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COURT OF APPEAL FOR ONTARIO

DOHERTY, ARMSTRONG and LANG JJ.A.

B E T W E E N :

THE UNITED MEXICAN STATES **Applicant (Appellant)**	**Patrick G. Foy, Q.C.** **J. Christopher Thomas, Q.C. and Robert J.C. Deane** **for the applicant (appellant)**
- and -	
MARVIN ROY FELDMAN KARPA **Respondent (Respondent)**	**Barbara McIsaac, Q.C.** **for the respondent (respondent)**
- and -	
THE ATTORNEY GENERAL OF CANADA **Respondent (Intervener)**	

Heard: May 21, 2004

On appeal from the judgment of Justice W. Dan Chilcott of the Superior Court of Justice dated December 3, 2003.

ARMSTRONG J.A.:

[1] A NAFTA arbitration tribunal found that the United Mexican States ("Mexico") engaged in discriminatory conduct by granting tax rebates to domestic companies that were denied to the Respondent's American owned company engaged in a similar business. Mexico applied to the Ontario Superior Court of Justice to set aside the arbitration award. The Ontario courts have jurisdiction because Ottawa was named as the place of arbitration, although the hearing took place in Washington, D.C. Justice Chilcott dismissed the application. Mexico now appeals to this court.

[2] The factual dispute underlying these proceedings is somewhat complex. To a large extent, however, that complexity is not germane to this appeal. There are three grounds of appeal. The first two are closely related. They turn on a determination of the appropriate standard of review and an application of that standard to issues raised by the appellant. The third ground of appeal engages public policy considerations.

[3] Like the application judge, I would hold that the award of the arbitration tribunal is entitled to a high degree of deference and again like the application judge, I would hold that the appellant has not shown any basis upon which to interfere with the arbitration award. I also agree that the award of the arbitration tribunal is not contrary to the public policy of Ontario. I would therefore dismiss the appeal.

Factual Background

[4] Marvin Ray Feldman Karpa ("Mr. Feldman") is a citizen of the United States who operated an export business in Mexico through Corporacíon de Exportaciones Mexicanas S.A. de C.V. ("CEMSA"). CEMSA purchased cigarettes from volume retailers such as Wal-Mart and Sam's Club within Mexico and sold them to purchasers outside Mexico.

[5] The production and sale of cigarettes are taxed pursuant to the *Impuesto Especial Sobre Produccion y Servicios* (the "Special Tax on Production and Services" or "IEPS"). If certain of the products subject to the IEPS tax are exported, rebates may be paid to the exporter. Cigarettes which are exported qualify for the rebate. However, in order to obtain the rebate, the exporter must provide invoices that "separately and expressly state the amount of the IEPS tax paid".

[6] CEMSA applied for the tax rebates periodically and, from time to time, such rebates were granted. However, Mexico subsequently changed its approach and CEMSA was denied the tax rebates because it was unable to produce invoices that separately stated the amount of the tax paid.

[7] The manufacturers of the cigarettes refused to sell to CEMSA and other exporters; consequently CEMSA purchased its cigarettes from volume retailers. The invoices issued to CEMSA by the volume retailers did not have the tax separately stated as such tax had been paid by the manufacturers who had sold to the retailers. However, the manufacturers did not separate the tax paid on their invoices to the retailers. Thus, the price paid by CEMSA for cigarettes included the tax, but, as already stated, such tax did not appear on its invoices received from the volume retailers.

[8] In addition to the denial of the tax rebates, CEMSA was refused registration as an authorized exporter of cigarettes by the Mexican authorities.

[9] In 1998, the Mexican Taxation Agency, the Secretaría de Hacienda y Credito Publica ("SHCP") performed an audit of CEMSA, which concluded that CEMSA had received between January 1996 and September 1997 IEPS tax rebates. SHCP claimed repayment of approximately US $25 million, which also included interest, adjustment for inflation and penalties. The audit also concluded that CEMSA had grossly over-stated the amount of the tax paid. It was subsequently established, and accepted by the arbitrators, that CEMSA had been exporting cigarettes to at least one company that did not exist.

