BEFORE THE
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
UNDER THE RULES GOVERNING THE ADDITIONAL FACILITY
FOR THE ADMINISTRATION OF PROCEEDINGS
AND UNDER THE NORTH AMERICAN FREE TRADE AGREEMENT

Fireman's Fund Insurance Company,
Claimant,
v.
The United Mexican States,
Respondent.

Case No. ARB(AF)/02/01

CLAIMANT'S MEMORIAL ON THE PRELIMINARY QUESTION

December 20, 2002

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I. Introduction

1. Respondent, the United Mexican States ("Mexico"), has challenged the jurisdiction of the Tribunal in this proceeding to hear certain of the claims advanced by Claimant, Fireman's Fund Insurance Company ("Fireman's Fund") of Novato, California. Specifically, Mexico contends that this dispute arises under Chapter Fourteen (Financial Services) of the North American Free Trade Agreement ("NAFTA"), and that, by virtue of NAFTA Article 1401(2), Fireman's Fund may not itself advance claims based on Mexico's violation of its obligation to afford national and fair and equitable treatment to investors of the other NAFTA parties. Nowhere in the Government's submission does it deny Mexico's discriminatory treatment (or, for that matter, its expropriation) of Fireman's Fund's investment. More important for the present phase of the proceedings, however, Mexico's submission is in error in suggesting that this dispute arises under Chapter Fourteen, rather than under Chapter Eleven, of the NAFTA.

2. As will be explained in detail below, Chapter Fourteen's applicability depends on whether Mexico's measures relate to an investment in a financial institution. A "financial

institution" is defined in NAFTA Article 1416 as an enterprise that is authorized to do business and regulated or supervised as a financial institution under the relevant domestic law. Fireman's Fund did not invest in a financial institution. Fireman's Fund invested in debentures issued by Grupo Financiero BanCrecer, S.A. de C.V. ("Grupo Financiero"), a financial holding company that is *not* authorized to do business, nor regulated or supervised, as a financial institution. Therefore, Fireman's Fund's investment in the debentures issued by Grupo Financiero not within the scope of Chapter Fourteen. It follows that Fireman's Fund may advance its claims under Chapter Eleven.

3. To set the context for these proceedings, Part II of the Memorial reviews the facts of Fireman's Fund's investment and the actions of the Mexican Government giving rise to this dispute; Part III summarizes the relevant procedural history. Part IV reviews the uncontested elements supporting this Tribunal's jurisdiction over the dispute, and Part V presents the key contested issue: whether Fireman's Fund's investment in Grupo Financiero's debentures is an investment in a financial institution triggering the application of Chapter Fourteen. This portion of the Memorial analyzes the Mexican legal regime applicable to financial holding companies and demonstrates that such holding companies are not "financial institutions" as defined in NAFTA Article 1416. Accordingly, as outlined in the conclusions in Part VI, Mexico's jurisdictional objections should be rejected.

II. Factual Background of the Dispute

4. At the First Hearing on July 22, 2002, the Tribunal expressly requested that the parties undertake in their submissions to familiarize the Tribunal with the nature and facts of the

dispute.[1] Because the Government of Mexico has provided only a limited survey of events, Fireman's Fund submits the following exposition of the facts of the dispute.

A. Fireman's Fund Insurance Company

5. Fireman's Fund Insurance Company is a company incorporated under the laws of the State of California and based in Novato, California.[2] It is a wholly-owned subsidiary of Allianz of America, Inc., a Delaware corporation that is wholly owned by Allianz AG of Munich, Germany ("Allianz"). It is a sister corporation to Allianz México.[3]

6. Fireman's Fund was founded approximately 150 years ago, and its principal business is the provision of various types of insurance, including accident and fire insurance. Fireman's Fund is bound and driven by its fiduciary duty to manage its assets and safeguard their value so as to retain the ability to pay policyholders' claims. This commitment is shared by Fireman's Fund's parent corporation, Allianz, one of the largest property and casualty insurers in the world.

B. The Investment

7. In September 1995, Fireman's Fund invested US $50 million in dollar-denominated debentures (stock exchange key GFCRECE 95L-D) issued by Grupo Financiero, a Mexican holding company.[4] Fireman's Fund made this investment in accordance with an agreement

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[1] *See* Statement of President Van Den Berg, Transcript (English) of Hearing of July 22, 2002, at page 50 (per unnumbered copy supplied by ICSID on September 10, 2002); Minutes/Summary (English) of the First Session of the Arbitral Tribunal, as certified by the Secretary of the Tribunal October 31, 2002, at para. 16.

[2] *See* Articles of Incorporation and Certificate of Status for Fireman's Fund Insurance Company (C0040-45).

[3] *See* Affidavit of Dr. Gerhart E. Reuss, December 16, 2002 at para. 1 ("Reuss Affidavit") (C0031).

[4] *See* Acta de Emisión de Obligaciones Subordinadas Denominadas en Dólares Estadounidenses Convertibles Forzosamente en Títulos Representativos del Capital del Grupo Financiero BanCrecer, S.A. de C.V., Serie "L" GFCRECE 95L-D ("Debenture Issuing Document for Dollar Debentures") (R0107-27); *see also* Receipt of Payment, September 29, 1995 (indicating that Fireman's Fund purchased US $50 Million in dollar-denominated debentures) (R0165).

between Fireman's Fund and Grupo Financiero to invest in one half of a US $100 million issuance of debentures by Grupo Financiero.[5]

8. The dollar-denominated debentures in which Fireman's Fund invested were subordinated and convertible into Series "L" shares of the capital stock of Grupo Financiero. Under the terms of the indenture (*i.e.*, the issuing document), the debentures were subject to conversion in three circumstances: (1) automatically, on their maturity date, October 12, 2000; (2) at the request of the issuer, with prior authorization from Banco de México (the Central Bank of Mexico, hereinafter the "Central Bank"); or (3) at the request of the subscriber, after four years.[6]

9. According to the terms of the indenture, the debentures would yield interest annually based on a 90-day London Interbank Offered Rate (LIBOR) plus four percentage points. Interest on the debentures would be paid on the last day of each 91-day period, upon proof that the debentures had not been converted into capital share certificates.[7]

10. Also in September 1995, on the same date and under identical terms, Grupo Financiero issued US $50 million worth of subordinated, convertible debentures denominated in Mexican pesos (stock exchange key GFCRECE 95L).[8] Mexican investors, many of whom were politically well-connected, purchased the peso-denominated debentures.[9]

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[5] *See* Reuss Affidavit at para. 5 (C0032).

[6] *See* Debenture Issuing Document for Dollar Debentures, Cls. 3, 10-10(2) (R0109, R0115-22).

[7] The only exception to the 91-day schedule was with respect to the first payment, which was made at the end of the first period, consisting of 27 days. *See* Debenture Issuing Document for Dollar Debentures, Cl. 9 (R0113-15).

[8] Acta de Emisión de Obligaciones Subordinadas Convertibles Forzosamente en Títulos Representativos del Capital del Grupo Financiero BanCrecer, S.A. de C.V., Serie "L" GFCRECE 95L ("Debenture Issuing Document for Peso Debentures") (R0086-106).

[9] *See* Reuss Affidavit at para. 7 (C0032).

11. Fireman's Fund's decision to invest in Grupo Financiero's debentures was based in significant part on the understanding that Mexican investors were undertaking identical investments. Fireman's Fund believed that it was important that local investors were undertaking the same risks under an identical instrument (albeit denominated in pesos) so that the investment would not be solely a foreign investment. Fireman's Fund sought thereby to insure itself against discriminatory treatment. To that end, Fireman's Fund conditioned its purchase of the dollar-denominated bonds on proof of the subscription and payment of the peso-denominated bonds.[10]

C. Discriminatory Treatment and Expropriation of the Investment

12. Nevertheless, Fireman's Fund suffered discriminatory treatment and expropriation of its investment in the course of a series of events beginning in 1997.

13. In the wake of the Mexican financial crisis of the mid-1990s, the Mexican Government began a program to resuscitate failing or weak Mexican banks. The Mexican financial authorities coordinated their work to prepare and implement rescue plans for individual banks.[11]

14. A governmental working group was formed to address the circumstances of BanCrecer, the Grupo Financiero banking subsidiary, which had been weakened by the financial crisis. The working group consisted of representatives of the Comisión Nacional Bancaria y de Valores (National Banking and Securities Commission, hereinafter the "Commission"), the Secretaría de Hacienda y Crédito Público (the "Ministry of Finance" or the "Finance Ministry"), the Central

[10] *See* Reuss Affidavit at para. 7 (C0032).

