## LIST OF AUTHORITIES

| Authority No. | Description |
|---|---|
| CA-12 | *Canfor Corp. et al. v. United States of America*, UNCITRAL, Order of the Consolidation Tribunal (7 Sep. 2005) |
| CA-13 | *Marvin Roy Feldman Karpa v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award (16 Dec. 2002) |
| CA-14 | *Lantzy v. Centex Homes*, 73 P.3d 517 (Cal. 2003), *as modified* (Aug. 27, 2003) |

## I. INTRODUCTION

1. Presently before the Consolidation Tribunal is a request by the Government of the United States of America ("United States") to consolidate, pursuant to Article 1126(2) of the North American Free Trade Agreement ("NAFTA"), the claims submitted to three arbitrations under Article 1120 of the NAFTA: *Canfor Corporation v. United States of America, Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc. v. The United States of America*, and *Terminal Forest Products Ltd. v. The United States of America*. The claims in all three proceedings were submitted to arbitration under the UNCITRAL Arbitration Rules.

2. The Consolidation Tribunal grants the request of the United States for the reasons set forth below and in the manner set forth in Section VI of this Order.

## II. PROCEDURE

3. The claims filed against the United States by Canfor Corporation ("Canfor"), Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc. (collectively referred to as "Tembec"), and Terminal Forest Products Ltd. ("Terminal"),[1] all Canadian producers of softwood lumber, concern a number of countervailing duty and antidumping measures adopted by the United States relating to Canadian softwood lumber products.

4. By letter dated 7 March 2005, the United States requested that the Secretary-General of the International Centre for the Settlement of Investment Disputes ("ICSID") establish a tribunal in accordance with Article 1126(5) of the NAFTA.[2] Pursuant to Article 1126(5), the Secretary-General appointed Mr. Davis R. Robinson, Esq., a United States national residing in the United States, Professor

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[1] In this Order collectively referred to as "Claimants."

[2] Available at http://www.state.gov/documents/organization/43492.pdf.

Armand de Mestral, a Canadian national residing in Canada, as arbitrators, and Professor Albert Jan van den Berg, a Dutch national residing in Belgium, as presiding arbitrator. This Consolidation Tribunal was established on 6 May 2005.

5. On 9 May 2005, the United States applied to the Consolidation Tribunal for a stay of the *Canfor* and *Tembec* proceedings pursuant to Article 1126(9) of the NAFTA.[3] Canfor, Tembec and Terminal objected to the request by letters dated 9, 10 and 12 May 2005. On 19 May 2005, after due consideration, the Consolidation Tribunal ordered, pursuant to Article 1126(9), a stay of proceedings in the *Canfor* and *Tembec* arbitrations, pending the Consolidation Tribunal's decision on the United States' request to consolidate.[4] The Tribunal confirmed its stay order on 1 June 2005. It adopted an expedited schedule concerning the question of request for consolidation.

6. The United States' submission in support of its request for consolidation, dated 3 June 2005, was received by ICSID on 4 June 2005 and by the Consolidation Tribunal on 5 June 2005. In that submission, the United States particularized its request:

> For the foregoing reasons, the United States respectfully requests that this Tribunal assume jurisdiction over, and hear and determine together, the entirety of the claims submitted by Canfor Corp., Tembec Inc. *et al.* and Terminal Forests Products Ltd. The United States further requests that, pursuant to Article

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[3] Article 1126(9) provides: "On application of a disputing party, a Tribunal established under this Article, pending its decision under paragraph 2, may order that the proceedings of a Tribunal established under Article 1120 be stayed, unless the latter Tribunal has already adjourned its proceedings."

[4] Unlike Article 1126(2), which requires an Article 1126 Tribunal to hear the parties prior to deciding on a request under Article 1126(2), Article 1126(9) does not contain a requirement for hearing the parties. Nonetheless, when considering the United States' request for a stay, the Consolidation Tribunal has had due regard to the observations expressed by all parties on the request for a stay. The request required an expeditious ruling in view of the hearing that was scheduled in the *Tembec* arbitration (i.e., 2 - 3 June 2005).

"conditional" Article 1101 objection to the merits; the Consolidation Tribunal should not consolidate either jurisdiction or the merits; the risk of disclosure of confidential information argues against consolidation; and reducing the risk of inconsistent decisions is not the Tribunal's overriding goal.

36. In its post-hearing brief of 22 July 2005 (which is the same as Terminal's post-hearing brief, except where expressly noted), Canfor responded to the questions of the Consolidation Tribunal raised at the hearing ("Canfor & Terminal PHB"). Those responses will be considered in the analysis of the Tribunal below.

37. In its reply post-hearing brief of 12 August 2005 (which was also filed on behalf of Terminal), Canfor responded to a number of the answers given by the United States to the Tribunal questions in its post-hearing brief (Canfor & Terminal R-PHB"). Those responses will also be considered in the analysis of the Tribunal below.

C. Position of Tembec

38. Tembec also objects to the United States' request to consolidate.

39. In its submission of 10 June 2005, Tembec contends that the Consolidation Tribunal should deny the request for consolidation as untimely and prejudicial under the UNCITRAL Arbitration Rules and principles of international law because: the request is untimely under Article 21(3) of the UNCITRAL Arbitration Rules; jurisdiction should be settled by the Article 1120 Tribunals before this Consolidation Tribunal considers whether to consolidate on the merits; and the doctrines of laches and estoppel are applicable.

40. Tembec also contends that the United States' objections to jurisdiction and the claims on the merits lack commonality to justify consolidation.

41. Tembec further asserts that consolidation is not in the interests of fair or efficient resolution of the claims because: the United States' request for consolidation imposed more delay on the resolution of Tembec's claims; the United States should not be given another "bite at the apple" on jurisdiction; the Claimants are prejudiced by the request for consolidation; the parties' autonomy to present their claims would be compromised by consolidation; consolidation proceedings would be inefficient during arguments, discovery, and procedural issues unique to the Claimants; consolidation would not be efficient even were commonality found among claims for liability; and Tembec should not bear through consolidation the burdens of the United States' frustration with Canfor and Terminal.

42. Finally, Tembec contends that the alleged risk of inconsistent results is no basis for consolidation because: the risk of inconsistent decisions is immaterial to the question of consolidation; consolidation will not obviate the risk of inconsistent decisions; all of the parties already have assumed the "risk" of inconsistent decisions; and the *CME/Lauder v. The Czech Republic* cases and accompanying literature cited by the United States are irrelevant where there is no affiliation among the Claimants.

43. In its post-hearing brief of 22 July 2005 ("Tembec PHB"), Tembec contends that the request for consolidation is untimely, in accordance with the ordinary meaning of Article 1126(2) and (8) of the NAFTA, Article 21 of the UNCITRAL Arbitration Rules, and principles of international law relating to the doctrines of laches and estoppel. In that context, Tembec asserts that the United States continues to withhold information with respect to *Corn Products International, Inc. v. United Mexican States*, and *Archer Daniels Midland Company and Tate & Lyle*

procedures to guarantee non-disclosure of proprietary business information could not be instituted and enforced with fairness or efficiency; and the competitive nature of the Claimants creates other procedural problems and inefficiencies, including the incentive for the Claimants to undermine each others' claims that is not present in separate proceedings, and questions of Claimants' procedural rights with respect to each others' claims); and Tembec has incurred, and may continue to incur, additional unnecessary expenses.

48. Finally, Tembec contends that the Consolidation Tribunal should exercise its discretion not to consolidate these cases because the United States has approached the consolidation issue unfairly as a means of advancing a negotiated settlement in the softwood lumber dispute.

49. In its post-hearing brief of 22 July 2005, Tembec also responded to the questions of the Consolidation Tribunal raised at the hearing. Those responses will be considered in the analysis of the Tribunal below.

50. In its reply post-hearing brief of 12 August 2005 ("Tembec R-PHB"), Tembec submits that the Tribunal may not consolidate the cases to decide the jurisdiction of the Claimants' claims because: the jurisdictional objections of the United States are not claims; the United States waived consolidation under Article 21(3) of the UNCITRAL Arbitration Rules; the jurisdictional objections are not common amongst Claimants; estoppel is part of the "governing law" under Article 1131 of the NAFTA and bars consolidation here; and fairness and efficiency require that the Article 1120 Tribunals finish their decisions on jurisdiction. Tembec also submits that the United States has not established commonality, arguing: the burden rests with the United States; common laws or facts are not common questions of law or fact; and the dispositive questions of law and fact are not common. Tembec further submits that consolidation would be unfair and inefficient, not merely inconvenient, because: submission of confidential

information will be unavoidable in the merits and damages phases; fairness requires protection of confidential information, but protection in a consolidated proceeding here would make adjudication unfair and inefficient; confidentiality concerns may make consolidation rare, but not "obsolete;" these and any subsequent consolidation proceedings before this Tribunal are unfair because the United States has a party-appointed arbitrator while the Claimants do not; and, by the United States' own absolute fairness/efficiency standard, these cases should not be consolidated. Tembec also contends that the cost estimates by the United States are inaccurate and unreliable. It then contends that the United States has not met the high standard for consolidation because: the NAFTA Parties drafted other high threshold procedural standards; and no claims have ever been consolidated, even when in dispute was a single measure of a single government. Tembec also argues that none of the United States' arguments regarding the "risk" of inconsistent decisions supports consolidation. Finally, Tembec submits that NAFTA Article 1126 does not grant the Tribunal broad discretion to consolidate without consent of the disputing parties.

D. Position of Terminal

51. Terminal opposes the application of the United States for consolidation of the proceedings for the reasons set forth by Canfor.

52. In addition to the arguments advanced by Canfor, Terminal argues that the fact that it has common counsel with Canfor weighs against consolidation. Canfor and Terminal agreed to common counsel on the condition that counsel not share confidential information, including confidential business information, about either Canfor or Terminal with the other company. As long as the claims are separate, Terminal contends that there is no need for separate counsel because there is little likelihood of any conflict arising from the mere fact that the two parties have the same counsel. However, if the proceedings were consolidated, then separate

counsel may need to be retained to represent Terminal's interests, which differ from Canfor's interests.

53. Terminal reiterates Claimants' concern with consolidating proceedings among Claimants who are competitors and who will have to disclose confidential information during the proceedings. Terminal is concerned that it will not be able to obtain a fair hearing under the circumstances.

54. With respect to the United States' contention that Terminal has merely filed a Notice of Arbitration but failed to prosecute its claims, Terminal points out that the United States has not filed any objections to Terminal's conduct in the arbitration or requested that it take any action. Likewise, since there have been no filings in this proceeding other than the Notice of Arbitration, including an objection to jurisdiction on behalf of the United States, Terminal objects to the United States' contention that commonality of the jurisdictional issue exists with respect to all three Claimants.

55. Further, Terminal argues that the United States has failed to establish the existence of common questions of fact or law, particularly because Terminal is focused almost entirely upon the high-value Western Red Cedar market. According to Terminal, the characteristics of that market are fundamentally different from the SPF (Spruce, Pine, Fir) market, on which Canfor and Tembec focus. Terminal explains that it is not in the commodity market and that many of the issues and much of the conduct of the United States as it relates to Terminal are significantly different from the issues and conduct relating to the other commodity producers of softwood lumber.

56. Finally, Terminal contends that consolidation will, if so determined, result in delay. Terminal will need to determine whether it needs separate counsel, will have to retain counsel, brief counsel on the case, and prepare a statement of claim.

parties in the *Corn Products* case recognized the ethical problems of Article 1126; and (ii) that consolidation under Article 1126 eliminates Tembec's right to select even one arbitrator to review the merits of the case.[33] The Consolidation Tribunal rejects these arguments for the following reasons.

82. With respect to the alleged incentive for members of an Article 1126 Tribunal, that situation is not uncommon in arbitration. Indeed, any arbitral tribunal that is faced with an objection to its jurisdiction would have the purported conflict. If this contention were correct, either no arbitral tribunal could decide on an objection to jurisdiction or every arbitral tribunal should always decide to decline jurisdiction. Yet, modern arbitration treaties, laws and rules require an arbitral tribunal to decide on any objection to jurisdiction.[34] In that respect, there is no difference between an Article 1120 Tribunal and an Article 1126 Tribunal.[35] For the reasons set forth above, Article 1126 Tribunals also derive their jurisdiction and legitimacy through consent of the parties.[36]

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[33] Tembec's Motion to Dismiss at 12-20.

[34] A general principle in international arbitration, referred to as "*compétence de la compétence*," provides that an arbitral tribunal has the power to determine its own jurisdiction over claims. *E.g.*, ICSID Convention of 1965, Article 41(1); UNCITRAL Model Law on International Commercial Arbitration of 1985, Article 16 (providing for the competence of an arbitral tribunal to rule on its jurisdiction); and UNCITRAL Arbitration Rules of 1976, Article 21 (providing that an arbitral tribunal shall have the power to rule on objections that it has no jurisdiction).

[35] Technically, an Article 1126 Tribunal does not decide on jurisdiction but rather gives a decision of an administrative nature. *See* Sub-section V.A(g) (page 38) *infra.*

[36] Tembec's reliance on Section 1.3 of the IBA Guidelines on Conflicts of Interest in International Arbitration of 2004 is not correct. Under the caption "Non-Waivable Red List," the Guidelines include the instance where: "The arbitrator has a significant financial interest in one of the parties or the outcome of the case." A situation appearing on the Non-Waivable Red List means that a prospective arbitrator must always decline an appointment. However, the "financial interest in . . . the outcome of the case" does not apply to the arbitrator's remuneration as arbitrator, but applies to situations such as sharing in the amount awarded on the merits.

83. It is conjecture to state that: "Presumably arbitrators will be more likely than courts to find jurisdiction, since arbitrators get paid if they hear a dispute."[37] There are reported cases in which an arbitral tribunal has declined jurisdiction.[38]

84. The perceived ethical conflict would apply to many professionals. To take two examples: a lawyer is to advise his or her client to bring a legal action; or a surgeon is to advise his or her patient about heart surgery. The lawyer is to advise his or her client about the strengths and weaknesses of the case and the chances of success; the surgeon is to advise the patient about the condition of the heart and the chances of success of the surgery. That is what the deontology of these professionals requires them to do. This situation basically is not any different for an arbitrator. He or she is to analyze the claims, and the factual and legal arguments in support thereof, and to make a determination in a professional, impartial and independent manner.

85. As to the agreement concluded in conjunction with the *Corn Products* case, parties are free under the NAFTA to determine by advance agreement the method of constituting an arbitral tribunal, which power also applies in connection with an Article 1126 Tribunal. *See* Article 1123 quoted at ¶ 79 above. But here, the parties did not so agree.

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[37] William W. Park, *Bridging the Gap in Forum Selection: Harmonizing Arbitration and Court Selection*, 8 TRANSNAT'L L. & CONTEMP. PROBS. 19, 50, (1999), quoted by Tembec, *id.* at 16.

[38] *See*, *e.g.*, *Waste Management, Inc. v. the United Mexican States*, Case No. ARB(AF)/98/2, Award on Jurisdiction of 2 June 2000, available at http://www.worldbank.org/icsid/cases/waste_award.pdf; *Joy Mining Machinery Limited v. Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction of 6 August 2004, available at http://www.worldbank.org/icsid/cases/joy-mining-award.pdf; *Consortium Groupement L.E.S.I. - DIPENTA v. Algeria*, ICSID Case No. ARB/03/8, Award of 10 January 2005, available at http://www.worldbank.org/icsid/cases/lesi-sentence-fr.pdf; *Lucchetti S.A. and Lucchetti Peru, S.A. v. Republic of Peru*, ICSID Case No. ARB/03/4, Award of 7 February 2005, available at http://www.worldbank.org/icsid/cases/lucchetti-award.pdf; *Hussein Nuaman Soufraki v. United Arab Emirates*, ICSID Case No.

(footnote cont'd)

86. Tembec seems to contend that the provisions relating to the constitution of an Article 1126 Tribunal are defective and in all cases should necessitate an agreement among the parties on the constitution of the Tribunal. However, no such agreement is required by the text of Article 1126. In the absence of a special advance agreement, members of an Article 1126 Tribunal are appointed by a neutral person, i.e., the Secretary-General of ICSID, a method to which all parties have consented as a result of Articles 1121 and 1123 of the NAFTA. If a party believes that an arbitrator lacks impartiality or independence, that party can challenge such an arbitrator under the applicable arbitration rules.[39] To accept the proposed interpretation of Article 1126 would be contrary to the principle of effectiveness, which, under the terms of the 1969 Vienna Convention, requires that meaning be given to the words of a treaty.

87. Furthermore, as it becomes evident from the present Order, while the text of Article 1126 in some instances demands interpretation, that does not mean that its provisions are defective or that they cannot be applied without a further agreement of the parties.

*(e) Discretionary power*

88. An Article 1126 Tribunal has discretionary power to make an order under Article 1126(2) of the NAFTA, subject to the requirements set forth below. The text of Article 1126(2) of the NAFTA uses the expression "*may* . . . order" (emphasis added). The discretionary power is also confirmed by the legislative history which

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ARB/02/7, Award of 7 July 2004, available at http://www.investmentclaims.com/decisions/Soufraki-UAE-Award-7Jul2004.pdf.

[39] Tembec did challenge one of the members of the present Tribunal, which challenge was rejected. *See* ¶ 8 *supra*.

the Article 1126 Tribunal is untimely under the UNCITRAL Arbitration Rules. The invocation by a disputing party of Article 1126 is not, by the ordinary meaning of its terms, a jurisdictional objection to an Article 1120 Tribunal. The issue of whether to consolidate is, as such, separate and apart from the issue of jurisdiction.

103. A different question is whether a party can no longer raise a plea as to the jurisdiction in the Article 1126 proceedings if it has not timely raised such a plea in the Article 1120 arbitration. According to Article 21(3) of the UNCITRAL Arbitration Rules, the plea should have been raised not later than in the statement of defense. Although Article 1126 of the NAFTA (and the UNCITRAL Rules for that matter) are silent on this different question, the Consolidation Tribunal is of the opinion that this question must in principle be answered in the affirmative. Thus, if a party has failed to raise the plea as to jurisdiction in the Article 1120 arbitration at the latest in the statement of defense (assuming that the Article 1120 arbitration has reached that stage), a party is in principle barred from raising the plea in the consolidation proceedings.[48]

*(h) The terms "all or part of the claims" and "one or more of the claims"*

104. Sub-paragraphs (a) and (b) of Article 1126(2) provide for the assumption of jurisdiction by an Article 1126 Tribunal of "all or part of the claims," or "one or more claims, the determination of which it believes will assist in the resolution of the others."

105. The Consolidation Tribunal notes that the request of the United States in the present case is one pursuant to sub-paragraph (a) of Article 1126(2) since it seeks

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[48] The bar is what the text of Article 21(3) of the UNCITRAL Arbitration Rules of 1976 provides. *Cf.* UNCITRAL Model Law on International Commercial Arbitration of 1985, which adds in the corresponding Article 16(2) *in fine*: "The arbitral tribunal may . . . admit a later plea if it considers the delay justified."

negotiators intended to narrow the scope of an Article 1126 Tribunal's competence. Moreover, if it were otherwise, Article 1126 would lose its object and purpose of procedural economy because an Article 1126 proceeding could then take place only after each of the Article 1120 Tribunals has ruled on jurisdictional objections.

108. In conclusion, an Article 1126 Tribunal can order many forms of consolidation under, in particular, sub-paragraph (a) of Article 1126(2). For example, an Article 1126 Tribunal can order the consolidation of all issues relating to liability, leaving damages to the Article 1120 Tribunals. An Article 1126 Tribunal may also order consolidation of a National Treatment claim under Article 1102 and/or a Most-Favored-Nation Treatment claim under Article 1103 and/or a Minimum Standard of Treatment claim under Article 1105, and leave an Expropriation claim under Article 1110 to the Article 1120 Tribunals.[51] Further, an Article 1126 Tribunal may consolidate issues relating to objections to jurisdiction (and/or admissibility) alone, and, to the extent that it rejects those objections, leave the remainder of the dispute to the Article 1120 Tribunals.[52]

*(i) The term "a question of law or fact in common"*

109. The notion of "question" in the term "a question of law or fact in common" as appearing in Article 1126(2) means a factual or legal issue that requires a finding to dispose of a claim. That meaning follows from the wording and structure of Article 1126(2). It refers to "claims [that] have been submitted to arbitration under Article 1120" and then to those claims "hav[ing] a question of law or fact in common."

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[51] Such a consolidation seems less likely since claims under Articles 1102, 1103, 1105 and 1110 of the NAFTA are regularly in the alternative on the basis of the same facts and it would not be in the interests of fair and efficient resolution of the claims to do so.

which are not expressed in the language of Article 1126 – as they could be interpreted to unduly curtail the explicit discretionary power given to an Article 1126 Tribunal when determining whether to issue an order under paragraph 2 of that Article.

*(j) Anticipated questions*

116. Another query is whether "a question of law or fact in common" should already have been presented to the Article 1120 Tribunals, or whether the alleged anticipation that such a question will arise, comes within the purview of Article 1126(2). The Consolidation Tribunal needs to address that question because the United States contends:

> Finally, although the United States is not in a position at this time to comprehensively articulate its defences to the merits of claimants' claims, given the similarities and factual allegations and claims of breach, the United States anticipates that should these cases proceed to the merits, it would raise many, if not all, of the same legal defenses to all three claims.[59]

117. Canfor and Terminal assert that anticipation for the purposes of consolidation is insufficient and that the Consolidation Tribunal must only be satisfied on the basis of evidence or pleadings, not mere anticipation or expectation.[60]

118. The Consolidation Tribunal agrees with Canfor and Terminal that a "mere anticipation or expectation" is insufficient for satisfying the condition of Article 1126(2) that there exist "a question of law or fact in common." However, where an issue has been raised in one or more Article 1120 proceedings that a party shows that it is with a degree of certainty to raise in other Article 1120

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[59] Tr. at 32:13-20; United States' Submission of 3 June 2005 at 12 and n. 28.

[60] Canfor & Terminal PHB ¶¶ 11-12.

and an Article 1126 arbitration when applying the term "in the interests of fair and efficient resolution of the claims." The Tribunal is of the view that efficiency in the sense of procedural economy is the operative goal of consolidation under Article 1126. That is basically an objective, fact-driven standard which an Article 1126 Tribunal can apply as it deems appropriate under the circumstances. Determining what is efficient under Article 1126(2) is not an accounting exercise of drawing up a matrix of comparative advantages and disadvantages and applying relative weighing factors. It suffices that the Article 1126 Tribunal is convinced that efficiency in the resolution of the claims will, under the circumstances before it, be served by a consolidation.

125. In making that determination, an Article 1126 Tribunal is also to consider what is "fair." That requirement indicates that the interests of all parties involved should be balanced in determining what is the procedural economy in the given situation. For example, a balance needs to be struck between a hearing that is longer for one party but at the same time shorter for another. It may also happen that what is procedurally less efficient for one party is procedurally more efficient for another. In that respect, the procedural economy that will redound to the benefit of a disputing State Party is another relevant factor, for the reasons explained earlier.[64] The necessary balancing further includes the consideration that all parties shall continue to receive the fundamental right of due process as it is set forth in Article 15(1) of the UNCITRAL Arbitration Rules (". . . the parties are treated with equality and each party is given a full opportunity of presenting his case").

126. While the standard of efficiency is an objective one, a guiding test is a comparison with the situation as it exists, and would continue to exist, if no consolidation were ordered. Factors to take into account in making such a comparison are: (i) time;

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[64] *See* Sub-section V.A(b) (page 27) *supra.*

(ii) information which is privileged or otherwise protected from disclosure under the Party's domestic law; and

(iii) information which the Party must withhold pursuant to the relevant arbitral rules, as applied.

(c) The Parties reaffirm that disputing parties may disclose to other persons in connection with the arbitral proceedings such unredacted documents as they consider necessary for the preparation of their cases, but they shall ensure that those persons protect the confidential information in such documents.

(d) The Parties further reaffirm that the Governments of Canada, the United Mexican States and the United States of America may share with officials of their respective federal, state or provincial governments all relevant documents in the course of dispute settlement under Chapter Eleven of NAFTA, including confidential information.

3. The Parties confirm that nothing in this interpretation shall be construed to require any Party to furnish or allow access to information that it may withhold in accordance with Articles 2102 or 2105.[76]

141. Furthermore, in general, the fact that parties to proceedings are competitors is not unique to consolidation proceedings. One sees that situation in arbitrations between a single claimant and a single respondent, including Article 1120 arbitrations. It has never been seriously suggested that arbitration cannot proceed

[76] Article 2102 (National Security) is to the effect that nothing in the NAFTA shall be construed: to require any State Party to furnish or allow access to any information the disclosure of which it determines to be contrary to its essential security interests; to prevent any State Party from taking any actions that it considers necessary for the protection of its essential security interests; or to prevent any State Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security. Article 2105 (Disclosure of Information) provides that nothing in the NAFTA shall be construed to require a State Party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the State Party's law protecting personal privacy or the financial affairs and accounts of individual customers of financial institutions.

