part test of national treatment which has been applied consistently by past NAFTA tribunals. The test requires one to identify the appropriate comparators; determine whether better treatment has been provided to a comparator than to an investor or investment; and inquire as to whether a reasonable explanation exists if differential treatment has been found.

Mexico provides no reason why the competitors Thunderbird established in its PSoC should not be considered the appropriate comparators for this case. In fact, Mexico essentially admits their "likeness" by labeling all of these businesses collectively as being illegal under Mexican law and alleging that its regulators have done their level best to shut all of them down (including the misleading assertion that all of them have indeed been shut down). Instead of putting any real effort into disputing the likeness of these businesses, Mexico focuses on the second and third prongs of the test.

First, Mexico has attempted to shift the second prong of the test away from a focus on the results of its measures to their allegedly ongoing application. It wants this Tribunal to only examine whether

Thunderbird or its investments were singled out for enforcement action because of their nationality. The actual question is whether a comparable business is receiving more favorable treatment – *in result*.[22] In this case, better treatment obviously includes the ability to conduct business, while Thunderbird's investments sit idle. The intent of Mexican officials is simply not relevant for consideration of the second prong of the national treatment test.[23]

The intent of government officials is relevant for the third prong of the test, but it is not merely a question of whether those officials intended to harm Thunderbird's investments on the grounds of nationality. In cases where discriminatory intent is proved (such as in *Myers*), it is obvious that no reasonable justification for differential treatment exists. The result is the same, however, if no reasonable justification is provided (or if the justification provided is not supported by the evidence and facts of the case).

Mexico has provided a very creative justification for the inequitable treatment offered by its officials to Thunderbird and its investments. Rather than explaining why the EDM's are closed, while "like" businesses are open, Mexico alleges – contrary to the available evidence – that all of those other businesses are actually closed or in the process of being closed. Rather than explaining how Thunderbird and its investments could be provided with outrageously arbitrary treatment, Mexico merely claims that Thunderbird lost its "likeness" because it allegedly failed to seek local judicial remedies sought by other like businesses.

First, Thunderbird did not lightly abandon any local avenues of judicial redress. The decision to direct the EDM's to cease court actions was based on a careful analysis of the relevant legal and political factors known to it at that time. These factors are addressed in the declaration of Javier Navarro submitted with this SoR. They included an evaluation of the likelihood of success, given evidence that these processes would not being conducted fairly; and they included the decision to choose the remedies available under the NAFTA instead of those available under domestic law.[24]

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[22] *Pope & Talbot* Award at para's. 39-42

[23] *Pope & Talbot* Award at para. 70; *Myers* Merits Award, at para. 254.

[24] At paragraph 208 of the SoD, Mexico suggests that it is obvious that an investor can maintain local court actions while maintaining a NAFTA claim. A review of Mexico's arguments in the first jurisdictional phase of *Waste Management* v. *Mexico* suggests that counsel for Mexico was possessed of a far different opinion of Article 1121 only a short time ago. The

Mexico mentions Article 1121 at paragraph 208 of the SoD. Combined with Articles 1116 and 1117, Article 1121 provides investors with a choice of either pursuing a remedy for treatment received at the hands of a NAFTA Party under Chapter 11, rather than only proceeding domestically. Article 1121 explicitly recognizes that an investor may commence a claim for damages under NAFTA Article 1102, so long as it does not attempt to seek damages before any other tribunal. It also provides investors with the option of simultaneously seeking declarative or injunctive relief in a domestic court. It does not say that such relief must be sought in order to qualify to bring a claim under any NAFTA provision. If Mexico's arguments were accepted, the choice provided to investors under Article 1121 would be rendered meaningless.

In other words, if Mexico's arguments were accepted, the terms of Article 1121 would be rendered redundant and the *exhaustion of local remedies rule* would be reinstated for all claims under Article 1102.[25] Such an interpretation would violate the principle of effectiveness, which requires interpreters not to adopt a construction of treaty provisions that would render another provision redundant or superfluous.[26] The NAFTA provides investors such as Thunderbird with a right to seek damages for inequitable treatment for which no reasonable justification exists. Rather than provided an explanation for its inequitable treatment of Thunderbird and its investments, the best that Mexico apparently can do is claim that it has been absolved of responsibility because the Thunderbird elected to seek compensation under the NAFTA rather than pursuing what appeared to be a futile exercise before local courts.

Alternatively, even if Mexico's justification is accepted – and Thunderbird could be considered to be in operating different circumstances with other gaming businesses because it did not exhaust its

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result of that hearing as a majority award in favour of Mexico, dismissing the claim because the investor had maintained various types of local court actions while pursuing the NAFTA claim. Waste Management subsequently abandoned those actions and re-filed its NAFTA claim.

[25] At paragraph 140 of its Award, the *Feldman* Tribunal noted that the exhaustion rule was not in effect for claims brought under NAFTA Chapter 11. A similar conclusion was reached by the *Loewen* Tribunal, although it also concluded that a "principle of finality" requires claimants seeking damages for a judicial measure (i.e. not a measure initiated by a political or bureaucratic official) to perfect their claims by first exhausting all appeals before proceeding under the NAFTA. In this case the measures at issue arise from the decisions of SEGOB officials, rather than those of a Mexican court.

[26] See, e.g.: United States - Standards for Reformulated and Conventional Gasoline (Reformulated Gasoline), W/DS2/AB/R, Report of the Appellate Body adopted on 20 May 1997, at 23.

local judicial remedies – Mexico is still liable under Article 1102 for two reasons.

First, Thunderbird did not fail to exhaust local remedies. It pursued judicial remedies arising out of each closure. It only abandoned those processes when it became obvious that further efforts would have been futile. Moreover, those efforts were abandoned as part of a prudent decision to ensure that no arguments as to the sufficiency of its Article 1121 waivers could be sustained against its NAFTA claim, as they had been in *Waste Management I*.

Second, several of Thunderbird's competitors are no longer engaged in litigation to stay open. For example, the Reflejos facility in Matamoros is open and operating under full protection of Mexican law, after the issuance of a final and binding judicial determination of its right to operate. *[Reply-Navarro]* The same result obviously should have accrued for Thunderbird's EDMs.

The bottom line, under Article 1102, is that some local Mexican businesses, operating in like circumstances, are open today while Thunderbird's EDMs are not. Mexico has provided no valid explanation – such as a claim that these businesses are using different gaming equipment and software – to justify this difference in treatment.

C. Mexico Breached the "Minimum Standard of Treatment" under NAFTA Article 1105 in its Destruction of the Thunderbird Investments.