[11] *See* Affidavit of Eduardo Fernández García ("Fernández Affidavit"), December 6, 2002, at para. 8 (C0017); *see also* Reuss Affidavit at para. 8 (C0032).

Bank, and the Fondo Bancario de Protección al Ahorro (Fund for the Protection of Bank Savings, hereinafter "FOBAPROA").[12]

15. In 1997, the working group began to develop a restructuring program for BanCrecer that was ultimately known as the Program of Rescue and Recapitalization for Grupo Financiero BanCrecer ("Recapitalization Program").[13] At a meeting at the Central Bank on February 26, 1998, FOBAPROA presented the formal details of the Recapitalization Program to Fireman's Fund. The head of FOBAPROA, the Governor of the Central Bank, and the President of the Commission were among those present at the meeting. FOBAPROA explained to Fireman's Fund that the dollar-denominated debentures "were to constitute an integral part of the overall plan to transform BanCrecer from a troubled bank into a viable one."[14]

16. Under the first part of a two-part plan, FOBAPROA undertook to clean up BanCrecer's balance sheet by offsetting BanCrecer's losses against the bank's equity capital and net worth, and by establishing a rescue fund that would, among other things, assume all of BanCrecer's non-performing loans. Through these transactions, non-performing loans and other losses would be removed from BanCrecer's balance sheet.[15]

17. The second part of the two-part plan, to be carried out simultaneously with the first, focused on the recapitalization of the newly cleaned-up BanCrecer. The second part of the plan

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[12] *See* Fernández Affidavit at para. 9 (C0017); *see also* Reuss Affidavit at para. 9 (C0032). FOBAPROA, a trust fund, was established to assist in the administration of the financial rescue operations for Mexican banks. Its governing board consisted of representatives from the Finance Ministry, the Commission, and the Central Bank. *See* Reuss Affidavit at para. 9 (C0032).

[13] *See* Reuss Affidavit at para. 10 (C0032-33).

[14] Reuss Affidavit at para. 11 (C0033).

[15] *See* Programa de Saneamiento y Capitalización Resumen de Términos y Condiciones ("Draft Recapitalization Program"), May 1998 (C0046-55); *see also* Reuss Affidavit at para. 11 (C0033).

envisioned an infusion of capital into the cleaned-up BanCrecer from three sources: (1) existing shareholders, (2) Allianz and/or any of its subsidiaries or affiliates, including Fireman's Fund, and (3) a foreign banking entity. Under the plan, Fireman's Fund's US $50 million dollar-denominated debentures would be redeemed and Fireman's Fund would invest the US $50 million from the debentures in the restructured BanCrecer, together with an additional US $50 million investment by Fireman's Fund, Allianz, or their affiliates. Fireman's Fund and Allianz would also undertake, with the assistance of J.P. Morgan, to find a foreign banking concern interested in investing US $200 million in BanCrecer.[16]

18. Under the plan presented, if Fireman's Fund and Allianz could not find a foreign investor, and, therefore, the recapitalization could not be effected, Fireman's Fund's debentures would be redeemed for US $25 million instead of US $50 million.[17] If, however, actions or omissions of the Mexican Government were to cause the Recapitalization Program to fail, Fireman's Fund would receive US $50 million for its debentures.[18]

19. FOBAPROA insisted that Fireman's Fund's participation was necessary to the Recapitalization Program. No other option to preserve the value of Fireman's Fund's investment was presented or discussed. Fireman's Fund thus understood that it had "no choice but to participate in the Program or lose the value of [its] investment."[19] FOBAPROA did not suggest that other bondholders would be treated differently.

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[16] *See* Draft Recapitalization Program (C0049-50); *see also* Fernández Affidavit at para. 11(d) (C0018); Reuss Affidavit at para. 12 (C0033).

[17] *See* Draft Recapitalization Program (C0050-51); *see also* Fernández Affidavit at para. 11(d) (C0018); Reuss Affidavit at para. 12 (C0033).

[18] *See* Reuss Affidavit at para. 12 (C0033).

[19] Reuss Affidavit at para. 13 (C0033).

20. The Recapitalization Program was formally approved by the FOBAPROA Technical Committee on February 27, 1998, the day after it was presented to Fireman's Fund.[20]

21. Simultaneously, and without Fireman's Fund's knowledge, an alternative plan was in progress to pay the holders of peso-denominated debentures the full cash value of their investment. The governmental working group had decided simply to repurchase the debentures of the Mexican investors at full value.[21] This decision was made with the full "knowledge of, and without objection from, the Mexican financial authorities, including the Commission, the Ministry of Finance and the Central Bank."[22] The repurchase was effected through a trust established by BanCrecer on November 28, 1997,[23] with funds effectively guaranteed by the

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[20] *See* Minutes of Meeting of FOBAPROA Technical Committee, February 27, 1998 ("FOBAPROA Meeting Minutes") (C0056-64); *see also* Reuss Affidavit at para. 15 (C0034); Press Release on Recapitalization Program, February 27, 1998 (C0103).

[21] *See* Letter from BanCrecer to National Banking and Securities Commission, November 17, 1997 (stating that procedures for the acquisition of the Grupo Financiero debentures, including the establishment of a trust, were underway in accordance with the decisions of the governmental working group) (R0166); Letter from BanCrecer to National Banking and Securities Commission, April 16, 1998 (stating in the cover letter that BanCrecer was remitting to the Commission a copy of the Trust Agreement establishing a trust for the purpose of acquiring peso-denominated debentures issued by Grupo Financiero and attaching the Trust Agreement dated November 28, 1997) (C0104-07); Letter from BanCrecer to National Banking and Securities Commission, July 13, 1998 (documenting the acquisitions to date by the BanCrecer Trust of the debentures issued by Grupo Financiero and indicating that the first such acquisition occurred as early as December 8, 1997) (C0108-10); Letter from National Banking and Securities Commission to Grupo Financiero BanCrecer, August 12, 1998 (referring to the acquisition of the debentures issued by Grupo Financiero in 1995 as forming part of the Program of Rescue and Recapitalization for Grupo Financiero BanCrecer) (C0111); *see also* Fernández Affidavit at para. 11(b) (C0018); Reuss Affidavit at paras. 14-15, 17-18 (C0033-35); *see also generally* FOBAPROA Meeting Minutes (stating that the FOBAPROA Technical Committee indicated that "the subordinated, convertible debentures ought to be repurchased partially" (*i.e.*, peso-denominated debentures only would be redeemed)) (C0059).

[22] Fernández Affidavit at para. 11(b) (C0018); *see also id.* at para. 16 (C0020); Letter from National Banking and Securities Commission to Grupo Financiero BanCrecer, August 12, 1998 (stating that it had taken note of the procedures for acquiring the debentures issued by Grupo Financiero in 1995 which were undertaken pursuant to the Recapitalization Program adopted by the governmental working group; letter copied to Ministry of Finance, Central Bank, Commission, and FOBAPROA) (C0111).

[23] *See, e.g.*, Letter from BanCrecer to National Banking and Securities Commission, April 16, 1998 (stating in the cover letter that BanCrecer was remitting to the Commission a copy of the Trust Agreement establishing a trust for the purpose of acquiring peso-denominated debentures issued by Grupo Financiero and attaching the Trust Agreement dated November 28, 1997) (C0104-07); *see also* Status of Debentures Purchased by BanCrecer Trust as of September 30, 2002 (identifying acquisition of peso-denominated debentures by BanCrecer Trust) (C0112).

Mexican Government.[24] Without the Mexican Government's permission and financial support, BanCrecer would not have been able to engage in the repurchase of the peso-denominated debentures. The repurchase was completed in 1998.[25]

22. Fireman's Fund did not know about the existence of the alternative arrangement for repurchasing bonds—which was made available only to holders of the peso-denominated bonds—until April 1998. Until that time, Fireman's Fund had been convinced by the Mexican Government that the only way to salvage its investment was to participate in the rescue of BanCrecer through the Recapitalization Program. Fireman's Fund believed that all of the bondholders were similarly situated, such that if the Recapitalization Program did not succeed, all bondholders (not just Fireman's Fund) would lose their investments.[26]

23. Fireman's Fund's first indication that an alternative arrangement existed was in late April 1998, when it received a copy of a letter dated April 16, 1998, from BanCrecer to the Commission referring to the repurchase of the peso-denominated debentures and remitting a copy of the Trust Agreement establishing the vehicle for acquiring the debentures.[27] After receiving this letter through the Chairman of BanCrecer, Fireman's Fund obtained a meeting at the end of April 1998 with the President of the Commission, Mr. Eduardo Fernández García. At the meeting, the President acknowledged that an alternative arrangement existed for Mexican investors holding the peso-denominated debentures but did not, despite Fireman's Fund's

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[24] *See* Fernández Affidavit at para. 11(c) (C0018).