"nonspecific so as to grant consolidation tribunals flexibility to fashion a proceeding to fit the circumstances."[77]

150. Canfor and Terminal disagree. They argue that the "Consolidation Tribunal's only powers are those set out in Article 1126(2). Those powers do not include the right to reserve judgment on whether to subsequently assume jurisdiction over further aspects of the proceedings at a later date." Moreover, Canfor and Terminal argue that such treatment is not what the United States is asking the Tribunal to do in any event.[78]

151. The Consolidation Tribunal is of the view that the text of Article 1126 does not leave room for reserving judgment concerning consolidation at some moment in the future. The text of Article 1126 demands a decision on a consolidation request "after hearing the disputing parties." That indicates that one proceeding, and one order, concerning a consolidation request are contemplated.[79] Moreover, once an Article 1126 Tribunal has issued an order on consolidation, its mandate transforms from deciding whether or not to consolidate into one of hearing and determining claims.

*(m) Where consolidated proceedings are to begin*

152. The United States submits that if the relevant Article 1120 claims were consolidated, this Tribunal would start anew procedurally.[80] Canfor and Terminal take the position that consolidated proceedings must pick up at the stage at which

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77 United States PHB at 8-9.

78 Canfor & Terminal PHB ¶¶ 76-78 and R-PHB ¶ 7. Tembec does not address the question in its PHB; *see also* Tembec's argument at ¶ 181 *infra.*

79 Another question is whether, subsequent to the disposition of a consolidation order, a disputing party may again request consolidation. As it is not an issue before the Tribunal, the Tribunal will not consider that question in the present Order.

80 United States PHB at 26-27.

a Tribunal, would be binding in the consolidation proceedings since in none of the three Article 1120 arbitrations in question has such a decision or award been issued. Hence, there is no question of a "*de facto* appeal process" by the United States as is argued by Canfor and Terminal.[83] In any event, it would seem that this question is theoretical because, if an Article 1120 Tribunal has rendered a decision on liability, there may no longer be a question of law or fact in common with another Tribunal insofar as liability is concerned.

*(n) The position of the Article 1120 Tribunals*

155. As mentioned, Article 1126(8) of the NAFTA provides: "A Tribunal established under Article 1120 shall not have jurisdiction to decide a claim, or a part of a claim, over which a Tribunal established under this Article has assumed jurisdiction."

156. If an Article 1126 Tribunal orders consolidation in full, the Article 1120 Tribunals cease to function because of the dictates of Article 1126(8).

157. If an Article 1126 Tribunal orders consolidation in part, then the relevant Article 1120 Tribunals no longer have jurisdiction over the part over which the Article 1126 Tribunal has assumed jurisdiction. The decision that the Article 1126 Tribunal gives with respect to the part over which it has assumed jurisdiction must be deemed to be binding on the Article 1120 Tribunals that are subject to the consolidation. It is not only a logical inference, but it also follows from the text of Article 1136(1): "An award made by a Tribunal shall have no binding force *except between the disputing parties and in respect of the particular case*." (emphasis

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[83] Canfor & Terminal R-PHB ¶ 30.

the claim.[92] Although Tembec defines *laches* as prohibiting a party's "exercise of a right that has been delayed,"[93] the authorities cited by Tembec all refer to the application of the principle in the context of claims, and refer to cases in which tribunals have applied the doctrine to claims. The Tribunal is not convinced that under international law this doctrine is appropriately invoked by a claimant to bar a procedural request for consolidation of claims. The Tribunal notes that, in some legal systems, laches may bar requests for consolidation, as, for example, under New York law.[94] However, the forms of equity known to Anglo-American common law do not form part of the corpus of public international law. While there is a borrowing of principles derived from domestic legal systems in public international law, this takes the form of general principles of law that do not necessarily replicate the rules of domestic law from which they derive their common origin.[95]

166. Even if it were appropriate to apply the doctrine of laches under principles of international law in this context, the Tribunal concludes that laches would not bar the United States' present request. The timeline under scrutiny is not so lengthy as to render the request for consolidation stale. Tembec argues that the United States delayed making its request for 12 to 18 months. A notion akin to laches has been applied by international tribunals primarily in cases where the delay involves decades (20 to 80 years), not months.[96] In any event, in the context of a request for consolidation, the *Tembec* Tribunal had not even held a hearing on the

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92 Ibrahim, n. 91 *supra*, at 676 – 83.

93 Tembec Submission of 10 June 2005 at 28.

94 *See* David D. Siegel, NEW YORK PRACTICE, 3d Edition §128 (1999) ("Laches, determined on a sui generis basis, can be an enemy.").

95 *See* Bin Cheng, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS (1987) 377.

96 *See* Ibrahim, n. 91 *supra.*

classifying them as misrepresentations warranting equitable relief. In light of the various exchanges between the Claimants and the United States, it is not possible to say that the United States wholly abandoned its rights under Article 1126, or led the Claimants reasonably to rely to their detriment that the United States would never invoke such rights.[99] During the first 18 months of defending against Tembec's claims, the United States may very well have intended not to seek consolidation. However, there is no denying that the *Canfor* and *Tembec* cases were filed 18 months apart, but proceeded at different paces with Tembec's claim catching up to Canfor's by March 2005 when one of the *Canfor* arbitrators recused himself. As mentioned, the United States at that point wasted no time in deciding to exercise its right to request consolidation. The Tribunal does not view such decision as having been made in bad faith. Therefore, the Tribunal declines to bar the consolidation request by operation of the doctrine of estoppel.

D. Commonality

170. Having regard to the analysis of Article 1126 in Section A above, and in particular in Sub-section A(i) (page 42), the Consolidation Tribunal concludes that the United States has shown to the satisfaction of the Tribunal that the claims submitted to arbitration under Article 1120 in these cases have questions of law and fact in common within the meaning of the text of Article 1126(2), considering the following.

171. To aid the Tribunal in making its commonality determination, the Tribunal requested that the parties submit charts, setting forth the purported questions of

[99] For example, as Tembec pointed out in its PHB at 13, in response to Tembec's request to the United States as to whether it would seek consolidation, the United States informed Tembec and Canfor that the United States might revisit its intention with regard to consolidation were another Chapter 11 claim filed in the *Softwood Lumber* proceedings.

claims asserted by Terminal on the same grounds.[100] Having also regard to the position taken by the United States in the *Canfor* and *Tembec* proceedings, there is indeed a degree of certainty that the United States will raise the same objection to jurisdiction in the *Terminal* proceedings.[101] The Tribunal accepts that also with respect to the defenses that the United States anticipates to make against liability and damages contentions in connection with Terminal's claims.

177. In April 2002, the Canadian Government and other parties, including Tembec and Canfor, filed requests for panel proceedings under Chapter 19 of the NAFTA to review Commerce's final affirmative antidumping and countervailing duty determinations.

178. The United States first objects to the jurisdiction of the three Article 1120 Tribunals in these cases because it contends that NAFTA provides for specialized bi-national panels constituted under Chapter 19 to have exclusive jurisdiction over claims that seek to impose obligations on a State Party with respect to its antidumping and countervailing duty laws. Thus, according to the United States, it has rejected investor-State arbitration of Canfor, Tembec and Terminal's claims because of the express terms of the NAFTA. The United States argues that the Chapter 11 proceedings would impose obligations on the United States outside the Chapter 19 proceedings against the express terms of Article 1901(3), [102] and that Chapter 19 has provided for an exclusive forum for resolution of claims relating to the United States' antidumping and countervailing duty laws.[103] Both Canfor and

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[100] United States' Request of 7 March 2005 at 3.

[101] *See* ¶¶ 116-118 *supra.*

[102] Article 1901(3) provides: "Except for Article 2203 (Entry into Force), no provision of any other Chapter of the Agreement shall be construed as imposing obligations on a Party with respect to the Party's antidumping law or countervailing duty law."

[103] In its R-PHB at 12, Tembec contends that "Article 1901(3) objections are not the same between Tembec and Canfor" and that "The United States indeed presented the issues differently,

(footnote cont'd)

matters that are essential to be decided in accordance with the doctrine of judicial economy. [footnote omitted] It need not decide matters that may be mooted by the Tribunal's decisions on other issues. [footnote omitted]"[104] Tembec argues that the Consolidation Tribunal should lift the stay of the Article 1120 proceedings and let the Article 1120 Tribunals complete their decisions on the jurisdictional objections of the United States.

182. In support of its argument, Tembec refers to the doctrine of judicial economy as developed by the WTO. At the WTO, however, the doctrine of judicial economy means that panels are not required to address all the legal claims that the complainant makes if the challenged measure violates different WTO provisions in either the same or various covered agreements. If the panel has already found that the challenged measure is inconsistent with a particular provision of a covered agreement, it is generally not necessary to proceed to examine whether the same measure is also inconsistent with other provisions that the complainant invokes. Panels have the discretion to decline to rule on these further claims, but they must do so explicitly.[105]

183. The doctrine of judicial economy in the sense as used by the WTO may be applied by an Article 1120 Tribunal or by an Article 1126 Tribunal when considering claims. An Article 1126 Tribunal cannot apply the doctrine in that sense when determining whether to issue an order under Article 1126(2). An Article 1126 Tribunal has not to decide whether it will hear and determine certain claims and not others. Rather, it has to determine whether it assumes jurisdiction over all or part of the claims or over one or more of the claims the determination of which it believes would assist in the resolution of the others. In that respect, the

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104 Tembec Submission of 10 June 2005 at 27-28; *see also* R-PHB at 6-7.

105 *See* http://www.wto.org/english/tratop_e/dispu_e/disp_settlement_cbt_e/c10s4p1_e.htm.

same industry and under the same circumstances (Article 1102); did not accord to Canadian investors and their investments treatment no less favorable than that which is available to any other foreign investor or its investment under a similar treaty (Article 1103); and did not accord to investments of Canadian investors treatment in accordance with international law (Article 1105). As a result, it is alleged that the United States engaged in expropriation of the property of the Canadian softwood lumber producers' investments in the United States (Article 1110).

188. *(i) Subsidy Determinations.* All of the Claimants allege that Commerce's preliminary and final determinations that there was a subsidy in Canada favoring softwood lumber producers were unlawful determinations. The United States allegedly evaluated the provincial stumpage program in Canada and determined that it constituted a subsidy. All three Claimants attack the methods employed by the United States in making its determination, including the use of cross-border benchmarks, and all three allege that Commerce made its determination under political pressure and to achieve a certain political result.

189. In stating its claim, Canfor provides detailed allegations as to the method that Commerce employed to determine the existence of a subsidy. A review of Commerce's determination involves consideration of whether the stumpage program constituted a financial contribution to producers in the softwood lumber industry; whether the stumpage program was specific to an enterprise or industry; and whether it provided a benefit to those within the industry. None of these factors, in the judgment of the Tribunal, involves a claimant-specific evaluation that would render consolidation of this issue a problem.

190. Tembec, on the other hand, supports its claim with detailed allegations of the political influence and pressure exerted on Commerce to make a particular determination that favored the United States lumber industry and hurt the

194. *(iii) Critical Circumstances Determination.* All three Claimants allege that the United States made a determination that "critical circumstances" existed with respect to the alleged Canadian softwood lumber subsidies and dumping activities. If critical circumstances are determined to be present, then under United States countervailing and antidumping duty law, retroactive duties may be applied to softwood lumber imports that occurred up to 90 days prior to the determination. To make such a determination, Commerce was required to find that a relevant and applicable export subsidy actually existed, and that there were massive imports over a relatively short period of time.

195. Canfor and Terminal dispute that the export subsidy that Commerce identified in its analysis, a subsidy program employed by the Province of Quebec for its producers, was an export subsidy. All three Claimants dispute the method employed by Commerce to calculate the amount of exports of softwood lumber that it deemed qualified as "massive exports" over a "relatively short time." Tembec additionally pleads specific allegations that Commerce coordinated with other branches of the United States government to bring about this predetermined result favorable to United States industry.

196. None of Claimants' allegations on this issue requires a claimant-specific determination. All three Claimants object to the critical circumstances determination as unlawful and identify at least one common way in which the determination was unlawfully made. Additionally, Canfor relies upon the effect of the critical circumstances determination on the softwood industry as a whole to establish damages, arguing that the United States' determination created "a potential retroactive liability for Canadian exporters including Canfor exceeding $300 million," but such an additional allegation is insufficient to deny consolidation in light of the commonality of the other issues.

197. *(iv) Antidumping Determinations.* Claimants all contend that the United States made preliminary and final determinations that Canadian softwood lumber producers were dumping softwood lumber in the United States market in an unlawful manner. All Claimants attack the methodologies employed by Commerce to determine that dumping existed and the manner in which Commerce calculated company-specific weighted average dumping margins, including use of unfair price comparisons and of the technique called "zeroing."

198. Tembec additionally alleges that certain United States Senators pressured Commerce to make findings on the dumping issue that were favorable to United States' industry, and that Commerce failed to take into account the Softwood Lumber Agreement in making its antidumping determination. While these allegations are particular to Tembec on this particular issue, Canfor and Terminal have put forth general allegations of political influence in stating their claims, and have identified Commerce's failure to take the Softwood Lumber Agreement into account in making its subsidy determination and critical circumstances determination, respectively.

199. While Claimants all object to the methodologies employed by Commerce to calculate the dumping margin, the determination is company-specific, requiring an analysis of company-specific cost and sales data. This is an area where Canfor, and the other Claimants, will have to produce individual, potentially confidential information. The analysis of the Tribunal will be partly company-specific. However, given the number of common objections relating to the dumping determination, such a company-specific analysis does not to pose a barrier to consolidation, also because of the protections that the Tribunal will craft in consultation with the parties.

200. *(v) The ITC Determinations.* The ITC made preliminary and final determinations relating to whether there was a reasonable indication that the

distributed annually to affected United States' domestic producers. Claimants all allege that the Byrd Amendment, in its adoption by the United States, and the United States' application or intended application of the amendment to softwood lumber countervailing and antidumping duties, violates NAFTA. This claim is not specific to any Claimant and, given the potential problems with inconsistent findings regarding the Byrd Amendment, supports consolidation of the claims.

204. *(viii) Tembec's Claim Relating to Class/Kind Determination.* Based on certain facts unique to Tembec, Tembec has one additional claim that it argues prohibits a finding of commonality supporting consolidation. Tembec's business relates in part to Eastern White Pine and Finger-Jointed Flangestock. These types of lumber are unique to Tembec in this case. Tembec alleges that it asked the ITC to perform separate analyses of these products with respect to its material injury determination, but that the ITC refused to do so. Tembec also alleges that it asked Commerce to treat these products as separate classes or kinds of merchandise in its countervailing duty and antidumping determinations because of their distinct characteristics. According to Tembec, a separate class or kind finding would have required Commerce to terminate its investigation as to Eastern White Pine and Finger-Jointed Flangestock because the petitioners made no allegations and provided no evidence as to this type of wood in their petition. Tembec alleges that, instead, Commerce lumped these wood types together with all types of softwood lumber in its evaluation of the petitions, and ended up limiting supply, creating market uncertainty and forcing Tembec to close its investments in the United States and Canada for these types of wood.

205. While this is a claim not common among Claimants, it is only one issue that is uncommon out of many that are common. The presence of this one claim does not destroy the commonality of the issues arising out of the other claims among the Claimants so as to prohibit consolidation within the meaning of Article 1126(2).

consideration of whether consolidation would be in the interests of the fair and efficient resolution of the claims.[115]

213. Canfor contends that it should not be required to reargue jurisdiction.[116] Yet, such an eventuality may become a consequence of consolidation.[117] In the present case, if not consolidated, Canfor may have been required to reargue jurisdiction in light of the resignation of one of the arbitrators after the hearing on jurisdiction in *Canfor* and in light of the provisions of Article 14 of the UNCITRAL Arbitration Rules.[118]

214. More in general, the Consolidation Tribunal has concerned itself with ensuring that there not be an unfair delay in the Claimants' proceedings.

215. With respect to factor (ii), the Consolidation Tribunal has considered the cost estimates submitted by each of the parties. While appreciating that cost estimates of the pursuit of any litigation are notoriously difficult to make, the Tribunal concludes that consolidated proceedings will be less expensive than three separate

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[115] Tembec is not entirely correct when it argues that this Tribunal "has no authority to force a claimant to submit a statement of claim." Tembec R-PHB at 42. The Article 1126 proceedings are conducted on the basis of the UNCITRAL Arbitration Rules. *See* Article 1126(1). According to Article 18(1) of the UNCITRAL Rules: "Unless the statement of claim was contained in the notice of arbitration, within a period of time to be determined by the arbitral tribunal, the claimant shall communicate his statement of claim in writing to the respondent and to each of the arbitrators . . . ." Article 28(1) of the UNCITRAL Rules further provides: "If, within the period of time fixed by the arbitral tribunal, the claimant has failed to communicate his claim without showing sufficient cause for such failure, the arbitral tribunal shall issue an order for the termination of the arbitral proceedings . . . ." In this connection it may be pointed out that a filing of a statement of claim is not a condition precedent to raising a plea that an arbitral tribunal does not have jurisdiction. Article 21(3) of the UNCITRAL Rules provides: "A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence . . ." An objection to jurisdiction, therefore, can be filed prior to a statement of claim.

[116] Canfor Submission of 10 June 2005 at ¶¶ 77-78.

[117] *See* ¶¶ 103 and 153 *supra.*

[118] Article 14 of the UNCITRAL Rules provides: "If under articles 11 to 13 the sole or presiding arbitrator is replaced, any hearings held previously shall be repeated; if any other arbitrator is replaced, such prior hearings may be repeated at the discretion of the arbitral tribunal."

arbitrations for the United States[119] and that, for each of the Claimants, costs will increase but not excessively.

216. It is not correct, as Canfor argues, that "the money spent on the Canfor Tribunal is simply thrown away"[120] since a fair amount of the work product submitted in the *Canfor* proceedings to date can be used again in the consolidation proceedings.

217. With respect to factor (iii), in light of the numerous common questions of law and fact in the three Article 1120 arbitrations, there is a risk that, if not consolidated, their Tribunal decisions will be inconsistent.

218. It may be recalled that, in the view of the Consolidation Tribunal, confidentiality is not a factor to be taken into account when considering "the interests of fair and efficient resolution of the claims," save for exceptional cases where consolidation would defeat efficiency of process or would infringe the principle of due process enunciated in Article 1115 of the NAFTA. Claimants' arguments on this subject lack, in the view of the Tribunal, relevance for the reasons stated earlier in this Order.[121] The arguments of the Claimants have not convinced the Consolidation Tribunal that an exceptional case will arise if the proceedings are consolidated.[122]

219. Nor are the due process rights of the Claimants curtailed due to confidentiality issues (assuming that they would arise to any appreciable extent) if the proceedings are consolidated. In particular, Claimants are mistaken when they argue that the United States will have an advantage by having confidential information: the United States will also have that information if the proceedings

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[119] In which the mathematical error of the calculation by the United States as identified by Tembec in its R-PHB at 34 is taken into account.

[120] Canfor Submission of 10 June 2005 at ¶ 82.

[121] *See* ¶¶ 138-146 *supra.*

[122] *See* ¶ 147 *supra.*

quantum further confirm the need of separate proceedings."[123] Second, as a general proposition, the present Tribunal disagrees with the statements found in ¶ 9 of the *Corn Products* Order: "Two tribunals can handle two separate cases more fairly and efficiently than one tribunal where the two claimants are direct and major competitors, and the claims raise issues of competitive and commercial sensitivity," and in ¶ 10: "However, confidential information among competitors is much more easily protected in separate proceedings, which in turn also permit a far more efficient arbitration process under such circumstances."[124] Third, in ¶ 14, the *Corn Products* Tribunal notes: "Yet, as CPI pointed out in its written submission, Mexico did not indicate, apart from jurisdiction, common defenses it intends to raise to the claims." While the present case involves also common questions of law and fact relating to jurisdiction, the same applies to liability as well, in respect of which the United States has raised, and intends to raise, common questions of law and fact.[125] Moreover, in the judgment of the present Tribunal, anticipated questions may also be taken into account if there is a degree of certainty that they will be raised.[126] Fourth, while acknowledging the risk of inconsistent awards, in ¶ 16 of the *Corn Products* Order, it is stated that: "This Tribunal does not have before it a large number of identically or very similarly situated claimants. . . . The tax could, for example, constitute an expropriation as to one claimant, but not another." This fact pattern does not apply to the present case. Lastly, in ¶ 19, the *Corn Products* Order emphasizes that the cases there "are not close to procedural alignment," which is not applicable in the present case either.

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123 *See* Sub-section V.A(i) (page 42) and Section V.D (page 65) *supra.*

124 *See* ¶¶ 138-147 and 219-220 *supra.*

125 *See* Section V.D (page 65) *supra.*

126 *See* Sub-section V.A(j) (page 45) and ¶ 176 *supra.*

223. The consequence of the decision of the present Consolidated Tribunal is that the Article 1120 Tribunals cease to function.[127]

224. The next step in the proceedings will be for the Tribunal to consult with the parties about the conduct and sequence of the proceedings, having regard to the observations made in Sub-section A(m) above (page 57).

225. The Tribunal reserves the decision on the award of costs of the present proceedings as referred to in Articles 38-40 of the UNCITRAL Arbitration Rules to a subsequent order, decision or arbitral award, having regard to the fact that none of the parties has made submissions on costs. Reservation of the decision on costs is also appropriate in light of the alternative relief sought by Canfor and Terminal in their reply post-hearing brief to the effect that, if consolidation is ordered, "the United States should be ordered to pay Canfor and Terminal's costs that have been thrown away by virtue of the United States having been dilatory in bringing this consolidation application,"[128] to which relief the United States has not had an opportunity to respond because of the timing of the relief sought.

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127 *See* Sub-section V.A(n) (page 59) *supra.*

128 Canfor & Terminal R-PHB ¶ 32.

## VI. DECISION OF THE CONSOLIDATION TRIBUNAL

226. For the foregoing reasons, the Consolidation Tribunal by order:

(1) ASSUMES JURISDICTION over all claims in the Article 1120 arbitrations *Canfor Corporation v. United States of America, Tembec Inc., Tembec Investments Inc. and Tembec Industries Inc. v. The United States of America*, and *Terminal Forest Products Ltd. v. The United States of America*, within the meaning of Article 1126(2)(a) of the NAFTA;

(2) DENIES Tembec's Motion to Dismiss of 27 June 2005; and

(3) RESERVES the decision on the costs of the present proceedings to a subsequent order, decision or arbitral award.

Made in Washington, D.C., 7 September 2005,

THE CONSOLIDATION TRIBUNAL:

Professor Armand L.C. de Mestral
Arbitrator

Davis R. Robinson, Esq.
Arbitrator

Professor Albert Jan van den Berg
Presiding Arbitrator

only to pay the demanded "financial costs" for which there was no provision under the Fiscal Code (counter-memorial, para. 142(b)). While the Claimant contended that CEMSA had by 1991 established a cigarette export business, the Respondent alleges that CEMSA's request for IEPS rebates in November 1990-1991 related solely to exports of beer and alcoholic beverages (counter-memorial, para. 142(a)).

10. According to the Claimant, an authorized producer of cigarettes in Mexico, Carlos Slim "protested [regarding Claimant's exports] and the government took administrative steps and passed legislation to cut off rebates to CEMSA in 1991" (memorial, p. 2). This assertion is contested by the Respondent. The 1991 legislation was apparently designed to provide IEPS rebates to exports undertaken by producers of cigarettes (such as Cigatam, a firm allegedly controlled by Carlos Slim), but to deny rebates for exports by resellers of cigarettes, such as CEMSA (memorial, p. 2, counter-memorial, para. 93). The amendments to Article 2, Section III in 1991, specified that a 0% rate applied to final exports, under the terms of the customs legislation, by producers and bottlers of the goods, and by foreign trade companies, as well as by persons entering into contracts with producers and bottlers, including for sale abroad, as long as they complied with certain requirements to be issued by SHCP (counter-memorial, para. 93). The Claimant, as a reseller, became ineligible for rebates.