1. Article 1105 Establishes "Minimum Standard of Treatment" - Not a "Minimal" Standard of Treatment

Mexico has failed to provide Thunderbird and its investments with the kind of treatment that is required of all States under the NAFTA and customary international law. Mexico has instead acted in a manner which violates international standards, such as, fair and equitable treatment and full protection and security, to which Thunderbird and its EDMs were entitled under NAFTA Article 1105. NAFTA Article 1105 provides, in relevant part:

> 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.

Thunderbird has provided three reasons why Mexico has beached Article 1105: detrimental reliance (based upon the general principle of good faith); failure to provide due process (constituting an administrative denial of justice); and arbitrariness in administration (constituting proof of an abuse of right). Thunderbird has justified these grounds by providing evidence of how the customary international law minimum standard of treatment can be violated in these three ways, alluding to the generally recognized sources of international law.

In response, Mexico has inexplicably alleged, at paragraphs 215 and 229, that Thunderbird has not demonstrated the existence "of any internationally accepted norm" that it violated in its treatment of Thunderbird and the EDM's. Mexico says so despite Thunderbird's having clearly followed the methodology established by the NAFTA tribunals in both *Mondev* and *ADF* for turning to "the established sources of international law" to explain the content of the standard of treatment owed under Article 1105.

The *Mondev* and *ADF* tribunals were presented with exactly the same kind of arguments about Article 1105 only being breached in the most egregious of circumstances, as has been argued by Mexico in this case. Both tribunals responded in kind to these arguments as follows:

> 180. In the very recent Award rendered 11 October 2002 in *Mondev International Ltd.* v. *United States of America*, a copy of which was forwarded to the Tribunal by the Respondent on 17 October 2002, the Tribunal made certain observations which appear to us to be both important and apropos:
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> > "It has been suggested, particularly by Canada, that the meaning of those provisions in customary international law is that laid down by the Claims Commission of the inter-war years, notably that of the Mexican Claims Commission in the *Neer* case. That Commission laid down a requirement that, for there to be a breach of international law, 'the treatment of an alien … should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of government action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.'
> >
> > The Tribunal would observe, however that the *Neer* case, and other similar cases which were cited, concerned not the treatment of foreign investment as such but the physical security of the alien. Moreover the specific issue in *Neer* was that of Mexico's responsibility for failure to carry out an effective police investigation into the killing of a United States citizen by a number of armed men who were not even alleged to

> be acting under the control or at the instigation of Mexico. In general, the State is not responsible for the acts of private parties, and only in special circumstances will it become internationally responsible for a failure in the conduct of the subsequent investigation.
>
> Thus there is insufficient cause for assuming that provisions of bilateral investment treaties, and of NAFTA, while incorporating the *Neer* principle in respect of the duty of protection against acts of private parties affecting the physical security of aliens present on the territory of the State, are confined to the *Neer* standard of outrageous treatment where the issue is the treatment of foreign investment by the State itself.
>
> Secondly, *Neer* and like arbitral awards were decided in the 1920s, when the status of the individual in international law, and the international protection of foreign investments, were far less developed than they have since come to be. In particular, both the substantive and procedural rights of the individual in international law have undergone considerable development. In the light of these developments it is unconvincing to confine the meaning of 'fair and equitable treatment' and 'full protection and security' of foreign investments to what those terms – had they been current at the time – might have meant in the 1920s when applied to the physical security of an alien. To the modern eye, what is unfair or inequitable need not equate with the outrageous or the egregious. In particular, a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith."173 (Emphases added)

181. It may be added that the Claims Commission in the *Neer* case did not purport to pronounce a general standard applicable not only with respect to protection against acts of private parties directed against the physical safety of foreigners while in the territory of a host State, but also in any and all conceivable contexts. There appears no logical necessity and no concordant state practice to support the view that the *Neer* formulation is automatically extendible to the contemporary context of treatment of foreign investors and their investments by a host or recipient State.[27]

Mexico suggests that the award in *Genin* v. *Estonia* supports its position that the minimum standard requires it to provide nothing more than access to a rudimentary court system to Thunderbird and its EDM's in order to remedy any unfair treatment provided by SEGOB officials. It apparently also relies on the *Genin* award to suggest that there are no available rules of international law relevant to the treatment Thunderbird and its EDM's received in Mexico. The *Genin* award simply does not provide such support.

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[27] *ADF* Award, at 180-181.

Unlike NAFTA tribunals such as *Mondev* and *ADF*, the *Genin* Tribunal merely said that the content of the minimum standard "is not clear." It found no violation of the minimum standard in the case before it because it was dealing with a garden-variety commercial banking dispute between the Investor and a banking regulator from a State newly emerging form a post-Soviet economy. Even so, the *Genin* Tribunal nonetheless recognized that Estonia was obliged, under the minimum standard provision included in that treaty, not to act in either an "arbitrary" or "discriminatory" manner towards the foreigner and its investments.[28] It would therefore appear that the *Genin* Tribunal also recognized that the "minimum standard" requires much more of a State than to merely refrain from acting in bad faith or to maintain access to a rudimentary court system.[29]

In order to define the content of the minimum standard in any given case, the *Genin* Tribunal simply provided no guidance. The *ADF* and *Mondev* Tribunals, by contrast, have actually provided an appropriate methodology:

> 183. We are not convinced that the Investor has shown the existence, in current customary international law, of a general and autonomous requirement (autonomous, that is, from specific rules addressing particular, limited, contexts) to accord fair and equitable treatment and full protection and security to foreign investments. The Investor, for instance, has not shown that such a requirement has been brought into the corpus of present day customary international law by the many hundreds of bilateral investment treaties now extant. It may be that, in their current state, neither concordant state practice nor judicial or arbitral case law provides convincing substantiation (or, for that matter, refutation) of the Investor's position. It may also be observed in this connection that the Tribunal in *Mondev* did not reach the position of the Investor, while implying that the process of change is in motion:

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[28] *Genin* v. *Estonia*, at para. 368.

[29] The Tribunal in *Loewen and Loewen* v. *U.S.A.* came to a similar conclusion, stating at paragraph 132:

> Neither State practice, the decisions of international tribunals nor the opinion of commentators support the view that bad faith or malicious intention is an essential element of unfair and inequitable treatment or denial of justice amounting to a breach of international justice. Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough, even if one applies the Interpretation according to its terms.

