

International Centre for Settlement of Investment Disputes
(Additional Facility)

FIREMAN'S FUND INSURANCE COMPANY

Claimant

and

THE UNITED MEXICAN STATES

Respondent

**DECISION
ON THE
PRELIMINARY QUESTION**

Before the Arbitral Tribunal constituted under Chapter Eleven of
the North American Free Trade Agreement, and comprised of:

Professor Andreas F. Lowenfeld
Mr. Francisco Carrillo Gamboa
Professor Albert Jan van den Berg (President)

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I. INTRODUCTION

1. Fireman’s Fund Insurance Company has brought a claim against the United Mexican States, alleging that Mexico has breached its obligations under the North American Free Trade Agreement (NAFTA), more specifically under Article 1102 (National Treatment), Article 1105 (Minimum Standard of Treatment), Article 1110 (Expropriation and Compensation) and Article 1405 (National Treatment) of the NAFTA, with the result that Claimant has suffered damages.
2. The United Mexican States challenges the competence of the Tribunal *ratione materiae* to hear those claims of Fireman’s Fund Insurance Company that are based on alleged violations of Articles 1102, 1105 and 1405 of the NAFTA. It contends that the measures in question are exclusively governed by Chapter Fourteen of the NAFTA relating to Financial Services. On the other hand, the United Mexican States does not object to the Tribunal’s competence to hear the merits of the dispute to the extent that the alleged violation concerns Article 1110 (Expropriation and Compensation) of the NAFTA (applicable through Article 1401(2)), without prejudice to the other exceptions available under the applicable rules.
3. The present Decision rules on the challenge to its competence brought by the United Mexican States.¹

¹ In present Decision, the Tribunal uses the terms “competence” and “jurisdiction” as being equivalent legal concepts. It is to be noted that the NAFTA refers to “jurisdiction” (see, e.g., Article 1126(2)); 1126(8)) and the Additional Facility Rules to “competence” (Article 46).

II. THE PARTIES

4. Claimant:

Fireman’s Fund Insurance Company
777 San Marin Drive
Novato, CA 94998
United States of America

hereinafter: “Fireman’s Fund” or “Claimant.”

5. Fireman’s Fund is incorporated under the laws of the Sate of California. It is a wholly owned subsidiary of Allianz of America, Inc., a Delaware corporation that is in turn wholly-owned by Allianz AG of Munich, Germany. It is a sister corporation to Allianz México. It has as its principal business the provision of various types of insurance, including accident and fire insurance.

6. In these proceedings, Fireman’s Fund was initially represented by Mr. Lawrence W. Newman and Mr. Raymundo E. Enriquez of the law firm Baker & McKenzie and from 9 August 2002, by Mr. Daniel M. Price of the law firm Sidley, Austin, Brown & Wood LLP, and Mr. Raymundo E. Enriquez of the law firm Baker & McKenzie.

7. Respondent:

THE UNITED MEXICAN STATES
General Directorate of Foreign Investments
Ministry of Commerce and Industrial Development
Mexico, DF, Mexico

hereinafter: “Mexico” or “Respondent.”

8. In these proceedings, the Government of Mexico is represented by Mr. Hugo Perezcano Díaz, Director General de Consultoría Jurídica de Negociaciones, Secretaría de Economía.

III. PROCEDURAL HISTORY

9. On 30 October 2001, Fireman's Fund submitted a Notice of Arbitration against Mexico pursuant to the provisions of Chapter Eleven of the NAFTA and requested that the claims set forth therein be submitted to arbitration under the Additional Facility Rules of the International Centre for Settlement of Investment Disputes ("ICSID").
10. In the Notice of Arbitration, Fireman's Fund alleges violations by Mexico of Article 1102, 1105, 1110 and 1405 of the NAFTA and seeks, with respect to each of its claims under those Articles, "an award of damages in its favor, and against Mexico of US\$50,000,000, together with applicable interest, its attorneys' fees and the costs incurred by it in this proceeding, together with such further and additional relief as the Arbitral Tribunal may deem appropriate." (Notice, ¶ 40).
11. Fireman's Fund supplemented its Notice of Arbitration by two letters dated 27 November 2001 and 11 January 2002.
12. Mexico submitted a letter dated 11 December 2001 in which it raised concerns about the applicability of Chapter Eleven of the NAFTA in the present case.
13. On 15 January 2002, the Secretary-General of ICSID informed the Parties that Fireman's Fund's application for access to the Additional Facility was approved and issued on the same day a Certificate of Registration of the Notice.