11. The Claimant initiated an *Amparo* action before the Mexican courts in February, 1991, challenging the constitutional validity of Article 2, Section III, in that it limited the 0% tax rate to producers and bottlers. The *Amparo* alleged that these measures infringed upon the constitutional principle of "equity of taxpayers" by excluding all other exporters from the possibility of obtaining the 0% rate (counter-memorial, para. 102). In April, 1991, the Fifth District Judge in Administrative Matters dismissed CEMSA's *Amparo*, in part, but granted it, in part, citing that SHCP had no authority to issue the implementing fiscal regulations for 1991, which CEMSA was challenging. The decision was appealed by both sides in May, 1991. In July, CEMSA also filed a criminal complaint against the SHCP officials responsible for enactment of the 1991 amendment to Article 2 section III of the IEPS Law, for abuse of authority and conspiracy (counter-memorial, para. 107).

of a memorial and counter-memorial, reserving any instructions that the parties file a reply and a rejoinder.

28. In the context of the parties' requests for documentation, the Claimant submitted communications of May 23, June 20, and July 11, 2000, to which the Respondent replied by a communication of July 11, 2000. Finding that the foregoing communications raised "jurisdictional issues that both parties wish[ed] the Tribunal to consider and rule upon before the exchange of written pleadings on the merits," the Tribunal, on July 18, 2000, issued Procedural Order No. 3 directing the parties to exchange written pleadings on preliminary jurisdictional matters and suspending the schedule set forth in the second procedural order. Under this order, the Claimant was requested to file a memorial on jurisdictional issues, the Respondent was then to file a counter-memorial, and the parties were then simultaneously to file further observations on such jurisdictional issues.

29. On July 18, 2000, the Claimant requested the revision of Procedural Order No. 3 asking for the jurisdictional issue to be joined to the merits, for the briefing schedule on other issues to be adjusted, and for a direction that discovery proceed pending such disposition. On July 20, 2000, the Respondent replied opposing the Claimant's request for revision of Procedural Order No. 3.

30. Referring to the correspondence from both the Claimant and the Respondent subsequent to the issuance of Procedural Order No. 3, the Tribunal on August 3, 2000 issued Procedural Order No. 4 reaffirming the directions given in Procedural Order No. 3 and fixing a revised schedule for the briefing of preliminary jurisdictional issues.

31. By respective communications of August 15, 2000, Canada and the United States requested that the Tribunal permit each of them to make submissions pursuant to NAFTA Article 1128 on the jurisdictional issues raised in the case within 14 days of the date of the last filing by a party on such issues. By letter of August 18, 2000, the Respondent referred to those communications from Canada and the United States, and requested an additional time period for commenting on their submissions made under NAFTA Article 1128 as well as on the Claimant's

additional observations on jurisdiction. By letter of August 21, 2000, the Claimant opposed such modification of the briefing schedule sought by the Respondent, and on the same day submitted his memorial on jurisdictional issues as directed by the Tribunal.

32. By letter of the Secretary of August 24, 2000, the Tribunal determined it unnecessary to modify the briefing schedule set forth in Procedural Order No. 4, under which "the parties have been afforded an opportunity of a simultaneous second round of written pleadings on preliminary issues in order to address, by way of further explanation, arguments already made." Also on August 24, 2000, the Tribunal invited Canada and the United States to file any NAFTA Article 1128 submissions on preliminary issues by October 6, 2000.

33. On August 29, 2000, the Respondent requested that the Tribunal order the production of documents by the Claimant concerning the preliminary issues briefed by the parties. On September 1, 2000, the Tribunal directed both parties to promptly comply with any requests for the production of documents which they regard to be in good faith, and after exhaustion of all best efforts, to be admissible, relevant and otherwise inaccessible to the party requesting them.

34. On September 8 and 11, 2000, respectively, the Respondent filed English and Spanish versions of its counter-memorial on preliminary issues. On September 13, 2000, following a request by the Claimant, the Respondent filed an English translation of the Appendixes of its counter-memorial.

35. On September 22, 2000, the parties simultaneously filed their additional observations on the preliminary jurisdictional issues in English and, in Spanish on September 27 and 28, 2000, respectively. On October 6, 2000, Canada and the United States of America filed their respective submissions under NAFTA Article 1128.

36. The Claimant, by letter of October 6, 2000, opposed what it alleged were two new motions made by the Respondent in its additional observations as submitted on September 22, 2000 regarding the production of documents and the matter of confidentiality with regard to

legal remedy just because the Claimant lost in one of the proceedings; at the time of the Respondent's submission, the Claimant appears to be prevailing in the second action, but it is not final. If that were true, every disappointed litigant who otherwise met the standing requirements of NAFTA Chapter Eleven, Section B, would bring a claim under international law (rejoinder, paras. 40, 41). The Respondent concludes therefore that, with the exception of the claim for an alleged denial of national treatment, all of the claims advanced in this proceeding would require the Arbitral Tribunal to apply domestic law in the place of the proper judicial body (counter-memorial, para. 40).

70. In addition, the Respondent maintains that, in any event, any CEMSA's claimed right to IEPS rebates would depend on issuing invoices separately and expressly stating the tax. This particular condition, which was never complied with by the Claimant, is now *sub judice* on appeal in the Mexican courts (counter-memorial, paras. 11, 360-364). Accordingly, the international responsibility of a State cannot be engaged unless and until the measure in issue has been tested at the local level and has become final by pronouncement of the highest competent authority (counter-memorial, para. 371). The exhaustion of local remedies rule is applicable under NAFTA as in general under international law. Nor does any relevant waiver exist here, since the waiver required by NAFTA Article 1121 is limited to damages only (transcript, vol. 2, pp. 79, 81) and, in any event, the Claimant neither discontinued proceedings in the domestic courts nor did he refrain from initiating others with respect to measures allegedly in breach of NAFTA Chapter Eleven, Section A (rejoinder, paras. 47-51).

G.3 Analysis

71. The decision on the issue of exhaustion of local remedies as a condition for claim admissibility primarily depends on the wording and construction of the relevant NAFTA provisions. Indeed, it is generally understood that the local remedies rule may be derogated from, qualified, or varied by virtue of any binding treaty (*Case Concerning Elettronica Sicula, S.p.A.*, United States of America v. Italy, 1989, I.C.J. Reports 4, para. 50). Such qualification took place here under NAFTA Articles 1121 and Annex 1120.1.

78. The Respondent observes that the Claimant, in spite of the waiver, did not in fact withdraw from several related domestic proceedings in Mexico; nor does the Respondent suggest that it was incumbent upon the Claimant to withdraw (see rejoinder, paras. 47, 48). The Arbitral Tribunal, however, does not find the point to be pertinent. Mexican courts are hailed by the Respondent as the appropriate forum for determining the Claimant's rights under the IEPS law (see, *e.g.*, counter-memorial, paras, 367, 368; rejoinder, paras. 48-51). In the first instance, we agree. However, questions as to whether Mexican law as determined by administrative authorities or Mexican courts is consistent with the requirements of NAFTA and international law are to be determined in this arbitral proceeding, and we are not barred from making that determination by the fact that not all of the issues have yet been resolved by Mexican courts. Otherwise, any arbitral tribunal could be prevented from making a decision simply by delaying local court proceedings. Nor is an action determined to be legal under Mexican law by Mexican courts necessarily legal under NAFTA or international law. At the same time, an action deemed to be illegal or unconstitutional under Mexican law may not rise to the level of a violation of international law.

G.4 Other Jurisdictional Constraints

79. As noted earlier, several jurisdictional issues in this arbitration have been resolved by the Tribunal's "Interim Decision on Preliminary Jurisdictional Issues" rendered on December 6, 2000. However, this decision was limited to "the specific preliminary issues set forth in [the Tribunal's] Procedural Order No. 4 and at paragraph 11" of the Interim Decision itself. Other jurisdictional issues were not precluded, to the extent they have arisen in the course of this arbitral proceeding.

80. Such an additional jurisdictional issue, which arose later, pertains to the authority of this Tribunal to grant declaratory relief with respect to the validity or legality of the 1998 audit and the corresponding tax assessment by SHCP vis-à-vis CEMSA.

81. It appears to be common ground between the Parties (memorial, paras. 121-126; counter-memorial, paras. 240-268) that in July 1998 SHCP launched an audit, or a verification

submission, 2002, paras. 7-8.). However, both Parties agree that this most recent decision is not final so that the proceeding remains *sub judice* before the competent federal courts (Claimant's May 8, 2002 submission, para. 17; Respondent May 8, 2002 submission, para. 18; memorial, para. 124; counter-memorial, para. 268).

84. What, then, is the relevance of these Mexican court decisions for this Tribunal? The Tribunal is not inclined to give them significant weight, in part because neither of the Parties has suggested that they are controlling, although the Mexican courts' discussion of legal issues provides necessary background to the Tribunal's understanding of these issues as required for a proper application of NAFTA and international law. First, of course, the 1998 assessment proceeding is not final. While the most recent decision favors the Claimant, the Respondent may prevail at the next step. Second, the 1998 decision, related to the negative response to a request presented to the tax authority (this decision differs from the Claimant's position specifically with regard to the exigency of separately stating the IEPS amounts in the invoices) which is final, essentially reinforces the Respondent's position, creating a conflict which this Tribunal cannot and should not try to resolve. Third, and probably most important, Mexican courts are applying Mexican law, while this Tribunal must apply the provisions of NAFTA and international law, which do not necessarily provide the same results as under Mexican law. Finally, as noted earlier, the Claimant has not challenged any of the Mexican court decisions, even those unfavorable to the Claimant, as breaching the international law standard for denial of justice, and it is premature to consider any question of possible non-compliance of a Mexican court decision by the Respondent, since the issue of compliance has not yet arisen.

85. The purely declaratory character of the relief sought by the Claimant, to wit to declare the Respondent's 1999 tax assessment as invalid, is not necessarily inconsistent with NAFTA Chapter 11, Section B, in particular Articles 1116(1) and 1117(1), which appear to limit relief to claim for "loss or damage by reason of, or arising out, that breach". It may also not be generally inconsistent with the exception of taxation measures in view of NAFTA Article 2103(6). Particular attention should be drawn, however, to the question whether such declaratory relief is admissible in the circumstances of this case.

is bound to have, under the terms of NAFTA Article 1136(1), a direct bearing upon any domestic litigation (pending or final) on the entitlement to tax rebates. Therefore the validity or legality of the 1999 tax assessment with respect to the tax rebates obtained in the years 1996 and 1997 hardly constitutes an independent or unrelated count in this arbitration. Rather, the validity or recovery of these tax rebates functionally have an impact on, and belong to, the Tribunal's evaluation whether a "creeping" or any other relevant (under NAFTA Articles 1110 and 2103(6)) form of expropriation has taken place. In addition, it appears to the Arbitral Tribunal that the Claimant as well understands this declaratory relief in the context of expropriation under NAFTA Article 1110 since his request seeks an arbitral finding that such tax assessment by the Respondent "constitutes a measure tantamount to expropriation under, and in breach of, NAFTA Article 1110" (memorial, submission A(4), p. 130). Similarly, the validity or recovery of these tax rebates may be relevant to determining whether Respondent has violated Article 1102, to the extent the Tribunal determines that Claimant has been treated less favourably with regard to the tax rebates than domestic investors in like circumstances, as discussed in Section I, *infra*. Therefore, since the Claimant submits this allegation of invalidity within the framework of NAFTA Articles 1102 and 1110, the invalidity issue will be dealt with within the appropriate framework but does not warrant an autonomous answer in the operative part of this Award.

## H MERITS

### H.1 Expropriation: Overview of the Positions of the Disputing Parties

89. In this proceeding, the Claimant's key contention is that the various actions of Mexican authorities, particularly SHCP, in denying the IEPS rebates on cigarette exports to CEMSA, resulted in an indirect or "creeping" expropriation of the Claimant's investment and were tantamount to expropriation under Article 1110. They were also arbitrary, confiscatory and discriminatory, a violation of the Claimant's right to due process (see memorial, Introduction and Summary, p. 6; first Swan's affidavit, paras. 30-34). The Claimant asserts that the "measures" he has complained about may also be characterized as a "denial of justice" (one aspect of denial of due process) under article 1110 (memorial, paras. 189-203). Nor does the Claimant believe that the Mexican government policy of limiting cigarette exports is justified by public policy

concerns, particularly in light of the stated purpose of the IEPS law in 1980, which was to encourage Mexican exports (memorial, para. 189, quoting Statement of Purpose of IEPS Law for 1981, Diario Oficial, Dec. 30, 1980).

90. In particular, the Claimant asserts that the 1993 Supreme Court *Amparo* decision required Mexican officials not only to provide CEMSA with the 0% excise tax rate on exports, but also to permit CEMSA to obtain rebates of the tax amounts included in the price CEMSA paid its suppliers, Walmart and Sam's Club. According to the Claimant, the decision makes no sense if it holds Article 2 of the IEPS Law -- permitting only manufacturers, not resellers, to obtain the 0% tax rate for exported cigarettes -- unconstitutional, but continues to permit SHCP to deny the rebates to firms that are not IEPS taxpayers and do not have invoices showing the tax amounts stated separately, as Article 4(III) of the IEPS law specifies. In seeking the rebates, the Claimant asserts that he reasonably relied on a series of letters from SHCP officials, oral assurances from those officials, and their actions in granting the rebates during some periods (1992 and April 1996 to September 1997). Rebates were granted although the officials were fully aware at all relevant times that the Claimant lacked invoices that stated the tax amounts separately, and would rely on their actions. Some of the same officials had denied those rebates during earlier periods. In fact, according to the Claimant, there was effectively an oral agreement or understanding with SHCP officials, concluded through a series of meetings and exchanges of letters in 1994 and 1995, to the effect that the 1993 *Amparo* decision provided the Claimant the right to receive rebates, rather than simply the right to a 0% IEPS tax on cigarette exports (memorial, paras. 68-69). This understanding, according to the Claimant, resulted from the impossibility of the Claimant's obtaining the invoices, the influences of the U.S. Embassy and the entry into force of NAFTA (memorial, Introduction and Summary, pp. 3-4).

91. It is the Claimant's view, however, that the Mexican government did not comply with the *Amparo* decision, despite the oral agreement to afford the Claimant the rebates. Rather, Mexican government officials sought return of the rebates that had been granted between April 1996 and September 1997, and ultimately denied the Claimant's rebates for October and November 1997, effectively preventing the Claimant from exporting cigarettes. The application of the IEPS law by Mexican authorities (particularly strict application of Article 4(III)) requiring

IEPS law, including but not limited to providing invoices with tax amounts separately stated, in accordance with Article 2 ( counter-memorial, paras. 168, 172).

94. Also, the Mexican circuit court has determined, *inter alia*, in the "nullification" proceeding initiated by the Claimant in 1998, that IEPS legal provisions requiring invoices stating the tax amounts separately as a condition of obtaining rebates are not inconsistent with principles of tax equity. In the Respondent's view, this is a determination under Mexican law that is not properly before the Tribunal (rejoinder, para. 16). While the arguments are in general detailed and complex, the Respondent believes that this litigation proves that Mexican administrative authorities acted consistently with Mexican law and court decisions (even though the case only applies by its actual terms to applications for rebates submitted in November and December 1997). Thus, there is no denial of justice under Mexican law, or other violation of international law that could be considered the basis for a violation of Article 1110.

95. The Respondent also questions whether the Claimant can demonstrate the ownership of an "investment" that was allegedly expropriated in Mexico by Mexican authorities; in the absence of an investment, the Claimant has no standing to bring an action under Chapter 11. In particular, to the extent the Claimant is seeking payment of rebate amounts for October and November 1997, this is a debt obligation that is specifically excluded from the definition of investment under NAFTA Article 1139. Nowhere is there an "investment" of which the Respondent seized ownership and control (counter-memorial, para. 302 ff.).

H.2 Applicable Law: NAFTA Article 1110 and International Law

96. A threshold question is whether there is an "investment" that is covered by NAFTA. The term "investment" is defined in Article 1139, in exceedingly broad terms. It covers almost every type of financial interest, direct or indirect, except certain claims to money. The first listed item under "investment" is "an enterprise." There is no disagreement among the parties that Corporación de Exportaciones Mexicanas, S.A. (CEMSA) is a corporate entity organized under the laws of Mexico, essentially wholly owned by the American citizen investor, Marvin Roy Feldman Karpa (first Feldman statement, para. 1). Among the dictionary definitions of "enterprise" are "a unit of economic organization or activity; *esp.* a business organization"

(Webster's New Collegiate Dictionary, 1977 ed.). As such, the Tribunal determines that CEMSA comes within the term "enterprise" and is thus an "investment" under NAFTA. This conclusion is consistent with that reached by other NAFTA Chapter 11 tribunals. For example, the tribunal in *S.D. Myers v. Canada* concluded that a Canadian corporation organized for the purpose of facilitating hazardous waste exports to the United States, an affiliate of S.D. Myers in the United States owned by the same shareholders as S.D. Myers, satisfied the NAFTA requirements for an "investment." (*S.D. Myers v. Government of Canada* , Partial Award, November 13, 2000, paras. 230-231, http://www.state.gov/documents/organization/3992.pdf.)

97. Expropriation under Chapter 11 is governed by NAFTA Article 1110, although NAFTA lacks a precise definition of expropriation. That provision reads in pertinent part as follows:

> 1. No Party may *directly or indirectly* nationalize or expropriate an investment of an investor of another Party in its territory or *take a measure tantamount to nationalization or expropriation* of such an investment ("expropriation"), except:
>
> (a) for a public purpose;
> (b) on a non-discriminatory basis;
> (c) in accordance with due process of law and article 1105(1); and
> (d) on payment of compensation in accordance with paragraphs 2 through 6.5

The key issue, in general and in the instant case, is whether the Respondent's actions constitute an expropriation.

98. The Article 1110 language is of such generality as to be difficult to apply in specific cases. In the Tribunal's view, the essential determination is whether the actions of the Mexican government constitute an expropriation or nationalization, or are valid governmental activity. If there is no expropriatory action, factors a-d are of limited relevance, except to the extent that they have helped to differentiate between governmental acts that are expropriation

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5 Emphasis added. Paras. 2-6 provide for compensation "equivalent to the fair market value of the expropriated investment immediately before the expropriation took place;" that compensation be paid without delay and be fully realizable; include interest in a hard currency; and be freely transferable. *Id*. Article 1110(1) (2-6).

and those that are not, or are parallel to violations of NAFTA Articles 1102 and 1105. If there is a finding of expropriation, compensation is required, *even if* the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).

99. The view that the conditions (other than the requirement for compensation) are not of major importance in determining expropriation is confirmed by the Restatement of the Law of Foreign Relations of the United States, a source relied on by many American and Canadian lawyers that has been discussed in the memorials of both the Claimant and the Respondent in this proceeding.6 For example, according to the Restatement, the public purpose requirement "has not figured prominently in international claims practice, perhaps because the concept of public purpose is broad and not subject to effective reexamination by other states." (AMERICAN LAW INSTITUTE, Restatement of the Law Third, the Foreign Relations of the United States, USA, American Law Institute Publishers, Vol. 1, 1987, (hereinafter Restatement), Section 712, Comment g.). Similarly, the Restatement suggests that if proper compensation is paid for an expropriation, the fact that the taking was not for a public purpose and was discriminatory, "might not in fact be successfully challenged." A comment observes, perhaps somewhat inconsistently, that "economic injuries [falling under section 712(3)] are generally unlawful because they are discriminatory or are otherwise arbitrary." (*Id.*, Sec. 712, Comment i.) This last clause suggests that if the government actions (legislative, administrative or judicial) are discriminatory or arbitrary (or perhaps unfair or inequitable), as arguably is the case here, they are more likely to be viewed as expropriatory, imparting a degree of circularity to the "expropriation versus regulation" dichotomy.

100. Most significantly with regard to this case, Article 1110 deals not only with direct takings, but indirect expropriation and measures "tantamount to expropriation," which potentially encompass a variety of government regulatory activity that may significantly interfere with an investor's property rights. The Tribunal deems the scope of both expressions to be

6 Memorial, paras. 151 ff.; counter-memorial, paras. 335 ff. (with some qualifications). It is important to note that the language used by the Restatement, section 712, differs significantly from that used in NAFTA, even though the concepts are similar.

105. The "comments" to the Restatement are designed to assist in determining, *inter alia*, how to distinguish between an indirect expropriation and valid government regulation:

> A state is responsible as for an expropriation of property under Subsection (1) when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory... *A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory....* (Restatement, Section 712, comment g, emphasis supplied.)

106. It is notable that the Restatement comment specifically includes "taxation" as a possible expropriatory action and establishes state responsibility, *inter alia*, for unreasonable interference with an alien's property. At the same time, non-discriminatory, bona fide *general* taxation does not establish liability. The Reporter's Notes to the Restatement further suggest that "whether an action by the state constitutes a taking and requires compensation under international law, or is a police power regulation or tax that does not give rise to an obligation to compensate even though a foreign national suffers loss as a consequence" must be determined in light of all the circumstances (Restatement, Section 712, Reporter's Note 5).

107. Along with the Restatement, this Tribunal has also sought guidance in the decisions of several earlier NAFTA Chapter 11 Tribunals that have interpreted Article 1110. The Tribunal realizes that under NAFTA Article 1136(1), "An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case," and that each determination under Article 1110 is necessarily fact-specific. However, in view of the fact that both of the parties in this proceeding have extensively cited and relied upon some of the earlier decisions, the Tribunal believes it appropriate to discuss briefly relevant aspects of earlier decisions, particularly *Azinian v. United Mexican States* and *Metalclad v. United Mexican States*. Nevertheless, there has been only one prior finding of a taking under Article 1110, in *Metalclad*, and the principal rationale for that decision was substantially overruled by the reviewing court, the Supreme Court of British Columbia. In the other decisions to date which

sought through a tax audit a refund of rebates paid to the Claimant in 1996 and 1997, increased by an inflation factor, interest and possible penalties. Also, under Article 2103(6) of NAFTA, the State Parties expressly confirm that tax regulatory activity may be expropriatory under Article 1110, albeit with significant limitations.9

110. No one can seriously question that in some circumstances government regulatory activity can be a violation of Article 1110. For example, in *Pope & Talbot*, Canada argued that "mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required."10 That tribunal rejected this approach:

> Regulations can indeed be characterized in a way that would constitute creeping expropriation... Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protection against expropriation. (*Id., para.* 99.)

However, the *Pope & Talbot* tribunal failed to find a violation of Article 1110 in that case. This Tribunal finds the legal arguments against a finding of expropriation more persuasive, for reasons described in detail below, and reaches the same conclusion on facts very different from those in *Pope & Talbot.*

111. This Tribunal's rationale for declining to find a violation of Article 1110 can be summarized as follows: (1) As *Azinian* suggests, not every business problem experienced by a foreign investor is an expropriation under Article 1110; (2) NAFTA and principles of customary

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9 First, NAFTA Article 2103 generally excludes tax measures from coverage under NAFTA: "Except as set out in this Article, nothing in this Agreement shall apply to tax measures." However, this exclusion is not absolute. Article 2103(3)(b) makes Article 1102 applicable to tax measures, and Article 2103(6) makes Article 1110 applicable under certain conditions. Article 1105 is not mentioned among the exceptions to the exclusion; therefore, it does not apply to tax measures, other than in a situation in which an expropriation under Article 1110 has been found, and there is an analysis as to whether the expropriatory action met the requirements of due process and Article 1105 as provided in Article 1110(1)(c).

10 *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, paras. 87-88, http://www.state.gov/documents/organization/3989.pdf. Canada also asserted that "tantamount" simply means "equivalent," and that this language was not intended to expand Article 1110's coverage beyond creeping expropriation to cover regulatory action. *Id*. para. 89.

taxpayer (see *supra* para.15). However, even assuming that the Claimant is a "taxpayer" under this provision given the peculiarities of the tax calculation for cigarettes – and there is some doubt as to this conclusion – he could not obtain the required invoices at any relevant time. The Claimant could not obtain the information from the retailers who supplied his cigarettes (since they did not know the tax amounts themselves), and the producers of the cigarettes were unwilling to provide the information.14 Thus, it appears to the Tribunal that the Claimant never really possessed a "right" to obtain tax rebates upon exportation of cigarettes, but only a right to the 0% tax rate. This is important, because as far as the Tribunal can determine, the only significant asset of the investment, the enterprise known as CEMSA, is its alleged right to receive IEPS tax rebates upon exportation of cigarettes, and to profit from that business.15 We also note that the Claimant concedes that "discrimination between cigarette producers and resellers is [not] necessarily a violation of international law." (See Claimant's May 8, 2002 submission, para. 9.) The Claimant relies, rather, on the alleged refusal of Mexican authorities to comply with the 1993 *Amparo* decision and the alleged subsequent agreement between the Claimant and SHCP officials that the Claimant would be permitted the rebates despite the absence of invoices stating the tax amounts separately.