> "Thirdly, the vast number of bilateral and regional investment treaties (more than 2000) almost uniformly provide for fair and equitable treatment of foreign investments, and largely provide for full security and protection of investments. Investment treaties run between North and South, and East and West, and between States in these spheres inter se. On a remarkably widespread basis, States have repeatedly obliged themselves to accord foreign investment such treatment. In the Tribunal's view, such a body of concordant practice will necessarily have influenced the content of rules governing the treatment of foreign investment in current international law. It would be surprising if this practice and the vast number of provisions it reflects were to be interpreted as meaning no more than the *Neer* Tribunal (in a very different context) meant in 1927." (Emphases added)

184. At the same time, *Mondev* went on to say that:

> "At the same time, Article 1105(1) did not give a NAFTA tribunal an unfettered discretion to decide for itself, on a subjective basis, what was 'fair" or 'equitable' in the circumstances of each particular case. While possessing a power of appreciation, the United States stressed, the Tribunal is bound by the minimum standard as established in State practice and in the jurisprudence of arbitral tribunals. It may not simply adopt its own idiosyncratic standard of what is 'fair' or 'equitable' without reference to established sources of law." (Emphasis added)

We understand *Mondev* to be saying – and we would respectfully agree with it – that any general requirement to accord "fair and equitable treatment" and "full protection and security" must be disciplined by being based upon State practice and judicial or arbitral case law or other sources of customary or general international law.

185. The Investor, of course, in the end has the burden of sustaining its charge of inconsistency with Article 1105(1). That burden has not been discharged here and hence, as a strict technical matter, the Respondent does not have to prove that current customary international law concerning standards of treatment consists only of discrete, specific rules applicable to limited contexts. It does not appear inappropriate, however, to note that it is not necessary to assume that the customary international law on the treatment of aliens and their property, including investments, is bereft of more general principles or requirements, with normative consequences, in respect of investments, derived from – in the language of *Mondev* – "established sources of [international]

law."[30]

Mexico provides no justification for its position that it can somehow fulfill its obligations under Article 1105 by merely maintaining a rudimentary court system. By contrast, Thunderbird has resorted to all of the "established sources of international law" (including custom, principle and treaty law, as interpreted in the teachings of highly qualified publicists and the decisions of international tribunals) to explain the content of the minimum standard applicable in this case. In doing so, the Investor has followed the methodology established by past NAFTA tribunals for determining the content of the standard in any given case. From these various sources of international law cited by Thunderbird, three theories of liability emerged.

First, Thunderbird has argued that it and its investments reasonably relied upon the advice of Mexican officials and suffered considerable losses as a result (see: pages 77 to 85 of the PSOC).

Second, Thunderbird has argued that Mexican officials failed to adhere to basic norms of due process in their treatment of the investor and its investments (see: pages 65 to 71 and 85 to 98 of the PSOC).

Third, Thunderbird has argued that where an investor establishes a *prima facie* case that the treatment received by its investments was manifestly arbitrary, the strategic burden falls upon the respondent state to rebut the otherwise inevitable conclusion that either a substantive denial of justice or an abuse of right has taken place (see paragraphs 71 to 77 and 85 to 98 of the PSOC).

There are many ways to breach the Article 1105 "Minimum Standard of Treatment" and in this case Thunderbird has demonstrated how Mexico has performed three of them - denials of justice, both procedural and substantive; abuse of rights; and detrimental reliance. The arbitrary and unjust actions of Guadalupe Vargas taken in direct contravention to the promises and commitments made by Mexico and upon which Thunderbird and its EDM enterprises relied clearly establish Mexico's breach of its Article 1105 "Minimum Standard of Treatment" obligation.

2. Detrimental Reliance.

At pages 77 to 79 of the PSOC, the Investor explains how a State breaches the standard of fair

[30] *ADF* Award, at para's. 183-185

and equitable treatment – owed under Article 1105 and as a matter of customary international law – when its agents or officials provide advice or information to a foreigner who relies upon it to its detriment. If the reliance was reasonable in the circumstances, the State shall be held responsible for having brought about the conditions which resulted in the foreigner's loss.

Mexico is utterly dismissive of these arguments, stating at paragraph 229 that Thunderbird has failed to establish that any applicable international law norm can be founded upon Article 1105. In doing so, Mexico completely ignores the case law provided by Thunderbird in the PSOC. Instead it writes about what it claims is "generally accepted" in international law, without providing a single citation to an accepted source of international law (see: e.g. paragraphs 218 or 229).

As a subsidiary source of international law, recognized under Article 38 of the *Statute of the Court of International Justice*, the decisions of international tribunals provide evidence of customary international law norms and general principles of law. The arbitral awards cited by the Investor in its PSOC demonstrate that detrimental reliance arises from the general international law principle of good faith. In his monograph on the principle of good faith, J.F. O'Connor discusses how "the concept of good faith in international law includes a strong element of rejection of injustice, dishonesty, unfairness or unreasonableness."[31] He goes on to discuss how the concept of detrimental reliance (as embodied in the *estoppel* rule) has arisen in PCIJ cases such as *Case Concerning the Temple of Preah Vihear (Cambodia v. Thaiiand)* and the ICJ's *North Sea Continental Shelf* cases, demonstrating how State Responsibility can attach where a state of affairs, later repudiated, results in detrimental reliance.[32]

Professor Cheng has even more clearly articulated how the principle of good faith operates to avoid circumstances of detrimental reliance:

> The protection of good faith extends equally to the confidence and reliance that can reasonably be placed not only in agreements but also in communications or other conclusive acts from another State. If State A has knowingly led State B to believe that it will pursue a certain policy, and State B acts upon this belief, as soon as State A

[31] J.F. O'Connor, *Good Faith in International Law* (Dartmouth: Brookfield, Ill., 1990), at 38.
[32] Ibid, at 92-93.

> decides to change its policy - although it is at perfect liberty to do so – it is under a duty to inform State B of this proposed change. Failure to do so, when it knows or should have known that State B would continue to act upon this belief, gives rise to a duty to indemnify State B for any damage it may incur. What the principle of good faith protects is the confidence that State B may reasonably place in State A.[33]

Contrary to the hyperbolic, and wholly unsubstantiated, allegations made by Mexico in its SoD, Thunderbird has a long history of taking a cautious and prudent approach to making investments in new legal jurisdictions. In Mexico, Thunderbird shunned the confrontational legal approach suggested by local lawyers who had worked for some of their competitors. It instead chose to retain counsel from the world's largest law firm to officially ask the appropriate regulatory officials (from SEGOB) whether its proposed gaming businesses would be subjected to prohibitive regulation by them.

Through the outcome of the *solicitude* process, Thunderbird was told, in no uncertain terms, that the business activities proposed for its investment enterprises would not fall under their jurisdiction. In other words, SEGOB officials provided the EDM's with written assurance that they would not be subjected to prohibitory SEGOB regulation, so long as they operated their businesses as proposed. The EDM's opened on this basis, and more EDM's were created and began ramping up for business observing the same model. Then the government changed; Sr. Vargas was appointed; and he commenced his unmitigated pattern of arbitrary treatment against Thunderbird and its EDM's. Until Mr. Vargas effectively changed his government's collective mind on the subject, the written assurances provided by SEGOB to Thunderbird and its EDM's told them that they were at liberty to engage in their planned gaming businesses. While Mexico is entitled to change its mind, it is not entitled to avoid paying compensation for the effects such change had upon investors reasonably relying on prior official advice.