14. On 17 May 2002, the Arbitral Tribunal was constituted. The Tribunal is composed of Professor Albert Jan van den Berg (appointed as President of the Tribunal by the Secretary-General of ICSID), of Dutch nationality, residing at Tervuren, Belgium, Professor Andreas F. Lowenfeld (appointed by Claimant), of US nationality, residing at New York, New York, and Mr. Francisco Carrillo Gamboa (appointed by Respondent), of Mexican nationality, residing at Mexico, D.F., Mexico. Ms. Claudia Frutos-Peterson of ICSID was designated to serve as Secretary to the Tribunal. All subsequent written communications between the Tribunal and the Parties were made through the ICSID Secretariat.
15. The first session of the Tribunal was held, with the Parties' agreement, in Washington, D.C., on 22 July 2002. The Summary of the First Session is deemed incorporated into this Decision.
16. At the first session it was agreed by the Parties that the proceedings in the present case are divided into three phases. The first phase would concern the Preliminary Question, the second phase would concern the merits of the case only as to liability, and the third phase, if necessary, would concern the quantification of damages.
17. As to the first phase of the proceedings, the Tribunal decided to establish a written and oral phase regarding Respondent's objection to competence and scheduled the proceedings pursuant to an agreement of the Parties.
18. By letters dated 29 July 2002, Claimant and Respondent informed the Tribunal that they had agreed on Toronto, Canada, as the place of arbitration for the purposes of Article 1130 of the NAFTA.

19. By letter of 9 August 2002, Claimant informed the Tribunal that the New York office of Baker & McKenzie was substituted by the Washington office of Sidley Austin Brown & Wood LLP, whereas the Mexico office of Baker & McKenzie was to continue its representation of Claimant. In light thereof, Claimant requested an extension of the dates agreed upon at the first session of the Tribunal for the submission by Claimant and Respondent of their pleadings relating to the first phase of the proceedings. By letter dated 13 August 2002, Respondent informed the Tribunal that it did not oppose Claimant's request. Accordingly, the request was allowed and a new schedule was fixed according to Claimant's proposal.
20. On 22 August 2002, Claimant submitted a Request for Production of Documents. On 23 August 2002, Respondent informed the Tribunal that it did not require the production of any documents at this stage of the proceedings, but that it reserved its right to submit such a request at a later stage of the proceedings.
21. Respondent filed objections to Claimant's Request for Production of Documents on 4 September 2002. Claimant replied on 9 September 2002. Respondent filed a rejoinder on 18 September 2002. By Procedural Order No. 1 of 19 September 2002, the Tribunal denied Claimant's Request for lack of specificity at this stage of the proceedings and failure to show whether, and if so to what extent, its Request comes within the purview of Article 32 of the Vienna Convention, including "the preparatory work of the treaty and the circumstances of its conclusions." The Tribunal allowed Claimant to renew its request within 15 days after the filing of Respondent's Memorial on the Preliminary Question.
22. On 22 October 2002, Respondent filed its Memorial on the Preliminary Question with exhibits.