119. The key contentious issue here is whether the denial of IEPS rebates for failure to meet with the invoice requirement constituted expropriation of the Claimant's investment (a right to export cigarettes) under Article 1110. A related issue is the denial of tax rebates for

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14 Although the tax base for the IEPS cigarette tax was the retail sale price, under the IEPS law the party responsible for paying the tax was the producer or its controlled distributor, not the retailer, presumably to assure that the full amount of the taxes would be paid in a distribution system where many of the retailers were small kiosk operators who apparently were not trusted to remit the proper tax amounts to SHCP, or to maintain records adequate to assure SHCP that the full taxes were being paid. See IEPS Law, Article 11 (1991).

15 The record is largely devoid of any statement of CEMSA's physical assets. The Claimant asserts that the initial capitalization of CEMSA upon its formation in 1998 was a total of $ 510,000 Mexican pesos, but there is no indication as to what percentage of this was paid in capital. Feldman declaration of March 28, 2001, para. 1. Moreover, the Claimant's claim for compensation is based almost entirely on a calculation of lost profits and its value as a going business [concern], plus a demand for the rebates anticipated but not paid for October - November 1997. See memorial, para. 231.

exports allegedly made to a low tax jurisdiction (Honduras), also purportedly barred under the IEPS law (see *supra* para.8). However, in determining whether the Claimant was deprived of a "fundamental right of ownership" (the term used by the *Pope & Talbot* tribunal) by Mexican government actions in the critical 1996-1997 period, it is important to observe that the invoice requirements of the IEPS law were not new, and had not been changed by Mexican officials (except to the extent or non-extent of enforcement ) to the detriment of the Claimant. At *all* times between January 1, 1987, including April 1990, when CEMSA was first registered as an export company, and January 1, 1998, when the new IEPS law definitively denied rebates except for the "first sale" in Mexico, Article 4(III) of the IEPS law as written (even if not always as applied) effectively required resellers such as CEMSA to obtain invoices stating the tax amounts separately. Even if the 1999 Mexican Fiscal Court proceeding ultimately results in a decision that the denial of the rebates for 1996-1997 is unconstitutional under Mexican law, this is not a situation in which the Claimant can reasonably argue that post investment changes in the law destroyed the Claimant's investment, since the IEPS law at all relevant times contained the invoice requirements. Of course, Mexico had first sought to ban such exports in 1990 by denying the 0% tax rate to resellers, but that effort was defeated by the Supreme Court. Thus, in retrospect, the Claimant's most intractable problem with regard to cigarette exports was *not* the 0% tax rate, but the technical requirements of the IEPS law with regard to invoices and, much later, the denial of tax rebates for exports to low tax jurisdictions, also clearly stated in the IEPS law during all relevant periods.

120. The Claimant argues that the 1993 *Amparo* Supreme Court decision resolved not only the 0% tax rate, but the invoice and taxpayer limitations in the IEPS law as well, and contends that SHCP improperly limited the scope of that decision to the 0% tax rate. There is language in the opinion that condemns discrimination between producers and other sellers generally, which is not limited to the 0% tax rate. Also, there is some inherent logic behind the Claimant's position; if the Claimant were correct, this would be a strong argument for finding a creeping expropriation or denial of justice. If the *Amparo* decision resolves only the 0% tax rate, but the Claimant cannot satisfy the other requirements of the IEPS law, including Article 4 regarding invoices, there is no possibility of CEMSA's benefiting from that decision with regard

to cigarette exports, as the company is still prevented from carrying on its cigarette export business.

121. The problem for the Claimant is that a careful reading of the *Amparo* Supreme Court decision reveals no mention of Article 4; the discussion is confined solely to the availability of the 0% tax rate under Article 2 of IEPS law to resellers as well as producers, and to a general assessment of the unconstitutionality of discrimination. For various reasons, Article 4 was not raised by the Claimant and was not discussed by the Supreme Court, even though the issue of the 0% tax rate was specifically raised with regard to both alcoholic beverages and cigarettes.16 There is no indication in the opinion that the Supreme Court intended to abrogate or modify this critical provision of the IEPS law, since it apparently did not even consider the issue, and the Tribunal has no way of guessing what the result would have been had the Article 4 issue been squarely presented to the Supreme Court. In this respect, even the Claimant admits that the court in the *Amparo* case did not review the mechanics of IEPS (reply, para. 43). Rather, as noted above, no Mexican court directly addressed these issues until the Claimant brought the April 1998 and March 1999 challenges.

122. Moreover, the *Amparo* judgment limited to Article 2 (and a parallel *Amparo* decision sought by another company, Lynx) *were* successful in protecting the Claimant's (and Lynx's) rights to export alcoholic beverages, since both the Claimant and Lynx could obtain the necessary invoices from their suppliers due to their ability to purchase alcoholic beverages directly from the Mexican manufacturers and function as eligible taxpayers, and the different IEPS tax structure applicable to alcoholic beverages.17 Thus, the decision had considerable

16 Several possible reasons emerged during the hearing. It was suggested that Article 4 of the IEPS law could only have been challenged within 15 days of the enactment of the provision, which occurred in 1984 or 1985, well before CEMSA was incorporated, or tbecause at the time the Article 4 requirements had not been applied to the Claimant (transcript, July 12, 2001, pp. 127-135, testimony of Oscar Enriquez Enriquez).

17 The IEPS applied to alcoholic beverages appears to function in a manner similar to normal value added taxes, with each succeeding seller being treated as a taxpayer. The special rules using the retail price as the tax base but making the producer or distributor the person

(Continued …)

depended substantially on the terms of the IEPS law, the Claimant was or should have been aware at all relevant times that the separate invoice requirement existed, as there has been no *de jure* change in it at any time relevant to this dispute. Equally important, the Tribunal is reluctant to find an expropriation based largely on the failure of Mexican government officials to comply with an agreement in which those officials allegedly waived an explicit requirement of a tax law, even though there is some evidence, albeit contested by the Respondent, that the requirement was *de facto* ignored at some times both for the Claimant and for other cigarette resellers, including but not limited to members of the [so-called] Poblano group.19 This, however, is not in the view of the Tribunal evidence of expropriatory action and will be dealt with below in the section on national treatment.

129. If the IEPS law, Article 4, obligation to possess invoices stating the tax amounts separately was simply a technical requirement of the IEPS law, the result here might be considered formalistic and unreasonable. As noted earlier (para. 114, note 11), it is under challenge as unconstitutional discrimination between taxpayers in Mexico, according to the still pending 1999 Fiscal Court proceedings. However, the Tribunal does not consider the invoicing requirements to be a mere formality or patently unreasonable, to be waived easily by officials based on their discretion. The obvious and legitimate purpose of the requirement that the IEPS tax amounts be stated separately on invoices to be submitted to SHCP authorities on demand as the basis of a tax rebate is to make it possible for the tax authorities to determine in a straight-forward manner whether the tax amounts on exported products for which a rebate is sought are accurate and not overstated. This is clearly a rational tax policy and a reasonable legal requirement.

19 As discussed more fully in the section of this award on discrimination, evidence in the record suggests that there are 5-10 or more firms registered under Mexican law as cigarette exporters. (Obregon-Castellanos testimony, transcript, July 9, 2001, p. 141). It may well be that the requirements of Article 4 have been waived from time to time for them as well given the practical impossibility for resellers to export without the tax rebates, although the Mexican government has unfortunately been unwilling or unable to enlighten the Tribunal on this fact.

130. The Claimant himself is an excellent example of why this requirement is necessary to protect the revenue. Without invoices, it was of course impossible for the Claimant to know the precise amount of the IEPS taxes included in the selling price of the cigarettes he purchased from Walmart or Sam's Club, for his exports in 1996 and 1997. However, a very close approximation of the IEPS tax amounts could have been made by the Claimant for these years, just as it was in 1992 (see Zaga-Hadid affidavit, annex A) based on the IEPS tax rate for cigarettes applicable in 1996 and 1997 (85%), by dividing the selling price (inclusive of tax) by 1.85 to determine the price net of taxes, and then subtracting that amount from the selling price to determine the tax amounts. For example, if as the Claimant alleges, he paid US$7.40 per carton for cigarettes, and the tax rate specified in the IEPS law was 85%, the tax included in the US$7.40 price was approximately US$3.40.20

131. The Claimant apparently used this formula in 1992, and received the rebates. He used a somewhat different formula in 1996, which over-stated the rebate amounts.21 Then, in 1997, he used a completely different formula, which had the effect of grossly overstating the tax amounts, US$6.55 instead of US$3.40 per carton, an overstatement of 93%.22 The Claimant asserts that this methodology was explicitly approved by Director of Major Taxpayers Jose Riquer Ramos (Feldman affidavit, Mar. 28, 2001, para. 70). Mr. Riquer has denied this (Riquer statement, May 17, 2001, paras. 19-25). In the final analysis, the Tribunal does not find the Claimant's testimony on this issue to be credible. It is inconceivable to the Tribunal that even if SHCP officials were prepared to forego the invoice requirement informally during some periods,

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20 Using the formula 7.40 = 1.85 X, where X is the price net of tax, X = 7.40/1.85 = 4.00. (*See* Feldman affidavit, Mar. 28, 2001, para. 6.) The remaining amount is the tax, US$7.40 - US$4.00 = US$3.40. See IEPS law, Article 2(1)(H).

21 Although the methodology used in 1996 is relatively obscure (see Zaga-Hadid affidavit, annex A, exh. 3 of memorial), the result of the methodology used was to increase the portion of the purchase price treated as IEPS taxes subject to rebates from 45.95% to 55.95% of the purchase price.

22 He arrived at this figure by simply multiplying the price of US$7.40 by 85%, in other words, treating 85% of the purchase price as tax amounts subject to government rebate upon exportation. (Zaga-Hadid affidavit, annex 3; first Feldman statement, para. 70.) This increased the tax amounts, in an unwarranted way, from 45.95% to 85% of the gross sales price.

*Metalclad,* Supreme Court of British Columbia, Reasons for Judgment of the Honorable Mr. Justice Tysoe, May 2, 2001, paras. 70-74, http://www.naftalaw.org.; transparency is a general NAFTA obligation of the NAFTA Parties under Chapter 18). While this Tribunal is not required to reach the same result as the British Columbia Supreme Court, it finds this aspect of their decision instructive.

134. Under the circumstances, therefore, the Claimant would have been wise to seek a formal administrative ruling on the applicability of Article 4 of the IEPS, and court review if the ruling were adverse, far before he was forced to do so in 1998, but for whatever reason he chose not to do so. Formal administrative procedures and the courts, according to the record, were at all times available to him, and have not been challenged here as being inconsistent with Mexico's international law obligations. Moreover, in Mexico, as in the United States and most other countries, oral or informal opinions are not binding on the tax authorities (see Article 34 of Fiscal Code, counter-memorial, paras. 18-20). Regardless of the results of the ruling process the Claimant would have been better off. If he had received a favorable ruling on Article 4, it would have been much easier for him to defend his rights under Mexican law and before this Tribunal. If he had lost, he could have at least avoided the uncertainties of his alleged right to rebates during much of the 1992-1997 period, and could have brought a NAFTA claim under Chapter 11 much earlier.

H.3.4 Public Purpose

135. As noted earlier, in the absence of a finding of expropriation and in view of the Restatement comments the Tribunal is reluctant to give excessive weight to the public purpose, non-discrimination and due process criteria in Article 1110(1). However, in this instance even if they are considered significant the Tribunal believes that they do not contradict an otherwise negative finding. The Claimant suggests, accurately in the view of this Tribunal, that Mexican government policy is designed to prevent cigarette resellers including CEMSA from exporting cigarettes from Mexico to other countries. He attributes this to political pressures from Carlos Slim, a major owner of Mexico's largest cigarette producer, Cigatam. He alleges that this policy is in conflict with normal Mexican policies that promote exports, and cites such policies as

evidence that the restrictions do not have a valid public purpose (see memorial, paras. 31, 188, 189).

136. However, the Tribunal has already indicated its view that there are rational public purposes for this policy. These include, *inter alia*, discouraging "grey" market exports and seeking to control illegal re-exportation of Mexican cigarettes into Mexico. There is ample evidence on the record to suggest that cigarette smuggling is a significant problem for Mexico, even if that evidence does not effectively link the Claimant with the illegal imports.24 It may be that Mexican authorities feel they have greater control over cigarette producers who export (or that such producers are constrained by licensing agreements, such as the one that presumably exists between Philip Morris of the United States and Cigatam, the Marlboro producer, in Mexico), than they do over independent resellers. Also, as noted above, there are valid public policy reasons for requiring invoices that separately state the IEPS tax amounts as a condition of receiving the refunds, i.e., to prevent inaccurate or excessive claims for rebates.25

H.3.5 Non-Discrimination

137. The Chapter 11 scheme establishes a right to national treatment for investors (and damages for breach thereof) that is distinct from the right to damages from acts of expropriation.26 In this respect, the Tribunal notes that the *S.D. Myers* tribunal, having weighed

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24 Respondent made an extensive effort in its briefs and during the hearing to document a series of export transactions by the Claimant, and to link those exports with re-entry of the cigarettes into Mexico. While Respondent was unable to demonstrate that the Claimant was aware of any such illegal practices, or that any of the cigarettes the Claimant exported were re-entered into Mexico, Respondent did demonstrate evidence of a serious problem. Counter-memorial, pp. 104-116, and transcript, July 12, 2001, pp. 148 ff.

25 See *supra*, paras. 130, 131, and Respondent's exhibits for cross-examination of the Claimant, Vol. II, tab 6.

26 Moreover, under international law, there is considerable doubt whether the discrimination provision of Article 1110 covers discrimination other than that between nationals and foreign investors, i.e., it is not applicable to discrimination among different classes of investors, such as between producers and resellers of tobacco products, at least unless all producers are nationals and all resellers are aliens. Thus, under the Restatement, the relevant comment states that "a program of taking that singles out aliens generally, or aliens of a (Continued …)

150. *S.D. Myers v. Canada* involved a government action barring exports (hazardous waste). There, the tribunal noted that expropriation normally constitutes a taking of "property" with a view toward transfer of ownership,31 a situation that did not occur in that case or in this one. No expropriation was found in *S.D. Myers*, although the Tribunal did find violations of Articles 1102, 1105 and 1106 (see paras. 123, 256, 280, 284).

151. Somewhat different issues arise in comparison with *Pope & Talbot* which again focused on the alleged denial of a right to export, in this instance, softwood lumber.32 The *Pope & Talbot* Tribunal had opined (in what would be considered *dicta* in the US legal system) that regulatory measures could constitute expropriation under Article 1110, and found that the lumber export control regime came within Article 1110. However, it also noted that the investor was able to continue to export and to earn profit on those exports, and declined to find a violation of Article 1110, based on this consideration and on the ground that the investor "remains in control of the Investment, it directs the day-to-day operations of the Investment, and no officers or employees of the Investment have been detained.... Canada does not...take any other actions outing the Investor from full ownership and control of his investment." The Tribunal suggested further that in determining "whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from its owner." ( *ibid.*, paras. 100, 102.)

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31 *S.D. Myers v. Government of Canada* , Partial Award, November 13, 2000, para. 280, http://www.state.gov/documents/organization/3992.pdf .

32 The Claimant had argued that the Canadian lumber export control regime had "deprived the Investment of its ordinary ability to alienate its product to its traditional and natural market," and that by reducing the claimant's quota of lumber that could be exported to the United States without paying a fee, Canada violated Article 1110. *Pope & Talbot v. Government of Canada*, Interim Award, June 26, 2000, para. 81, http://www.state.gov/documents/organization/3989.pdf .

claiming such rebates unless those claimants have invoices showing the tax amounts stated separately. Thus, a SHCP official would be acting *ultra vires* if he agreed that CEMSA could apply for and receive IEPS rebates without regard to the amounts or whether the correct formula for calculating the rebates was used by CEMSA. Moreover, the fact that the overstatement of the rebate amounts by CEMSA was discovered only after an audit reinforces the reasonableness of Mexican legislation (Article 4 of the IEPS law) which requires a taxpayer to have invoices with the correct tax amounts stated therein as a condition of receiving the rebates.

161. Thus, according to the Respondent, there is simply no indication of discrimination between foreign investors and domestic investors in this instance. Evidence on the record indicates that the Poblano group, like CEMSA, even if unrelated, is also being audited with regard to irregularities in tax payments. SHCP conducts hundreds or thousands of audits each year and the fact that it audits one company (which happens to be foreign) sooner than it audits a company in like circumstances (which happens to be domestic) is not in itself evidence of discrimination. Administrative agencies must receive some latitude in carrying out their duties, as the tribunals in *Pope & Talbot v. Canada* and *S.D. Myers v. Canada* have stated.

162. According to Mexico, denial of CEMSA's registration as an export trading company – a separate but related issue – was not a denial of national treatment, because in this instance CEMSA and the Poblano Group were not in like circumstances. CEMSA was at the time under audit and SHCP had discovered discrepancies in the amounts of the IEPS rebates sought for 1996 and 1997. The Poblano Group was not at that time under audit. Thus, it was reasonable for SHCP to deny export registration to CEMSA until the irregularities discovered in the audit had been resolved.

163. Assuming, *arguendo*, that there is different treatment, Mexico argues that it is not sufficient under Article 1102 just to show different treatment for there to be a violation of Article 1102. Rather, any discrimination shown between the Claimant and domestically owned cigarette seller/exporters must be shown to be a result of the fact that the Claimant is a foreign national. (rejoinder, para. 174; see transcript, July 10, 2002, pp. 107-109.)

164. Neither Canada nor the United States has exercised its right under Article 1128 to express views on the proper interpretation of Article 1102 in its Article 1128 submission, and the Tribunal for that reason is left to consider only the views of the Claimant and Mexico.34

I.2 Analysis by the Tribunal

165. The national treatment/non-discrimination provision is a fundamental obligation of Chapter 11.35 The concept is not new with NAFTA. Analogous language in Article III of the GATT has applied as between Canada and the United States since 1947, and with Mexico since 1985, with regard to trade in goods. Article 1602 of the United States - Canada Free Trade Agreement, with regard to investment, applied between those two NAFTA Parties from 1989-1993. NAFTA's Article 1102(2) provides that

"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."

(Article 1102(1) is the same except that it refers to "investors" rather than to "investments of investors;" under Article 1102(3), the obligation applies to state/provincial governments as well, but this is not relevant here.)

166. Despite its deceptively simple language, the interpretative hurdles for Article 1102 are several. They include (a) which domestic investors, if any, are in "like circumstances" with the foreign investor; (b) whether there has been discrimination against foreign investors, either *de jure* or *de facto*; (c) the extent to which differential treatment must be demonstrated to

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34 Mexico has provided excerpts from United States submissions in other cases, which imply that there must be a showing that the reason for differential treatment is nationality. See, *e.g.,* U.S. Submission of April 7, 2000, in *Pope & Talbot,* http://www.state.gov/documents/organization/4097.pdf. However, such statements were made in the context of cases with different fact situations and, possibly, legal and policy considerations. Under those circumstances, this Tribunal chooses not to consider them.

35 See Daniel M. Price & P. Brian Christy, *An Overview of the NAFTA Investment Chapter, in* The North American Free Trade Agreement: A New Frontier in International Trade and Investment in the Americas 165, 174 (Judith H. Bello, Allan F. Holmer & Joseph J. Norton, eds., 1994).

Poblano Group was provided IEPS tax rebates denied during some periods to the Claimant, notwithstanding the same lack of invoices stating the tax amounts separately, as required by Article 4 and, after January 1, 1998, notwithstanding the bar to rebates except on the first sale. There is also a lack of detailed information as to whether SHCP has made effective efforts to recoup the rebates provided to the Poblano Group for the 1996-1997 period, as it has with respect to the Claimant, or for IEPS payments made in 1998 to 2000. On the grounds that there is an ongoing audit of Caesar Poblano, the principal owner of the Poblano Group companies, SHCP has declined to provide any detailed information on the treatment of the Poblano Group and how that treatment compares to treatment by SHCP of the Claimant. One of SHCP's witnesses, Mr. Diaz Guzman, did, however, state that only one of the three trading companies he identified was in the process of audit (as of March 2001), so presumably there are two others which have not been audited, despite being in like circumstances with the Claimant.

169. Also, given that this is a case of likely *de facto* discrimination, it does not matter for purposes of Article 1102 whether in fact Mexican law authorizes SHCP to provide IEPS rebates to persons who are not formally IEPS taxpayers and do not have invoices setting out the tax amounts separately, as has been required by the IEPS law consistently since at least 1987 and perhaps earlier. 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.

### I.2.1 In Like Circumstances

170. In the investment context, the concept of discrimination has been defined to imply *unreasonable* distinctions between foreign and domestic investors in like circumstances (Restatement, Sec. 712, Comment f). As discussed in the Article 1110 section (*supra,* paras. 115, 129), there are at least some rational bases for treating producers and re-sellers differently, *e.g.*, better control over tax revenues, discourage smuggling, protect intellectual property rights,

and prohibit gray market sales, even if some of these may be anti-competitive.37 Thus, as discussed in the expropriation section, the Tribunal does not believe that such producer - reseller discrimination is a violation of international law.

171. In this instance, the disputing parties agree that CEMSA is in "like circumstances" with Mexican owned resellers of cigarettes for export, including the two members of the Poblano Group, Mercados Regionales and Mercados Extranjeros (see memorial, para. 222; counter-memorial, para. 486), although Mexico of course denies that there has been any discrimination largely on the ground that CEMSA and the Poblano Group are effectively the same entity. In the Tribunal's view, the "universe" of firms in like circumstances are those foreign-owned and domestic-owned firms that are in the business of reselling/exporting cigarettes. Other Mexican firms that may also export cigarettes, such as Mexican cigarette producers, are not in like circumstances. While the Claimant's *Amparo* decision held discrimination between producers and resellers of alcohol and tobacco products (at least as to the availability of the 0% tax rate for exported goods) to be unconstitutional, such discrimination is effectively reinstated by the 1998 IEPS law that limits IEPS tax rebates to the first sale, excluding any subsequent purchaser/exporter from the benefit, and has effectively been upheld in the other litigation brought by the Claimant in 1998, also discussed earlier. The Tribunal also notes that Article 1102 says nothing regarding discrimination among different classes of a Party's own investors.

172. Accordingly, the Tribunal holds that the companies which are in like circumstances, domestic and foreign, are the trading companies, those in the business of purchasing Mexican cigarettes for export, which for purposes of this case are CEMSA and the corporate members of the Poblano Group.

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37 With minor exceptions, NAFTA does not regulate the creation and maintenance of monopolies. "Nothing in this Agreement shall be construed to prevent a Party from designating a monopoly." Article 1502(1). Thus, affording cigarette producers a monopoly on exports would not appear to be an article 1102 violation, as long as all non-producers, both domestic and foreign, are treated in the same manner.

than five, and likely more than ten firms registered as cigarette exporters (transcript, July 9, 2001, p.141), but was evasive with regard to tobacco exporter numbers even though he testified confidently and explicitly that there were 400 registered exporters of alcoholic beverages (transcript, July 11, 2001, p. 10).

175. The evidence also shows that CEMSA was denied registration as an export trading company, apparently in part because this action was filed, and in part as a result of the ongoing audit of the rebates for exports during 1996 and 1997, even though, as Mr. Diaz Guzman indicated, three other cigarette export trading companies had been granted registration. An unsigned memorandum which reasonably could have been generated only in SHCP indicates that registration was being denied on the basis of the audit of the Claimant's rebate payments. There is no evidence that any domestic reseller/exporter has been denied export privileges in this manner. Moreover, there appears to have been differential treatment between CEMSA and Mr. Poblano with regard to registration issues as well. According to the Claimant's witness, Mr. Carvajal, taxpayer CEMSA filed its application for export registration status on June 30, 1998; information was still being requested in writing seven months later. For taxpayer Mr. Poblano, information was requested by SHCP orally within 14 days of the date of Poblano's application, and any questions were apparently resolved (transcript, July 11, 2001, p. 3).