[25] *See* Letter from Fireman's Fund Insurance Company to Grupo Financiero BanCrecer, July 7, 1999 (R0174-75).

[26] *See* Reuss Affidavit at para. 14 (C0033).

[27] *See* Letter from BanCrecer to National Banking and Securities Commission, April 16, 1998 (stating in the cover letter that BanCrecer was remitting to the Commission a copy of the Trust Agreement establishing a trust for the purpose of acquiring peso-denominated debentures issued by Grupo Financiero and attaching the Trust Agreement dated November 28, 1997) (C0104-07); *see also* Reuss Affidavit at para. 17 (C0034).

request, offer or grant to Fireman's Fund the possibility of having its debentures exchanged for cash in the same manner.[28] Instead, the President said that, under the Recapitalization Program, Fireman's Fund would receive "value" for its debentures, in the form of an investment in a newly cleaned-up and recapitalized BanCrecer, equivalent to that which the peso-denominated debentures were receiving in cash. As explained by Mr. Fernández in his affidavit, the Mexican Government was interested in "the participation of Fireman's Fund in the Recapitalization Program" and intended to use Fireman's Fund's bonds as "leverage" to keep them involved.[29] In addition, the President of the Commission made it clear to Fireman's Fund that "any attempt...to request formally the repurchase of its debentures would jeopardize the entire execution of the Recapitalization Program, thus rendering Fireman's Fund's investment worthless."[30]

24. Because its requests for equal treatment were denied and because it saw no other alternative, Fireman's Fund made good faith efforts throughout 1998 and early 1999 to secure a potential foreign banking partner to invest in the restructured BanCrecer as envisioned under the Recapitalization Program.[31] During this time, however, the Mexican Government's implementation of the Recapitalization Program was stalled by various developments. First, the letter of intent to be used in negotiations with potential foreign investors, though fully drafted, was never signed by the Mexican financial authorities.[32] Without this letter of intent, Fireman's Fund and Allianz could not proceed with overtures to potential foreign banking partners, one of

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[28] *See* Fernández Affidavit at para. 11(e) (C0019).

[29] Fernández Affidavit at paras. 11(d)-11(e) (C0018-19).

[30] Reuss Affidavit at para. 19 (C0035); *see generally* Fernández Affidavit at para. 11(e) (C0019).

[31] *See, e.g.*, Memorandum from José Juan de Olloqui, January 27, 1999 (referencing and attaching materials from presentation in Madrid before Banco Bilbao Vizcaya regarding investment opportunities in BanCrecer) (C0113-31); *see also* Restructuring Proposal to Banco Bilbao Vizcaya from J.P. Morgan, February 1999 (identifying investment opportunities in BanCrecer) (C0132-208); Reuss Affidavit at para. 21 (C0035).

[32] *See* Fernández Affidavit at para. 11(f) (C0019); *see also* Draft Recapitalization Program (draft letter of intent)

whom, Argentaria of Spain, had already expressed an interest in investing in BanCrecer.[33] Second, FOBAPROA returned to BanCrecer the entire non-performing loan portfolio that it had previously taken over pursuant to the Recapitalization Program.[34] Finally, in April 1999, the Instituto para la Protección al Ahorro Bancario (Institute for the Protection of Bank Savings, hereinafter "IPAB"), which took over FOBAPROA's responsibilities following the enactment of a new financial reform law in January 1999,[35] announced a plan to recapitalize BanCrecer and auction it to the highest bidder, instead of pursuing the Recapitalization Program.[36]

25. At this point, it was clear to Fireman's Fund that the Recapitalization Program offered to it was not going to be implemented. In light of these developments, Fireman's Fund wrote a letter on April 5, 1999, to the Finance Minister, the President of the Commission, and the Governor of the Central Bank formally requesting that the dollar-denominated debentures be repurchased in the same manner as the peso-denominated debentures. Fireman's Fund stated that it might still be willing to invest the proceeds from the debentures in a restructured BanCrecer, and, thus, forego remitting the proceeds to the United States.[37]

26. Having received no response to its April 5 letter, Fireman's Fund requested on July 7, 1999, that Grupo Financiero seek permission from the proper financial authorities in Mexico to

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(C0046-55).

[33] *See* Letter from Argentaria to Allianz México, February 25, 1998 (indicating a willingness to consider investing in BanCrecer) (C0209-14); *see also* Fernández Affidavit at para. 11(f) (C0019); Reuss Affidavit at para. 10 (C0032-33). Argentaria later merged with Banco Bilbao Vizcaya and is now known as Banco Bilbao Vizcaya Argentaria.

[34] *See* Letter from FOBAPROA to BanCrecer, November 11, 1998 (C0215-16).

[35] *See* Ley de Protección al Ahorro Bancario, Título Cuarto del Instituto para la Protección al Ahorro Bancario, *Diario Oficial*, January 19, 1999 (C0217-35).

[36] *See* Fernández Affidavit at para. 11(g) (C0019); *see also* Reuss Affidavit at paras. 25-26 (C0036).

[37] *See* Letter from Allianz México to Finance Minister, President of the National Banking and Securities Commission, and Governor of the Central Bank of Mexico, April 5, 1999 (C0236-37); *see also* Reuss Affidavit at para. 27 (C0036).

acquire the dollar-denominated debentures on the same terms as the peso-denominated debentures had been acquired.[38] On July 16, 1999, Grupo Financiero sought permission from the Central Bank to acquire the dollar-denominated debentures on those terms.[39] On August 16, 1999, the Central Bank denied Grupo Financiero's request, stating that statutory conditions (that the Central Bank could only authorize advance payments to obtain resources or assist operations on adequate terms for the market and/or financial system) were not satisfied.[40] There is no evidence that any such deliberation or legal analysis ever took place with respect to the repurchase of the peso-denominated debentures.[41]

27. The Mexican Government was well aware that it had treated the Mexican investors and Fireman's Fund differently and that such disparate treatment would give rise to international liability. In fact, the Commission requested, through a Discussion Note dated September 9, 1999, that the treatment of Fireman's Fund's debentures be put on an IPAB meeting agenda.[42] The Commission specifically pointed in the Note to the "unequal treatment of a foreign institution" and observed that the Mexican Government's refusal to repurchase Fireman's Fund's debentures "would, in the opinion of the National Banking and Securities Commission, constitute relevant proof" in a NAFTA arbitration.[43] As stated by the former President of the

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[38] *See* Letter from Fireman's Fund Insurance Company to Grupo Financiero BanCrecer, July 7, 1999 (R0174-75); *see also* Reuss Affidavit at para. 29 (C0036-37).

[39] *See* Letter from Grupo Financiero BanCrecer to Central Bank of Mexico, July 16, 1999 (R0176); *see also* Fernández Affidavit at para. 11(h) (C0019); Reuss Affidavit at para. 29 (C0036-37).

[40] *See* Letter from Central Bank of Mexico to Grupo Financiero BanCrecer, August 16, 1999 (C0238); *see also* Fernández Affidavit at para. 11(h) (C0019); Reuss Affidavit at para. 29 (C0036-37).

[41] Although Fireman's Fund expressly requested documents that would indicate such analysis in its renewed document request dated November 4, 2002, Mexico produced none. It is appropriate to infer, therefore, that no such assessment took place.

[42] *See* Discussion Note, Exhibit A to Fernández Affidavit (C0022-24).

[43] Discussion Note, Exhibit A to Ferndández Affidavit (C0024).