The evidence on the record shows that Thunderbird and its EDM's did everything within their collective power to ensure that a stable legal footing existed in Mexico before commencing business.

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[33] B. Cheng, *General Principles of Law as Applied by International Courts and Tribunals* (Grotius: Cambridge, 1987), at 137.

They hired the best counsel and issued conservative statements on their prospects to investors. Contrary to Mexico's erroneous arguments, they even waited to obtain this approval before opening for business. Immediately upon their opening, these businesses were making a considerable profit, establishing a clear "track record" which was only ended by the arbitrary conduct of Mexican officials.

Mexico does not refute the law supporting this theory of liability because it cannot do so. Whether embodied in the equitable rule of estoppel or in the principle of good faith, the theory of detrimental reliance clearly stands as an element of the kind of "fair and equitable" treatment that is required of the NAFTA Parties under both Article 1105 and customary international law.

3. Administrative Denial of Justice.

Mexico's destruction of Thunderbird's investment enterprises was largely carried out through by the actions of J. Guadalupe Vargas Berrara, the Director of Juegos Y Sorteros appointed shortly after Fox took office in December, 2002. *[Velasco, para. 7, 15; Watson, para.16]* His actions were unjust, arbitrary and deceitful.

At paragraphs 218 and 235 of the SoD, Mexico states that it has satisfied its obligations under Article 1105 by providing "adequate mechanisms" for the EDM's to pursue their allegations of unfair administrative treatment. In claiming that the EDM's took advantage of these mechanisms (although apparently not enough to satisfy Mexico's new exhaustion rule for Article 1102), Mexico has all but admitted that Thunderbird and its EDM's were manifestly denied due process at the hands of SEGOB officials.

In fact, Mexico has very little to say in the SoD about how SEGOB officials treated Thunderbird and the EDM's, including the administrative proceedings which preceded the final closure of the EDM facilities. Mexico merely suggests, without any evidence, that these sham proceedings were presided over by someone who was actually not in the hearing room at any time during those proceedings. Mexico chooses instead to devote numerous pages of its SoD to attempting to mislead the tribunal about the character of the gaming equipment used by the EDM's in Mexico. It does so without providing any relevant evidence about the machines and software used by the EDM's – much in the same fashion that SEGOB officials made the decisions to close down the EDM's. SEGOB officials similarly relied on

no evidence to support Mr. Vargas' wholly subjective, and uninformed, belief that he was dealing with nothing more than "money swallowers" (i.e. simple slot machines) that had to be shut off as soon as possible.

The customary international law doctrine of denial of justice provides some guidance as to the kind of due process owed under NAFTA Article 1105. But relevant treaty practice and tribunal decisions can also provide such guidance. For example, the United States and Chile, and the United States and Singapore, have agreed in two new international trade treaty texts (which were modeled upon the NAFTA) that include the minimum standard required under provisions similar to NAFTA Article 1105. The text of these provisions states that "fair and equitable treatment":

> …includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.[34]

Contrary to the import of Mexico's arguments, denials of justice (which could also be characterized as violations of "due process" or "procedural fairness") have never been limited to the outcome of a judicial proceeding; they include all manners of administrative and regulatory decision-making. For example, cases where the doctrine of denial of justice was effectively applied to non-court measures include various awards of the USA-Mexico Claims Commission, such as:

a) In the case of *Samuel Davies* v. *Mexico* the claimant was awarded damages for his cords of wood, which had been unreasonably seized by junior-rank Mexican officials.[35]

b) In *Okie* v. *Mexico*, the Tribunal found that the provision of Mexican law that did not permit a refund of overpaid customs fees to Mr. Okie violated international law and it ordered Mexico to repay the funds. This violation of international law was caused by a Mexican regulatory measure of general application and no finding of any particular intent was made by the Tribunal.[36]

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[34] Article 15.5(2)(a) of the draft *U.S.A. – Singapore Free Trade Agreement*, available at: www.naftalaw.org; and Article 10.4(2)(a) of the draft *U.S.A. – Chile Free Trade Agreement*, available at: www.naftalaw.org.

[35] *Samuel Davies* v. *Mexico* (1929) IV RIAA 517.

[36] *Okie* v. *Mexico* (1926) IV RIAA 55.

c) In *G.W. MacNear, Inc* v. *Mexico*, a Chamber of the US-Mexico Claims Commission found that the improper detention, and eventual sale, of the investor's wheat at the border, constituted a violation of international law.[37]

There is no support in the relevant NAFTA jurisprudence for Mexico's arguments either. It relies on cases such as *Azinian*, *Mondev* and *Loewen* for the proposition that claims of denial of justice / failure to provide due process only relate to the maintenance of a fair court system. All three of these cases involved commercial disputes that were taken to court by the investors (with the decisions of courts being the only measures at issue in the letter two proceedings). Mexico ignores the obvious fact that in the *Myers* and *Pope* and *ADF* cases (the former two of which included findings of a breach of Article 1105) the argument that providing access to a court was good enough was resoundingly rejected. These were regulatory disputes, just as Thunderbird's case is a regulatory dispute. For the purposes of determining whether there has been of breach of Article 1105, the question of whether access was provided to a court system will be completely irrelevant (unless, of course, access was unreasonably denied or justice was arbitrarily administered).

Rather than address the various doctrinal authorities provided by the Investor to explain the content of the principle of due process in international law, Mexico has attempted to create a straw man out of comments made at pages 68 to 69 of the PSOC concerning NAFTA Articles 1804-1805. At 231 of the SoD, Mexico wrongly suggests that the Investor is attempting to seek compensation for Mexico's breach of Article 1805. While the manifestly arbitrary manner in which SEGOB officials conducted themselves in closing down the EDM's undoubtedly rises to the level of conduct prohibited under Article 1804, that is an argument for Canada to take up with Mexico under Chapter 20. As directed by the methodology provided by the *Mondev* and *ADF* tribunals, the relevance of Articles 1804-1805 (much like any other relevant treaty provision) for these proceedings is to provide context for the interpretation of what constitutes "fair and equitable treatment" under Article 1105.

[37] *G.W. MacNear, Inc* v. *Mexico* (1928) IV RIAA 373.