176. The extent of the evidence of discrimination on the record is admittedly limited. There are only a few documents in the record bearing directly on the existence of differing treatment, particularly the statement of Mr. Diaz Guzman, the "mystery" memorandum from SHCP's files, and the tax registration statement for Mercados Regionales, owned by the Poblano Group. One member of this Tribunal believes that this evidence on the record is insufficient to prove discrimination (see dissent). The majority's view is based first on the conclusion that the burden of proof was shifted from the Claimant to the Respondent, with the Respondent then failing to meet its new burden, and on an assessment of the record as a whole. But it is also based on a very simple two-pronged conclusion, as neither point was ever effectively challenged by the Respondent:

a. No cigarette reseller-exporter (the Claimant, Poblano Group member or otherwise) could legally have qualified for the IEPS rebates, since none under the facts established in this

case would have been able to obtain the necessary invoices stating the tax amounts separately.

b. The Claimant was denied the rebates at a time when at least three other companies in like circumstances, i.e. resellers and exporters (see *supra* para. 171) apparently including at least two members of the Poblano Group, were granted them.

177. On the question of burden of proof, the majority finds the following statement of the international law standard helpful, as stated by the Appellate Body of the WTO:

> … various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or respondent, is responsible for providing proof thereof. Also, it is a generally accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a claim or defence. *If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.* (Emphasis supplied.)38

Here, the Claimant in our view has established a presumption and a *prima facie* case that the Claimant has been treated in a different and less favorable manner than several Mexican owned cigarette resellers, and the Respondent has failed to introduce any credible evidence into the record to rebut that presumption.

178. In weighing the evidence, including the record of the five day hearing, the majority is also affected by the Respondent's approach to the issue of discrimination. If the Respondent had had available to it evidence showing that the Poblano Group companies had not been treated in a more favorable fashion than CEMSA with regard to receiving IEPS rebates, it

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38 *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, Adopted 23 May 1997, WT/DS33/AB/R, p. 14. Accordingly, *Asian Agricultural Products Limited v. Republic of Sri Lanka*, ICSID Reports, pp. 246, 272, 1990. ("In case a party adduces some evidence which *prima facie* supports his allegation, the burden of proof shifts to his opponent.").

despite the likely absence of invoices stating the tax amounts separately (*e.g*. memorial, para. 36; App. 1047-1070). As a result of this decision and Lynx' *Amparo* victory (which applied specifically only to alcoholic beverage exports), SHCP also paid rebates to Lynx for IEPS taxes applicable to cigarette exports in 1992, along with substantial additional amounts for interest and inflation.40 This was a period during which CEMSA faced uncertainty over the availability of rebates for cigarette exports, despite the fact that limited exports were made in 1992 by CEMSA. However, by 1996, when SHCP recognized Lynx' right to the rebates, SHCP had denied rebates to CEMSA for test shipments for several years.

180. All of this confirms a further weakness in the Respondent's argument that there can be no *de facto* discrimination under circumstances where rebates are essentially granted initially on the basis of a ministerial decision, with the detailed analysis coming later in the event of questions or an audit. Given the Claimant's notoriety at SHCP over the years, the newspaper articles and threats of litigation against SHCP officials, the audit that was initiated and then abruptly terminated in 1995, the multiple meetings with SHCP officials, etc., it is difficult for the Tribunal to believe that the Claimant's requests and actions were not well-known to and carefully monitored by SHCP officials. Those factors certainly created the necessary conditions for discrimination.

I.2.3 Discrimination as a Result of Nationality

181. It is clear that the concept of national treatment as embodied in NAFTA and similar agreements is designed to prevent discrimination on the basis of nationality, or "by reason of nationality." (U.S. Statement of Administrative Action, Article 1102.) However, it is not self-evident, as the Respondent argues, that any departure from national treatment must be

40 See Zaga-Hadid testimony, transcript, July 13, 2001, p. 142, tables introduced into evidence during the hearing. Allegations that Lynx had been intentionally paid excessive rebates by SHCP were denied (third witness statement of Diaz-Guzman, App. 06455-06456) and further disputed at the hearing by both parties. The evidence on this issue before the Tribunal is conflicting, and the Tribunal is not convinced that the amounts paid, including interest paid and the inflation adjustment for the 1993-1996 period, were in fact excessive.

*explicitly* shown to be a result of the investor's nationality. There is no such language in Article 1102. Rather, Article 1102 by its terms suggests that it is sufficient to show less favorable treatment for the foreign investor than for domestic investors in like circumstances. In this instance, the evidence on the record demonstrates that there is only one U.S. citizen/investor, the Claimant, that alleges a violation of national treatment under NAFTA Article 1102 (transcript, July 13, 2001, p. 178), and at least one domestic investor (Mr. Poblano) who has been treated more favorably. For practical as well as legal reasons, the Tribunal is prepared to assume that the differential treatment is a result of the Claimant's nationality, at least in the absence of any evidence to the contrary.

182. However, in this case there is evidence of a nexus between the discrimination and the Claimant's status as a foreign investor. In the first place, there does not appear to be any rational justification in the record for SHCP's less favorable *de facto* treatment of CEMSA other than the obvious fact that CEMSA was owned by a very outspoken foreigner, who had, prior to the initiation of the audit, filed a NAFTA Chapter 11 claim against the Government of Mexico. Certainly, the action of filing a request for arbitration under Chapter 11 could *only* have been taken by a person who was a citizen of the United States or Canada (rather than Mexico), i.e., as a result of his (foreign) nationality. While a tax audit in itself is not, of course, evidence of a denial of national treatment, the fact that the audit was initiated shortly after the Notice of Arbitration (first Feldman affidavit, paras. 85-86) and the existence of the unsigned memo at SHCP noting the filing of the Chapter 11 claim in the context of the Claimant's export registration efforts, at minimum raise a very strong suspicion that the events were related, given that no similar audit action was taken against domestic reseller/exporter taxpayers at the time.

183. More generally, requiring a foreign investor to prove that discrimination is based on his nationality could be an insurmountable burden to the Claimant, as that information may only be available to the government. It would be virtually impossible for any claimant to meet the burden of demonstrating that a government's motivation for discrimination is nationality rather than some other reason. Also, as the Respondent argues, if the motives for a government's actions should not be examined, there is effectively no way for the Claimant or this Tribunal to make the subjective determination that the discriminatory action of the government is a result of

investors that are treated less favorably, that is, in the same manner as the foreign investor. At the same time, there is no language in Article 1102 that states that the foreign investor must receive treatment equal to that provided to the *most* favorably treated domestic investor, if there are multiple domestic investors receiving differing treatment by the respondent government.

186. It may well be that the size of the domestic investor class here is larger than two – one Mexican government witness stated that there might be 5-10 or more registered to export cigarettes – and it may also be that some of those other investors have been treated in a manner more similar to the Claimant's treatment than to the more favorable treatment afforded to the Poblano Group. However, in the absence of evidence to this effect presented by Mexico – the only party in a position to provide such information – the Tribunal need not decide whether Article 1102 requires treatment equivalent to the best treatment provided to *any* domestic investors. Presumably, if there was evidence that another domestic investor had 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. In this case, the known "universe" of investors is only two, or at the most three, one foreign (the Claimant) and one domestic (the Poblano Group companies), and the Tribunal must make its decision on the evidence before it. Thus, the only relevant domestic investor is the Poblano Group and the comparison must be between the Poblano Group and Claimant.

187. 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 favorable treatment of the Claimant, compared with treatment by SHCP of the Poblano Group. For the Poblano Group and for other likely cigarette reseller/exporters, 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

case of only *de facto* discrimination (memorial, para. 233). Regarding the valuation of damages, the Claimant asks for three elements of compensation (memorial, paras. 236-246):
(1) $64,582,645 Mexican pesos (or US$6,458,264) for IEPS due in the period of October-December 1997; (2) $90,350,605 Mexican pesos (or US$9,035,060) for lost profits in the period of January 1, 1994 - May 1996, calculated on the expected exports applying a profit margin of 62.4% and (3) $148,886,141 Mexican pesos(or US$14,888,614), requesting CEMSA's "going concern value" on the basis of the present discounted value of the future cash flow. The sum of the three elements amounts to $303, 819, 391 Mexican pesos (or US$30,381,938).

191. In his reply of June 11, 2001, the Claimant asserted that his calculation of IEPS, even if erroneous, was never challenged by the Respondent (reply, paras. 72-75). He adds a claim for lost profits after December 1, 1997, without specifying any amounts (reply, para. 76(3)). He concludes by alleging that, even if CEMSA claimed more IEPS than Cigatam already paid, it would "still be entitled to damages in the order of twenty million dollars" (reply, para. 78).

192. The Respondent, on the other hand, alleges that CEMSA's financial records in the critical period were either inadequate or missing altogether. In addition, it is asserted that CEMSA's cigarette export business was not profitable (counter-memorial, paras. 513-517). Further, the Respondent denies that CEMSA was "a normal trading company" (counter-memorial, para. 560) or had any fair market value at all material times (counter-memorial, paras. 532-539, 564).

193. In its rejoinder, the Respondent objects to the calculation of damages by the Claimant (rejoinder, paras. 202-262). In particular, the Respondent challenges the new claim for lost profits and concludes that the gross profit on each carton sold could be, at best, only five cents (rejoinder, para. 258).

194. The Tribunal, first, observes that under NAFTA Article 1117(1) *in f.* (as well as Article 1116(1) *in f.*) an investor of a Party on behalf of an enterprise may submit to arbitration a claim that the other Party violated, among other provisions, the obligation to accord national

200. Again, even had there been greater specificity on the part of the Claimant, the Tribunal is not convinced on the basis of the evidence in the record that CEMSA's operations would have been profitable, should CEMSA had received the IEPS rebates during the relevant time in the proper amounts. As discussed earlier, when the IEPS tax rate was 85%, the Claimant erroneously treated 85% of the invoice price as taxes subject to rebate. (In fact, only approximately 45.95% of the invoice price was properly attributable to taxes.) If the gross price to Sam's was US$7.40, and it is assumed that the IEPS rebate is 85% of the gross price, the net price (less the rebates) would be US$4.00 (7.40/1.85). This produces a gross margin of only US$0.05 from an export selling price of US$4.05, which could not possibly cover the Claimant's expenses, including but not limited to the 14% interest on his loans from the Poblano Group (see Feldman affidavit, paras. 6, 72). Even if these approximations are slightly off, there is simply insufficient gross margin to cover normal operating expenses, let alone profit, unless of course, the Claimant can obtain IEPS tax rebates from SHCP, as he did in 1996 and 1997.

201. Assertions that the Claimant, had he been aware of the correct amount of the rebates, would have simply raised his US$4.05 per carton selling price, are totally unpersuasive from a business or economic point of view. Any reasonable businessman would set his prices based on supply and demand. If the Claimant could have obtained US$5.00 or US$6.00 or more per carton, he undoubtedly would have done so, as the Respondent contends (see rejoinder, paras. 216-221). Moreover, the Claimant had no significant customer base. All of his sales in his best year, 1997, were either to members of the Poblano Group, or to an apparently fictitious company, Dilosa, S.A. which may have been allegedly doing business in Honduras, a low tax jurisdiction for which IEPS rebates were not legally available (IEPS Law, 1997, Article 2(III)). In short, the Tribunal is convinced that the Claimant did not have a viable business exporting cigarettes purchased from retailers in Mexico, and could not have made a profit regardless of whether SHCP provided the IEPS rebates, assuming of course that the rebates sought and provided approximated the actual amount of IEPS taxes originally assessed on the cigarettes.

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operation could not have been profitable, and a money losing business seldom has significant value as a going concern.

31 Cal.4th 363
Supreme Court of California

Henry V. LANTZY et al., Plaintiffs and Appellants,
v.
CENTEX HOMES et al.,
Defendants and Respondents.

No. S098660.
|
Aug. 4, 2003.
|
As Modified Aug. 27, 2003.

**Synopsis**

**Background:** Subdivision homeowners brought action against developer and related entities for breach of implied warranty, strict liability, and negligence. The Superior Court, Contra Costa County, No. C99–03025, David Bernard Flinn, J., sustained developer's demurrer without leave to amend. Homeowners appealed. The Court of Appeal reversed.

**Holdings:** Upon granting developer's petition for review, superseding opinion of the Court of Appeal, the Supreme Court, Baxter, J., held that:

ten-year limitations period to bring action for latent defect in construction involving real property is not subject to equitable tolling while potential defendant's promises or attempts to repair defect are pending; disapproving *Grange Debris Box & Wrecking Co. v. Superior Court*, 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515, and *Cascade Gardens Homeowners Assn. v. McKellar & Associates*, 194 Cal.App.3d 1252, 240 Cal.Rptr. 113;

defendants may be equitably estopped to assert statute of limitations as defense to action concerning latent construction defect;

developer and related entities were not equitably estopped from asserting that homeowners' claims were barred; and

homeowners were not entitled to opportunity to amend first amended complaint to state facts sufficient to set forth equitable estoppel.

Judgment of Court of Appeal reversed.

Werdegar, J., filed dissenting opinion, in which Kennard, J., concurred.

Opinion, 107 Cal.Rptr.2d 795, superseded.

**Attorneys and Law Firms**

***657 *365 **520** Duke Gerstel Shearer, Dawn R. Brennan and Alan R. Johnston, San Diego, for Plaintiffs and Appellants.

Luce, Forward, Hamilton & Scripps, Charles A. Bird, San Diego; Morgan, Miller & Blair, Kenneth M. Miller and Kathleen M. DeLaney, Walnut Creek, for Defendants and Respondents.

Fred J. Hiestand for the Civil Justice Association of California as Amicus Curiae on behalf of Defendants and Respondents.

David S. Jaffe; Piper Marbury Rudnick & Wolfe, Jeffrey A. Rosenfeld, Los Angeles, and Stephen R. Mysliwiec for National ***658** Association of Builders as Amicus Curiae on behalf of Defendants and Respondents.

Dale, Braden & Hinchcliffe, George D. Dale and Dianne M. Costales for the California Building Industry Association as Amicus Curiae on behalf of Defendants and Respondents.

**Opinion**

***366** BAXTER, J.

Depending on the theory of recovery, a lawsuit alleging a latent defect in the construction of an improvement to real property must be brought within three or four years after the plaintiff discovers the defect, or should have done so. (See Code Civ. Proc., §§ 337, subd. 1, 338, subds. (b), (c); *Regents of University of California v. Hartford Acc. & Indem. Co.* (1978) 21 Cal.3d 624, 630, 147 Cal.Rptr. 486, 581 P.2d 197 (*Regents* ).)[1] However, a 1971 statute established a further general rule that no action for latent construction defects may be commenced more than 10–years after "substantial completion" of the construction project. (§ 337.15; as enacted by Stats.1971, ch. 1569, § 1, p. 3149.)[2] This "absolute" 10–year limitations period applies regardless of when the defect was discovered. (*Regents, supra,* at p. 631, 147 Cal.Rptr. 486, 581 P.2d 197.)

  

Pre–1971 cases held that the discovery-based limitations period for a latent-defect suit alleging breach of an express or implied warranty is "tolled"—that is, halted and suspended in progress—while the defendant's promises or attempts to honor the warranty by repairing the defect are pending. Relying heavily on these earlier authorities, and in suits not confined to warranty theories, two Court of Appeal cases concluded that the alternate 10–year statute of limitations of section 337.15 is also subject to tolling for repairs. (*Grange Debris Box & Wrecking Co. v. Superior Court* (1993) 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515 (*Grange Debris* ); *Cascade Gardens Homeowners Assn. v. McKellar & Associates* (1987) 194 Cal.App.3d 1252, 240 Cal.Rptr. 113 (*Cascade Gardens* ).) A more recent Court of Appeal decision disagreed. (*FNB Mortgage Corp. v. Pacific General Group* (1999) 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841 (*FNB Mortgage* ).)

****521** Here the trial court sustained a demurrer without leave to amend and dismissed the action, concluding that the 10–year limitations period could not be extended by a defendant's promises or attempts to repair. The Court of Appeal reversed this judgment. The appellate court held that section 337.15 is subject both to equitable tolling during periods of repair and to equitable estoppel if defendants engaged in conduct that delayed the filing of suit. We granted review to resolve the extent to which the doctrines of equitable ***367** tolling and equitable estoppel should apply to the 10–year statute of limitations set forth in section 337.15.

We agree with *FNB Mortgage, supra,* 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841, that section 337.15's 10–year statute of limitations for latent construction defects is not subject to a general rule of equitable *****659** tolling while promises or attempts to repair are pending. A broad tolling-for-repairs rule would contravene the Legislature's clear intent, at the time it adopted section 337.15, to ensure a generous but firm cutoff date for latent-defect suits. Moreover, the extraordinary length of the limitations period set forth in section 337.15 weighs strongly against the need for such a tolling rule as a matter of fair procedure.

Though we thus find no basis for equitable *tolling* during any period in which the defendant's promises or efforts to repair are pending, we do not foreclose application of the distinct doctrine of equitable *estoppel.* A defendant whose conduct induced plaintiffs to refrain from filing suit within the 10–year period might be equitably estopped to assert that the statute of limitations had expired. However, plaintiffs' first amended complaint alleges no facts sufficient to establish such an estoppel, and we find no basis upon which to allow a further opportunity to amend.

We will therefore reverse the Court of Appeal's judgment. We will also disapprove the *Grange Debris* and *Cascade Gardens* decisions insofar as they conflict with the views expressed in this memorandum.

## FACTS

Plaintiffs filed their original complaint on August 5, 1999, and a first amended complaint on December 3, 1999, asserting both individual and class claims. The first amended complaint alleged as follows:

The Eagles Ridge project is a 450–unit development of single-family homes in Antioch. Defendants—Centex Homes and related entities (collectively Centex), American Consolidated Industries, Inc., and numerous Does—variously designed, developed, built, and/or sold the Eagles Ridge homes, or designed, manufactured, sold, and/or installed the windows. The four individual plaintiffs, whose claims typify those of the other class members, are homeowners within the development who bought their houses directly from defendants. The Eagles Ridge homes suffer from design or manufacturing defects, including leaks in the windows and window systems, that have caused damage to each of the individual residences. These defects were discovered within three years before the lawsuit was filed. They may have developed earlier, but could not have been discovered sooner with reasonable diligence. "[A]s problems resulting from unknown defects were discovered," ***368** defendants represented to plaintiffs that they would correct all problems, were experts in the construction field, and would take the steps required to ensure the quality and integrity of the residences. "[A]t various times [d]efendants have attempted to make repairs ... or advised plaintiffs that the ... windows were not defective and not to file a lawsuit." Despite their promises and attempts to repair, defendants "have not properly completed [,] reconstructed, repaired and/or restored the windows, interior waterproofing systems, and walls associated therewith." By their conduct, defendants are estopped to assert that the statute of limitations has expired. Damages are recoverable on theories of implied warranty, strict liability, and negligence.

  

Defendants demurred on two grounds. They urged the entire action was barred by section 337.15's 10–year limitations period for latent construction defects. They also insisted the complaint's class allegations were insufficient. In support of their statute of limitations argument, defendants asked the court to take judicial notice that the Notices ****522** of Completion on the four homes owned by the individual plaintiffs were recorded in November 1988, some *****660** 10–years and 9 months before plaintiffs filed their original complaint.

In response, plaintiffs urged that the first amended complaint properly pled a class action. With respect to the statute of limitations, plaintiffs argued that the complaint sufficiently alleged both *equitable tolling* for repairs and *equitable estoppel* to assert the statute by virtue of defendants' conduct that forestalled a timely lawsuit.

On April 24, 2000, the trial court filed its "Order After Hearing on Demurrer." The order sustained the demurrer without leave to amend on grounds that the action was barred by the statute of limitations. The order reasoned: The parties "appear to agree" that, unless "tolled" for about nine months, section 337.15's 10–year limitations period had expired before the complaint was filed. [3] For two reasons, the allegations of the complaint are not *specific* enough to establish a repairs-based "estoppel." First, plaintiffs allege *in the alternative* that defendants *either* promised and attempted to repair *or* denied the defects and made demands not to sue; the latter conduct is insufficient to create an "estoppel." Second, by alleging simply that repairs were attempted "at various times," plaintiffs leave open the possibility this conduct occurred *after November 1998* (when the statute of limitations expired unless tolled), and thus was not timely to create a "tolling." Amendments might cure these factual deficiencies, but amendment would be futile here, because section 337.15 is a "statute of repose," and thus is not subject to "equitable tolling" for repairs.

***369** Plaintiffs appealed, and the Court of Appeal reversed. Unlike the trial court, the Court of Appeal agreed with those decisions (*Grange Debris, supra,* 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515; *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113) that extended equitable tolling for repairs to section 337.15, and rejected the contrary reasoning of *FNB Mortgage, supra,* 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841. Moreover, the Court of Appeal concluded, just as section 337.15 is subject to equitable tolling, the statute also is not immune from equitable estoppel. The Court of Appeal ruled that plaintiffs had pled grounds for an equitable estoppel, sufficient to survive demurrer, by alleging that defendants' repeated promises to repair had caused them to delay filing suit.

We granted Centex's petition for review. [4] We now conclude that the Court of Appeal's judgment must be reversed.

## DISCUSSION

### *1. Equitable tolling.*

Section 337.15, enacted in 1971, provides generally that "[n]o action may be brought" against those involved in the design, supervision, or construction of an improvement to real property, or their sureties, for latent defects in the design or construction, or for injury to property caused by such defects, unless the suit is filed within 10–years after "substantial completion" of the project. (*Id.,* subd. (a).) *****661** The 10–year period begins to run no later than "[t]he date of recordation of a valid notice of completion." (*Id.,* subd. (g)(2).) Section 337.15 "shall [not] be construed as extending the period prescribed by the laws of this state for bringing any action." (*Id.,* subd. (d).)

As we explained in *Regents, supra,* 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197, a suit to recover for a construction defect generally is subject to limitations periods of three or four years, depending on whether the theory is breach of warranty (§ 337, subd. 1 [four years: "action upon any contract, obligation or liability founded upon an ****523** instrument in writing"] ) or tortious injury to property (§ 338, subds. (b), (c) (formerly subds. 2, 3) [three years: trespass or injury to real or personal property] ). However, these periods begin to run only when the defect would be discoverable by reasonable inspection. (*Regents, supra,* at p. 630, 147 Cal.Rptr. 486, 581 P.2d 197.) On the other hand, "section 337.15 ... imposed an absolute requirement that a suit ... to recover damages for a [latent] construction defect be brought within 10 years of the date of substantial completion of construction, regardless of the date of discovery of the defect." (*Regents, supra,* at p. 631, 147 Cal.Rptr. 486, 581 P.2d 197, fn. omitted.) "The ***370** interplay between these statutes sets up a two-step process: (1) actions for a latent defect must be filed within three years ... or four years ... of discovery, but (2) in any event must be filed within ten years ... of substantial completion." (*North Coast Business Park v. Nielsen Construction Co.* (1993) 17 Cal.App.4th 22, 27, 21 Cal.Rptr.2d 104.)

  

Section 337.15 states several situations in which the 10 year limit shall not apply (see text discussion, *post* ), but it contains no provision for extension of the limitations period during periods of repair. Nonetheless, plaintiffs urge that the statute is subject to "equitable tolling" while the defendant's promises or attempts to remedy a defect are pending.

Equitable tolling is a judge-made doctrine "which operates independently of the literal wording of the Code of Civil Procedure" to suspend or extend a statute of limitations as necessary to ensure fundamental practicality and fairness. (*Addison v. State of California* (1978) 21 Cal.3d 313, 318–319, 146 Cal.Rptr. 224, 578 P.2d 941 (*Addison* ); see also *Bollinger v. National Fire Ins. Co.* (1944) 25 Cal.2d 399, 411, 154 P.2d 399 (*Bollinger* ).) This court has applied equitable tolling in carefully considered situations to prevent the unjust technical forfeiture of causes of action, where the defendant would suffer no prejudice. (E.g., *Lambert v. Commonwealth Land Title Ins. Co.* (1991) 53 Cal.3d 1072, 1080, 282 Cal.Rptr. 445, 811 P.2d 737 (*Lambert* ) [claim against title insurer accrues upon insurer's refusal to defend title, but two-year limitations period is equitably tolled until underlying title action is resolved]; *Prudential–LMI Com. Insurance v. Superior Court* (1990) 51 Cal.3d 674, 687–693, 274 Cal.Rptr. 387, 798 P.2d 1230 (*Prudential–LMI* ) [one-year period to sue on casualty insurance policy begins upon "inception of the loss," but is equitably tolled from timely notice of loss until insurer denies claim]; *Addison, supra,* at pp. 317–321, 146 Cal.Rptr. 224, 578 P.2d 941 [six-month period for state court suit against public agency was equitably tolled during plaintiffs' timely federal suit raising both federal and state claims]; *Elkins v. Derby* (1974) 12 Cal.3d 410, 414–420, 115 Cal.Rptr. 641, 525 P.2d 81 (*Elkins* ) [one-year period for personal injury action was tolled while plaintiff, acting in good faith, pursued worker's compensation remedy against defendant]; *Bollinger, supra,* at pp. 410–412, 154 P.2d 399 [15–month period *****662** to sue on fire insurance policy was tolled while timely prior action, erroneously dismissed as premature, was pending].)

