

IN THE MATTER OF
CHAPTER 11 OF THE NORTH AMERICAN FREE
TRADE AGREEMENT

B E T W E E N:

PRIMERO MINING CORP.

Disputing Investor

- and -

THE GOVERNMENT OF THE UNITED MEXICAN STATES

Respondent

**NOTICE OF INTENT TO SUBMIT
A CLAIM TO ARBITRATION**

June 2, 2016

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NOTICE OF INTENT TO SUBMIT A CLAIM TO ARBITRATION PURSUANT TO CHAPTER ELEVEN OF THE NORTH AMERICAN FREE TRADE AGREEMENT

Executive Summary

In accordance with Article 1119 of the North American Free Trade Agreement (“NAFTA”), Primero Mining Corp. (“Primero”) hereby gives written notice of its intention to submit to international arbitration claims against the Government of the United Mexican States (“Mexico”).

Primero is a Canadian gold and silver mining company with operating mines in Canada and Mexico and a strong portfolio of development and exploration projects. The company’s flagship asset is the San Dimas mine located on the border of the Sinaloa and Durango states in central west Mexico and operated by Primero Empresa Minera S.A. de C.V. (“PEM”), Primero’s wholly owned Mexican subsidiary.¹

This dispute relates to a campaign of intimidation and improper pressure tactics adopted by Mexican authorities in connection with Primero’s investments at San Dimas. This campaign is aimed at revoking legal rights granted to PEM and upon which Primero relied to expand its investment in Mexico. Mexican authorities granted these legal rights to PEM by means of an Advance Pricing Agreement No. 900 08-2012-52885 delivered on October 4, 2012 (the “APA”) that was expressly intended to provide PEM with stability and legal certainty regarding the treatment of PEM’s transfer pricing arrangements for the years 2010 through 2014. The APA, which is based upon international standards promoted by the OECD, was granted to PEM only following an exhaustive and careful review of PEM’s transfer pricing arrangements by the Mexican authorities.

Following the election of a new government, newly appointed Mexican officials started to pressure PEM into relinquishing its legal rights stemming from the APA. As PEM refused to let itself be intimidated by the Mexican officials’ threats, an unprecedented application was filed

¹ Primero holds 1, 600,620 shares of PEM and a Mexican nominee holds one share of PEM.

by Mexico's tax authority to nullify the APA. The nullification application represents a complete reversal of the position of the Mexican authorities and an attempt to revoke the legal framework upon which Primero relied, which risks saddling PEM with substantial, albeit indeterminate, liabilities.

These measures, taken as a whole, are arbitrary, discriminatory, unfair and inequitable. They also threaten to expropriate PEM's vested legal rights and, if implemented, would substantially deprive Primero of its investment in Mexico. This pattern of conduct has violated, and continues to violate, Mexico's core commitments to Canadian investors in NAFTA Chapter 11 and entitles Primero to compensation.

I. Name and Address of the Disputing Investor

1. Primero is a company existing under the laws of the province of British Columbia, Canada, and hence, an enterprise of Canada under NAFTA Article 1139.

2. The full name and address of the disputing investor is:

Primero Mining Corp.

79 Wellington Street West

TD Tower South

Suite 2100, P.O. Box 139

Toronto, Ontario, M5K 1H1

3. Primero wholly owns Primero Empresa Minera S.A. de C.V.,² a company incorporated in Mexico (PEM071128HJA) and located at Aquiles Serdan #1157, Zona Centro, Durango, Dgo., Mex. CP34000.

4. PEM operates the San Dimas mine, which employs nearly 1,100 people. The San Dimas

² See *supra* n.1.

mine has been repeatedly awarded Clean Industry certification by the *Procuraduria Federal de Proteccion al Ambiente* (PROFEPA), Mexico's Environmental Protection agency, and has been repeatedly recognized as a Socially Responsible Company by the Mexican Centre for Philanthropy (CEMEFI).