Commission, Mr. Fernández,

> The Commission's concern was that if the dispute [were] submitted to international arbitration[,] it was very likely that a tribunal would find breaches of international obligations, and Mexico would lose and be compelled to pay Fireman's Fund the full value of the dollar-denominated bonds. In addition, there was concern that Mexico's reputation in the international investment community would suffer.[44]

Based on these concerns, the Commission recommended settlement negotiations with Fireman's Fund.[45] Settlement negotiations had in fact commenced in July 1999 but had ended a month later because of concerns on the part of some officials in the Finance Ministry regarding political risks associated with settlement.[46]

28. On September 14, 1999, the Consultative Committee of the Board of Governors of IPAB ("Committee") convened a meeting. The Committee was composed of representatives of IPAB, the Commission, the Ministry of Finance, and the Central Bank, and its purpose was to assist the Board of Governors of IPAB in analyzing and recommending action on certain questions, including recapitalization plans for Mexican banks. At the September 14 meeting, the Committee discussed the circumstances surrounding the disparate treatment by Mexico of the Mexican investors and Fireman's Fund. In addition to acknowledging that the Mexican financial authorities had ratified the repurchase of the peso-denominated debentures and that the Central Bank had refused Grupo Financiero's request to treat the dollar-denominated bonds equally, the Committee was well aware that the Central Bank's refusal had essentially rendered Fireman's Fund's debentures worthless. Nevertheless, the view was expressed that "it was appropriate to

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[44] Fernández Affidavit at para. 12 (C0019).

[45] *See* Fernández Affidavit at para. 13 (C0019); *see also* Discussion Note, Exhibit A to Fernández Affidavit (C0024).

[46] *See* Reuss Affidavit at paras. 30-31 (C0037).

protect individual investors (the Mexican holders of peso-denominated debentures) while leaving an institutional investor (Fireman's Fund) at risk."[47]

29. A notice of the same date published in the *Diario Oficial* announced that Grupo Financiero planned to convert the dollar-denominated debentures into Series "L" shares in Grupo Financiero, using the second means of conversion spelled out in the indenture.[48] The Chairman of BanCrecer told Fireman's Fund that Grupo Financiero, at the insistence of the IPAB, planned "to write off such newly converted shares against BanCrecer losses immediately upon their conversion, effectively rendering the shares worthless."[49] Fireman's Fund filed for an injunction against any such action on the grounds that the prior written authorization of the Central Bank was required under the issuing document.[50] On October 12, 1999, after Fireman's Fund obtained the injunction,[51] the Central Bank refused the necessary authorization for the anticipatory conversion of the dollar-denominated debentures.[52]

30. Grupo Financiero failed to make its October 14, 1999, interest payment on the dollar-denominated debentures.[53] No interest payments were made to Fireman's Fund thereafter.[54]

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[47] Fernández Affidavit at para. 16 (C0020).

[48] *See* Notice of September 14, 1999, published in *Diario Oficial* (indicating Grupo Financiero's intent to convert dollar-denominated debentures into shares) (R0179); *see also* Reuss Affidavit at para. 32 (C0037); discussion *supra* at para. 8.

[49] Reuss Affidavit at para. 32 (C0037).

[50] *See* Temporary Injunction Request filed on behalf of Fireman's Fund Insurance Company, September 29, 1999 (C0239-45); *see also* Reuss Affidavit at para. 32 (C0037).

[51] *See* Order of the Court, October 4, 1999 (granting request for temporary injunction) (C0246-49); *see also* Reuss Affidavit at para. 33 (C0037).

[52] *See* Letter from Central Bank of Mexico to Grupo Financiero BanCrecer, October 12, 1999 (C0250); *see also* Reuss Affidavit at para. 33 (C0037).

[53] *See* Letter from S.D. Indeval, S.A. de C.V. to Casa de Bolsa Santander Mexicano, S.A., October 18, 1999 (indicating that Grupo Financiero had not effected interest payments for the period ending October 14, 1999) (C0251-52); *see also* Reuss Affidavit at para. 34 (C0037).

[54] *See* Reuss Affidavit at para. 34 (C0037).

31. On November 3, 1999, at an extraordinary shareholders' meeting of Grupo Financiero, it was resolved, among other things, that (1) IPAB would take control of BanCrecer; (2) BanCrecer would, therefore, cease to be a subsidiary of Grupo Financiero; and (3) Grupo Financiero would be dissolved and liquidated.[55]

32. Although the maturity date for the dollar-denominated debentures has passed (October 12, 2000), none of the steps necessary to convert the debentures to shares of Grupo Financiero have taken place. As noted in the Commission's records, no conversion has ever taken place, notwithstanding that an anticipatory conversion had been announced.[56]

III. Procedural History of the Dispute

33. On November 15, 1999, when it was clear to Fireman's Fund that a mutually acceptable solution to its dispute with the Mexican Government could not be reached, Fireman's Fund filed a notice of intent to submit a claim to arbitration.

34. Thereafter, Fireman's Fund continued to seek a negotiated settlement with the Mexican Government. After the Presidential elections of July 2000, however, it was clear to Fireman's Fund that it would not be possible to reach an agreement with the incumbent administration.[57] Therefore, in November 2000, Fireman's Fund filed an amended notice of intent to submit a claim to arbitration.

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[55] Minutes of Extraordinary Shareholders' Meeting of Grupo Financiero BanCrecer, November 3, 1999, Parts IV and VI (R0180-98).

[56] *See* Records of the National Banking and Securities Commission (C0253-57).

[57] *See* Reuss Affidavit at para. 37 (C0038).

35. Fireman's Fund nevertheless continued to seek a negotiated solution with the newly elected administration during the first half of 2001.[58] After these negotiations, too, failed to bring about a mutually agreed solution, Fireman's Fund filed its Notice of Arbitration bringing claims against the Mexican Government on October 30, 2001. In its Notice of Arbitration, Fireman's Fund specifically alleged that Mexico had violated Articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment), and 1110 (Expropriation) of the NAFTA. Fireman's Fund noted that Mexico's discriminatory actions would also violate Article 1405, the specialized national treatment obligation under Chapter Fourteen, if, in the alternative, the dispute were determined to be governed by that Chapter.[59]

36. By way of a letter addressed to the International Centre for the Settlement of Investment Disputes on December 11, 2001, the Mexican Government raised concerns about the applicability of Chapter Eleven in this case. Mexico formally articulated these concerns in its first submission before the Tribunal on October 21, 2002, as an objection to the Tribunal's competence to hear claims of infringement of Fireman's Fund's rights under Articles 1102, 1105, and 1405 of the NAFTA.

37. Nowhere in Mexico's submission has it denied that the Government's treatment of Fireman's Fund was discriminatory or that it stripped Fireman's Fund's investment of all value.

IV. The Tribunal Has Jurisdiction under Chapter Eleven To Arbitrate this Dispute

38. Mexico has not disputed that Fireman's Fund has advanced claims under the NAFTA for which it is entitled to invoke the dispute settlement procedures of Chapter Eleven, Section B

[58] *See* Reuss Affidavit at para. 38 (C0038).

[59] Because Article 1405, though binding on Mexico, is not directly enforceable in an investor-state action, it is not discussed further in this submission.

(Articles 1115 through 1138). Fireman's Fund has properly invoked these procedures under Article 1116 (Claim by an Investor of a Party on Its Own Behalf).

39. First, Fireman's Fund is a U.S. enterprise, as defined in Articles 1139 and 201. As noted in paragraphs 5 and 6 above, it is a corporation organized under the laws of the State of California and carries out business in the United States.

40. Second, Fireman's Fund is an investor of the United States under Article 1139 because it has made an investment in Mexico. Specifically, Fireman's Fund subscribed to convertible debentures with an original maturity of five years issued by a Mexican enterprise, Grupo Financiero. Those debentures constitute an investment under Article 1139 as, in particular, debt securities with an original maturity of at least three years, under definition (c) of "investment" in that Article.

41. Third, Fireman's Fund is alleging breaches by Mexico under Section A of Chapter Eleven, including, in particular, violations of Articles 1102, 1105, and 1110. Fireman's Fund further alleges that it has suffered loss or damage by reason of, and arising out of, those breaches.

42. Thus, Fireman's Fund satisfies all of the jurisdictional requirements for claims advanced by an investor on its own behalf under Chapter Eleven, and, in particular, the requirement that it has made an investment within the meaning of Article 1139. Mexico does not dispute this. All that Mexico disputes is whether that investment is an investment in a financial institution and, therefore, subject to the specialized dispute settlement provisions of Chapter Fourteen.[60] As will be explained below, Chapter Fourteen is inapplicable to this dispute.