The NAFTA Arbitration

[10] On April 30, 1999, Mr. Feldman referred these matters to arbitration by filing a notice of arbitration pursuant to chapter 11, article 1120, of the North American Free Trade Agreement ("NAFTA"). A tribunal was established which was composed of Professor Konstantinos D. Kerameus of Greece (President), Professor David A. Gantz of the United States and Mr. Jorge Covarrubias Bravo of Mexico.

[11] In his notice of application, Mr. Feldman sought damages in the amount of 475 million pesos, which was roughly the equivalent of US$ 50 million. Mr. Feldman based his claim on three grounds:

(i) Mexico's refusal to pay the IEPS rebates to CEMSA was tantamount to nationalization or expropriation contrary to article 1110 of NAFTA;

(ii) Mexico's refusal to pay the IEPS rebates constituted a denial of natural justice and a violation of international law contrary to article 1105:1 of NAFTA; and

(iii) Mexico's refusal to pay the IEPS rebates to CEMSA constituted a breach of article 1102 of NAFTA which requires Mexico to accord to investors of another party to NAFTA treatment no less favourable than it accords to its own investors.

[12] A majority of the tribunal (Messrs. Kerameus and Gantz) concluded that Mexico had breached article 1102. While declining to find a breach of the expropriation provision in article 1110, the majority said that "the actions by the Mexican government against the claimant – even though in some instances inconsistent and arbitrary – should not be treated as expropriatory…". The third member of the tribunal, Mr. Covarrubias, agreed with that result. All three declined to give effect to the alleged denial of natural justice.

[13] Neither the application to the Superior Court nor the appeal to this court involve the alleged breaches of articles 1110 and 1105:1, so there is no need to consider further those parts of the arbitration award.

[14] The issue in respect of article 1102 of NAFTA was defined in the majority award as follows at para. 169:

The question, rather, is whether rebates have *in fact* been provided for domestically owned cigarette exporters while denied to a foreign re-seller, CEMSA. Mexico is of course entitled to strictly enforce its laws, but it must do so in a non-discriminatory manner, as between foreign investors and domestic investors. Thus, if the IEPS Article 4 invoice requirement is ignored or waived for domestic cigarette reseller/exporters, but not for foreign owned cigarette reseller/exporters, that *de facto* difference in treatment is sufficient to establish a denial of national treatment under Article 1102.

[15] There was no issue that rebates were denied to CEMSA. The only question for the tribunal was whether domestic cigarette exporters received IEPS rebates without requiring them to produce invoices showing the quantum of tax paid separately.

[16] Mr. Feldman sought to prove his case through the production of records from the Mexican taxing authority in respect of its treatment of domestic taxpayers. Mexico refused to produce such records on the basis of its statutory duty to preserve taxpayer confidentiality. Mexico relied upon Article 69 of its Federal Fiscal Code, which Mexico said prohibited the production of such information.

[17] The parties agreed upon the following protocol for the production of documents which was contained in Procedural Order No. 2 (3 May 2000) of the arbitration proceedings:

In accordance with Article 41(2) of the Additional Facility Arbitration Rules, the Tribunal may, if it deems it necessary at any stage of the proceeding, call upon the parties to produce documents, witnesses and experts. In addition, either party may seek from the other party the disclosure of reasonably specified documents and the production of statements on specific points by identified witnesses or experts. Disputes related thereto will be decided upon by the Tribunal, which may require a party to produce documents and written or oral statements by witnesses or experts. If a party does not comply with such a request by the Tribunal, the Tribunal may draw the appropriate inferences.

[18] Mr. Feldman continued to request the production of other taxpayers' records and Mexico continued to object based upon Article 69 of its Fiscal Code. Eventually, Mexico agreed to file a statement from an official of the taxing authority attesting to the circumstances of any IEPS rebates paid to cigarette resellers other than CEMSA and any subsequent action taken by SHCP. Mr. Feldman agreed to this approach "if a thorough search is made of SHCP's files and Respondent [Mexico] acknowledges the IEPS rebates made to resellers other than CEMSA".

[19] Mexico filed a statement of Eduardo E. Diaz Guzmán, the General Administrator of Major Taxpayers for SHCP. He provided the following information regarding IEPS rebates for cigarette exports:

SAT's databases provide the following information regarding IEPS rebates for cigarette exports;

1. 5 marketer companies have requested IEPS rebates in transactions involving cigarette exports;

2. 3 of these applications were authorized and 2 were rejected;

3. The approximate total of the rebates granted to these 3 companies is $91,000,000.00 (ninety-one million pesos);

4. Rebates were granted to one of the companies during September, October and December of 1996; January, February and June through December of 1997; January through December of 1998; January through March of 1999 and January of 2000

A second company was granted rebates during October and November of 1999, and January, February, March and May of 2000.