As these cases illustrate, the effect of equitable tolling is that the limitations period *stops running* during the tolling event, and begins to run again only when the tolling event has concluded. As a consequence, the tolled interval, no matter when it took place, is tacked onto the end of the ***371** limitations period, thus extending the deadline for suit by the entire length of time during which the tolling event previously occurred. [5]

****524** The Legislature may preclude equitable tolling by stating its intention "to disallow tolling under any circumstances not enumerated in the statute." (*Laird v. Blacker* (1992) 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691 (*Laird* ) [attorney malpractice limitations statute (§ 340.6) providing that limitations period shall "in no event" be tolled except as specified (*id.,* subd. (a))]; see also, e.g., *Battuello v. Battuello* (1998) 64 Cal.App.4th 842, 847, 75 Cal.Rptr.2d 548 (*Battuello* ) [special one-year limitations statute (§ 366.2) for surviving action against deceased person, providing that period "shall not be tolled or extended for any reason" except as specified (*id.,* subd. (b))].)

Moreover, equitable tolling should not apply if it is "inconsistent with the text of the relevant statute" (*United States v. Beggerly* (1998) 524 U.S. 38, 48, 118 S.Ct. 1862, 141 L.Ed.2d 32 [quiet title action must commence within 12 years after discovery of government's title claim; generous limitations period, beginning only upon discovery, already provides for equitable tolling, and further tolling not warranted]; see also *Lampf v. Gilbertson* (1991) 501 U.S. 350, 363, 111 S.Ct. 2773, 115 L.Ed.2d 321 [where federal securities fraud action was subject to limitations of one year from discovery, or three years from violation, three-year period was "outside" limit not subject to tolling] ) or contravenes clear legislative policy (cf. *Abreu v. Svenhard's Swedish Bakery* (1989) 208 Cal.App.3d 1446, 1456, 257 Cal.Rptr. 26 [equitable tolling would violate policy of uniform federal statute of limitations for suits claiming violations of labor contracts] ).

"As with other general equitable principles, application of the equitable tolling doctrine requires a balancing of the injustice to the plaintiff occasioned by the bar of his claim against the effect upon the important public interest or policy expressed by the ... limitations statute." (*Addison, supra,* 21 Cal.3d 313, 321, 146 Cal.Rptr. 224, 578 P.2d 941.)

***372** Plaintiffs insist that in construction defect cases, the rule of tolling for repairs is well established. As they observe, two Court of Appeal decisions, *Grange Debris,* *****663** *supra,* 16 Cal.App.4th 1349, 1360, 20 Cal.Rptr.2d 515, and *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 1256–1258, 240 Cal.Rptr. 113, have concluded that the 10–year limitations period of section 337.15 is tolled while the defendant's promises or attempts to remedy the defect are pending. For this holding, *Grange Debris* relied solely on *Cascade Gardens. Cascade Gardens,* in turn, invoked the

  

"clear authority" of several earlier decisions, *Aced v. Hobbs–Sesack Plumbing Co.* (1961) 55 Cal.2d 573, 585, 12 Cal.Rptr. 257, 360 P.2d 897 (*Aced* ), *Mack v. Hugh W. Comstock Associates* (1964) 225 Cal.App.2d 583, 589, 37 Cal.Rptr. 466 (*Mack* ), and *Southern Cal. Enterprises v. Walter & Co.* (1947) 78 Cal.App.2d 750, 755, 178 P.2d 785 (*Southern Cal. Enterprises* ). (*Cascade Gardens, supra,* at p. 1256, 240 Cal.Rptr. 113.)

But *Aced, Mack,* and *Southern Cal. Enterprises* are inapposite to the question before us. They predate the 1971 adoption of section 337.15, and were narrowly concerned with how to apply the limitations period for express or implied warranties. These cases simply confirmed that the statute of limitations for breach of warranty does not begin to run until discovery of the defect, and is thereafter tolled during periods the warrantor claims he can honor the warranty by repairing the defect, and attempts to do so. (*Aced, supra,* 55 Cal.2d 573, 577, 585, 12 Cal.Rptr. 257, 360 P.2d 897 [radiant heating system; plaintiff stipulated he was relying solely on a theory of implied warranty]; *Mack, supra,* 225 Cal.App.2d 583, 585, 589, 37 Cal.Rptr. 466 [radiant heating system; plaintiff alleged breach of express warranty]; *Southern Cal. Enterprises, supra,* 78 Cal.App.2d 750, 752–753, 755, 178 P.2d 785 [installed carpet; plaintiff alleged breach of express warranty].)

*Aced, Mack,* and *Southern Cal. Enterprises* did not consider how tolling should apply to an alternative, overarching limitations period later enacted specifically for suits alleging defects in the construction of improvements to real property —a limitations period measured, regardless of discovery, from the date the work of construction was completed. ****525** Contrary to the assumption of *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, those earlier cases are not persuasive authority for extending a "tolling for repairs" rule to section 337.15. [6]

***373** In *FNB Mortgage, supra,* 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841, the Court of Appeal properly discounted the pre–1971 precedents, rejected the holding of *Cascade Gardens,* and concluded that the 10–year limitations period of section 337.15 is not equitably tolled for repairs. *FNB Mortgage* reached the correct result. [7]

*****664** At the outset, the plain language of section 337.15 suggests that the 10–year limitations period is not subject to extension for reasons not stated in the statute itself. Unlike subdivision (a) of section 340.6, the attorney malpractice limitations statute (see *Laird, supra,* 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691; see also, e.g., §§ 340.5 [malpractice by health care provider], 366.2, subd. (b) [surviving action against deceased person] ), section 337.15 does not ban nonstatutory tolling in so many literal words. But the structure and tone of section 337.15 do differ markedly from garden-variety California limitations statutes. The latter simply provide the various "periods prescribed for the commencement of [specified] actions." (§ 335; see also, e.g., §§ 336, 336a, 337, 337.5, 338, 339, 341.) By contrast, section 337.15 declares, in stentorian terms, that "[*n* ]*o action* [*for latent construction defects* ] *may be brought* ... more than 10–years after the *substantial completion* of the development or improvement." (*Id.,* subd. (a), italics added.)

Section 337.15 itself provides several clear exemptions from the 10–year limit. The limit does not apply to actions for personal injury. (§ 337.15, subd. (a)(1), (2); cf. § 337.1, subd. (a)(3) [four-year limitation period for *patent* construction defects].) It does not apply to suits based on "willful misconduct or fraudulent concealment." (§ 337.15, subd. (f); cf. §§ 340.5, 340.6, subd. (a) [both permitting "tolling" for "fraud" or "intentional concealment"].) It does not apply to a cross-complaint for indemnity by one participant in the project against another, if the cross-complainant himself was sued directly within the 10–year period. (§ 337.15, subd. (c); *Valley Circle Estates v. VTN Consolidated, Inc.* (1983) 33 Cal.3d 604, 608–615, 189 Cal.Rptr. 871, 659 P.2d 1160 (*Valley Circle Estates* ).) It cannot be asserted by "any person in actual possession or ... control ... of [the] improvement ... at the time any deficiency [therein] constitutes the proximate cause" of the damage for which recovery is sought. (§ 337.15, subd. (e).) An argument thus arises, under the maxim *inclusio unius est exclusio alterius,* that the Legislature intended to omit other exceptions.

***374** But if doubt remains from the language of section 337.15, it is dispelled by reference to the well-known goal of this special limitations statute. "[T]he purpose of section 337.15 is to protect contractors and other professionals and tradespeople in the construction industry from perpetual exposure ****526** to liability for their work. (*Regents*[, *supra,*] 21 Cal.3d 624, 633, fn. 2 [147 Cal.Rptr. 486, 581 P.2d 197]; *Wagner v. State of California* (1978) 86 Cal.App.3d 922, 929–930, 150 Cal.Rptr. 489.) The statute reflects a legitimate concern that 'expanding concepts of liability could imperil the construction industry unless a statute of limitations was enacted.' (*Moseley v. Abrams* (1985) 170 Cal.App.3d 355, 362, 216 Cal.Rptr. 40.) Such concerns legitimately include

  

the prohibitive cost of insurance against a perpetual and never ending risk." (*Sandy v. Superior Court* (1988) 201 Cal.App.3d 1277, 1285, 247 Cal.Rptr. 677.)

The history of section 337.15 confirms that the statute is the result of general legislative concern about the economic effects of indefinite "long tail" defect liability *****665** on the construction industry. Section 337.15 was a response to considerable expansion of California's common law of construction liability. Traditionally, a builder's sole liability for his finished product was on an express or implied warranty, which required privity between plaintiff and defendant, and the builder thus owed no duty to third persons once the owner accepted the improvement. (See, e.g., *Kolburn v. P.J. Walker Co.* (1940) 38 Cal.App.2d 545, 550, 101 P.2d 747.) In the 1950's and 1960's, these limitations gave way to the principle that a builder may be liable to those foreseeably injured or damaged by construction defects under theories of negligence (*Dow v. Holly Manufacturing Co.* (1958) 49 Cal.2d 720, 724–728, 321 P.2d 736; *Oakes v. McCarthy Co.* (1968) 267 Cal.App.2d 231, 247–249, 73 Cal.Rptr. 127 (*Oakes* )) and, at least in the case of a mass home developer, strict tort liability (*Kriegler v. Eichler Homes, Inc.* (1969) 269 Cal.App.2d 224, 226–229, 74 Cal.Rptr. 749). [8]

At the same time, courts increasingly recognized ways to extend the limitations periods for suits on construction defects. As indicated above, ***375** 1960's decisions confirmed that the time to sue on a construction warranty was tolled while promises or attempts to repair were pending. (*Aced, supra,* 55 Cal.2d 573, 585, 12 Cal.Rptr. 257, 360 P.2d 897; *Mack, supra,* 225 Cal.App.2d 583, 589, 37 Cal.Rptr. 466.) Contemporaneous cases held that the statutes of limitations for the burgeoning theories of construction defect recovery did not begin to run until the defects were or should have been discovered (see, e.g., *Aced, supra,* at pp. 583–584, 12 Cal.Rptr. 257, 360 P.2d 897 [warranty]; *Avner v. Longridge Estates* (1969) 272 Cal.App.2d 607, 616–618, 77 Cal.Rptr. 633 [strict liability]; *Oakes, supra,* 267 Cal.App.2d 231, 254–255, 73 Cal.Rptr. 127 [negligence]; see also *Regents, supra,* 21 Cal.3d 624, 630, 147 Cal.Rptr. 486, 581 P.2d 197) or while they were fraudulently concealed (e.g., *Balfour, Guthrie & Co. v. Hansen* (1964) 227 Cal.App.2d 173, 189, 38 Cal.Rptr. 525).

In 1967, the Legislature responded in part to these developments by adopting section 337.1. (Stats.1967, ch. 1326, § 1, p. 3157.) This statute provides that recovery for death, injury, or damage caused by a "*patent* deficiency" (§ 337.1, subd. (a), italics added) in the design, supervision, or construction of an improvement to realty must be sought within *four* years after substantial completion of the improvement. (*Id.,* subds. (a), (c).) A "patent deficiency" is defined as one "apparent by reasonable inspection." (*Id.,* subd. (e).) Notwithstanding the general rule, if an injury to person or property occurs in the fourth year after completion, suit may be brought within one year after the injury, but no *****666** more ****527** than five years after completion. (*id.,* subd. (b).) the limitations period provided by section 337.1 cannot be asserted by one who actually possesses or controls the property at the time the deficiency causes the actionable damage or injury. (*Id.,* subd. (d).) Owner-occupied single family residences are exempt from the four-year limit. (*id.,* subd. (f).)

Despite this 1967 legislation, members of the building industry still faced exposure to liability for all defects in their past projects so long as these defects remained undiscovered and undiscoverable by reasonable inspection. On April 14, 1970, Assemblyman Powers introduced Assembly Bill No. 2528 (1970 Reg. Sess.), seeking to limit suits for latent construction defects to an *eight*-year period after substantial completion. After numerous amendments in committee, the bill was placed in the inactive file at the request of Assemblyman Powers, and it died there on August 21, 1970. (See Assem. Final Hist. (1970 Reg. Sess.) p. 761.) [9]

***376** In October 1970, the Assembly Interim Committee on Judiciary, chaired by Assemblyman Hayes, convened a public hearing "to determine if a statute of limitations can be drafted in actions for hidden (or latent) construction defects." (Assem. Judiciary Interim Com. Hearing on Application of the Doctrine of Strict Tort Liability to Building Construction (Oct. 23, 1970) p. 1 (1970 Committee Hearing).) Building industry representatives testified at length that the trend toward expanded and time-extended defect liability was producing a risk for which insurance was available only at prohibitive cost, if at all, thus threatening the industry's economic health. (1970 Com. Hearing, pp. 4–51.) [10]

Appended to the 1970 Committee Hearing transcript was a survey of construction defect limitations periods adopted in other states. According to this survey, the applicable statutes of limitations ranged from four to twelve years after substantial completion of the projects in question. (1970 Com. Hearing, appen. B, pp. 11–12.)

  

On April 15, 1971, Assemblyman Hayes introduced Assembly Bill No. 2742 (1971 Reg. Sess.) (Assembly Bill No. 2742), which, as amended, became section 337.15. (See Assem. Final Hist. (1971 Reg. Sess.) ***667 p. 873.) As originally drafted, Assembly Bill No. 2742 provided that suits for latent construction defects, other than those based on willful misconduct or fraudulent concealment, would be subject to a limitations period of *six* years after substantial completion. (Assem. Bill No. 2742, as introduced Apr. 15, 1971.) A subsequent Assembly amendment removed personal injury actions from the limitations period, increased the period to 10–years, and provided for cross-complaints beyond the 10–year period by persons sued directly within that time. (Assem. Amend. to Assem. Bill No. 2742, July 22, 1971.) [11]

*377 **528 The above-described survey of the laws of other states was made part of the legislative record of Assembly Bill No. 2742 in both the Assembly and the Senate. (See Assem. Com. on Judiciary, Analysis of Assem. Bill No. 2742, appen. B; Sen. Com. on Judiciary, Analysis of Assem. Bill No. 2742 as amended Oct. 22, 1971, pp. 1–4.) Analyses of the bill consistently described it as "bar[ring]" or "[p]rohibit[ing]" latent defect suits brought beyond the proposed limitations period. (Assem. Com. on Judiciary, Analysis of Assem. Bill No. 2742, p. 1; Sen. Com. on Judiciary, Analysis of Assem. Bill No. 2742 as amended Oct. 22, 1971, p. 1; Assemblyman James A. Hayes, letter to Governor Reagan (Nov. 9, 1971) requesting signature on Assem. Bill No. 2742; Enrolled Bill mem. to Governor on Assem. Bill No. 2742, Nov. 16, 1971.)

Thus the Legislature, faced with a developing body of common law on the subject, carefully considered how to provide a fair time to discover construction defects, and to sue upon such defects if necessary, while still protecting a vital industry from the damaging consequences of indefinite liability exposure. For latent deficiencies, the lawmakers rejected shorter periods in favor of a limit in the upper range of those previously adopted by other jurisdictions. Moreover, by placing exemptions in the latent defect statute for personal injury, willful misconduct, and fraudulent concealment, the legislators demonstrated an intent to pick and choose the particular exceptions they wished to allow and those particular aspects of the prior case law they wished to embrace. The implication arises that except as stated, and for important policy reasons, the Legislature meant the generous 10–year period set forth in section 337.15 to be firm and final.

Significantly, the adopters of both sections 337.1 and 337.15 knew that the case law had engrafted a "tolling for repairs" rule onto the four-year discovery-based limitations period for breach of a construction warranty. Yet, despite the Legislature's careful attention to other issues raised by prior court decisions, it did not provide a "repairs" extension in either section 337.1 or section 337.15.

On the contrary, the Legislature specified in section 337.15 that *whatever limitations periods might otherwise apply,* "no action" for injury to property arising from latent construction defects "may be brought" more than 10 years after substantial completion of the project. (§ 337.15, subd. (a); see also *id.,* subd. (d); ***668 *Regents, supra,* 21 Cal.3d 624, 631, 147 Cal.Rptr. 486, 581 P.2d 197.) The inference arises that regardless of whatever *tolling rules* might otherwise apply *within* the 10–year *378 period, the Legislature intended no such extension of the "absolute" (*Regents, supra,* at p. 631, 147 Cal.Rptr. 486, 581 P.2d 197) 10–year limit itself. The legislative failure to ratify tolling for repairs under these circumstances is another indication that a judicial doctrine extending the 10–year limitations period for this reason would contravene the intent of section 337.15.

In one common circumstance, an equitable tolling rule would directly undermine the statutory purpose. As we have seen, section 337.15 allows one sued directly within the statutory period to cross-complain for indemnity against another project participant, even if the statute of limitations for direct actions has by then expired, so long as the cross-complaint is filed before a trial date has been set. (§§ 337.15, subd. (c), 428.10, subd. (b), 428.50, subd.(b); *Valley Circle Estates, supra,* 33 Cal.3d 604, 608–615, 189 Cal.Rptr. 871, 659 P.2d 1160.) [12] Thus, potential **529 indemnitors can never be entirely certain they are safe once the 10–year period passes. But they should generally be able to assume that any suit which may give rise to cross-complaints against them was filed within 10–years after substantial completion of the project.

A general rule that the limitations period is tolled for repairs would destroy such an assumption. As was emphasized in *FNB Mortgage, supra,* 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841, such a rule would allow "[a]n unsuspecting subcontractor [to] be sued for indemnity, long after the statute's 10–year limitations period had passed, and despite the absence of any action alleging defects within the 10–year period, simply because the indemnitee (the subsequent cross-complainant) was deemed to have tolled the 10–year

period [by offering or attempting to repair] and was thus subject to subsequent suit." (*Id.* at p. 1133, 90 Cal.Rptr.2d 841.) The "unsuspecting subcontractor[s]" caught in this net might include architects and engineers who, as in the example provided during the 1970 Committee Hearing, had since retired, but were still forced to maintain expensive errors and omissions coverage to meet their potential "long tail" liability for alleged defects in projects completed many years in the past.

Hence, the purpose of section 337.15, as revealed by its history, weighs against a judicially imposed rule that the 10–year limitations period set forth in this statute is tolled for repairs. On the other hand, countervailing policies ***379** of practicality and fairness do not compel such a rule. If the defendant's acts or promises occurred well before expiration of the 10–year limit, an extension *at the end* of the limitations period is unnecessary to protect the plaintiff's *****669** rights.[13] And because the limitations period provided by section 337.15 is so "exceptionally long" (*Aas, supra,* 24 Cal.4th 627, 653, 101 Cal.Rptr.2d 718, 12 P.3d 1125), it indicates the Legislature's effort to provide, within the strict statutory period itself, a reasonable time to discover, adjust, and, if necessary, sue upon latent defects. Given the particular considerations that led the Legislature in 1971 to seek a generous but firm cutoff date for construction defect lawsuits, further extension of the period by judicial fiat is not warranted.

This case contrasts starkly with those in which we found a special need for equitable tolling. In each prior instance, the *brevity* of the literal limitations period would otherwise have caused forfeiture of a cause of action, or other undue hardship, despite the plaintiff's diligent efforts to pursue his claim in a correct and orderly way. In *Lambert, supra,* 53 Cal.3d 1072, 282 Cal.Rptr. 445, 811 P.2d 737, absent equitable tolling, literal application of the *two-year* statute of limitations for actions against a title insurer would have forced the insured "to defend the underlying [title] action, at [his] own expense, and *simultaneously* to prosecute—again at [his] own expense—a separate action against the title company for failure to defend." (*Id.* at p. 1078, 282 Cal.Rptr. 445, 811 P.2d 737.) In *Prudential–LMI, supra,* 51 Cal.3d 674, 274 Cal.Rptr. 387, 798 P.2d 1230, the insured had only *one year* after inception of the loss to sue his insurer for coverage, but that period could easily run out while the insurer, having received a timely notice of loss, conducted the investigation necessary to determine whether the claim should be paid or denied. (*Id.* at pp. 687–693, 274 Cal.Rptr. 387, 798 P.2d 1230.)

****530** In *Bollinger, supra,* 25 Cal.2d 399, 154 P.2d 399, the insured *did* sue within the *15 months* allowed by the policy, but that action was dismissed, after the limitations period had expired, on a false technicality urged by the insurer. (*Id.* at pp. 404–411, 154 P.2d 399.) Similarly in *Addison, supra,* 21 Cal.3d 313, 146 Cal.Rptr. 224, 578 P.2d 941, the plaintiffs *did* sue in *federal* court within the *six-month* period for actions against public agencies. Just after this brief limitations period expired by its literal terms, the government defendant moved to dismiss the federal action, whereupon plaintiffs immediately filed their state court complaint. As plaintiffs feared, the federal court subsequently dismissed their federal causes of action and ***380** declined to retain their pendent state claims, leaving them without a remedy unless equitable tolling was applied. (*Id.* at pp. 317–319, 146 Cal.Rptr. 224, 578 P.2d 941.)

Finally, in *Elkins, supra,* 12 Cal.3d 410, 115 Cal.Rptr. 641, 525 P.2d 81, the plaintiff, acting in good faith, first pursued a timely worker's compensation remedy against the defendants, thereby foreclosing resort to tort litigation. After the *one-year* statute of limitations for personal injury actions had expired, the worker's compensation referee found that the plaintiff was not the defendant's "employee" within the meaning of the worker's compensation *****670** statutes, and was thus not entitled to benefits. The plaintiff then promptly filed his court action. We applied the well-established California principle that "the running of the limitations period is tolled '[w]hen an injured person has several legal remedies and, reasonably and in good faith, pursues one.' [Citations.]" (*Id.* at p. 414, 115 Cal.Rptr. 641, 525 P.2d 81.)

No similar issues are presented here. Because plaintiffs had *three* or *four* years *after discovery,* and up to *ten* years after the project's completion, to bring their suits for latent construction defects, many of the concerns that might warrant equitable tolling are ameliorated. Indeed, were we to conclude that the generous limitations period of section 337.15 is equitably tolled for repairs, despite the absence of any specific indication that the 1971 Legislature so intended, the implication would arise that *all* statutes of limitations are similarly tolled or suspended in progress while the parties make sincere efforts to adjust their differences short of litigation. We find no such general principle in California law.

Plaintiffs and the dissent urge several reasons why section 337.15 should be equitably tolled for repairs. None is persuasive.

  

First, it is urged that if the Legislature had intended to disallow equitable tolling of section 337.15, it would have done so expressly, as in sections 340.5 (health care malpractice) and 340.6, subdivision (a) (attorney malpractice; see *Laird, supra,* 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691; see also *Battuello, supra,* 64 Cal.App.4th 842, 847, 75 Cal.Rptr.2d 548 [§ 366.2; one-year limitations period for surviving action against deceased person] ). But an *express* legislative ban on equitable tolling is not the only circumstance in which courts will decline to apply this judicially developed doctrine. As is explained above, they will also do so where, as here, tolling would contravene the legislative purpose. Of course, the no-tolling result we reach under section 337.15 is *consistent* with our construction of the similar *but shorter* "two-step" statute of limitations (one year from discovery or four years from wrongful act or omission, whichever occurs first) for attorney malpractice. (§ 340.6, subd. (a); see *Laird, supra,* 2 Cal.4th 606, 618, 7 Cal.Rptr.2d 550, 828 P.2d 691.)

Next, plaintiffs and the dissent assert that the legislative history of section 337.15 focuses exclusively upon the problem of a statute of limitations that ***381** *began* only when the *plaintiff discovered* the defect. There is no indication, plaintiffs assert, that the Legislature meant to preclude the *defendant* from tolling the limitations period, once begun, by his own voluntary action.

But while delayed discovery was an important issue, the legislators' concerns, as indicated above, were broader. They sought to ensure ample time to discover and sue upon latent construction defects, while still establishing a predictable period within which the construction and insurance industries must make provision for such suits. And though a defendant who promises or undertakes repairs might be said to "control" the time for ****531** suit *against him,* his conduct, as we have noted, would have consequences for unsuspecting coparticipants in the project, whose exposure to indemnity liability would thereby be extended.