[60] Fireman's Fund does not take issue with Mexico's extended explanation of how, as a legal matter, the dispute

V. Chapter Fourteen Is Inapplicable to this Dispute

43. Mexico's sole jurisdictional objection is that Chapter Fourteen rather than Chapter Eleven applies to this dispute. Mexico is motivated to argue for the applicability of Chapter Fourteen because if that Chapter governs, an investor such as Fireman's Fund is more limited in the range of claims it may bring directly against the Party than it is in an arbitration under Chapter Eleven. Article 1401(2) limits the investor's private right of action available under Chapter Fourteen to alleged breaches of Articles 1109, 1110, 1111, 1113, and 1114. Thus Mexico, whose submission never makes any effort to deny the discriminatory and inequitable nature of its treatment of Fireman's Fund's investment, seeks to shield itself from Fireman's Fund's claims under Articles 1102 (National Treatment) and 1105 (Minimum Standard of Treatment) behind a technical defense: the jurisdictional limitations on investor-state dispute settlement proceedings under Chapter Fourteen. However, this strategy by the Government of Mexico for avoiding responsibility for its Article 1102 and 1105 violations is flawed—Chapter Fourteen is inapplicable here and avails Mexico no escape from its substantive NAFTA undertakings.

44. The scope and coverage of Chapter Fourteen are defined in Article 1401(1), which states:

> This Chapter applies to measures adopted or maintained by a Party relating to:
>
> (a) financial institutions of another Party;
>
> (b) investors of another Party, and investments of such investors, in financial institutions in the Party's territory; and
>
> (c) cross-border trade in financial services.

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settlement provisions of these two Chapters intersect. *See* Respondent's Memorial on the Preliminary Question ("Mexico's Memorial") at paras. 14-24, 26.

45. Fireman's Fund invested US $50 million in convertible debentures issued in Mexico by Grupo Financiero, a holding company. Because that holding company owned financial institutions (*e.g.*, BanCrecer), Mexico asserts that the holding company is itself a financial institution, and therefore that Chapter Fourteen is applicable under Article 1401(1)(b). Under its interpretation, Mexico argues that this dispute involves measures relating to a U.S. investor and its investment in a financial institution in the territory of Mexico, and that, therefore, Mexico's consent to arbitration extends only to claims under Articles 1109-11, 1113, and 1114.[61]

46. Mexico's argument attempts to blur critical realities. First, Fireman's Fund invested in debentures issued by a financial holding company, not debentures issued by any of its financial institution subsidiaries. Second, under Mexican law, a financial holding company such as Grupo Financiero is not itself a financial institution.

47. By its plain language, the relevant provision of Chapter Fourteen turns on whether the investment in question is made in a "financial institution." Only Mexican measures relating to an investment in a financial institution could bring the case within the terms of Article 1401(1)(b). The term "financial institution" is defined in Article 1416 as follows:

> [F]inancial institution means any financial intermediary or other enterprise that is authorized to do business and regulated or supervised as a financial institution under the law of the Party in whose territory it is located.

48. The status of an enterprise as a financial institution under Article 1416 turns on the treatment of the enterprise under domestic law—here, the law of Mexico. To be a "financial

[61] *See* Mexico's Memorial at paras. 13, 25. There are no measures "relating to...financial institutions of another Party" (*i.e.*, U.S. financial institutions) or to cross-border trade in financial services at issue in this dispute. Thus Article 1401(1) subsections (a) and (c) are inapplicable, and Mexico has not invoked them.

institution," a holding company such as Grupo Financiero would have to be (i) authorized to do business, and (ii) regulated or supervised, "as a financial institution" under Mexican law.

49. As will be explained in detail below, under Mexican law, a financial holding company such as Grupo Financiero does not meet these requirements and, therefore, is not a financial institution. As a result, the Mexican Government's actions in treating Fireman's Fund and its investment inequitably and less favorably than an identical investment by Mexican nationals, and in expropriating the investment of Fireman's Fund, are *not* measures related to U.S. investors and their investments "in financial institutions" in Mexico under Article 1401(1)(b). Mexico's measures affecting Fireman's Fund and its investment, accordingly, are outside the scope and coverage of Chapter Fourteen.

A. Grupo Financiero Is a Financial Holding Company

50. Grupo Financiero is a holding company—specifically, a financial holding company, or *sociedad controladora*—authorized to own controlling interests in financial institutions such as BanCrecer. Such financial holding companies are directly governed by the Financial Holding Company Act (the *Ley para Regular las Agrupaciones Financieras*, hereinafter the "FHCA")[62] and its implementing Regulations.[63]

51. The FHCA sets out the function of financial holding companies such as Grupo Financiero. Under the particular corporate model specified in the FHCA, an essentially passive financial holding company acquires and holds controlling equity interests in at least two or three

[62] *Ley para Regular las Agrupaciones Financieras* (R0427-47).

[63] *Reglas Generales para la Constitución y Funcionamiento de Grupos Financieros* (C0258-95).

financial institutions of different types. The financial holding company device thus organizes financial institutions into semi-integrated "financial groups" with a shared brand identity.

52. To establish the status of Grupo Financiero as a "financial institution," the Government of Mexico in its submission simply identifies (i) the Mexican governmental authorities responsible for regulating or supervising financial holding companies, and (ii) the laws under which they do so.[64] In effect, Mexico is arguing that because a financial holding company is regulated by Mexican financial authorities, or governed by laws that may also pertain to financial institutions, such a holding company must be a financial institution.

53. Mexico's argument neglects the most critical feature of the Article 1416 definition of "financial institution": the enterprise in question must be authorized to do business, and regulated or supervised, "as a financial institution." Fireman's Fund does not dispute that financial holding companies are regulated by financial authorities of the Mexican Government. Nor does Fireman's Fund dispute that financial holding companies are governed by laws and regulations such as the FHCA that are administered by such financial authorities. However, Fireman's Fund does dispute any suggestion that financial holding companies are authorized to do business, regulated, or supervised *as financial institutions*. They are not. That fact, explained in more detail below, is fatal to Mexico's Chapter Fourteen argument.

B. Under Mexican Law, Financial Holding Companies Are Not Financial Institutions

54. Financial holding companies such as Grupo Financiero are not authorized, regulated, or supervised as financial institutions under Mexican law. Financial holding companies and

[64] *See* Mexico's Memorial at paras. 28-37, 77-78.

financial institutions are entirely distinct entities under Mexican law, and these two types of entities play very different roles in the Mexican financial system. The former, financial holding companies, are simply special-purpose ownership vehicles with no active role in the financial system; they provide no financial services, engage in no transactions with the public, and pose no direct financial risks to individual consumers of financial services or to the financial system as a whole. Financial institutions, by contrast, act as financial intermediaries and engage in financial transactions with the public, and their financial soundness is of paramount importance to consumers of financial services and to the Mexican financial system.

55. This distinction, which is detailed below, is confirmed by the Opinion of Mr. Fernando Borja Mujica, a former Finance Ministry official with direct responsibilities for regulation of financial holding companies and financial institutions.[65] While in government, Mr. Borja also served as Mexico's appointed representative on the inter-governmental NAFTA Article 1412 Financial Services Committee charged with, *inter alia*, "supervis[ing] the implementation of [Chapter Fourteen] and its further elaboration" and "consider[ing] issues regarding financial services that are referred to it by a Party." Mexico itself continues to rely on Mr. Borja's expertise in this area: after his departure from government service, Mexico appointed him to the roster of Chapter Fourteen financial services panelists under NAFTA Article 1414. By the terms of Article 1414(3), all such appointees must, *inter alia*, be deemed by the Party to "have expertise or experience in financial services law or practice, which may include the regulation of financial institutions" and "be chosen strictly on the basis of objectivity, reliability and sound judgment." Mr. Borja's analysis confirms that, under Mexican law, financial holding companies are not authorized to do business, regulated, or supervised as financial institutions.

[65] *See generally* Opinion of Fernando Borja Mujica ("Borja Opinion") (C0001-15).

1. The Text of Mexican Law Distinguishes between Financial Holding Companies and Financial Institutions

56. Mexican law on its face clearly distinguishes between financial holding companies and financial institutions. The clearest case in point is the *lex specialis* directly governing the establishment and activities of financial holding companies: the FHCA and its associated Regulations.