5. For the purposes of NAFTA Article 1139, Primero is therefore a Canadian investor that owns and controls an investment in Mexico.

II. NAFTA Provisions Breached by Mexico

6. Primero intends to invoke the following non-exhaustive grounds in international arbitration proceedings against Mexico. These proceedings will be brought on Primero's own behalf under NAFTA Article 1116 and on behalf of PEM, a Mexican enterprise that Primero owns and controls, under NAFTA Article 1117. As set out below, Mexico has made express and specific representations and commitments to PEM upon which Primero relied, with respect to its investment in the San Dimas mine. Mexico now has blatantly disregarded its own express representations and commitments, however, causing substantial harm to Primero and jeopardizing PEM's operations. In so doing, Mexico violated its obligation to protect Primero's foreign investment under NAFTA Chapter Eleven.

- Article 1102 (National Treatment): 1. [...] 2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments. 3. [...]
- Article 1105(1) (Minimum Standard of Treatment): Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.[...]
- Article 1110(1) (Expropriation and Compensation): No Party may directly or indirectly

nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6 [i.e., without delay, fully realizable, and at fair market value including interest].

III. Factual Basis and Legal Issues Giving Rise to the NAFTA Claim

A. Mexico Made a Specific Commitment to PEM Regarding Transfer Pricing

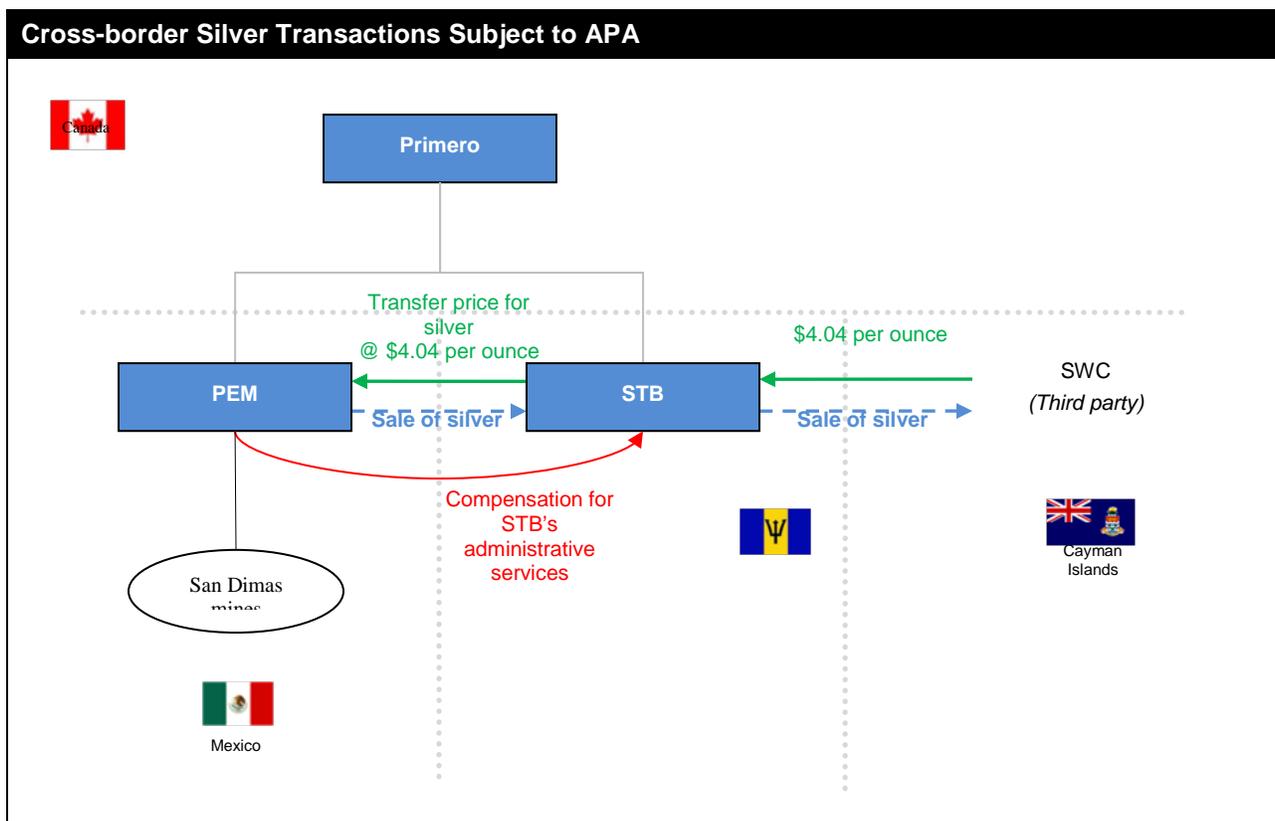
7. On August 6, 2010, Primero purchased for approximately US\$489 million the assets of the San Dimas mine from subsidiaries of Goldcorp Inc., an unrelated company. As a condition to the purchase of the San Dimas mine, Primero was required to assume the obligation to continue to sell refined silver to the unrelated company Silver Wheaton (Caymans Ltd.) ("SWC") under a streaming agreement.³ Pursuant to that agreement, SWC was to receive from a Goldcorp subsidiary a minimum of 220 million ounces of silver over an initial term of 25 years at the lesser of the market price – also known as the "spot" price – or the fixed price which, as of August 2010, was set at US\$ 4.04 per ounce (adjusted yearly at a rate of 1%). As contractually required, such external sales are made by the subsidiary Silver Trading Barbados ("STB"), which Primero had to acquire from Goldcorp as part of the deal. Internally, the refined silver is transferred by PEM to STB within the Primero group.