The third company was granted rebates in September and December of 1996 and January of 1997.

5. According to a letter dated October 27th of 2000, the General Revenue Administration, through the Local Revenue Administration of Monterrey, is in the process of determining and collecting the reim-bursement of illegitimate rebates paid to one of the 3 companies. The process continues to this date.

[20] In a second statement, Mr. Diaz said that the payment of a rebate does not end the matter. Taxpayers who have received rebates that are found to be invalid are subject to an order for repayment and other sanctions for a period of up to five years.

[21] The majority, in concluding that there had been a breach by Mexico of article 1102, stated at para. 187 of the award:

On the basis of this analysis, a majority of the Tribunal concludes that Mexico has violated the Claimant's rights to non-discrimination under Article 1102 of NAFTA. The Claimant has made a *prima facie* case for differential and less favourable treatment of the Claimant, compared with treatment by SHCP of the Poblano Group. For the Poblano Group and for other likely cigarette reseller/exports, the Respondent has asserted that audits are or will be conducted in the same manner as for the Claimant, and implied that they will ultimately be treated in the same way as the Claimant. However, the evidence

that this has occurred is weak and unpersuasive. The inescapable fact is that the Claimant has been effectively denied IEPS rebates for the April 1996 through November 1997 period, while domestic export trading companies have been given rebates not only for much of that period but through at least May 2000, suggesting that Article 4(III) of the law has been *de facto* waived for some if not all domestic firms. While the Claimant has also been effectively precluded from exporting cigarettes from 1998 to 2000, there is evidence that the Poblano Group companies have apparently been allowed to do so, notwithstanding Article 11 of the IEPS law. Finally, the Claimant has not been permitted to register as an exporting trading company, while the Poblano Group firms have been granted this registration. All of these results are inconsistent with the Respondent's obligations under Article 1102, and the Respondent has failed to meet its burden of adducing evidence to show otherwise.

[22] The majority awarded damages to CEMSA calculated on the basis of rebates withheld from CEMSA. The damages were adjusted by excluding sales to a fictitious company and by eliminating certain excessive claims by CEMSA. The amount awarded was 7,496,428 new pesos, which is approximately US $1.6 million.

[23] The dissenting member of the tribunal, Mr. Covarrubias, held that the evidence was insufficient to establish the claim of discrimination. Indeed he held that there was no evidence of discrimination. He was critical of the majority view that the burden of proof was shifted from the claimant to the respondent. He was also critical of the majority for drawing adverse inferences against the respondent that were unsupported by the evidence.

[24] In respect of damages, the dissenting arbitrator stated that CEMSA had no legal entitlement to the rebates and it was "repugnant" to order Mexico to pay damages based upon a calculation of adjusted rebate figures.

The Application to the Superior Court of Justice

[25] In the Superior Court of Justice, Mexico proceeded under the *International Commercial Arbitration Act*, R.S.O 1990, c. I-9 and the UNICITRAL Model Law on International Commercial Arbitration, which is attached as a schedule to the Act. Mexico sought to set aside the majority award on three grounds:

(i) the procedure adopted by the majority was contrary to the agreement of the parties;

(ii) Mexico was unable to present its case by reason of the majority drawing impermissible inferences from the evidence; and

(iii) the award of damages is in conflict with public policy contrary to article 34(2)(b)of the Model Law.

[26] The Attorney General of Canada intervened in the Superior Court in support of Mexico. The Attorney General submitted that the majority failed to take into account article 2105 of NAFTA, which provides that no party to NAFTA is required to produce information, the disclosure of which would impede law enforcement or would be contrary to the party's law protecting personal privacy. The Attorney General also submitted that the majority award was in error in respect of the drawing of negative inferences against Mexico. The Attorney General took no position on the other issues.

[27] The application judge refused to give effect to any of the grounds raised by Mexico and the intervenor. The application was therefore dismissed.