23. On 4 November 2002, Claimant submitted a Renewed Request for production of documents. Respondent filed its objections to the Renewed Request on 12 November 2002, Claimant replied on 14 November 2002 and, at the request of the Arbitral Tribunal, Respondent filed a rejoinder to Claimant's reply on 20 November 2002. On 22 November 2002, the Tribunal granted Claimant's Renewed Request, without prejudice as to whether the documents disclosed to Claimant would be admissible in the plenary proceedings. Respondent was requested to produce the requested documents no later than 3 December 2002.
24. On 20 December 2002, Claimant filed its Memorial on the Preliminary Question with exhibits, including an opinion by Mr. Fernando Borja Mujica, and affidavits by Eduardo Fernández García and Dr. Gehart E. Reuss.
25. By letters dated 9 January 2003, Mr. K. Thompson, Counsel for the Government of Canada and Mr. David A. Pawlak, Attorney-Adviser for the Government of the United States of America informed the Tribunal that their respective Governments did not intend to file a NAFTA Article 1128 submission on the issue of competence. Mr. David A. Pawlak indicated further that, in accordance with the schedule adopted at the first session of the Tribunal, his Government might avail itself of the opportunity to make such a submission on 27 February 2003.
26. On 14 January 2003, Respondent requested the submission of a Reply and Rejoinder on the Preliminary Question and the postponement of the Hearing scheduled to take place on 6-7 February 2003. By letter dated 15 January 2003 Claimant objected to the Request, by letter dated 16 January 2003 Respondent replied, and by letter of 17 January 2003 Claimant reaffirmed its objections to the Request. On 23 January 2003, the Tribunal rejected Respondent's Request on the ground that it had not sufficiently substantiated the need for a Reply and a

Rejoinder. The Tribunal further determined that it would safeguard both Parties' right to fully present their contentions.

27. The Parties and the President of the Tribunal held a telephone conference on 30 January 2003 concerning the organizational aspects of the Hearing (summarized in the letter dated 30 January 2003 from the Secretary of the Tribunal, which is deemed to be incorporated into this Decision).
28. During the telephone conference, ICSID received a letter dated 29 January 2003 from Respondent submitting a "dictamen" by the Secretaría de Hacienda y Crédito Público ("SHCP") and signed by Mr. Luis Mancera de Arrigunaga. The President ordered the dictamen to be forwarded to the Claimant but not to the Tribunal members pending resolution of its admissibility into the record. At the telephone conference, Claimant voiced its concerns about the submission by Respondent. The Parties agreed that if the dictamen were admitted by the Tribunal, Claimant would be granted the opportunity to (1) cross examine the author of Respondent's submission at the Hearing, (2) conduct direct examination of Claimant's own witnesses at the Hearing to elicit views on Respondent's submission, and (3) file supplemental written affidavits or opinions in response to the submission by the close of business Tuesday 4 February 2003. By letter dated 31 January 2003, Claimant maintained its concerns and requested that the Tribunal decide whether the submission was appropriate. On the same day, the Tribunal ruled:

The Tribunal notes that the submission of the opinion issued by the Secretaría de Hacienda y Crédito Público as proposed by the Respondent in its letter of 29 January 2003 is not contemplated by the procedural order adopted in the present case. The Tribunal also notes that it has rejected Respondent's request to file a reply to Claimant's Counter Memorial, but that at the same time it has confirmed that it will safeguard both parties' right to fully present

their case. The Tribunal further notes that the parties have agreed on certain modalities if the Tribunal were to accept the submission and that the Claimant states that the agreed modalities mitigate the reservations expressed by Claimant with respect to the filing.

Under those circumstances, having also regard to the present record regarding the jurisdictional issue and the interest of expeditious proceedings, the Tribunal declares the submission admissible, subject to the agreed modalities.

The Tribunal wishes to make it clear, however, that it will not tolerate further submissions from either party that are not called for, save for exceptional circumstances.

29. On 6 and 7 February 2003, the Hearing on the Preliminary Question took place in at the offices of ICSID, Washington D.C. For Claimant appeared: Mr. Daniel M. Price, Mr. Stanimir A. Alexandrov, and Judge Stephen M. Schwebel (all from Sidley, Austin, Brown & Wood, LLP), as well as Mr. Raymundo E. Enriquez (Baker & McKenzie). For Respondent appeared: Mr. Hugo Perezcano Díaz (Director General de Consultoría Jurídica de Negociaciones), Mr. J. Christopher Thomas, QC, Mr. J. Cameron Mowatt (Thomas & Partners) and Mr. Stephan E. Becker (P.C. Shaw Pittmann, LLP).
30. After the Opening Statements, the Tribunal put forward a number of questions to the Parties to be addressed during the examination of the witnesses and/or Closing Statements (TR pp. 76-83). In the course of the Hearing, the Tribunal asked further questions (TR pp. 413-416). To the extent that the Parties and/or their witnesses addressed the above questions and to the extent that they are relevant, they will be considered below.
31. The following witnesses were examined at the Hearing:

- Mr. Luis Mancera de Arrigunaga (called by Respondent)
- Mr. Fernando Borja Mujica (called by Claimant)
- Mr. Eduardo Fernández García (called by Claimant)

32. With the consent of Respondent, Claimant waived calling Dr. Gehart E. Reuss who had made a witness statement for Claimant.
33. The Government of Canada was represented at the Hearing by Mr. Kevin S. Thompson, Counsel, Trade Law Bureau of the Department of Foreign Affairs and International Trade and the Department of Justice, and Mr. Dean Corno of the Department of Finance. The Government of the United States of America was represented at the Hearing by Mr. David A. Pawlak, US Department of State, Office of the Legal Adviser.
34. By letter dated 13 February 2003, the Tribunal submitted to the Parties a question concerning Article 1416(7)(a) of the NAFTA. Each Party submitted a response to the above question on 24 February 2003.
35. On 27 February 2003, the Government of Canada filed a First Submission Pursuant to Article 1128 of the NAFTA. The Government of Canada took the position that the determination of whether an entity is “authorized to do business and regulated or supervised as a financial institution” for the purposes of Chapter Fourteen should reflect the fact that it is for the NAFTA Parties, through their respective regulatory and supervisory frameworks, to define the types of entities, and hence the scope of activities, that fall within Chapter Fourteen.

36. Also on 27 February 2003, the Government of the United States of America filed a Submission pursuant to Article 1128 of the NAFTA. The Submission by the Government of the United States of America responds to the Tribunal's question on whether a bank holding company under United States law should be considered a "financial institution" within the meaning of Article 1416. It stated that under United States law (i.e., the Bank Holding Company Act of 1956), United States bank holding companies meet all aspects of the definition of a "financial institution" in Article 1406 of the NAFTA. It also submitted that holding companies under the laws of other Parties may differ from bank holding companies under United States law, as may be the case with respect to the laws that apply to such companies.
37. The date set for rendering the present Decision was extended by the Arbitral Tribunal several times.
38. The Tribunal deliberated at various occasions.

IV. BACKGROUND

39. The Tribunal gives the background below in the context of its decision on the Preliminary Question only. With respect to factual findings, they are based on the facts as presented by Claimant and Respondent in their written and oral submissions in the present phase of the arbitration to the extent that they are relevant to the Preliminary Question. The Tribunal's factual findings are without prejudice to its factual findings on the merits of this case.
40. At the outset it is useful to give a brief overview of the relevant competent authorities in Mexico.

41. One of the principal laws governing the financial sector in Mexico is the Ley de Instituciones de Crédito (“LIC,” Act of Credit Institutions, also called the Banking Act), which applies to the general operation of banks.
42. *Banco de México* is the central bank of the country and is an independent legal person of public law. Its primary objective is to maintain the stability of the national currency and, additionally, to promote the proper development of the financial system and to foster the proper functioning of the payment system.
43. The *Comisión Nacional Bancaria y de Valores* (“CNBV” or “Commission,” formerly Comisión Nacional Bancaria) is authorized to supervise and regulate financial entities in order to provide for their stability and proper functioning as well as to maintain and promote the proper and balanced development of the financial system and, in connection therewith, the protection of the public interest.
44. The *Secretaría de Hacienda y Crédito Público* (“SHCP,” Secretariat of Finance and Public Credit) is a division of the federal executive power, whose principal function is to define the policies of federal Government in matters of tax, public spending, financing, creditworthiness, banking, money, currency and pricing, and tariffs for goods and services of the public sector.
45. Financial holding companies (“sociedades controladoras de grupos financieros”) are subject to the supervision of the commission determined by the SHCP (Article 30 of the Ley para Regular las Agrupaciones Financieras of 1990, “LRAF”). In the present case, the SHCP determined that commission to be the CNBV. The latter has wide powers of inspection and supervision (*see* in particular Articles 1, 6, 7, 11, 12, 17, 20, 23, 26 and 30 of the LRAF, and the Ley de la Comisión Nacional Bancaria y de Valores of 1995, “Ley de la CNBV,” in particular Articles 2, 3(IV),

and 4). The LRAF is elaborated in various successive Circulares: No. 1158 of 1992, No. 1384 of 1997 and No. 1456 of 1999. They are also governed by the LRAF's implementing Regulations (Reglas Generales para la Constitución y Funcionamiento de Grupos Financieros of 1991, "Regulations").