8. Following the acquisition, the internal transfer of silver from PEM to STB was initially recorded at the spot price. Because these internal transfers did not reflect the actual revenues realized within the Primero group, PEM, after first consulting with the *Servicio de Administración Tributaria* ("SAT"), the Mexican tax authority, proceeded to rectify its internal

³ In a "streaming transaction," future quantities of a metal are purchased in consideration for an upfront deposit plus future payments at fixed prices. Streaming transactions are a common hedging tool in the mining industry geared toward avoiding fluctuating market levels.

process for transfer of refined silver. At around the same time, PEM made a request to SAT for an advance pricing agreement under Article 34-A of the Mexican Tax Code. PEM's request sought to confirm, for tax years 2010 through 2014, that SAT would accept that the internal transfers were properly based on the fixed price for refined silver actually realized by PEM, as opposed to being deemed to occur at any other price including the spot price.

9. The transactions governing PEM's sale of silver per the APA Request can be summarized as follows:



10. On October 4, 2012, SAT approved PEM's proposed transfer pricing methodology for the sale of refined silver for fiscal years 2010 through 2014. In a 37 page-long ruling, SAT thoroughly analyzed PEM's arguments, and granted the APA based upon the extensive documentation provided by PEM (which SAT listed in the APA). In the APA, SAT notably decided the following:

“PRIMERO.- La presente resolución será aplicable para los ejercicios 2010, 2011, 2012, 2013 y 2014, respecto de la operación de venta de plata refinada par parte de Primera Empresa Minera, S.A. de C.V., a su parte relacionada en el extranjero STB.

SEGUNDO.- Que a solicitud de Primera Empresa Minera, S.A. de C.V., se confirma que para la operación de venta de plata refinada a STB, PEM par los ejercicios fiscales de 2010 y 2011 está obteniendo rendimientos similares a los que hubieran utilizado con o entre partes independientes en operaciones comparables, tal coma lo establece el artículo 215 de la LISR vigente.

TERCERO.- Se confirman los resultados obtenidos par Primera Empresa Minera, S.A. de C.V., únicamente por la operación de venta de plata refinada a STB en las declaraciones normales y/o complementarias para los ejercicios 2010 y 2011 de fechas 27 de agosto de 2011 y 30 de marzo de 2012 respectivamente.