Plaintiffs and the dissent emphasize our statement in *Regents, supra,* 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197, that section 337.15 is not a "substantive limit upon the plaintiff's cause of action" (*Regents, supra,* at p. 640, 147 Cal.Rptr. 486, 581 P.2d 197), but merely an "ordinary, *****671** procedural statute of limitations" (*id.* at p. 641, 147 Cal.Rptr. 486, 581 P.2d 197) to which, they assert, equitable tolling may thus properly apply. However, their reliance on *Regents* is misplaced. The issue there was whether the surety on a contractor's bond—then not among the persons specifically mentioned in the statute—nonetheless could claim the protection of section 337.15's 10–year limitations period. The *Regents* majority answered that question no. (*Id.* at pp. 632–643, 147 Cal.Rptr. 486, 581 P.2d 197.) The dissenters argued that because section 337.15 was a substantive limit on legal rights and duties, it precluded the plaintiff, in any suit brought after expiration of the 10–year period, from proving a contractor's breach of duty which the surety must make good. (*Regents, supra,* at pp. 644–649, 147 Cal.Rptr. 486, 581 P.2d 197 (conc. & dis. opn. of Clark, J.); see *id.* at p. 640, 147 Cal.Rptr. 486, 581 P.2d 197 (maj.opn.).) The majority rejected *that* contention (*id.* at pp. 640–642, 147 Cal.Rptr. 486, 581 P.2d 197), but nothing in the holding of *Regents* compels a conclusion that where section 337.15 does apply, it should be subject to equitable tolling. [14]

Plaintiffs and the dissent note that the Legislature has not expressly disagreed with the equitable tolling rule set forth in *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, and *Grange Debris, supra,* 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515 (but see *FNB Mortgage, supra,* 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841). Of course, the Legislature has not revisited section 337.15 at all since 1981, well before these cases were decided. [15] There are many reasons why the Legislature fails to address intervening judicial constructions of a statute, including inattention, press of ***382** other business, and trust in the courts to correct their own errors. (*People v. King* (1993) 5 Cal.4th 59, 77, 19 Cal.Rptr.2d 233, 851 P.2d 27; *County of Los Angeles v. Workers' Comp. Appeals Bd.* (1981) 30 Cal.3d 391, 404, 179 Cal.Rptr. 214, 637 P.2d 681.) Hence, " 'legislative inaction is a " 'weak reed upon which to lean.' " ' " (*Harris v. Capital Growth Investors XIV* (1991) 52 Cal.3d 1142, 1156, 278 Cal.Rptr. 614, 805 P.2d 873, quoting *Troy Gold Industries, Ltd. v. Occupational Safety & Health Appeals Bd.* (1986) 187 Cal.App.3d 379, 391, fn. 6, 231 Cal.Rptr. 861.) Here, mere legislative silence fails to dissuade us from our conclusion that section 337.15 is not subject to equitable tolling for repairs.

Plaintiffs suggest that equitable tolling for repairs protects homeowners from unscrupulous builders who might otherwise make false promises or "band-aid" repairs in order to forestall suit until after the 10–year period had passed. Tolling for repairs is also good policy, plaintiffs maintain, because it encourages resolution of construction defect disputes without resort to the courts. But a tolling rule seems just as likely to *discourage* a potential defendant from

  

undertaking voluntary remedial efforts before the limitations period expires. If his efforts failed, he would only have prolonged the already lengthy ***672 period during which he was exposed to suit. [16]

*383 **532 Moreover, if a plaintiff can show, in a particular case, that the defendant's promises or attempts to repair prevented a timely suit, the defendant may be equitably *estopped* from invoking the protection of the statute of limitations. (See discussion, *post.*) Thus, an automatic rule of equitable *tolling* is not necessary to counteract fraudulent assurances of repair.

We therefore conclude that the 10–year limitations period set forth in section 337.15 is not subject to tolling in progress while a potential defendant's promises or attempts to repair the defect are pending. The distinct question remains whether a defendant may nonetheless be equitably estopped to assert this statute of limitations if he prevented a timely suit by his conduct upon which the plaintiffs reasonably relied. [17]

***2. Equitable estoppel.***

Plaintiffs assert that even if equitable tolling does not apply, their first amended complaint states facts which should estop these particular defendants from relying on the limitations period of section 337.15. Plaintiffs invoke the venerable principle that " '[o]ne cannot justly or equitably lull his adversary into a false sense of security, and thereby cause his adversary to subject his claim to the bar of the statute of limitations, and then be permitted to plead the very delay caused by his course of conduct as a defense to the action when brought.' " ***673 (*Carruth v. Fritch* (1950) 36 Cal.2d 426, 433, 224 P.2d 702, quoting *Howard v. West Jersey & S.S.R. Co.* (N.J.Ch.1928) 102 N.J. Eq. 517, 141 A. 755, 757–758.)

Equitable tolling and equitable estoppel are distinct doctrines. " 'Tolling, strictly speaking, is concerned with the point at which the limitations period begins to run and with the circumstances in which the running of the limitations period may be suspended.... Equitable estoppel, however, ... comes into play only after the limitations period has run and addresses ... the circumstances in which a party will be estopped from asserting the statute of limitations as a defense to an admittedly untimely action because his conduct has induced another into forbearing suit within the applicable limitations period. [Equitable estoppel] is wholly independent of the limitations period itself and takes its life ... from the equitable principle that no man [may] profit from his own wrongdoing in a court of justice.' " (*Battuello, supra,* 64 Cal.App.4th 842, 847–848, 75 Cal.Rptr.2d 548, quoting *Bomba v. W.L. Belvidere, Inc.* (7th Cir.1978) 579 F.2d 1067, 1070.) **533 Thus, equitable estoppel is *384 available even where the limitations statute at issue expressly precludes equitable tolling. (*Leasequip, Inc. v. Dapeer* (2002) 103 Cal.App.4th 394, 405–408, 126 Cal.Rptr.2d 782 [§ 340.6; attorney malpractice statute of limitations]; *Battuello, supra* [§ 366.2; special one-year limitations period for surviving actions against deceased person].)

One aspect of equitable estoppel is codified in Evidence Code section 623, which provides that "[w]henever a party has, by his own statement or conduct, intentionally and deliberately led another to believe a particular thing true and to act upon such belief, he is not, in any litigation arising out of such statement or conduct, permitted to contradict it." (See *DRG/ Beverly Hills, Ltd. v. Chopstix Dim Sum Cafe & Takeout III, Ltd.* (1994) 30 Cal.App.4th 54, 60, 35 Cal.Rptr.2d 515.) But " '[a]n estoppel may arise although there was no designed fraud on the part of the person sought to be estopped. [Citation.] To create an equitable estoppel, "it is enough if the party has been induced to refrain from using such means or taking such action as lay in his power, by which he might have retrieved his position and saved himself from loss." ... "... Where the delay in commencing action is induced by the conduct of the defendant it cannot be availed of by him as a defense." ' " (*Vu v. Prudential Property & Casualty Ins. Co.* (2001) 26 Cal.4th 1142, 1152–1153, 113 Cal.Rptr.2d 70, 33 P.3d 487 (*Vu* ), quoting *Benner v. Industrial Acc. Com.* (1945) 26 Cal.2d 346, 349–350, 159 P.2d 24, italics omitted; see also *Ginns v. Savage* (1964) 61 Cal.2d 520, 524–525, 39 Cal.Rptr. 377, 393 P.2d 689.) [18]

Accordingly, (1) if one potentially liable for a construction defect represents, while the limitations period is still running, that all actionable damage has been or will be repaired, thus making it unnecessary to sue, (2) the plaintiff reasonably relies on this representation to refrain from bringing a timely action, (3) the representation proves false after the limitations period has expired, and (4) the plaintiff proceeds diligently once the truth is discovered (cf. ***674 *Vu, supra,* 26 Cal.4th 1142, 1153, 113 Cal.Rptr.2d 70, 33 P.3d 487), the defendant may be equitably estopped to assert the statute of limitations as a defense to the action. [19]

*385 The Court of Appeal concluded that plaintiffs' first amended complaint adequately pled the prerequisites

of equitable estoppel. According to the Court of Appeal, "[plaintiffs] alleged in their complaint that Centex had repeatedly promised to repair the damage to their homes. Based on these allegations, [plaintiffs] argued Centex was equitably estopped to assert the statute of limitations as a defense because ... Centex's promises caused them to delay filing suit.... [T]hese allegations were sufficient to overcome a demurrer based on the statute of limitations contained in section 337.15."

We disagree. The complaint's sole allegation on this issue is "that *at various times* Defendants have attempted to make repairs ... or advised Plaintiffs that the defective windows were not defective and not to file a lawsuit," but have not properly repaired the leaking windows and associated damage, and "are [therefore] estopped to assert that Plaintiffs have not commenced this action in a timely fashion."

This is insufficient. Contrary to the Court of Appeal's reasoning, the complaint is devoid of any indication that defendants' conduct *actually and reasonably induced plaintiffs to forbear suing within the 10–year period of section 337.15*. There is no suggestion that ****534** the repair attempts alleged, if successful, would have obviated the need for suit. Moreover, for all that appears, the "various times" at which defendants' alleged conduct occurred were times well before the statute of limitations ran out, or even, as the trial court suggested, after it had expired. And there is no claim that the inadequacy of these repairs, or the falsity of defendants' alleged "no defect" representations, remained hidden until after the limitations period had passed.[20] Hence, plaintiffs have pled no facts indicating that defendants' conduct directly prevented them from filing their suit on time. Accordingly, the first amended complaint establishes no basis to estop defendants from asserting that plaintiffs' causes of action are barred by the 10–year statute of limitations.

***3. Amendment of complaint.***

As noted above, the trial court sustained defendants' demurrer to plaintiffs' first amended complaint without affording plaintiffs an opportunity to amend. The court found, among other things, that the complaint failed to state facts sufficient to estop defendants from asserting that the statute of limitations had expired. The court conceded that amendment might cure the purely factual ***386** deficiencies, but it ultimately reasoned that tolling for repairs was simply not available, as a matter of law, to extend the limitations period of section 337.15.

*****675** In reversing, the Court of Appeal determined that *both* tolling *and* estoppel were available, and that the first amended complaint was sufficient on both theories. We, on the other hand, have concluded that while section 337.15's 10–year limitations period is not *tolled* for repairs, defendants might be *estopped* under particular circumstances to invoke this statute of limitations. However, we have agreed with the trial court that the current complaint fails to state sufficient facts to establish such an estoppel.

Without stressing the point, plaintiffs have urged at all stages that if their complaint is deficient, but could be remedied by additional factual allegations, a chance should be afforded to assert such facts. The question thus arises whether plaintiffs should be allowed an opportunity to amend to state facts sufficient to set forth an equitable estoppel. In the specific circumstances of this case, we conclude the answer is "no."

Of course, "[i]t is axiomatic that if there is a reasonable possibility that a defect in the complaint can be cured by amendment ..., a demurrer should not be sustained without leave to amend. [Citations.]" (*Minsky v. City of Los Angeles* (1974) 11 Cal.3d 113, 118, 113 Cal.Rptr. 102, 520 P.2d 726.) But the particular history of this case persuades us there is no reasonable possibility plaintiffs can state credible facts to support an equitable estoppel.

We realize that after the trial court sustained defendants' demurrer to the first amended complaint—the ruling at issue here—plaintiffs did offer more specific estoppel allegations in a proposed second amended complaint. This proposed complaint made express claims that, from the time plaintiffs purchased their homes until expiration of the 10–year limitations period, defendants engaged in a pattern of falsely promising repairs, or making sham repairs they knew would fail, and then refused to respond further once the 10–year period had passed, all with the purpose and effect of inducing plaintiffs to forbear suing within the statutory time. The trial court rejected the proposed complaint, both as untimely and on the incorrect assumption that if section 337.15 could not be *tolled* for repairs, equitable *estoppel* was equally unavailable.

But even if the new allegations of the proposed second amended complaint were technically sufficient to establish an estoppel, several circumstances negate any inference that these new assertions had a substantial basis in fact. In the first place, the gravamen of the new allegations—that defendants' promises and attempts to repair continued ****535**

throughout the entire 10–year ***387** period, that plaintiffs were thereby induced to forbear suing until the period expired, and that defendants then abruptly refused further cooperation —must have been within plaintiffs' personal knowledge at the time they filed their lawsuit. No reason appears why these assertions, if true, were not presented sooner.

Doubt about the credibility of the new allegations is heightened by developments in this court. During oral argument, plaintiffs' counsel was asked what additional facts, not included in the first amended complaint, could be asserted to support a theory of equitable estoppel. At a minimum, counsel could have referred us to the claims set forth in the proposed second amended complaint. He did not do so. Instead, he responded only that repairs promised or attempted by defendants *at any time* during the 10–year period gave rise, as a matter of law, to a form of *implicit reliance* by plaintiffs that defects in the construction of plaintiffs' homes would be remedied. This, counsel argued, should extend the statute of limitations by *****676** a time equivalent to the period during which repairs were pending. In short, counsel simply reiterated a theory of equitable *tolling* which we have rejected in this opinion.

Under these circumstances, we are convinced there is no reasonable possibility plaintiffs can assert new, credible facts suggesting that defendants are equitably estopped to assert the 10–year statute of limitations for latent construction defects. Accordingly, no basis appears to allow a remand for purposes of amendment. [21]

## *388 CONCLUSION

Equitable tolling does not apply to the 10–year statute of limitations set forth in section 337.15. The Court of Appeal decisions in *Grange Debris Box & Wrecking Co. v. Superior Court, supra,* 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515, and *Cascade Gardens Homeowners Assn. v. McKellar & Associates, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, are disapproved to the extent they concluded otherwise. Moreover, plaintiffs have failed to plead facts that would equitably estop defendants from asserting this limitations period, and there appears no reasonable possibility the deficiency can be remedied by credible amendment of the complaint. The trial court thus correctly sustained defendants' demurrer to plaintiffs' first amended complaint without leave to amend, and dismissed the action. The Court of Appeal erred by overturning the judgment of dismissal. The judgment of the Court of Appeal is therefore reversed.

GEORGE, C.J., CHIN, BROWN and MORENO, JJ., concur.

****536** Dissenting Opinion by WERDEGAR, J.

I respectfully dissent. I cannot join the majority in rejecting application of equitable tolling to the 10–year limitation on actions for latent construction defects (Code Civ. Proc., § 337.15). [1] Accordingly, I would affirm the judgment of the Court of Appeal. Second, while I agree with the majority that in an appropriate case a defendant may be equitably estopped to *****677** assert that section 337.15's 10–year limitation has expired, I disagree that there is no reasonable possibility plaintiffs in this case can allege sufficient facts to establish such an estoppel. Consequently, I would allow plaintiffs an opportunity to amend their complaint in order to correct any deficiencies the majority purports to identify.

*Tolling*

Statutes of limitations are not so rigid as they are sometimes regarded. (*Bollinger v. National Fire Ins. Co.* (1944) 25 Cal.2d 399, 411, 154 P.2d 399.) It is well established that statutes of limitation are not to be applied inflexibly where equity and justice favor the application of equitable tolling, and suspension of the running of a particular statute will not frustrate its purpose of preventing surprise through the revival of stale claims. (See *Elkins v. Derby* (1974) 12 Cal.3d 410, 417–419, 115 Cal.Rptr. 641, 525 P.2d 81.) For instance, [t]he statute of limitations is tolled where one who has breached a warranty claims that the defect can be repaired and attempts to make repairs. (*Aced v. Hobbs–Sesack Plumbing Co.* (1961) 55 Cal.2d 573, 585, 12 Cal.Rptr. 257, 360 P.2d 897 (*Aced* ).) Another established application of the general principle —today repudiated by the majority—has been that, ***389** "[i]n cases involving construction defects ... the statute of limitations is tolled during each period the defendant attempts to repair the defect." (3 Witkin, Cal. Procedure (4th ed. 1996) Actions, 684, p. 871.)

The majority argues that "the purpose of section 337.15, as revealed by its history, weighs against a judicially imposed rule that the 10–year limitations period set forth in this statute is tolled for repairs. On the other hand, countervailing policies of practicality and fairness do not compel such a rule." (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 668, 73 P.3d at p.

529.) I disagree. As Justice Richardson long ago explained in a unanimous opinion for this court, "the equitable tolling doctrine fosters the policy of the law of this state which favors avoiding forfeitures and allowing good faith litigants their day in court." (*Addison v. State of California* (1978) 21 Cal.3d 313, 320–321, 146 Cal.Rptr. 224, 578 P.2d 941 (*Addison* ).)

As its opinion nowhere specifies the elements of equitable tolling, the majority leaves the inaccurate impression that, unless we in this case categorically bar that remedy in construction defect cases, it will appear by judicial "fiat" (maj. opn., *ante,* 2 Cal.Rptr.3d at p. 668, 73 P.3d at p. 529) or happen automatically whenever "a potential defendant's promises or attempts to repair the defect are pending" (*id.* at p. 672, 73 P.3d at p. 532). The majority misdescribes the law. Courts do not enjoy unfettered discretion to toll a statute of limitations. Rather, "application of the doctrine of equitable tolling requires timely notice, and lack of prejudice, to the defendant, and reasonable and good faith conduct on the part of the plaintiff." (*Addison, supra,* 21 Cal.3d at p. 319, 146 Cal.Rptr. 224, 578 P.2d 941.)

According to the majority, "the plain language of section 337.15 suggests that the 10–year limitations period is not subject to extension for reasons not stated in the statute itself." (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 525.) I discern no such suggestion. Section 337.15 does not mention tolling, equitable or otherwise. The omission is significant; had the Legislature meant to preclude equitable tolling, it easily could have said so, as it has in other statutes of limitation. (See §§ 340.5 ["no event" shall toll limit on actions against health care providers except those specified], 340.6 [same for attorney malpractice actions], 366.2, subd. (b) *****678** [limit on actions on liability of a deceased person "shall not be tolled or extended for any reason" except as specified in certain code sections].)

****537** Thus, contrary to the majority, equitable tolling in this case is not inconsistent with the text of the statute. (See maj. opn., *ante,* 2 Cal.Rptr.3d at p. 662, 73 P.3d at p. 524.) The majority in any event is not actually relying on section 337.15's plain language, but, rather, on its perception of that statute's "structure and tone" (maj. opn., *ante,* 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 525), which the majority characterizes as "stentorian" (*ibid.*). Such observations are at best irrelevant, since, as the majority ***390** concedes, the tolling remedy at issue "is a general equitable one which operates independently of the literal wording of the Code of Civil Procedure." (*Addison, supra,* 21 Cal.3d at p. 318, 146 Cal.Rptr. 224, 578 P.2d 941; see maj. opn., *ante,* 2 Cal.Rptr.3d at p. 661, 73 P.3d at p. 523.)

The majority also advances a legislative intent argument, based on the Legislature's asserted failure when enacting section 337.15 to provide an express repairs extension, despite knowing that case law had earlier "engrafted a 'tolling for repairs' rule onto the four-year discovery-based limitations period for breach of a construction warranty" and its asserted "careful attention" to other (unspecified) issues raised by prior court decisions. (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 667, 73 P.3d at p. 528.) But in California it "is established that the running of the statute of limitations may be suspended by causes not mentioned in the statute itself" (*Bollinger v. National Fire Ins. Co., supra,* 25 Cal.2d at p. 411, 154 P.2d 399),[2] and the Legislature is presumed to have been aware of that principle when it enacted section 337.15 (*People v. Seneca Ins. Co.* (2003) 29 Cal.4th 954, 972, 129 Cal.Rptr.2d 842, 62 P.3d 81).

Framing the legislative intent argument somewhat differently, the majority asserts the Legislature's silence respecting equitable tolling when enacting section 337.15 bespeaks its intent to bar application of that long-established doctrine in this context. "We can rarely determine from the failure of the Legislature to pass a particular [provision] what the intent of the Legislature is with respect to existing law." (*Ingersoll v. Palmer* (1987) 43 Cal.3d 1321, 1349, 241 Cal.Rptr. 42, 743 P.2d 1299.) For that reason, we should not presume the Legislature intended to overthrow long-established principles of law unless such intention is made clearly to appear either by express declaration or by necessary implication .... (*Juran v. Epstein* (1994) 23 Cal.App.4th 882, 896, 28 Cal.Rptr.2d 588.)

The majority does not deny the Legislature has acquiesced for many years in *Cascade Gardens Homeowners Assn. v. McKellar & Associates* (1987) 194 Cal.App.3d 1252, 240 Cal.Rptr. 113 (*Cascade Gardens* ) and *Grange Debris Box & Wrecking Co. v. Superior Court* (1993) 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515 (*Grange Debris* ), cases confirming that courts may apply the doctrine of equitable tolling to section 337.15. (See *Cascade Gardens, supra,* at p. 1256, 240 Cal.Rptr. 113; *Grange Debris, supra,* at p. 1360, 20 Cal.Rptr.2d 515.) Sixteen years ago, *Cascade Gardens* held on the basis of "[c]lear authority" that "under certain circumstances" and where "principles of equity *****679** and justice ... allow," section 337.15 is subject to equitable tolling while repairs are undertaken. (*Cascade Gardens, supra,* at p. 1256, 240 Cal.Rptr. 113, citing *Aced, supra,* 55 Cal.2d at p.

585, 12 Cal.Rptr. 257, 360 P.2d 897; ***391** *Mack v. Hugh W. Comstock Associates* (1964) 225 Cal.App.2d 583, 589–590, 37 Cal.Rptr. 466 (*Mack*), and *Southern Cal. Enterprises v. Walter Co.* (1947) 78 Cal.App.2d 750, 755, 178 P.2d 785 (*Southern Cal. Enterprises* ).) As the majority concedes, the Legislature has never expressly disagreed with *Cascade Gardens* or taken any action to overrule or limit its holding. (See maj. opn., *ante,* 2 Cal.Rptr.3d at p. 671, 73 P.3d at p. 531.) Accordingly, it would be reasonable for us to presume the Legislature is aware of the judicial construction and approves of it. (See *People v. Williams* (2001) 26 Cal.4th 779, 789, 111 Cal.Rptr.2d 114, 29 P.3d 197; *People v. Hallner* (1954) 43 Cal.2d 715, 720, 277 P.2d 393.)

****538** The majority, however, seeks to repudiate *Cascade Gardens* on grounds that three cases on which that court relied are inapposite because they were breach of warranty cases that predate the adoption of section 337.15. (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 663, 73 P.3d at p. 524, discussing *Aced, supra,* 55 Cal.2d 573, 12 Cal.Rptr. 257, 360 P.2d 897; *Mack, supra,* 225 Cal.App.2d 583, 37 Cal.Rptr. 466, and *Southern Cal. Enterprises, supra,* 78 Cal.App.2d 750, 178 P.2d 785.) But that *Aced, Mack,* and *Southern Cal. Enterprises* were decided before section 337.15 was enacted is irrelevant, as *Cascade Gardens* relied on these cases not for any conclusion respecting section 337.15's legislative history or wording, but solely as authority for the proposition that "repairs, such as those undertaken by [the defendants there] toll statutes of limitations as a matter of law" (*Cascade Gardens, supra,* 194 Cal.App.3d at p. 1256, 240 Cal.Rptr. 113). The majority does not dispute that *Aced, Mack,* and *Southern Cal. Enterprises* so held.

The majority characterizes *Cascade Gardens* ' authorities as "narrowly concerned with how to apply the limitations period for express or implied warranties" (maj. opn., *ante,* 2 Cal.Rptr.3d at p. 663, 73 P.3d at p. 524), but that does not tell the whole story. While *Cascade Gardens* cited warranty cases, it did so not for peculiarly warranty-related principles, but, rather, as "cases involving [or discussing] construction defects, defective products, and other breaches of warranty [in which] the defendant attempts to repair the defect" (3 Witkin, Cal. Procedure, *supra,* Actions, 684, p. 871). For example, the *Mack* opinion expressly addressed tolling of other "Code of Civil Procedure sections ... relating to the tortious injury or damage to person or property ...." (*Mack, supra,* 225 Cal.App.2d at p. 589, 37 Cal.Rptr. 466 [considering "the application of these statutes" and concluding "the proper one to apply" "was tolled during the entire period when the respondents attempted to repair the heating plant" involved in the case]; see also *Cascade Gardens, supra,* 194 Cal.App.3d at p. 1257, fn. 4, 240 Cal.Rptr. 113 [analogizing *Mack* ].) In *Aced,* although we cited several cases showing that construction contracts "ordinarily ... give rise to an implied warranty" (*Aced, supra,* 55 Cal.2d at p. 582, 12 Cal.Rptr. 257, 360 P.2d 897), we also noted the rule that "[t]he statute of limitations is tolled when one who has breached a warranty claims that the defect can be repaired and attempts to make repairs." (*Id.* at p. 585, 12 Cal.Rptr. 257, 360 P.2d 897.) And the Court of Appeal in *Southern Cal. Enterprises* actually was at pains to *distinguish* the case of the " 'typical warranty' " (*Southern Cal. Enterprises, supra,* 78 Cal.App.2d at p. 757, 178 P.2d 785) from the rule governing that case, which it ***392** stated as: " 'if the seller promises that something shall happen *****680** or shall not happen to the goods within a specified future time, the promise though it may be called a warranty cannot be broken until that time has elapsed and until then the statute will not begin to run' " (*id.* at p. 758, 178 P.2d 785; see also *id.* at p. 757, 178 P.2d 785). In sum, the reasoning of *Cascade Gardens* and the warranty cases on which it relied—that promises to repair extend the limitations periods for suits on construction defects (maj. opn., *ante,* 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 526, describing, inter alia, *Aced* and *Mack* )—is fully applicable in this case.