4. Manifest Arbitrariness Constitutes Proof of an Abuse of Right.

The prohibition against abuse of rights is well-established in international law. As Professor Mann noted:

> It is the lack of fair and equitable treatment, or of good faith, that is the real and fundamental and, at the same time, the most comprehensive cause of action which all other aspects of State responsibility … are mere illustrations. The difficulties lie in the application rather than the existence of a doctrine the substance of which it is hard to deny.[38]

And in commenting upon the decision of the International Court of Justice in the *US Nationals in Morocco Case*, where it was held that Moroccan authorities were obliged to conduct a customs valuation "reasonably and in good faith," Sir Gerald Fitzmaurice noted over forty years ago:

> There is little legal content in the obligation to exercise a right in good faith unless failure to do so would, in general, constitute an abuse of rights. Here therefore the Court may be said to have taken a step towards the recognition of the doctrine propounded in earlier cases by Judge Alvarez.[39]

And as long ago as 1933, Professor Schlochauer observed how the doctrine of abuse of rights has been closely-linked to the increasing economic interdependence of States, prohibiting the kind of arbitrariness in government action that could have been acceptable in centuries past:

> Ultimately the pre-judicial prohibition on arbitrariness, in its most comprehensive meaning, simultaneously found a place and recognition in the international legal system in the norm of "pacta sunt servanda". Its specific development in the sense of the emergence of norms characterized as abuse of rights has, however, in international law only hesitantly been achieved and is in fact only a concomitant to recent developments. The tighter their multi-meshed international relations are tied, the less free and unchecked are States in exercising their "rights" according to subjective discretion. It is a necessary consequence of the move from the "independence des états" to

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[38] F.A. Mann, *The Legal Aspects of Money*, 5th Ed. (Oxford: Clarendon, 1992) at 476.

[39] G. Fitzmaurice, "The Law and Practice of the International Court of Justice, 1951-54: General Principles and Sources of Law" (1953) 30 *Brit. Y.B. Int'l. L.* 53.

> "interdépendence", to the construction of the "communauté internationale", that the originally purely individualistic character of the international legal order changes to a social character and that international law, which is above all trade and commercial law, constructs its norms from the point of view of social goals. This leads to a progressive widening of state responsibility, whereby it deals above all with the imposition of restrictions on the degree to which a subject of international law has a claim vis-à-vis another, without the powers of the first state being extended, in other words with certain restrictions on the free discretions of states.[40]

Mexico all but ignores the arguments of the Investor concerning arbitrary government conduct as being the antithesis of "fair and equitable treatment" - even though the manifestly arbitrary conduct visited upon Thunderbird and the EDM's cannot go unanswered. Nonetheless, instead of explaining its conduct, Mexico simply argues that the customary international law minimum standard of treatment is really a minimal standard of treatment. In essence, Mexico is is responding to undisputed evidence of overwhelming arbitrariness by arguing that the only "treatment" it owes to Thunderbird under customary international law, and Article 1105, does not involve the application of a "standard" of fairness or equity at all. Rather, Mexico by arguing that Article 1105 merely establishes a threshold for the review of State conduct, and it argues that the threshold is very high (i.e. that it applies only to the most egregious denials of justice by a domestic court).

In reply, the Investor will repeat the words of Professor Schwarzenberger, recalled at page 75 of its memorial:

> Arbitrariness in any form is – or ought to be – abhorrent to *homo juridicus*. His whole professional outlook is dominated by the attitude that, in the eyes of the law, equal situations require equal remedies.
>
> Yet, anybody who is acquainted with the techniques by which judicial precedents are applied and distinguished is aware of the element of subjectivity which is

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[40] Hans-Jürgen Schlochauer, "Die Theorie des abus de droit im Völkerrecht" (1933) 17 Zeitschrift für Völkerrecht 373 at 378-379, translated by Michael Byers, "Abuse of Rights: An Old Principle, A New Age" (2002) 47 *McGill L.J.* 389 at 405-406.

inseparable from deciding even on a judicial level what situations are supposed to be equal.

In the fields of quasi-judicial, administrative or political decisions, it is even more difficult to verify the arbitrary exercise of discretion. The wider the scope of discretion, the easier it is to find plausible arguments to hide irrelevant or objectionable reasons behind such reasons. If discretion is exercised within as wide a framework of territorial jurisdiction, only the most potent abuses of sovereignty could possibly be caught by any prohibition of the arbitrary use of sovereign right..[41]

As Professors Schwarzenberger and Mann both indicated, rooting out cases of abuse of right is a delicate undertaking – because one cannot trust in the good faith of those government officials who would violate this principle being forthright about their inappropriate conduct. Instead, one can rely on the legal maxim known in common law as: *res ipsa loquitur*. In the face of *prima* facie evidence of arbitrary conduct, an international tribunal can conclude that "the thing speaks for itself."

Thunderbird submits that it has thoroughly established how manifestly arbitrary the results of SEGOB regulation have been on its investments. Its facility in Nuevo Laredo was inexplicably closed by Guadalupe Vargas in February 2001. In response, Thunderbird demonstrated incredible good faith by submitting itself to an additional administrative hearing which it later learned would be presided over by the Vargas himself. The results of that hearing were shockingly arbitrary. Rather than procuring any evidence to demonstrate that Thunderbird was failing to comply with the terms of the solicitud, Vargas rejected all of Thunderbird's evidence on the most facile of grounds. The closures which followed this scandalous administrative proceedings were so heavy-handed that they included seizures and arrests by numerous, well-armed police officers.

Mexico has utterly failed to explain how its treatment of the EDM's can be justified as reasonable and proportionate in the circumstances. All it says is that it provides all foreigners with access to its court system and that it expects Thunderbird to be bound to use it under the NAFTA. Mexico's argument ignores the obvious reply that NAFTA Chapter 11 does not require a claimant to

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[41] Georg Schwarzenberger, *International Law and Order* (1971) at pp. 100-101.

exhaust local remedies before bringing a claim, and that NAFTA Article 1105 requires more of the Parties than providing access to their courts.

Moreover, as the *Loewen* Tribunal recently observed, it is not necessary for a claimant to demonstrate that either bad faith or a discriminatory animus exists behind the manifestly unjust outcome of an administrative or judicial process. It is enough to prove to an impartial, international tribunal that such manifest arbitrariness took place:

> Neither State practice, the decisions of international tribunals nor the opinion of commentators support the view that bad faith or malicious intention is an essential element of unfair and inequitable treatment or denial of justice amounting to a breach of international justice. Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough, even if one applies the [Free Trade Commission's July 31 2001] Interpretation according to its terms.[41]

Accordingly, once a *prima facie* claim of arbitrariness has been established, the burden strategically shifts to the State respondent to explain its conduct in the circumstances. Thunderbird has provided copious amounts of unrefuted evidence demonstrating that its EDM's were the victims of truly arbitrary treatment at the hands of SEGOB officials. Mexico has evaded all of the questions raised by this evidence, advancing only spurious and unsupported claims about the moral character of Thunderbird employees. If Mexico cannot explain the arbitrary result visited upon the EDM's by its officials, this Tribunal should conclude that it has failed to accord the "fair and equitable" treatment required under Article 1105 and customary international law.