57. Article 7 of the FHCA plainly demarcates the difference between financial holding companies (*sociedades controladoras*) on the one hand, and financial institutions such as banks, insurance companies, and broker-dealers (*entidades financieras*)[66] on the other. Under Article 7, a formal financial group (*grupo financiero* or *agrupación financiera*) consists of (i) a financial holding company, and (ii) several different types of financial institutions:

> Los grupos a que se refiere la presente Ley estarán integrados por una sociedad controladora y por algunas de las entidades financieras siguientes: almacenes generales de depósito, arrendadoras financieras, empresas de factoraje financiero, casas de cambio, instituciones de fianzas, instituciones de seguros, sociedades financieras de objeto limitado, casas de bolsa, instituciones de banca múltiple, así como sociedades operadoras de sociedades de inversión y administradoras de fondos para el retiro.
>
> El grupo financiero podrá formarse con cuando menos dos tipos diferentes de las entidades financieras siguentes: instituciones de banca múltiple, casas de bolsa e instituciones de seguros. En los casos en que el grupo no incluya a dos de las mencionadas entidades, deberá contar por lo menos con tres tipos diferentes de

[66] The term *entidades financieras* translates in context to "financial institutions" and is synonymous in Mexican law with *instituciones financieras* (the terminology used in NAFTA Art. 1416). By way of illustration, the Basic Dictionary of Free Trade (*Diccionario Básico de Libre Comercio*) published by the Mexican Ministry of the Economy's predecessor agency SECOFI translates the term "financial institution" interchangeably with both *institución financiera* and *entidad financiera* (C0302, C0303). Likewise, the FHCA's list of *entidades financieras* in Article 7 comprises only entities that are unmistakably financial institutions (R0429), and FHCA Article 27-A defines "*institución financiera del exterior*" as "*la entidad financiera*" of a party to a treaty with rights of establishment in Mexico (R0438). Even if the terms are not exactly coterminous, *entidades financieras* is the broader term of the two, and the FHCA makes clear that financial holding companies are not encompassed even within its scope.

> entidades financieras de las citadas en el párrafo anterior que no sean administradoras de fondos para el retiro.[67]

Therefore, the very text of the law governing financial holding companies draws a distinction between financial holding companies and financial institutions.

58. The Ministry of Finance's own resolution authorizing Grupo Financiero and its subsidiaries (including BanCrecer) to constitute a financial group under the FHCA describes the group as consisting of the holding company (Grupo Financiero) and "the following financial institutions."[68] Mexico's submission also describes the group as being comprised of "the holding company and various financial institutions."[69]

59. Likewise, the implementing Regulations define a group under the FHCA as the combination of (i) one financial holding company and (ii) several financial institutions and ancillary enterprises, that obtains the authorization of the Finance Minister to form and operate as a financial group:

> Grupo, al integrado por una sociedad controladora, por las entidades financieras y por las empresas, que obtengan la

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[67] FHCA, Article 7 (R0429) in translation:

"The groups referred to in this Law shall be comprised of a holding company and some of the following financial institutions: general deposit warehouses, leasing companies, factoring companies, foreign exchange bureaus, bonding companies, insurance companies, limited purpose financial companies, broker-dealers, commercial banks, as well as companies operating investment companies and administrators of pension funds.

A financial group may be formed with at least two different types of the following financial institutions: commercial banks, broker-dealers, or insurance companies. In cases where the group does not include two of the above-mentioned institutions, it must include at least three different types of the financial institutions listed in the preceding paragraph other than administrators of pension funds."

[68] Resolution of the Ministry of Finance of October 29, 1992, published in the *Diario Oficial,* January 18, 1993 (R0048-49): "Articulo Quinto – El grupo financiero estará integrado por *la sociedad controladora* y por *las entidades financieras* siguentes: 1. Arrendadora Financiera Bancreser, S.A. de C.V., Organización Auxiliar del Crédito; 2. Banco de Crédito y Servicio, S.A., Institución de Banca Múltiple; 3. Factoraje Bancreser, S.A. de C.V., Organización Auxiliar del Crédito" (emphasis added).

[69] Mexico's Memorial at para. 40: "Durante todo el período relevante, el grupo financiero estuvo conformado por GF Bancrecer como *sociedad controladora*, y diversas *entidades financieras* dedicadas a la banca comercial, factoraje financiero, arrendamiento financiero, operación de valores, etc." (emphasis added).

> autorización de la Secretaría para constituirse y funcionar como grupo financiero en los términos de la Ley y de las presentes reglas.[70]

Again, this definition distinguishes between financial holding companies and financial institutions.

60. The texts of the FHCA and its Regulations relating to the functions of holding companies also make clear that financial holding companies and financial institutions cannot be one and the same. Article 16 of the FHCA explains that financial holding companies exist to hold ownership interests in financial institutions:

> La sociedad controladora a que se refiere el artículo anterior, tendrá por objeto adquirir y administrar acciones emitidas por los integrantes del grupo.[71]

Likewise, the Regulations define a financial holding company (*controladora*) as the company that is formed for the acquisition and administration of the shares of financial institutions and ancillary enterprises:

> Controladora, a la sociedad que de conformidad con el Título Tercero de la Ley, se constituya para la adquisición y administración de las acciones de las Entidades Financieras y de las Empresas.[72]

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[70] Regulations, Title I, Section 2, Subsection IV (C0262), in translation: "[By] Group, [the regulations refer to] the combination of one financial holding company, the financial institutions, and [ancillary] enterprises that obtain the authorization of the Ministry to form and function as a financial group under the terms of the [FHCA] and these regulations."

[71] FHCA, Article 16 (R0432) in translation: "The financial holding company to which the preceding article refers shall have as its purpose the acquisition and administration of shares issued by the members of the group."

[72] Regulations, Title I, Section 2, Subsection V (C0262), in translation: "[By] Holding Company, [the regulations refer to] the company that, in conformity with Title Three of the [FHCA], is formed for the acquisition and administration of the shares of the Financial Institutions and the ancillary Enterprises." In addition, Subsection VI defines financial institutions (*entidades financieras*) for purposes of the Regulations as those financial institutions listed in Article 7 of the FHCA (*i.e.* commercial banks, insurance companies, foreign exchange bureaus, investment companies, etc.) (C0262). A financial group can also include ancillary enterprises (*empresas*), which are defined in Subsection VIII as companies in which the financial holding company holds an interest, that provide services that are complementary or auxiliary to the financial holding company or the constituent companies in the financial group

The texts of Article 16 and the Regulation would both be incoherent if financial holding companies were themselves financial institutions under Mexican law.

61. The language of other provisions of Mexican law also reflects this distinction. As Mr. Borja notes, the legislation he drafted to implement Mexico's new financial services undertakings under the NAFTA agreement maintained the differentiation between financial holding companies and financial institutions. In a specific example, NAFTA opened the door to corporate affiliations between entities in the Mexican financial system and those in Canada and the United States. To reflect this change, it was necessary to incorporate the concept of a "foreign affiliate" into Mexico's financial laws. In doing so, the Mexican Government crafted *separate* definitions for affiliates of financial institutions and for affiliates of financial holding companies. Thus, for example, Article 27-A of the FHCA distinguishes between an affiliate of a foreign financial institution (*filial*), defined as a Mexican company authorized to organize and operate like any of the financial institutions listed in Article 7, and a financial holding company affiliate (*sociedad controladora filial*), defined as a Mexican company authorized to organize and operate as a financial holding company in which a foreign financial institution has an ownership interest.[73] Mr. Borja confirms this reading of these provisions of Mexican law, for which he had substantial drafting and implementation responsibilities.[74]

(C0262).

[73] *See also* Credit Institutions Law (*Ley de Instituciones de Crédito*), Article 45-A (R0389); Bonding Companies Law (*Ley Federal de Instituciones de Fianzas*), Article 15-A (C0320); Securities Law (*Ley del Mercado de Valores*), Article 28 *Bis*-1 (C0411).

[74] *See* Borja Opinion at para. 36 (C0009).

62. Even the NAFTA annexes prepared by Mexico to describe reservations under Mexican law make a similar textual distinction.[75] Although NAFTA significantly opened the Mexican financial market, Mexico reserved the right to impose measures restricting the acquisition or establishment of Mexican financial institutions to U.S. or Canadian financial institutions engaged in the same type of financial services. In other words, for example, a bank in Mexico could only be established or acquired by a U.S. or Canadian bank. This restriction is spelled out in Mexico's Annex VII(B)(14).[76] However, Mexico made one exception to this rule. Annex VII(C)(5) provides that U.S. and Canadian commercial banks and securities companies "may also establish a *financial holding company* in Mexico, and thereby establish or acquire *other types of financial institutions* in Mexico" (emphasis added). The language of Annex VII(C)(5) is thus another example of the distinction made under Mexican law between financial holding companies on the one hand and financial institutions on the other.