Pointing to section 337.15's express exceptions, the majority invokes the maxim *inclusio unius est exclusio alterius,* apparently to suggest that, by including express statutory exceptions, the Legislature meant to displace established, generally applicable equitable exceptions. (See maj. opn., *ante,* 2 Cal.Rptr.3d at p. 664, 73 P.3d at 525.) The majority does not develop the argument, perhaps realizing that the [cited] maxim, while helpful in appropriate cases, is no magical incantation, nor does it refer to an immutable rule. (*California Fed. Savings Loan Assn. v. City of Los Angeles* (1995) 11 Cal.4th 342, 351, 45 Cal.Rptr.2d 279, 902 P.2d 297.) As the Court of Appeal pointed out, a recognized exception to the maxim arises when its application would conflict with well-established legal principles that the Legislature has not expressly repudiated. (*Juran v. Epstein, supra,* 23 Cal.App.4th at p. 896, 28 Cal.Rptr.2d 588; see also *Battuello v. Battuello* (1998) 64 Cal.App.4th 842, 848, 75 Cal.Rptr.2d 548.) Accordingly, as the Court of Appeal concluded, the presence of enumerated exceptions in ****539** section 337.15 does not imply legislative intent to exclude equitable tolling.

  

Confirming trial courts' discretionary access to equitable tolling, contrary to the majority, would not undermine the legislative purposes underlying section 337.15. (See maj. opn., *ante,* 2 Cal.Rptr.3d at pp. 664–668, 73 P.3d at pp. 525–528.) The majority's lengthy recitation of section 337.15's legislative history confirms "the statute is the result of general legislative concern about the economic effects of indefinite 'long tail' defect liability on the construction industry" (maj. opn., *ante,* 2 Cal.Rptr.3d at p. 664, 73 P.3d at p. 526), but it ultimately does not support the majority's position. Plaintiffs argue persuasively that the Legislature's primary aim when enacting section 337.15 was to eliminate generalized application of the "discovery rule" in construction defect litigation. Retention of equitable tolling would not undermine section 337.15's impact on the perceived evils of that rule, because, as the majority acknowledges, a defendant who promises or undertakes repairs is generally able to control the time of any suit against it. (See maj. opn., *ante,* 2 Cal.Rptr.3d at p. 670, 73 P.3d at p. 530.)

Ultimately, the majority can point to but one circumstance—that involving the so-called unsuspecting subcontractor—in which it can credibly claim an equitable tolling rule would undermine the statutory purpose. (See maj. opn., ***393** *ante,* 2 Cal.Rptr.3d at p. 668, 73 P.3d at p. 528.) The majority's objection, however, depends on the questionable assumption that subcontractors responsible for defects generally will neither participate in nor be informed about repairs contractor defendants might promise or undertake. Common sense suggests that such a circumstance, if it ever occurs, is likely to be the exception. In any event, the majority does not persuade me this theoretical possibility should drive our construction of section 337.15.

*****681** As we long have understood, section 337.15 is an "ordinary statute of limitations, subject to the same rules ... as other statutes of limitations." (*Regents of University of California v. Hartford Acc. Indem. Co.* (1978) 21 Cal.3d 624, 642, 147 Cal.Rptr. 486, 581 P.2d 197.) One such generally applicable rule has been that statutes of limitations may be subject to equitable tolling during periods of repair. (*Cascade Gardens, supra,* 194 Cal.App.3d at p. 1256, 240 Cal.Rptr. 113.) Given the Legislature's long-standing acquiescence in *Cascade Gardens* and its progeny, the absence of an express reference to equitable tolling in section 337.15 affords no justification for barring that generally available remedy in construction defect cases. I conclude that equitable tolling of section 337.15 to protect homeowners from unscrupulous builders and to encourage amicable resolution of construction defect disputes should remain available in appropriate cases when plaintiffs can demonstrate the remedy's required elements.

*Estoppel*

I agree with the majority that a defendant whose conduct induces plaintiffs to refrain from filing suit within the statutory period may, depending on the circumstances, be equitably estopped to assert that section 337.15's 10–year limitation on latent construction defect actions has expired. (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 659, 73 P.3d at p. 521.) The majority concludes that plaintiffs' first amended complaint alleges insufficient facts to establish such an estoppel. (*Id.* at p. 674, 73 P.3d at p. 533.) Assuming that conclusion is correct, I would allow plaintiffs an opportunity to amend their complaint.

The majority correctly notes that "plaintiffs did offer more specific estoppel allegations in a proposed second amended complaint. This proposed complaint made express claims that, from the time plaintiffs purchased their homes until expiration of the 10–year limitations period, defendants engaged in a pattern of falsely promising repairs, or making sham repairs they knew would fail, and then refused to respond further once the 10–year period had passed, all with the purpose and effect of inducing plaintiffs to forbear suing within the statutory time." (Maj. opn., *ante,* 2 Cal.Rptr.3d at pp. 675–676, 73 P.3d at pp. 534–535.) "It is axiomatic that if there is a reasonable possibility that a ****540** defect in the complaint can be cured by amendment or that the pleading liberally construed can state a cause ***394** of action, a demurrer should not be sustained without leave to amend." (*Minsky v. City of Los Angeles* (1974) 11 Cal.3d 113, 118, 113 Cal.Rptr. 102, 520 P.2d 726.)[3] The majority acknowledges this axiom (see maj. opn., *ante,* 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534), but fails to apply it.

Conceding that plaintiffs' proposed allegations may be "technically sufficient to establish an estoppel," the majority nevertheless denies plaintiffs that remedy, partly on the ground that plaintiffs' belated presentation of the proposed second amended complaint gives rise to doubt about the credibility of its allegations. (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 535.) But elsewhere the majority acknowledges that plaintiffs have urged "at *all stages* that if their complaint is deficient, but could be remedied by additional *****682** factual allegations, a chance should be

afforded to assert such facts." (*Ibid.* at p. 675, 73 P.3d at p. 534, italics added.)

The record contains a declaration, submitted to the superior court by one of plaintiffs' counsel, stating that only five days *after* defendants' demurrer was granted without leave to amend did counsel become aware, through conversations with another attorney, of the facts plaintiffs proposed to allege in their second amended complaint. Moreover, we previously have stated, in a case where the defense of estoppel set out in the amendment was known for a considerable time before the trial, that the fact the new matter set up by the amendment was well known to the [party] when he filed his original [pleading] was no good reason why he should not have been permitted to amend. (*Tolbard v. Cline* (1919) 180 Cal. 240, 245, 180 P. 610; see also 49A Cal.Jur.3d (2002) Pleading, 224, p. 371.) The majority on the other hand cites no authority for its apparent implication that plaintiffs' failure to supply a reason why the second amended complaint was not "presented sooner" (maj. opn., *ante,* 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534) is grounds for denying them an opportunity to amend their complaint, nor do I know of any such authority. To the contrary, "[a]ny judge, at any time before or after commencement of trial, in the furtherance of justice, ... may allow the amendment of any pleading ...." (§ 576.)

The majority also professes doubt about the credibility of the new allegations for the reason that, when plaintiffs' counsel was asked at oral argument what additional facts, not included in the first amended complaint, could be asserted to support a theory of equitable estoppel, he responded that "repairs promised or attempted by defendants *at any time* during the 10–year period gave rise, as a matter of law, to a form of *implicit reliance* by plaintiffs," thus reiterating a theory of equitable tolling, rather than specifically referring us to ***395** the claims set forth in the proposed second amended complaint. (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534.) The majority concludes that this omission and the proposed amendment's timing "negate any inference that these new assertions had a substantial basis in fact." (*Ibid.*) The conclusion does not follow. After all, the majority does not claim that plaintiffs *abandoned* or *repudiated* the allegations of the proposed second amended complaint, nor, indeed, did plaintiffs do so.

I am aware of no requirement that an issue or position that has been briefed before this court must be reiterated at oral argument in order to be preserved, nor of any principle that counsel who is nonresponsive to the courts question concerning a position is deemed to have abandoned that position. In addressing the topic of reliance before us, plaintiffs certainly were entitled to argue implicit reliance and even to reiterate their tolling theory, without being deemed to abandon the alternative, and perfectly consistent, position respecting amendment that they have urged at all stages of this litigation— ****541** viz., "that if their complaint is deficient, but could be remedied by additional factual allegations, a chance should be afforded to assert such facts." (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 675, 73 P.3d at p. 534.) In accordance with our liberal rules respecting amendment of the pleadings (see, e.g., §§ 473, 576), I would afford plaintiffs that opportunity.

For the foregoing reasons, I dissent.

KENNARD, J., concurs.

**All Citations**

31 Cal.4th 363, 73 P.3d 517, 2 Cal.Rptr.3d 655, 03 Cal. Daily Op. Serv. 6914, 2003 Daily Journal D.A.R. 8638

Footnotes

1 All further unlabeled statutory references are to the Code of Civil Procedure.

2 Section 337.15 continues to apply fully to many construction projects, including all nonresidential projects, but certain categories of residential construction, including (1) common interest developments and (2) residential units first sold after January 1, 2003, are subject to separate, more recent legislation affecting the applicable limitations periods for suit upon latent defects in those projects. (Civ.Code, §§ 895 et seq., 941, 1375; see further discussion, *post.*) The homes at issue here were first sold before January 1, 2003, and no party has suggested they are part of a common interest development. Hence, as the parties do not dispute, section 337.15 applies to this case.

3 The trial court never expressly ruled on defendants' request for judicial notice of the November 1988 completion notices on plaintiffs' homes. However, as the trial court indicated, there seems no dispute that plaintiffs' suit is untimely under the 10–year statute of limitations except for the possibility of equitable tolling or equitable estoppel.

4 No other defendant has appeared on appeal, either in the Court of Appeal or in this court. The California Building Industry Association, the National Home Builders Association, and the Civil Justice Association of California have filed amicus curiae briefs in this court on behalf of Centex.

5 As the text indicates, tolling extends the limitations period *no matter when* the tolling event occurred. This produces generally fair results where, as in the usual equitable tolling situation, the underlying limitations period itself is quite short. (See text discussion, *ante* and *post.*) But where a lengthy limitations statute such as section 337.15 is at issue, automatic tolling bears a far less direct relationship to fundamental fairness. The facts of *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, demonstrate the point. There, a certificate of completion of a construction project was recorded on July 13, 1973. If not tolled, the 10–year limitations period of section 337.15 would thus have expired on July 12, 1983. However, during the four-month period from January 1974 until April 1974, the contractor attempted repairs. The plaintiffs finally brought their suit on August 12, 1983. The Court of Appeal deemed the suit timely under section 337.15 because the *1973–1974* repair efforts had postponed expiration of the 10–year period by four months, from *July to November 1983.* (*Cascade Gardens, supra,* at pp. 1254–1258, 240 Cal.Rptr. 113.)

6 Although the dissent concedes that *Aced, Mack,* and *Southern Cal. Enterprises* were "warranty cases" (dis. opn., *post,* 2 Cal.Rptr.3d at p. 679, 73 P.3d at p. 538), it insists *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, properly cited those early decisions to support a general "tolling for repairs" rule that applies even against the later-adopted "absolute" 10–year limitations period of section 337.15. We disagree. The dissent splices together isolated snippets from the early cases to suggest that their reasoning on tolling issues extended beyond warranty principles. But this strained treatment of the early authorities obscures their overall context. *Aced, Mack,* and *Southern Cal. Enterprises* were *warranty* cases *in fact,* and they justified their holdings on the tolling-for-repairs issue by applying *warranty law* (*Aced, supra,* 55 Cal.2d 573, 577, 582–586, 12 Cal.Rptr. 257, 360 P.2d 897; *Mack, supra,* 225 Cal.App.2d 583, 588–590, 37 Cal.Rptr. 466; *Southern Cal. Enterprises, supra,* 78 Cal.App.2d 750, 758–759, 178 P.2d 785) to statutes of limitations not influenced by the special concerns that prompted enactment of section 337.15 (see discussion, *post* ).

7 In a decision rendered after both *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, and *Grange Debris, supra,* 16 Cal.App.4th 1349, 20 Cal.Rptr.2d 515, but before *FNB Mortgage, supra,* 76 Cal.App.4th 1116, 90 Cal.Rptr.2d 841, the court in *A & B Painting & Drywall, Inc. v. Superior Court* (1994) 25 Cal.App.4th 349, 30 Cal.Rptr.2d 418 refused to extend the tolling rule of *Cascade Gardens* to a situation in which the repairs were made by someone other than the defendant. (*A & B Painting, supra,* at pp. 354–355, 30 Cal.Rptr.2d 418.)

8 In recent cases, decided long after adoption of section 337.15, we have refined the respective purviews of warranty and tort theories as they apply to construction defects. Under the so-called economic loss rule, tort recovery is available only insofar as a defect causes personal injury or damage to *property other than the defective product,* while "the law of contractual warranty governs damage to the product itself." (*Jimenez v. Superior Court* (2002) 29 Cal.4th 473, 483, 127 Cal.Rptr.2d 614, 58 P.3d 450; *Aas v. Superior Court* (2000) 24 Cal.4th 627, 639, 101 Cal.Rptr.2d 718, 12 P.3d 1125 (*Aas* ).) The applicability of those theories appears further affected by new legislation applicable to individual housing units first sold on or after January 1, 2003. (See Civ.Code, § 895 et seq., as enacted by Stats.2002, ch. 722, § 3.) The new law sets detailed quality and performance standards for new residential construction and provides that a homeowner may sue for (1) specific violations of the statutory standards (Civ.Code, § 896) and (2) any other "function or component of [the] structure," to the extent inadvertently omitted from the standards, that causes damage (*id.,* § 897).

9 Centex asked us to take judicial notice of various legislative materials, including documents from the enactment histories of (1) Assembly Bill No. 2528 (1970 Reg. Sess.) (see text discussion, *ante* ), (2) Assembly Bill No. 2742 (1971 Reg. Sess.), which became section 337.15, and (3) Assembly Bill No. 312 (1979–1980 Reg. Sess.), which amended section 337.15, in response to our decision in *Regents, supra,* 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197, to provide that the sureties of persons involved in construction projects are also protected by the 10–year limitations period for latent construction defects. It is not clear that we must take judicial notice of these materials in order to consider them. However, they are relevant to the legal arguments Centex advances, and they appear to be proper subjects of judicial notice. (Evid.Code, §§ 452, subd. (c) [official acts of legislative, executive, and judicial departments of the United States or any state], 459.) Plaintiffs did not object, and we therefore granted the request for judicial notice.

10 For example, Jack Barrish, President of the Structural Engineers of California, testified about "an architect in Sacramento [who] retired some five years ago and is still having to carry coverage. There is no statute of limitations. So in order to protect his estate, he is still carrying insurance covering his old projects." (1970 Com. Hearing, p. 48.) Barrish further testified that "[i]n my particular case, I was forced to take out coverage with a new carrier and for half the coverage I pay more than three times the rate, because of the exposure the engineer has. [¶] We have been informed by our factors ...

  

that were the statute of limitations to be passed, then there would be more coverage at less rate for more people against possible suits of this nature." (*Ibid.*)

11 As originally enacted in 1971, section 337.15 measured the limitations period from the time of "substantial completion" of the improvement, but did not define "substantial completion." Subdivision (g), added in 1981 (Stats.1981, ch. 88, § 1, pp. 204–205), modified the measurement period to provide that the 10–year period would commence upon "substantial completion ..., *but not later than* the date of one of the following, *whichever first occurs:* [¶] (1) The date of final inspection by the applicable public agency. [¶] (2) The date of recordation of a valid notice of completion. [¶] (3) The date of use or occupation of the improvement. [¶] (4) One year after termination or cessation of work on the improvement." (Italics added.)

12 As this court recognized in *Valley Circle Estates, supra,* 33 Cal.3d 604, 189 Cal.Rptr. 871, 659 P.2d 1160, the rule of section 337.15, subdivision (c), allowing cross-complaints for indemnity beyond the 10–year period, is consistent with the common law rule that an action for equitable indemnity does not accrue, for purposes of the statute of limitations, until the indemnitee pays a judgment or settlement that entitles him to indemnity, and that a tort defendant retains the right to seek equitable indemnity from another tortfeasor even if the plaintiff's action against the cross-defendant is barred. (*Valley Circle Estates, supra,* at p. 611, 189 Cal.Rptr. 871, 659 P.2d 1160; see also *People ex rel. Department of Transportation v. Superior Court* (1980) 26 Cal.3d 744, 748, 751, 163 Cal.Rptr. 585, 608 P.2d 673, and cases there cited; *Watts v. Crocker–Citizens National Bank* (1982) 132 Cal.App.3d 516, 524, 183 Cal.Rptr. 304.)

13 At oral argument, plaintiffs' counsel made clear their position that the 10–year limitations period should automatically be tolled, or suspended in progress, during any time a defendant's promises or efforts to repair were pending, *no matter when these events occurred.* In support of this view, counsel urged that a homeowner's "acceptance" of the defendant's promises or repairs *at any time* during the 10–year limitations period is a form of *implicit reliance* which justifies a corresponding additional time, at the end of the limitations period, to determine whether the repairs were successful. But a policy judgment of that magnitude is for the Legislature, not the courts. For reasons we have detailed, we cannot conclude the Legislature made such a judgment when it adopted section 337.15.

14 The year after *Regents, supra,* 21 Cal.3d 624, 147 Cal.Rptr. 486, 581 P.2d 197, was decided, the Legislature obviated the holding of that case, at least for the future, by expressly extending the protection of section 337.15 to sureties. (Stats.1979, ch. 571, § 1, p. 1797.)

15 Plaintiffs insist that section 337.15 has been amended "on numerous occasions" since *Cascade Gardens, supra,* 194 Cal.App.3d 1252, 240 Cal.Rptr. 113, was decided, but this simply is not so. Section 337.15 was last amended by Statutes 1981, chapter 88, section 1, pages 204–205. *Cascade Gardens* was decided six years later, in 1987.

16 As evidence that the Legislature supports the principle of tolling for repairs in construction defect cases, plaintiffs direct our attention to new Civil Code section 895 et seq., adopted in 2002. (See fns. 2, 8, *ante.*) This statutory scheme comprehensively revises the law applicable to construction defect litigation for individual residential units, other than condominium conversions, first sold after January 1, 2003. (Civ.Code, §§ 896, 938.) Where it applies, the new scheme expressly *supersedes* section 337.15, though it retains the basic premise that suit may commence no later than 10–years after substantial completion of the project. (Civ.Code, § 941, subds.(a), (d).) Among other things, the new law *requires,* as a prerequisite to suit, elaborate "nonadversarial procedure[s]" to try to resolve the dispute (*id.,* §§ 910 et seq., 914), including a prelitigation opportunity for the builder to effect repairs (*id.,* §§ 917–928). Civil Code section 927 states that if the statute of limitations runs *during the repair process,* the time for filing a suit for an actionable defect, or for inadequate repairs, is tolled from the date the claimant originally notified the builder of his claim until 100 days after the repair process is complete. The new scheme further provides, in cryptic fashion, that "[e]xisting statutory and decisional law regarding tolling of the statute of limitations shall apply to the time periods for filing an action ... under this title," but that *repairs* shall *not* toll the limitations period *except as specifically provided in section 927.* (Civ.Code, § 941, subd. (e).) Civil Code section 895 et seq. demonstrates only that the Legislature knows how to toll the statute of limitations for repairs when it wishes to do so. Moreover, a 2002 statute that provides for a limited form of *statutory* tolling while *mandatory* dispute resolution efforts proceed, but otherwise explicitly *excludes* tolling for repairs, affords little support for the premise that *equitable* tolling should apply under a 1971 statute of limitations to a defendant's *voluntary* efforts to remedy alleged defects. We reach a similar conclusion with respect to Civil Code section 1375, specially applicable to common interest developments, which includes somewhat similar express provisions for tolling while *mandatory* dispute adjustment procedures go forward in timely fashion. (*Id.,* subds. (a), (c).)

17 We need not and do not decide here whether section 337.15 is subject to the several separate *statutes* that specify when certain limitations periods will be tolled. (E.g., §§ 351 [defendant's absence from state], 352 [plaintiff's minority or

  

insanity], 352.1 [plaintiff's incarceration], 352.5 [pending restitution order against defendant], 354 [plaintiff's disability by virtue of state of war], 356 [injunction against commencement of action].)

18 The defendant's statement or conduct must amount to a misrepresentation bearing on the *necessity* of bringing a timely suit; the defendant's mere denial of *legal liability* does not set up an estoppel. (*Vu, supra,* 26 Cal.4th 1142, 1149–1153, 113 Cal.Rptr.2d 70, 33 P.3d 487; *Neff v. New York Life Ins. Co.* (1947) 30 Cal.2d 165, 174–175, 180 P.2d 900.)

19 Because equitable estoppel, unlike equitable tolling, operates independently of the limitations period itself (see text discussion, *ante* ), it is not clear that a defendant who is directly sued beyond the 10–year period of section 337.15, but is estopped by his personal conduct from asserting the statutory bar, may thereafter cross-complain against another project participant for indemnity pursuant to subdivision (c) of the statute. That issue is not before us, and we do not address it.

20 As indicated above (see fn. 18, *ante* ), to the extent defendants' alleged advice that the windows were not defective, and that a lawsuit should not be filed, was a mere *denial of defendants' liability,* rather than a *representation of fact,* it was insufficient to establish an estoppel to assert the statute of limitations. (*Vu, supra,* 26 Cal.4th 1142, 1149–1153, 113 Cal.Rptr.2d 70, 33 P.3d 487.)

21 There is no ground to conclude that plaintiffs simply have not understood the distinction between tolling and estoppel, as they apply to this case. Though tolling was the principal issue debated in the trial court, and though the parties sometimes referred to the two theories as one, the record nonetheless suggests plaintiffs were aware of estoppel as a distinct concept, and understood it was prudent to allege facts supporting that theory. The first amended complaint alleged, inter alia, that defendants made promises to repair, assured plaintiffs they were construction experts and would remedy all defects, and "advised [p]laintiffs ... not to file a lawsuit." As a result, the complaint asserted, defendants were "estopped" to assert the action was untimely. In opposition to defendants' demurrer, plaintiffs urged that the first amended complaint sufficiently alleged plaintiffs' "[r]eliance" on defendants' promises and attempts to repair, and that defendants' conduct, as alleged, "estopped" them from invoking the statute of limitations.

In papers supporting their later motion to amend, plaintiffs' counsel represented that they had recently learned of defendants' similar conduct in *other* residential developments, whereby defendants "wilfully lulled homeowners into a sense of security [by promising repairs] until [d]efendants were confident that these homeowners would refrain from instituting litigation until the applicable statute of limitations had expired." This language suggests counsel understood the essential elements of equitable estoppel, while failing to explain why similarly relevant allegations *within plaintiffs' personal knowledge* were not presented sooner, if true.

Finally, plaintiffs' appellate briefs, both in the Court of Appeal and in this court, indicate their full awareness that tolling and estoppel are distinct theories. Hence, there could have been no confusion about the import of this court's question at oral argument.

1 All further statutory references are to the Code of Civil Procedure.

2 The majority inferentially acknowledges the point in recognizing the possibility that "section 337.15 is subject to the several separate *statutes* [not mentioned in section 337.15] that specify when certain limitations periods will be tolled." (Maj. opn., *ante,* 2 Cal.Rptr.3d at p. 672, fn. 17, 73 P.3d at p. 532, fn. 17.)

3 As the majority concedes, the trial court found there was a possibility that amendment could cure any factual deficiencies in plaintiffs' estoppel allegations. (See maj. opn., *ante,* 2 Cal.Rptr.3d at pp. 675–676, 73 P.3d at pp. 534–535) The majority also concedes amendment "might cure" any factual deficiencies in plaintiffs' allegations respecting equitable tolling. (*Id.* at p. 660, 73 P.3d at p. 522.)