5. Conclusion

These facts clearly establish a breach of the "Minimum Standard of Treatment" obligation under Article 1105 of NAFTA. Thunderbird and its EDM entities detrimentally and reasonably relied upon the actions and statements of the Mexican government in pursuing its investment enterprises. Over a year later, Mexico reversed course and reneged on its official statements causing Thunderbird and its EDM enterprises to lose investments worth tens of millions of dollars. Through arbitrary actions lacking

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[41] *Loewen* Award, at para. 132.

any notions of impartiality, Mexico seized, closed and sealed these investment enterprises. The reasons behind Mexico's reversal of position and subsequent destruction of Thunderbird's investments enterprises are unknown. The timing of the actions (i.e., commencing shortly after a change of administration), the acquiescence of high government officials in the actions of Guadalupe Vargas and the favorable treatment given to its own investors undertaking identical activities clearly suggest a conscious governmental directive by Mexico to single out and proceed against a foreign investor.

Mexico did not provide "fair and equitable treatment" to Thunderbird and its EDM entities in relation to their investment enterprises. Mexico has breached its Article 1105 obligation and should be held responsible for damages arising from that breach.

D. Mexico Expropriated the Thunderbird Investments without Payment of Compensation in Violation of NAFTA Article1110.

NAFTA Article 1110 provides for the payment of compensation for any act of expropriation, regardless of whether such a taking is lawful under international law. This is because Article 1110(1) provides that, under all circumstances, regardless of whether the taking is for a public purpose, non-discriminatory or otherwise in accordance with the minimum standard of treatment, compensation must be paid in accordance with the other paragraphs of this provision. As stated in pages 99 to 104 of the PSOC, a NAFTA party is required to pay full, prompt and effective compensation for any action that results in the substantial deprivation of an investment. Substantial deprivation takes place when a measure "effectively neutralizes" the benefit expected to be derived from an investment.[42]

At paragraphs 253 to 258, Mexico appears to diverge from this customary international law approach to expropriation, suggesting that any good faith exercise of regulatory power can never be construed as an expropriation, no matter what the effects on an investment. This approach is also at odds with the plain text of Article 1110(1), which denotes that compensation must be paid in accordance with paragraphs (2) to (4), even in cases where the taking has been non-discriminatory, has afforded due process, and was for a public purpose. As noted at pages 103-104 of the PSOC, the tribunals in the *Pope* and the *Feldman* claims acknowledged that there is no blanket exception for

[42] *CME* Award, at para. 604.

expropriations that the State claims to be an exercise of its "police power".

The Investor agrees with Mexico, however, concerning the fundamental issue for application of Article 1110 in this case. It is clear that Mexico has effectively neutralized the businesses of each EDM with its regulation. It is clear that Mexico has not paid compensation for these takings. The only question that remains is whether any "acquired rights" legitimately existed in the businesses maintained by the EDMs - for which compensation must now be paid. Mexico is correct to suggest, at paragraphs 242 to 252 that it need not pay compensation for effectively neutralizing an unlawful business undertaking, but it is quite wrong to argue that Thunderbird's investments operated on such a basis.

The question is one of legitimate expectation: were Thunderbird and its EDM's in a position to reasonably expect to derive benefits from the establishment of their skill-game businesses in Mexico? What steps did they take, or could they have taken, to reasonably entertain such an expectation? As noted above, the Investor and its investments did all that they could have done to ensure that their proposed businesses were not prohibited under Mexican law. They were presented with various options that would have established their businesses on a more tenuous legal basis, but they chose instead to hire the world's largest law firm and the certainty of the solicitud process they advised to undertake. Thunderbird and the EDMs engaged in this solicitud process with SEGOB officials – the very people responsible for enforcing Mexico's prohibitions on games of chance – to ensure that their skill game businesses would not run afoul of any applicable laws. They did so as part of the due diligence process which also involved obtaining all necessary licenses, such as those required to serve alcohol, and registering to ay all applicable taxes.

At paragraph 210, Mexico argues that the Feldman case and this claim are fundamentally different, with respect to national treatment. As described above, this argument is without merit. Had Mexico made this argument about Article 1110, however, it would have been correct. The *Feldman* and *Thunderbird* cases are different with respect to the applicability of Article 1110. In *Feldman*, the investor never sought out the advice of Mexican officials, in order to confirm whether it properly qualified for the tax rebates that it would later be denied. The *Feldman* Tribunal concluded that there had been no expropriation, in part, on the basis that the investor had not sought out such regulatory

clarification. Accordingly, it reasoned, he could not entertain any legitimate expectation to obtain such rebates going forward.[43]

Mr. Feldman never took advantage of any Mexican administrative procedure before commencing a business that apparently relied upon the collection of tax rebates. He certainly did not engage the *solicitud* process utilized by Thunderbird the EDM's, prior to their commencing businesses in Mexico. Instead, Mr. Feldman followed a model closer to the one chosen by Thunderbird's domestic competitors: adopt a willfully blind position as to whether the planned investment activity is permitted under local regulation; and then pursue all legal and political means necessary to evade any regulatory action that arises from the establishment of the investment. This is a model that Thunderbird categorically rejected.

The question of legitimate expectation, under Article 1110, can be analyzed in the same manner as the question of detrimental reliance, under Article 1105. Thunderbird and its EDM's expected to derive significant benefits from these gaming businesses because of their participation in the *solicitud* process. They relied on the outcome of this process to establish their businesses. Whether that reliance was reasonable is the same question as whether the expectations they held were legitimate. Accordingly, because the businesses established and maintained by Thunderbird and the EDM's have been completely destroyed, the same facts that support a finding that Article 1105 has been breached also support a finding that Article 1110 has been breached.[44]

In this regard Mexico's additional objection, recorded at paragraphs 239 to 240 of the SoD, is supercilious. In this case, a breach of Article 1110 will also constitute a breach of Article 1105, as a matter of simple logic. Moreover, it is well established that the prohibition against expropriation without prompt, adequate and effective compensation is a rule of customary international law anyway.[45] For example the author of the *Restatement*, Professor Andy Lowenfeld, has written:

It is important in this discussion to distinguish between the *common principles* that may

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[43] *Feldman* Award, at 134.

[44] If a lesser degree of interference was involved, the claim would only have been brought under Article 1105.