63. Textual analysis alone, therefore, establishes that financial holding companies are not financial institutions, because the terms are not used, and cannot be used, interchangeably in Mexican law. A financial holding company exists to hold shares in financial institutions. It cannot itself be a financial institution and still meet this definition. It is a basic legal canon common to all modern legal systems that a law (like a treaty) may not be interpreted in a manner that would deprive any of its provisions of purpose or effect.[77] Deeming a financial holding

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[75] *See* Borja Opinion at para. 37 (C0009-10).

[76] This rule and its exception are also outlined in the Executive Branch's authoritative explanation of the changes to Mexican law implementing Mexico's NAFTA commitments. *See* Motivos de las Reformas a la Ley Para Regular las Agrupaciones Financieras (Dec. 23, 1993), published in the FHCA Regulations at XIX, XXI (C0277, C0279).

[77] For example, the Vienna Convention's first general rule of interpretation (Article 31(1)) requires that every treaty term be given effect. *See* International Law Commission, *Commentary (Treaties)*, Art. 27 para. 6, YEARBOOK OF THE INTERNATIONAL LAW COMMISSION 251 (1966); *see also* Robert Jennings & Arthur Watts, 1 OPPENHEIM'S INTERNATIONAL LAW 1280 (9th ed. 1992) ("[A]n interpretation is not admissible which would make a provision meaningless, or ineffective."); Hersch Lauterpacht, 1 OPPENHEIM INTERNATIONAL LAW: A TREATISE 955 (8th ed.

company to be a financial institution would have just that effect on the FHCA, its Regulations, and even Mexico's NAFTA annexes, by rendering their separate treatment of the two kinds of entities meaningless.

2. Mexican Law Does Not Authorize Financial Holding Companies To Do Business as Financial Institutions

64. The distinction under Mexican law between financial holding companies and financial institutions is not only textual. Above all, it is functional. Financial holding companies and financial institutions perform different roles in the Mexican financial system, and that separation of their activities is maintained by law. As a consequence, they are authorized to do business, regulated, and supervised very differently.

65. The financial institutions listed in Article 7 of the FHCA are each authorized (under other laws governing their respective formation and activities) to engage in providing specific kinds of financial services to the public.[78] When held by a financial holding company, financial institutions may also work together to provide complementary financial services of different types to the public under a common brand name.[79] Clearly, the principal purpose of financial institutions is to interact with the public in order to provide financial services such as deposit-taking, lending, currency exchange, payment processing, investments, stock trading, factoring, insurance, and bonding.

1955); *Corfu Channel* (U.K. v. Albania), 1949 I.C.J. 4, 24 (April 9) (merits).

[78] This is in contrast, for example, to the financial system in countries such as Germany, where a single financial institution may provide several different types of financial services to the public. Mexico instead adopted a model for its financial system wherein different financial services are provided by different types of financial institutions, and it is only through a common ownership vehicle such as a financial holding company that such financial institutions can operate to provide a complementary assortment of financial services. *See* Borja Opinion at paras. 20-21 (C0004-05).

[79] *See* FHCA, Article 8 (R0429) (providing for common branding of financial institutions).

66. The authorized activities of financial holding companies, by contrast, are extremely limited. By law, financial holding companies may only (i) hold shares of financial institutions,[80] (ii) enter into a guarantee arrangement to permit indirect pooling of assets among the financial institutions they own, (iii) issue subordinated convertible debentures to raise capital, and (iv) engage in a very limited range of investment and borrowing activities on their own behalf.[81] Financial holding companies are merely passive vehicles for the common ownership of financial institutions.

67. This functional distinction between a financial holding company as an ownership vehicle and a financial institution as an entity actually engaged in providing financial services to the public is also reflected in Mexico's NAFTA Annexes VII(B)(14) and VII(C)(5), described at paragraph 62 *supra*. Annex VII(B)(14) permits, for example, a U.S. bank to acquire or establish a Mexican bank. If the U.S. bank wishes to acquire or establish another type of financial institution (*e.g.*, an insurance company) it can do that only indirectly, through the establishment of a financial holding company under the exception in Annex VII(C)(5). The financial holding company itself is thus no more than a *bridge* to ownership of types of financial institutions in Mexico other than, in this example, a bank.

68. It is also of particular importance to emphasize that a financial holding company is expressly prohibited by law from performing any of the functions of a financial institution. Article 16 of the FHCA is explicit in providing that a financial holding company may not, in any

[80] The holding company must own voting shares representing at least 51% of the paid-in capital of each financial institution. *See* FHCA, Article 15 (R0431-32): "El control de las asambleas generales de accionistas y de la administración de todos los integrantes de cada grupo, deberá tenerlo una misma sociedad anónima controladora. Dicha controladora será proprietaria, en todo tiempo, de acciones con derecho a voto que representen por lo menos el cincuenta y uno por ciento del capital pagado de cada uno de los integrantes del grupo...."

[81] *See* FHCA, Articles 16 and 23 (R0432, 0434-35).

circumstances, engage in the financial services activities undertaken by the financial institutions it owns:

> En ningún caso la controladora podrá celebrar operaciones que sean propias de las entidades financieras integrantes del grupo.[82]

Thus, a holding company may not engage in or provide any financial services; such services may only be provided by financial institutions. Consequently, there is no need to "regulate or supervise" financial holding companies "as financial institutions," as Article 1416 of NAFTA requires.

69. Likewise, the Regulations implementing the FHCA expressly provide that a financial holding company may not be involved in any way in the management of the operations of their financial institutions:

> A la Controladora le estará prohibido:...(III) Efectuar trámites o gestión alguna sobre las operaciones de las Entidades Financieras.[83]

70. This strict separation between the functions of financial holding companies and the functions of financial institutions is reinforced by Article 8 of the FHCA, which provides, *inter alia*, that financial institutions may not base any of their operations in the offices of their parent financial holding company:

> En ningún caso podrán realizarse operaciones propias de las entidades financieras integrantes del grupo a través de las oficinas de la controladora.[84]

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[82] FHCA, Article 16 (R0432), in translation: "In no case may the holding company perform the operations typical of the financial institutions that are members of the group."

[83] Regulations, Title III, Section 10(8) (C0267), in translation: "It shall be prohibited for the Holding Company:...(III) To take any administrative steps or exercise management over the operations of the Financial Institutions."

[84] FHCA, Article 8 (R0429), in translation: "In no case may the typical operations of the financial institutions that

3. Under Mexican Law, Financial Holding Companies and Financial Institutions Are Regulated and Supervised Differently

71. The functional differences between financial holding companies and financial institutions, and indeed the separation of their activities required by law, are reflected in the different regulatory and supervisory regimes that apply to them. Financial holding companies are subject only to regulation of their corporate structure (*i.e.*, the FHCA) and supervision of their accounting practices. Because they cannot engage in the provision of financial services and they do not interact with the public, there is no need to subject them to the extensive prudential regulation and supervision applied to financial institutions, whose practices and financial soundness are of critical importance.

72. This analysis is endorsed by Mexican authorities with direct experience in regulating financial holding companies and financial institutions. Mr. Eduardo Fernández García, former President of the Commission for six years and an eighteen-year senior veteran of the Central Bank, and Mr. Fernando Borja Mujica have both provided statements explaining that, based upon their understanding and experience as former regulators, these are well-understood and established differences between financial holding companies and financial institutions.

73. Mr. Fernández states, for example, that "[w]hen we were creating the financial holding company structure, it was understood by all concerned that it was central to the regulatory regime to ensure that financial holding companies did *not* operate as financial institutions," because financial holding companies were simply a vehicle for common control and ownership

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are members of the group be carried out from the offices of the holding company."

of financial institutions.[85]

74. Likewise, Mr. Borja explains:

> As a regulator, I always distinguished between financial holding companies, on the one hand, and financial institutions, on the other hand. Fundamentally, these two kinds of entities have a different nature—that is, different roles and purposes in the financial system, with different permitted activities—and as such they are regulated and supervised differently under Mexican law.[86]

Mr. Borja goes on to explain that this difference turns on the fact that financial institutions—unlike financial holding companies—interact with the public and implicate the overall soundness of the financial system and, therefore, are subject to a strict regime of prudential regulation and supervision.[87]

75. As a consequence of their different functions, Mr. Borja explains that regulatory schemes integral to the supervision of financial institutions do not apply to financial holding companies.[88] Capitalization requirements, for example, are core elements in the regulation of financial institutions. Financial institutions are required to hold minimum levels of capital (also known as "regulatory capital") based on the types of services they provide, the institutions' market risks, risks associated with the assets in their portfolios, the solvency of their debtors, and risks

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[85] Fernández Affidavit at para. 4 (C0016).