Asimismo, se confirman los resultados obtenidos por Primera Empresa Minera, S.A. de C.V., únicamente por la operación de venta de plata refinada a STB en el dictamen para el ejercicio 2011 de fecha 3 de julio de 2012...”

11. In reaching this decision, SAT considered that PEM was at arm’s length with unrelated but similarly situated companies, as such companies would have agreed to operate within the same constraints as PEM did. This justified granting the APA as regards transfer pricing of the refined silver between PEM and STB. SAT, however, *denied* PEM’s other request which was to deem the administrative services provided by STB, paid by PEM, in connection with the sale of silver comparable to services provided by third parties.

12. In reliance on the APA, Primero further developed and expanded its investment in the San Dimas mine (as well as in its other development properties in Mexico such as in Ventanas and Cerro Del Gallo), including through capital investment to identify new ore resources, optimize and expand mining facilities. PEM has diligently declared its revenues to SAT ever since, including from sales of gold and of silver to companies other than SWC, by way of STB, (all such sales having been made at the spot price), and provided further information from time to time as required under the APA and the Mexican Tax Code, such as its annual income tax returns or financial documents related to the annual production of refined silver and revenue derived therefrom.

B. SAT Now Improperly Seeks to Repudiate Its Commitment

13. SAT has now capriciously changed its mind and wants to overturn its previous decision, to which Mexico is bound by law. Indeed, on August 4, 2015, SAT filed a lawsuit seeking retroactive invalidation of the APA (that SAT had *itself* granted to PEM), through an administrative procedure called a *juicio de lesividad*,⁴ before the *Sala Especializada en Juicios en Línea Tribunal Federal de Justicia Fiscal y Administrativa* located in Mexico City. SAT's request was lodged notwithstanding the fact that the APA had already expired at the end of 2014. PEM only received service of process regarding this *juicio* on February 2, 2016.

14. As will be explained below, the initiation of this *juicio de lesividad* is an extraordinary and unprecedented measure taken by Mexico's SAT⁵ because no fraud or misrepresentation from PEM in obtaining the APA existed.

15. The mere filing of the *juicio de lesividad* has generated significant legal uncertainty that has harmed Primero. If SAT's application is successful, it will cast a significant shadow on Primero's ability to maintain the viability of its investment in Mexico. The *juicio* is also unjustifiable as SAT's allegations upon which the *juicio* is based are meritless.

1. SAT's attempt to invalidate the binding APA is politically motivated

16. About two months after the APA was issued, President Enrique Peña Nieto's new Government, composed of members of the Institutional Revolutionary Party (PRI), succeeded Felipe Calderon's National Action Party (PAN) government. Most, if not all, heads and high officials of federal governmental agencies were replaced as well. Among the newcomers was Oscar Molina Chie, a former tax litigator turned public attorney who was appointed the head of

⁴ Article 36 provides: "Las resoluciones administrativas de carácter individual favorables a un particular sólo podrán ser modificadas por el Tribunal Federal de Justicia Fiscal y Administrativa mediante juicio iniciado por las autoridades fiscales."

⁵ In fact, no other *juicio de lesividad* was initiated against any company between 2011 and 2016 (access to archived records in Mexico is limited due to a 5-year document retention policy), although, in that timeframe, 58 APAs were granted.

SAT's unit in charge of large taxpayers such as PEM.