[28] In this court, Mexico contends that the application judge erred in failing to set aside the majority award and raises the same three grounds in support of its submissions. The Attorney General of Canada did not participate in this appeal.

Governing Legislation

(i) NAFTA

[29] The North American Free Trade Agreement was concluded between the governments of Canada, the United Mexican States and the United States of America, and came into force on January 1, 1994. Chapter 11 of NAFTA provides for the settlement of disputes concerning alleged breaches of NAFTA by means of a tripartite arbitration panel. Mr. Feldman was entitled to submit his claim to arbitration because he is a national of the United States of America and satisfies the definition of "investor" under article 1139:

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

[30] Pursuant to article 1124:4, the presiding arbitrator is drawn from a roster of 45 arbitrators who meet the qualifications of the Convention on the Settlement of Investment Disputes between States and Nationals of other States and the rules of the International Centre for Settlement of Investment Disputes (ICSID).

[31] This arbitration was governed by the ICSID Additional Facility rules which provide in article 52(4):

The award shall be final and binding on the parties. The parties waive any time limits for the rendering of the award which may be provided for by the law of the country where the award is made.

(i) International Commercial Arbitration Act

[32] The application to set aside the arbitration award in the Superior Court was brought pursuant to the *International Commercial Arbitration Act*, R.S.O. 1990, c. I-9 (the "ICAA"). Under s. 2(1), the ICAA incorporates the Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade and is appended as a schedule to the Act.

[33] Article 34 of the Model Law provides for access to judicial review by the courts:

(1) Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs (2) and (3) of this article.

(2) An arbitral award may be set aside by the court specified in article 6 only if:

(a) the party making the application furnishes proof that:

(i) a party to the arbitration agreement referred to in article 7 was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of this State, or

(ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case, or

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside, or

(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Law from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Law; or

(b) the court finds that:

(i) the subject-matter of the dispute is not capable of settlement by arbitration under the law of this State, or

(ii) the award is in conflict with the public policy of this State.

(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the award or, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal.

Standard of Review

[34] Notions of international comity and the reality of the global marketplace suggest that courts should use their authority to interfere with international commercial arbitration awards sparingly.

[35] In another context, Austin J.A. made reference to "the strong commitment made by the legislature of this province to the policy of international commercial arbitration through the adoption of the ICAA and the Model Law…": see *Automatic Systems Inc. v. Bracknell Corp.* (1994), 18 O.R. (3d) 257 at 216 (C.A.).

[36] Gibbs J.A., speaking for the majority of the British Columbia Court of Appeal in *Quintette Cole Ltd. v. Nippon Steel Corp.*, [1990] B.C. J. No. 2241, addressed the issue of judicial deference to international commercial arbitration awards as follows at page 6:

It is important to parties to future such arbitrations and to the integrity of the process itself that the court express its views on the degree of deference to be accorded the decision of the arbitrators. The reasons advanced in the cases discussed above for restraint in the exercise of judicial review are highly persuasive. The "concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes" spoken of by Blackman, J. are as compelling in this jurisdiction as they are in the United Sates or elsewhere. It is meet therefore, as a matter of policy, to adopt a standard which seeks to preserve the autonomy of the forum selected by the parties and to minimize judicial intervention when reviewing international commercial arbitral awards in British Columbia. That is the standard to be followed in this case."

[37] Quite apart from principles of international comity, our domestic law in Canada dictates a high degree of deference for decisions of specialized tribunals generally and for awards of consensual arbitration tribunals in particular.

[38] The Supreme Court of Canada has provided a list of factors which should be considered when determining the appropriate degree of deference to be accorded to a tribunal subject to judicial review. See *Pushpanathan v. Canada (Minister of Citizenship and Immigration),* [1998] 1 S.C.R. 982 at pp. 1005-1012. The Supreme Court divided the factors into four categories:

(i) the presence of a privative clause;

(ii) the expertise of the tribunal;

(iii) the purpose of the governing legislation; and

(iv) whether the issue to be determined is a question of law or fact.