[86] Borja Opinion at para. 18 (C0004).

[87] *See, e.g.,* Borja Opinion at para. 27 (C0007) ("Unlike financial holding companies, financial institutions provide financial services to the public at large. As a result, it is necessary to impose very different regulations on financial institutions than on financial holding companies, which are simply special-purpose ownership vehicles."), and para. 33 (C0008) ("A financial holding company, which is merely an ownership vehicle, need only provide information and assurances regarding that ownership structure [to obtain authorization to do business]; a financial institution, which is actually undertaking to provide financial services, is subject to much more elaborate and even intrusive requirements before it will be authorized to engage in those activities.").

[88] *See* Borja Opinion at paras. 25, 29-32 (C0006, C0007-08).

associated with insurance and bonding requirements.[89] These minimum capital, capital adequacy, and reserve requirements are designed for the protection of the public and the financial system, by ensuring that financial institutions have sufficient funds to support their operations and that shareholders have a substantial stake in the financial institutions' viability.

76. Financial holding companies, in contrast, are not subject to any such capitalization requirements. Apart from the statutory minimum start-up capital required of every Mexican corporation of any type, financial holding companies face no requirements whatsoever to hold minimum capital or reserves.[90] This is because they are prohibited by law from engaging in the sort of financial services that require capital regulation to safeguard the soundness of entities providing such services. Financial holding companies also are not subject to other regulations central to the supervision of financial institutions, such as money laundering statutes.

77. The difference between the regulation of financial holding companies and the regulation of financial institutions is present from the creation of such entities. Although both types of entities require authorization from the financial authorities before they may do business, Mr. Borja explains that the process of obtaining authorization—like the authorization ultimately received—is not comparable.[91] In applying for authorization to do business, financial holding companies essentially need only supply basic corporate information and their plans for acquiring

[89] *See, e.g.*, Credit Institutions Law, Article 50 (R0394-95); Securities Law, Article 17 *Bis*-2 (C0395-96); Bonding Companies Law, Article 18 (C0326); Insurance Law (*Ley General de Instituciones y Sociedades Mutualistas de Seguros*), Article 29 (C0470-77); Investment Companies Law (*Ley de Sociedades de Inversión*), Articles 12, 34 (C0554-55, C0561-62); Pension Funds Law (*Ley de los Sistemas de Ahorro para el Retiro*), Articles 24, 41 (C0590, C0594-95); Auxiliary Credit Institutions Law (*Ley General de Organizaciones y Actividades Auxiliares del Crédito*), Article 8 (C0625-28).

[90] *See* Borja Opinion at para. 32 (C0008). It may also be noted that Mexico's Annex VII(C) supplies definitions of "capital" for purposes of the Annex, in which the definition changes depending on the type of financial institution in question. Financial holding companies appear nowhere on that list of financial institutions and the capital requirements for those financial institutions.

[91] *See* Borja Opinion at para. 33 (C0008).

and cross-collateralizing the financial institutions they will hold.[92] Financial institutions, by contrast, must submit very detailed plans for their financial services activities and the means by which they will finance, secure, and manage those operations.[93]

78. As noted, these differences in the regulation and supervision of financial holding companies and financial institutions stem from their different functions. As mere ownership vehicles, financial holding companies do not require the type or degree of regulation necessary for financial institutions. Recent developments in Mexican law further emphasize this distinction. While FHCA-authorized financial holding companies were once the only vehicle for concentrated corporate ownership of financial institutions, Mexican law has since been liberalized to allow any company to own a controlling stake in a financial institution.[94] Thus, companies entirely outside the regulatory and supervisory reach of the Mexican financial authorities can now own financial institutions. Financial institutions, in contrast, continue to be subject to the traditional, comprehensive prudential regulation and supervision by the Mexican financial authorities.

C. Financial Holding Companies Are Not Covered by Article 1416

79. As demonstrated above, a financial holding company such as Grupo Financiero—although regulated by Mexican financial authorities—is *not* authorized to do business, regulated, or supervised *as a financial institution* under the laws of Mexico. Therefore, Grupo Financiero

[92] *See* FHCA, Article 9 (R0429-30) and Regulations, Title II, Section 3 (C0263).

[93] *See* Credit Institutions Law, Article 10 (R0376-77).

[94] *See, e.g.,* Credit Institutions Law, Article 13 (R0377); Securities Law, Article 19 (C0400-01); *see also* Borja Opinion at para. 38 (C0010).

is not a financial institution within the meaning of Article 1416 of NAFTA and Fireman's Fund's debentures are not an investment in a financial institution.

80. The definition of financial institution in Article 1416 is a "[1] financial intermediary or other enterprise [2] that is authorized to do business and [3] regulated or supervised as a financial institution under the law of the Party in whose territory it is located." Although a financial holding company is an "enterprise," it fails the second and third elements of the definition in any event.

81. A financial holding company is not authorized to do business as a financial institution. In fact, a financial holding company is expressly prohibited by law from doing business as a financial institution under Articles 8 and 16 of the FHCA.

82. Further, a financial holding company is not regulated or supervised as a financial institution. Because it provides no financial services to the public and engages in no transactions that require prudential regulation or supervision to protect the public or the financial system, a financial holding company is not subject to the regulation and supervision imposed upon financial institutions. Of particular significance, a financial holding company faces no minimum capital, capital adequacy, or reserve requirements that are at the core of financial institution regulation and supervision.

83. Therefore, Fireman's Fund has not made an investment in a financial institution within the meaning of Article 1401(1)(b), and Chapter Fourteen does not apply.

D. The Concept of Regulatory Capital Is Not Relevant

84. The Government of Mexico devotes extensive discussion to the question of whether the dollar-denominated debentures acquired by Fireman's Fund constitute "regulatory capital" in Grupo Financiero. Mexico argues that they do in order to meet the elements of the specialized definition of "investment" applicable under Chapter Fourteen.[95]

85. NAFTA Article 1416 defines "investment" for purposes of Chapter Fourteen by reference to Article 1139 (Investment Definitions), the elements of which are all satisfied here, *see infra* at paragraphs 38-42, with a further restriction that "with respect to 'loans' and 'debt securities' referred to in that Article…a loan to or debt security issued by a financial institution is an investment only where it is treated as regulatory capital by the Party in whose territory the financial institution is located."

86. It is sufficient, however, simply to observe that Grupo Financiero, the issuer of the debt securities, is not a financial institution, for the reasons set forth above. Because the debentures are not "debt securit[ies] issued by a financial institution," they do not fall within the definition of "investment" in Article 1416.[96] It is, therefore, not Chapter Fourteen but Chapter Eleven that governs Fireman's Fund's claims.

VI. Conclusion

87. Fireman's Fund has suffered discriminatory and inequitable treatment and expropriation of its investment at the hands of the Mexican financial authorities. It has properly advanced

[95] Mexico's Memorial at paras. 51-69.

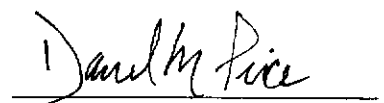
[96] It is undisputed that the debentures acquired by Fireman's Fund constitute an investment within the meaning of Article 1139. *See* paras. 38-42 *supra*.

claims based on Mexico's violations of its NAFTA obligations, including under Articles 1102, 1105, and 1110.

88. Those claims are ripe for the Tribunal's review on the merits. None are barred by Article 1401(2), as Mexico claims, because this dispute is outside the reach of Chapter Fourteen, as set forth in Article 1401(1). Fireman's Fund's investment is not an investment in a "financial institution" under Article 1401(1)(b) because, under Mexican law, a financial holding company such as Grupo Financiero is not authorized to do business, regulated, or supervised as a financial institution.

89. Therefore, Fireman's Fund respectfully requests that the Tribunal reject the jurisdictional objections advanced by the Government of Mexico and proceed promptly to consider the case on its merits.

Respectfully submitted,



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