17. Under Mr. Molina's leadership, foreign enterprises have been targeted by SAT. SAT has threatened to reassess these foreign companies for hundreds of millions of dollars in back-taxes on allegations of violations of Mexican tax law, so SAT could coerce these enterprises into reaching a tax settlement.⁶ In fact, Mr. Molina has admitted that SAT is targeting "a pool of 270 multinationals that the agency has flagged for possibly skirting their tax obligations by shifting profits to countries with lower taxes despite having a big presence in Mexico."⁷ This large number of "flagged" foreign companies indicates that, under the guise of alleged "tax avoidance probes," SAT is arbitrarily targeting foreign investors. The reason for this may be related to the fact that Mexico's revenues in recent years have consequently fallen below expectations in the wake of the oil crisis.⁸

18. It is axiomatic that Mexico should not be allowed to complain that the very policies it enacted to attract foreign investment reduce its tax revenues. In any event, there is no profit shifting to another country in the case of PEM. All of the *actual* revenues of Primero's group of companies that come from Mexican operations are taxed in Mexico. That SAT, now that Mexico is seeking new revenues, is remorseful over its prior (correct) assessment of the PEM/STB transfer pricing transactions does not allow it to break its commitment under Mexican law.

2. *Mexican authorities exerted undue coercive pressure against PEM*

19. Even before the *juicio* was filed, SAT sought to intimidate PEM, during meetings or

⁶ See, e.g., Alexander Coolidge, "Mexico feuds with P & G, other over taxes," Sept. 1, 2015, <http://cin.ci/1FhB4GM>; Alexandra Alper, "Exclusive: Mexico withheld millions in tax refunds from P&G, Unilever, Colgate," *Reuters*, Sept. 1, 2015; Alexandra Alper, "Exclusive: Hasbro pays Mexico tax authorities \$65 million in settlement after probe," *Reuters*, Feb. 4, 2015.

⁷ Luis Rojas and Alexandra Alper, "Mexico eyes seven multinationals in tax avoidance probe," *Reuters* (Jan. 23, 2014).

⁸ In particular, Mexico's State-owned oil producer Pemex has reported historic losses for 12 consecutive quarters since 2012. See Adam Williams and Andrea Navarro, "Pemex Reports Biggest Loss Ever as Oil Market Rout Cuts Deeper," *Bloomberg* (October 28, 2015), <http://www.bloomberg.com/news/articles/2015-10-28/pemex-reports-12th-straight-loss-as-oil-price-batters-profits>. Mexico's dependency on its oil industry is well known as 40% of its revenues derive from oil production. See <http://www.coha.org/mexico-an-oil-nation-in-crisis/>

otherwise, making vague, unsubstantiated complaints about PEM's tax arrangements. SAT threatened to "make an example" out of PEM and initiated tax audits for certain fiscal years covered by the APA. Other investigations and inspections were also conducted against PEM, such as by customs officials, even leading to PEM's temporary suspension from Mexico's list of importers and exporters. This suspension, which was in effect from May 2015 until August 2015, compromised PEM's operations and caused substantial damage to Primero.

3. *SAT's grounds for retroactive invalidation of the APA are entirely meritless*

20. As PEM refused to acquiesce to what became evident as Mexico's improper tactics, SAT commenced the *juicio*, notwithstanding the fact that Mexican law only allows annulment of APAs on the basis of fraud or misrepresentation. All of SAT's arguments in the *juicio* highlight the fact that SAT merely raises *its own* alleged mishandling of PEM's APA Request in order to seek its nullification, not any fault attributable to PEM.

21. Handicapped by the positions to which it adhered in the APA, SAT conjures up its meritless *juicio* by making a great number of convenient factual shortcuts and flatly false statements in connection with Primero's investment at San Dimas. For example, SAT bases a large part of its argument on the false premise that no independent party would have assumed an obligation deriving from an agreement with a term of 25 years establishing a fixed price for silver at US\$ 4.04 dollars an ounce. SAT's simplistic argument completely fails to capture the reality of the economic transaction that PEM had conveyed to SAT. PEM had declared in its APA Request that its strategy was to become a major gold producer, the sale of silver being only ancillary to its core activity. In light of the prospects that existed regarding overall mining production, the assumed contingency resulting from the silver streaming arrangement with SWC – which was also offset by a reduction in the purchase price of the mine – did not make the investment unattractive. PEM further expressly stated to SAT that it would potentially make additional profits by selling the excess refined silver above and beyond the amount it is contractually obligated to sell to SWC at the fixed price. SAT's express acknowledgment of these objectives in the APA discredits its subsequent argument that the PEM-STB intra-group sale of refined silver lacks commercial reality.