[39] The ICSID Additional Facility rules, which govern this arbitration, provide that "the award shall be final and binding" and no more. There are no additional words to exclude appeals and judicial review. Indeed, judicial review is expressly provided for under s. 34 of the Model Law. It would therefore appear that, in this case, there does not exist what has sometimes been referred to as a "full" privative clause. That said, s. 34 of the Model Law limits judicial review to traditional jurisdictional grounds. In addition, s. 34 provides judicial review if the subject matter of the dispute is not capable of settlement by arbitration under Ontario law or the award is in conflict with the public policy of Ontario.

[40] There was nothing in the record before us that described the particular expertise of the tribunal members. We do know that the president of the tribunal was selected from a special roster of 45 individuals. The individuals listed on the roster are required, pursuant to NAFTA, article 1124:4, to be "experienced in international law and investment matters". The application judge observed that Mexico did not challenge the expertise of any of the tribunal members.

[41] NAFTA tribunals settle international commercial disputes by an adversarial procedure under which they determine legal rights in a manner not dissimilar to the courts. This may suggest that such tribunals ought not to attract a high degree of deference upon judicial review. However, I accept that there is merit in the submission of counsel for Mr. Feldman that "the dispute settlement mechanism and the need for expertise, all combine to indicate that the statutory purpose is to take the resolution of these disputes out of the hands of domestic courts." If this is so, it would again suggest a high degree of deference on review by the courts.

[42] The matters to be decided by the tribunal in this case were heavily fact laden. I will have more to say about the nature of the particular issues to be determined by the tribunal later in these reasons. However, it is trite to say that a tribunal, which is engaged primarily in a fact-finding task, is entitled to a high degree of judicial deference.

[43] Taking the above factors into account, I conclude that the applicable standard of review in this case is at the high end of the spectrum of judicial deference.

The Grounds of Appeal

(i) Was the arbitral procedure contrary to the agreement of the parties?

[44] Mexico submits that the procedure adopted by the majority of the tribunal violated the arbitration agreement from which all NAFTA tribunals derive their jurisdiction. The agreement to arbitrate under chapter 11 involves an express acceptance that the hearing will be carried out in accord with the procedures set forth in NAFTA. Mexico submits that if the tribunal failed to follow the procedural provisions in NAFTA, then Mexico's consent to the submission to arbitration is vitiated and should be set aside by the court pursuant to article 34(2)(a)(iv) of the Model Law.

[45] Mexico submits that the majority award is contrary to article 2105 of NAFTA by drawing adverse inferences from Mexico's failure to make disclosure of information related to domestic taxpayers. Article 2105 provides:

Nothing in this Agreement shall be construed to require a party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the Party's law protecting personal privacy or the financial affairs and accounts of individual customers of financial institutions.

[46] Mexico further argues that since a chapter 11 tribunal is without authority to compel disclosure of taxpayer information, it has no authority to draw an adverse inference from a party's inability to lawfully provide such information.

[47] Mexico refers in particular to paragraph 178 of the arbitration award, where the majority made reference to the failure of the appellant to provide an explanation why it did not lead evidence to show that a domestic group of companies had not been treated in a more favourable fashion than CEMSA. The appellant also refers to paragraph 186 of the award where the majority observed:

Presumably, if there was evidence that another domestic investor has been treated in a manner equivalent to the Claimant, in terms of export registration, audit, and granting or withholding of rebates, the Respondent would have provided that evidence to the tribunal…

[48] Resolution of this ground of appeal, requires consideration of the second ground of appeal.

(ii) Was Mexico prevented from presenting its case?

[49] Mexico relies upon article 34(2)(a)(ii) of the Model Law which provides that an arbitral award may be set aside by the court if the party seeking judicial review was unable to present its case.

[50] This ground of appeal is linked to the first ground of appeal in that Mexico relies upon the majority's drawing of adverse inferences from the appellant's failure to present evidence in respect of the treatment of domestic taxpayers.

[51] Mexico submits that, pursuant to Article 69 of its Fiscal Code, it was prohibited from disclosing the treatment afforded to other taxpayers and that such position was consistently stated to the tribunal. Mexico further submits that by drawing adverse inferences from its failure to present evidence of the position of other taxpayers, the tribunal effectively prevented Mexico from presenting its defence. According to counsel for Mexico, such conduct by the tribunal was contrary to the agreement between the parties and Procedural Order No. 2 of the tribunal. Procedural Order No. 2 provided in part that if a party did not comply with a request by the tribunal to produce documents and witness statements, the tribunal may draw "the appropriate inferences". Mexico argues that it fulfilled its obligations by delivering the two statements of Diaz Guzmán and at no time prior to the issuance of its award did the tribunal suggest that the information from Mr. Diaz was insufficient.