[45] See, e.g: United States Department of State, Bureau of Economic and Business Affairs, "U.S. Bilateral Investment Treaty Program Fact Sheet" (1 July 2003), at: http://www.state.gov/e/eb/rls/fs/22422.htm.

be said to have ripened into customary international law, and *particular provisions* of BITs that even if widely utilized are applicable only between the treaty partners or investors entitled to the benefits of the treaty in question. For example, an agreement to arbitrate under a particular set of rules, or a prohibition of specified performance requirements would not be regarded as general principles, but would depend upon the applicability and text of a give treaty. But the understanding that international law is applicable to the relation between host states and foreign investors, that expropriation must be for a public purpose and must be accompanied by just compensation, and that disputes between foreign investors and host states should be subjected to impartial adjudication or arbitration are general principles, and do not depend on the wording or indeed on the existence of a given treaty. [emphasis added][46]

Because Mexico owes a customary international law obligation to Thunderbird and its EDM's not to effectively take (or destroy) their businesses without the payment of prompt, adequate and effective compensation, it accordingly does not matter whether Article 1110 exists. The identical remedy is owed by Mexico under Article 1105.

More importantly, however, there is simply no merit to Mexico's argument that Article 1110 is somehow limited to claims made under Article 1116, rather than Article 1117. Article 1117 permits an investor who owns or controls an investment to claim damages on behalf of that investment for any breach of Section A of Chapter 11, so long as some form of harm or damage was suffered by the investment enterprise arising out of that breach. Mexico has taken the businesses established by Thunderbird's EDM's. Each of these investment enterprises has suffered critical harm arising out of these takings. The requirements of Article 1117 have accordingly been met. There is absolutely no basis for concluding that Article 1117 somehow precludes claims involving breaches of Article 1110.

Similarly, there is absolutely no basis for concluding that Article 1110 indicates that it is only available for claims under Article 1116. Article 1110 specifies that the "investment of an investor" cannot be taken without the payment of compensation. "Investment" is defined under Article 1139 as

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[46] A. Lowenfeld, *International Economic Law* (Oxford: New York, 2002) at 488.

including many different kinds of economic rights or interests, including investment enterprises (on whose behalf an Article 1117 claim may be brought). However, this does not mean that the "investment" whose taking may require the payment of compensation under Article 1110 must be an investment enterprise.

For example, paragraphs (7) & (8) of Article 1110 explicitly contemplate the taking of investments other than an investment enterprise. It is mere semantics for Mexico to argue that the EDM's are not entitled to compensation for the destruction of their businesses because, as "investments," they cannot qualify as the "investors" mentioned in Article 1110. Playing Mexico's game, one need only recast the economic interests involved in the EDM's gaming businesses as the "investments" subject to the kind of "interference" that constitutes a taking under Article 1110. This is the kind of analysis undertaken by the *Pope* Tribunal when it wrote:

> As noted, Article 1110 sets requirements that must be met by Parties expropriating "an investment of an investor of another Party." The Investor is acknowledged to be an "investor of another Party," but Canada claims that the ability to sell lumber to the U.S. market is not an investment within the meaning of [the] NAFTA. Article 1139(g) defines investment to include, among other things, "property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes."
>
> While Canada suggests that the ability to sell softwood lumber from British Columbia to the U.S. is an abstraction, it is, in fact, a very important part of the "business" of the investment. Interference with that business would necessarily have an adverse effect on the property that the Investor has acquired in Canada, which, of course, constitutes the investment. While Canada's focus on the "access to the U.S. market" may reflect only the Investor's own terminology, that terminology should not mask the fact that the true interests at stake are the Investment's asset base, the value of which is largely dependent on its export business. The Tribunal concludes that the Investor properly asserts that Canada has taken measures affecting its "investment," as the term is defined in Article

1139 and used in Article 1110.[47]

The businesses of the EDM's have been completely frustrated by the conduct of SEGOB officials. The results have been catastrophic for each of them. Thunderbird holds an ownership interest in, and has maintained complete control over, all of the EDM's. Thunderbird, as an investor of a Party, has brought a claim under Article 1117 on behalf of its investments in Mexico. The investments have suffered critical harm as a result of this conduct, which rises to the level of "substantial interference" under Article 1110. Thus, all of the elements of Article 1117 and 1110 have been met and Mexico must pay compensation in accordance with the terms of Article 1110.

Alternatively, the Investor hereby seeks leave to amend its PSOC to include a claim for 100% of the damages caused to the businesses of each EDM as a result of Mexico's breach of Article 1110 , using Article 1116. It is entitled to bring this claim on its own behalf for all of the losses suffered as a result of these takings because it has controlled all of the EDMs at all relevant times. Under Article 20 of the UNCITRAL Rules, this Tribunal may permit an amendment so long as Mexico is not prejudiced under the circumstances. Given that the Investor's original Statement of Claim included Article 1116, Mexico would obviously not be prejudiced by such an amendment, as it has already received months and months of notice concerning the facts of this claim.

Moreover, as the *Mondev* Tribunal has noted, international law does not permit a remedy to be denied to a deserving claimant on merely technical, or formalistic grounds:

> Having regard to the distinctions drawn between claims brought under Articles 1116 and 1117, a NAFTA tribunal should be careful not to allow any recovery, in a claim that should have been brought under Article 1117, to be paid directly to the investor. There are various ways of achieving this, most simply by treating such a claim as in truth brought under Article 1117, provided there has been clear disclosure in the Article 1119 notice of the substance of the claim, compliance with Article 1121 and no prejudice to the Respondent State or third parties. International law does not place emphasis on merely formal considerations, nor does it require new proceedings to be commenced

[47] *Pope* Award, at para's. 97-98.

> where a merely procedural defect is involved. In the present case there was no evidence of material nondisclosure or prejudice, and Article 1121 was complied with. Thus the Tribunal would have been prepared, if necessary, to treat Mondev's claim as brought in the alternative under Article 1117. In the event, the matter does not have to be decided, since the case can be resolved on the basis of Claimant's standing under Article 1116. But it is clearly desirable in future NAFTA cases that claimants consider carefully whether to bring proceedings under Articles 1116 and 1117, either concurrently or in the alternative, and that they fully comply with the procedural requirements under Articles 1117 and 1121 if they are suing on behalf of an enterprise.[48]

If it is necessary to do so, this Tribunal may accordingly treat Thunderbird's claim under Article 1117 as a claim under Article 1116, in order to provide the damages sought. The Investor hereby requests this relief in the further alternative, should its other arguments be rejected.

VI.