22. Simply, the methodology suggested by PEM was commercially sound, which is why SAT accepted it in 2012.⁹

C. SAT's Discriminatory Conduct Against Primero Manifestly Disregards the Mexican Legal Framework

23. Article 14 of the Mexican Constitution, *inter alia*, guarantees legal certainty.¹⁰ For a *juicio de lesividad* to be entertained by the courts, SAT must demonstrate that the determination in question, such as the APA, was *illegal*.¹¹ Mexican law and jurisprudence are clear that the illegality that could cause an APA to be cancelled retroactively is only *fraud or misrepresentation* from the taxpayer.¹² No other ground for revocation of an APA on the basis of illegality is permitted under Mexican law.

24. But here, the accusations made by SAT all relate to vague and unsubstantiated allegations of wrongdoing that, even if true, would be imputable to Primero's predecessors-in-interest, and not to Primero. Unsurprisingly, however meritless these allegations are, what SAT did *not* do was to accuse PEM of having committed any misrepresentations when it made its APA Request – and it could not as no such wrongdoing occurred.

25. In sum, the APA could not be invalidated absent wrongdoing from PEM in securing the APA. Yet, this is precisely what SAT is seeking to do with its *juicio*. SAT is simply renegeing, in violation of its international legal obligations in the NAFTA, on its 5-year commitment to tax

⁹ It should be noted that, had the transfer price between PEM and STB remained set at the spot price, Primero's STB would have had to incur ever-increasing losses, which would have had to be covered by PEM through internal guarantees and therefore would have impacted PEM's taxable revenue.

¹⁰ Art. 14 de la Constitución Política de los Estados Unidos Mexicanos: "A ninguna ley se dará efecto retroactivo en perjuicio de persona alguna."

¹¹ *See*, Art. 68, Mexican Tax Code ("resolutions issued by a tax authority will be deemed legal unless otherwise demonstrated").

¹² *See e.g.*, Segunda Sala de la Suprema Corte de Justicia de la Nación [Mexican Supreme Court] mediante el criterio de número 2a. CXXXI/2015 (10a.). To be sure, Article 34-A of the Mexican Federal Tax Code, which instituted the APA procedure, provides that APAs can be granted under the conditions set forth in Article 215 LISR. Article 215 LISR, in turn, specifies that the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the "OECD Guidelines") control its interpretation. And the OECD Guidelines are clear that an "APA should be subject to cancellation, even retroactively, **in the case of fraud or misrepresentation of information during an APA negotiation...**" *See* OECD Guidelines, at 4. 138 (emphasis added).

silver on the basis of the revenues actually achieved by PEM on sales to STB.

D. SAT's Wrongful Acts Engage Mexico's International Responsibility

26. SAT's aggressive pursuit of a *juicio de lesividad* against PEM notwithstanding the patent lack of fraud or misrepresentation from PEM underscores the zeal with which SAT has gone against PEM. SAT's *juicio*, along with the measures that led to it, engage Mexico's responsibility as a matter of international law. Through SAT's actions, Mexico has violated its obligations to treat Primero's investment fairly and equitably, and on an equal footing with its own national companies under NAFTA.

1. Mexico's conduct is unfair and inequitable

27. By entering into the APA, Mexico in effect sought to stabilize the tax regime applicable to Primero's intra-group sale of refined silver. In that sense, the APA can be understood as being a stabilization agreement, the deviation to which is consistently sanctioned by international tribunals.¹³ The *juicio de lesividad* proceedings frustrate Primero's legitimate expectations to be protected against retroactive changes that would harm its interests in Mexico contrary to the commitments made in the lawful APA. While the APA has not been nullified at this time, the SAT's politically motivated attempts to do so are themselves a breach of the international law standard of treatment.¹⁴ This legal uncertainty is an actionable harm to Primero.