[52] It is Mexico's position that the tribunal's finding that Mexico breached article 1102 was a direct function of the tribunal's drawing of adverse inferences contrary to the procedural accord sanctioned by Procedural Order No. 2.

[53] As suggested above, this ground of appeal flows directly from the first ground. To some extent, they are different sides of the same coin. I will therefore deal with these two grounds of appeal together.

Analysis

[54] NAFTA article 2105 was not raised by Mexico during the course of the arbitration. It was raised for the first time after the release of the award. Counsel for Mexico submitted a request for the Correction and Interpretation of the Award pursuant to the ICSID Additional Facility Rules. Mexico requested the tribunal to consider the application of article 2105 in regard to the findings of the majority. The tribunal refused to do so and observed that Mexico was effectively seeking a new decision. The original dissenting member of the tribunal joined with the majority in this refusal.

[55] However, counsel for Mexico did raise the issue of Article 69 of the Mexican Fiscal Code during the arbitration hearing as discussed above. In particular, in its Rejoinder pleading, Mexico stated:

186. The national treatment allegation presents special problems of proof for the defense because SHCP is bound by domestic law to preserve taxpayer confidentiality. The Respondent cannot disclose names and provide details of what

actions it has taken or is in the course of taking against other taxpayers for impermissible claims of IEPS rebates.

187. The Reply seeks to exploit this domestic law restraint on the defense by criticizing the Respondent for complying with its taxpayer confidentiality law and failing to discharge the burden of proof (see paragraph 1 of the Reply).

188. The Respondent objects to this tactic, but, for the reasons noted below, it is unnecessary in this case to consider this issue further. [emphasis added]

The Rejoinder pleading then referred to evidence led by counsel for Mexico in relation to action taken against domestic companies who had received rebates. On this issue, the Rejoinder concluded:

194. Thus, there is ample record evidence that Mexican-owned enterprises in like circumstances to CEMSA are being investigated. Some were the Claimant's financiers, suppliers, and customers.

[56] The majority considered this evidence and did not find it persuasive. In paragraph 187 of the award (referred to in para. 21 above), the majority observed:

…the Respondent [Mexico] has asserted that audits [of domestic exporters] are or will be conducted in the same manner as for the Claimant [Mr. Feldman], and implied that they will ultimately be treated in the same way as the Claimant. However, the evidence that this has occurred is weak and unpersuasive.

[57] Mexico was not required by the tribunal to produce any information which it did not wish to produce contrary to Article 69 of the Fiscal Code. It chose to file the statements of Mr. Diaz and other evidence. The majority were not persuaded that Mexico had satisfied the burden of responding to the *prima facie* case made by the claimant, Mr. Feldman.

[58] I see some merit in Mexico's argument that if the tribunal is without authority to compel disclosure of taxpayer information, it has no authority to draw an adverse inference from a party's inability to provide such information. However, I am not satisfied that this reflects what happened in this case. As stated above, Mexico was not required at the hearing to produce information it did not wish to produce. It decided, however, to produce certain taxpayer information. That information failed to satisfy the tribunal which, in turn, led the tribunal to conclude that if Mexico had evidence that a domestic taxpayer had "been treated in a manner equivalent to the claimant…[it] would have provided that evidence." In my view, the tribunal was entitled to come to such a conclusion.

[59] I also do not accept the argument advanced in respect of Procedural Order No. 2. Under that order, the tribunal "may draw the appropriate inferences" when a party fails to comply with an order to produce documents. There was no order by the tribunal pursuant to Procedural Order No. 2 with which Mexico failed to comply. I do not see that Procedural Order No. 2 is relevant to the circumstances here.

[60] It is also important to bear in mind that the issue as defined by the arbitration tribunal was essentially a question of fact – "whether rebates have *in fact* been provided for domestically owned cigarette exporters while denied to a foreign reseller, CEMSA". In this case, the majority found, on Mexico's own evidence, that it had allowed rebates for domestic exporters that it had refused to CEMSA. On a finding of fact, for which there is support in the evidence, the court must defer to the tribunal.