DAMAGES

At paragraph 318 of the SoD, Mexico derisively argues that the Investor's arguments concerning the appropriate theories of causation and damages to be applied in a NAFTA case are "long, and mainly irrelevant." The Investor stands by its argumentation, and the legal authorities cited for it. It merely notes that no matter how much Mexico would like the law to be different, it cannot change it using strong language and the mere force of its will.

In essence, the Investor and Respondent actually agree on the international law of damages applicable in this case. Mexico simply mischaracterizes the evidence to present facts which support a naturally lower damages figure than the one claimed by Thunderbird on behalf of its EDM's. Both agree on the principles of proximate cause, and that damages for the destruction of a "going concern" can include consideration of lost profits. Mexico suggests, contrary to the evidence on the record, that the EDM's were no more than failing start up's with only a theoretical hope of profit. In contrast, Thunderbird submitted an expert report, and applicable jurisprudence, to demonstrate that the "going

[48] *Mondev* Award, at para. 86.

concern" value of its investments in Mexico was real and easily verifiable, even when adopting the most conservative of assumptions concerning future profitability.

At paragraph 231, Mexico states that "it is worth pointing out that any potential buyer of the EDM companies would be very concerned about the dubious legitimacy of the operations of the establishments in question." Obviously this argument presupposes the Respondent's claim that it was fairly regulating the investments, and as such is entirely inappropriate for a damages analysis. As Article 1110(2) acknowledges, one cannot assume the impact of an illegal State action in determining the value of a lost investment when one is attempting to place that investment back in the position it occupied had such action never taken place.[49]

At paragraphs 327 to 331, Mexico adopts a painfully selective interpretation of the terms of Article 1110, which appears to fault the investor and its expert for not using the term "fair market value" enough in their materials. It therefore argues that the Investor has failed to provide any evidence of what the fair market value of the businesses operated by the EDM's would have been, but for Mexico's breach of international law.

As Dame Higgins succinctly stated before her appointment to the ICJ:

> The value of property is what the market will pay for it. And if, at the moment of dispossession, an arms-length willing buyer could be found for that property, the price he would offer would (at least if the business was a going concern) reflect his estimate of certain profits. There is no 'real' value of property, to which the estimate of profits is added. [For example] In a ten-year contract, if nationalization takes place in year 5, the value of the enterprise *as at year 5* will include the purchaser's estimate of unspeculative profits in years 6-10. [50]

One need only review the award issued by the Tribunal in *Metalclad* to see that slavish reliance on the text of Article 1110(2)-(4) will not be chosen over a common sense approach to determining the extent of actual damages in any given case. In that case the Tribunal refused to accept the investor's

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[49] At para. 325 of the SoD, Mexico appears to contradict itself by admitting that this is the correct approach to valuation under international law.

[50] R. Higgins, "Problems & Process: International Law and How We Use It" (Clarendon: Oxford, 1994) at 144.

submission that the fair market value of its investment should be based upon a DCF analysis because it concluded that there was no going concern which could reasonably support it.[51] It similarly ignored the same kinds of "market capitalization" arguments that have been made by Mexico in this case, because they were obviously unhelpful in determining the extent of the actual losses suffered by that investment. Accordingly, the Tribunal instead conducted an analysis of the amount of money sunk into the investment by the investor, and compensated it for its losses accordingly.

Following the same general approach, the *Myers* Tribunal adopted the same kind of DCF analysis advocated by Thunderbird to value the loss suffered when that investment was discriminatorily denied access to the Canadian market for PCB waste destruction for 14 months. It did so even though Myers Canada basically had no real track record in Canada (as its business plan had been completely frustrated by Canadian officials on the very same day it was scheduled to begin operations). It did so because Myers provided evidence of frustrated contracts and bids, and held forward its track record in the United States as relevant to determining it likelihood of success in completing those contracts and winning those bids in Canada – had it not been prevented from entry.

Thunderbird has advanced an even stronger claim than did the claimant in *Myers*. Thunderbird can not only point to its successes in similar business environments elsewhere in the region (as could Meyers); it can also rely on over a year of successful operations in Mexico for its EDM's businesses. And unlike what took place in *Metalclad* – where the Tribunal stated that a DCF analysis would be inappropriate because "the property's future profits were so dependent on as yet unobtained preferential treatment from the government that any prediction would be speculative"[52] – Thunderbird officials did obtain assurances from SEGOB officials which confirmed to them that their proposed businesses could operate as profitably as they had planned.

Mexico has also engaged in a wholesale misconstruction of the Investor's damages analysis and evidence, suggesting that the wrong valuation criteria were used; that relevant historic data was ignored; and that relevant potential risks were note considered. The Investor relies on its expert evidence

[51] *Metalclad* Award, at para's. 121-123.
[52] *Metalclad* Award, at para. 122.

concerning the appropriate valuation criteria and historical data to be used, and it notes that Mexico has provided no evidentiary basis upon which to justify the alleged, unconsidered risks it sets out at paragraphs 354 to 357 of the SoD.

Finally, at paragraphs 358 to 359, Mexico inexplicably argues that Thunderbird has failed to prove that any damages were suffered under Articles 1102 or 1105. While there will be times when an analysis of losses sustained under one heading of liability will differ from those suffered under another, this is not one of those cases. Regardless of whether one construes what happened to Thunderbird and its EDM's as a failure to provide the most favourable treatment available to similarly-situated businesses (under Article 1102); a failure to provide "fair and equitable treatment" (under Article 1105) or an indirect taking of its businesses (under Article 1110), the result is the same. Thunderbird's EDM's are all out of business. Under the NAFTA and the basic principles of the customary international law on damages, if Mexico is found to have breached any of these provisions, it will be ordered to pay an amount of compensation necessary to place these investments in the place they would have been, but for the breach. To do so, Mexico must pay to each EDM the fair market value of their business, based upon the most appropriate valuation analysis available. In this case, that analysis is obviously the DCF approach put forward by the Investor and supported by its expert report on damages.

VII.

CONCLUSION

The facts of this case clearly establish breaches by respondent The United Mexican States of its NAFTA Article 1102, 1105 and 1110 obligations owed to claimant International Thunderbird Gaming Corporation and its Mexican investment enterprises, Entertainmens de Mexico S. de R. L. De C. V., Entertainmens de Mexico Laredo S. de R. L. de C.V., Entertainmens de Mexico Reynosa S. de R.L. de C.V., Entertainmens de Mexico Puebla S. de R.L. de C.V., Entertainmens de Mexico Monterey S. de R.L. de C.V. and Entertainmens de Mexico Juarez. S. de R.L. de C.V.

Claimant respectfully requests that the Tribunal award damages in amount representing the full restitution value of each of Thunderbird's investment enterprises at the date of seizure by Mexico.

Date: February 9, 2004

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