2. Mexico's conduct is discriminatory

28. The national treatment principle prohibits both *de jure* and *de facto* nationality-based

¹³ See, e.g., *Duke Energy v. Ecuador*, ICSID Case No. ARB/04/19 (US/Ecuador BIT), Award, August 18, 2008, paras. 208, 366; *Letco v. Liberia*, Award and rectification, (1987) 26 ILM 647, 666-667; *Agip v. Congo*, Award, November 30, 1979, (1982) 21 ILM 726, 734-735; *Mine v. Guinea* (Annulment) (1990) 5 ICSID Review, 95, 11

¹⁴ *Railroad Development Corporation (RDC) v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Award, 29 June 2012, para. 147.

discrimination.¹⁵ They require that PEM be accorded the most favorable treatment accorded to non-Canadian investments in like circumstances. Here, SAT has sought to make an example out of PEM, singling it out for particularly harsh treatment. The steps taken by the SAT against Primero's investment are unprecedented, even in the context of an administration that has targeted foreign taxpayers rather than domestic ones.

3. *In the event of nullification, PEM would be at risk of expropriation*

29. Furthermore, in the event of nullification of the APA, PEM would be at risk of substantial tax reassessments and could be required to pay significant unwarranted back-taxes. As most of Primero's revenues are generated by PEM's operations at San Dimas, the effect of retroactive spot price-based taxes resulting from the potential nullification of the APA could be disastrous and may compromise PEM's very subsistence. Mexico's reversal of the APA would, in effect, deny Primero the benefit of its investment in Mexico and thus constitute a measure tantamount to an expropriation under NAFTA Article 1110, for which Primero will be entitled to full compensation as a matter of international law.

E. SAT's Wrongful Acts Cause Harm to Primero and its Investment in Mexico

30. As a result of SAT's reckless and abusive use of the *juicio* procedure, Primero has already incurred significant expenses and reputational damage. Primero's shares are listed in the New York and Toronto stock exchanges and Primero was therefore obligated to disclose SAT's filing of the *juicio de lesividad* to the financial markets. As a result, the value of Primero's stock decreased by over 28% of its market capitalization the day the *juicio* was disclosed.

31. Following Primero's disclosure, several shareholder lawsuits were brought against it in the United States federal courts which involve significant expenses for Primero to defend, notwithstanding their lack of merit. At the same time, PEM is now forced to defend itself against the *juicio de lesividad* procedure in the Mexican courts, which entails further substantial costs.

¹⁵ *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. The United Mexican States*, ICSID Case No. ARB (AF)/04/5 (NAFTA), Award (Redacted Version), 21 November 2007, para. 193.

F. Procedural Cooling-Off Period Prescribed Under NAFTA

32. Primero finally notes that more than 6 months have elapsed since the *juicio de lesividad* was filed, thereby satisfying the requirement of NAFTA Article 1120. Should the situation not be remedied by Mexico within 90 days, Primero reserves the right to commence arbitration proceedings under NAFTA Article 1119.

G. Issues Raised

33. Has Mexico taken actions inconsistent with its obligations under NAFTA?

34. If the answer to this question is yes, what is the quantum of compensation to be paid to Primero as a result of Mexico's failure to comply with its obligations under NAFTA?

IV. Relief Sought and Tentative Amount of Damages Claimed

35. For the reasons provided above, Primero seeks:

- a) Declaratory relief that Mexico's measures are inconsistent with its obligations contained in Part A of Chapter Eleven of the NAFTA;
- b) Monetary relief commensurate with any harm caused by or arising out of Mexico's measures that are inconsistent with its obligations contained in Part A of Chapter Eleven of the NAFTA;
- c) Costs associated with these proceedings, including all professional fees and disbursements;
- d) Pre-award and post-award (including any post-judgment) interest at a rate to be fixed by the arbitral tribunal; and
- e) Such further relief that counsel may advise and/or that the arbitral tribunal may deem appropriate.



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