[61] I am unable to conclude that the majority of the tribunal acted in breach of NAFTA article 2105 or Procedural Order No. 2. In my view, the arbitral procedure was not contrary to the agreement of the parties and Mexico was not prevented from presenting its case.

(iii) Is the award of damages in conflict with public policy?

[62] Mexico submits that the damages awarded to Mr. Feldman's company were based upon unlawful rebates and are, therefore, contrary to public policy. Counsel for Mexico relies upon s. 34(2)(b)(ii) of the Model Law, which provides that an arbitral award may be set aside by the court if the court finds an award is in conflict with the public policy of Ontario.

[63] Mexico also finds support for its position in the reasoning of the dissenting arbitrator at page 16:

If, in actual fact, the Claimant is not entitled to IEPS rebates, it is repugnant to grant him a somewhat equivalent amount as compensation for damages, only because he alleges that there is a [*sic*] another investor – *a Mexican investor, in like circumstances* - - who has been granted IEPS rebates without being entitled to them either. This issue becomes even more sensitive if we consider, as described above, that the economic viability of CEMSA's business was based on obtaining illegal tax rebates; otherwise such business was pointless.

If the approach taken in this Award were to prevail, it would suffice for any investor from a NAFTA State to show that another State party to the same Treaty has made only one mistake or miscalculation in the administration of a tax, favouring a single national investor - - *whose circumstances are apparently similar* - - to claim and obtain a benefit from that State, to the detriment of its public finance.

[64] Mexico further submits that the tribunal's award of damages is contrary to public policy because CEMSA, as found by the tribunal, had substantially over-claimed the tax paid and said it was exporting to a fictitious company in Honduras.

[65] Finally, Mexico argued that the application judge misapprehended its submission in the court below to the extent that he understood counsel to submit that the award "is contrary to public policy because CEMSA was unable to provide invoices showing the tax separately".

Analysis

[66] A chapter 11 tribunal has authority to make an award of monetary damages pursuant to NAFTA, article 1135. The question for the court is whether the particular award in this case is contrary to public policy. In *Re Corporacion Transnacional de Inversiones, S.A. de C.V. et al and STET International S.p.A. et al* (2000), 49 O.R. (3d) 414, this court cited with approval the statement of principle by Feldman J. in *Schreter v. Gasmac Inc.* (1992), 7 O.R. (3d) 608 at p. 623 (Gen. Div.):

> The concept of imposing our public policy on foreign awards is to guard against enforcement of an award *which offends our local principles of justice and fairness in a fundamental way*, and in a way which the parties could attribute to the fact that the award was made in another jurisdiction where the procedural or substantive rules diverge markedly from our own, or where there was ignorance or corruption on the part of the tribunal which could not be seen to be tolerated or condoned by our courts.

[67] The damages are equivalent to the rebates that CEMSA had been refused at the same time that domestic exporters were receiving rebates. Mexico was in effect waiving the requirement to produce invoices stating the tax separately for domestic exporters, while at the same time refusing to waive the requirement for CEMSA. In my view, the award of damages is not contrary to public policy. There is nothing fundamentally unjust or unfair about the award. It is rationally connected to the discriminatory conduct found by the tribunal and seeks to redress the effect of the discrimination. The award is a logical quantification of the harm caused to CEMSA by the discriminatory conduct.

[68] I do not accept the submission of counsel for Mexico that CEMSA's conduct in claiming fictitious rebates renders the award contrary to public policy. While this court does not condone such conduct, the extent to which it should affect the award of damages is for the tribunal to decide. The tribunal made allowances for the inflated rebate claims in its assessment of damages. I cannot conclude that its failure to deny any monetary recovery is contrary to public policy.

[69] In the conclusion that I have reached on this issue, it is not necessary to determine whether the application judge misapprehended the argument on public policy.

CONCLUSION

[70] For the above reasons, I would dismiss the appeal.

COSTS

[71] The parties are agreed that the successful party to the appeal should be entitled to costs on a partial indemnity basis fixed at $25,000. I would so order costs payable to the respondent in that amount, including disbursements and Goods and Services Tax.

RELEASED:

"DD" "Robert P. Armstrong J.A."

"JAN 11 2005" "I agree Doherty J.A."

"I agree Susan Lang J.A."