46. Under the particular corporate model specified in the LRAF, an essentially passive financial holding company acquires and holds controlling interests in at least two or three financial institutions of different types. The financial holding company device thus organizes financial institutions into semi-integrated "financial groups" with a shared brand identity.
47. The authorized activities of a financial holding company are limited. By law, it may only (i) hold shares of financial institutions belonging to the group, (ii) enter into a guarantee arrangement (Convenio) to permit indirect pooling of assets among the financial institutions it owns, (iii) issue subordinated debentures convertible into shares representing capital, and (iv) engage in a limited range of investment and borrowing activities on its behalf (*see* LRAF, Articles 16, 23 and 28).
48. Furthermore, Article 16 of the LRAF explicitly provides that a financial holding company may not engage in the financial services activities undertaken by the financial institutions that it owns. Likewise, the implementing Regulations provide that a financial holding company may not be involved in any way in the management of the operations of their financial institutions enterprises (Regulations, Title III, Section 10(8)). Similarly, Article 8 of the LRAF provides that the financial institution subsidiaries may not base any of their operations in the offices of their parent financial holding company.

49. As regards the facts, on 29 October 1992 the SHCP gave, in accordance with Article 6 of the LRAF, the authorization for the formation and functioning of Grupo Financiero BanCreceer, S.A. de C.V., a Mexican corporation (hereinafter: “GF BanCreceer”):

ARTICULO PRIMERO.- En uso de la facultad que el artículo 6o. de la Ley para Regular las Agrupaciones Financieras confiere a la Secretaría de Hacienda y Crédito Público, se otorga autorización a Grupo Financiero Bancreceer, S.A. de C.V., para constituirse y funcionar como grupo financiero.

(...)

ARTICULO TERCERO.- La sociedad controladora tendrá por objeto adquirir y administrar acciones emitidas por los integrantes del grupo financiero.

(...)

ARTICULO OCTAVO.- La sociedad controladora estará sujeta a la inspección y vigilancia de la Comisión Nacional Bancaria.

ARTICLE FIRST.- In use of the powers granted to the Secretaría de Hacienda y Crédito Público pursuant to article 6th of the Ley para Regular las Agrupaciones Financieras, Grupo Financiero Bancreceer, S.A. de C.V., is hereby authorized to be incorporated and to operate as a financial group.

(...)

ARTICLE THIRD.- The holding company shall have the corporate purpose of acquiring and administrating those shares issued by the entities that constitute the financial group.

(...)

ARTICLE EIGHTH.- The holding company shall be subject to the inspection and supervision of the Comisión Nacional Bancaria.

50. GF BanCreceer is the holding company of BanCreceer, S.A. (hereinafter: “Banco BanCreceer”).
51. In September 1995, Fireman’s Fund purchased US\$ 50 million in dollar-denominated mandatorily convertible five year subordinated debentures issued by GF BanCreceer.
52. Also in September 1995, GF BanCreceer issued similar debentures denominated in Mexican pesos, the value of which was equivalent to US \$ 50 million at the time.

According to Claimant, all the pesos-denominated debentures were sold to Mexican investors.

53. The issue of the two series of debentures by GF BanCreceer in 1995 was authorized by Banco de México subject to a number of limitations and conditions, including those contemplated by Article 23 of the LRAF and Article 64 of the LIC (*see* authorization granted by Banco de México, 15 September 1995, Exh. R-0050-0055).
54. Following the financial crisis in Mexico, in 1997, Banco BanCreceer encountered financial difficulties. A working group was formed to address the circumstances of Banco BanCreceer, consisting of the CNBV, the SHPC, the Banco de México and the Fondo Bancario de Protección al Ahorro (“FOBAPROA,” Fund for the Protection of Bank Savings). The working group developed a Program of Rescue and Recapitalization for GF BanCreceer. Part of the Program developed by the working group was that Fireman’s Funds’s US\$ 50 million dollar-denominated debentures would be redeemed and Fireman’s Fund would, *inter alia*, invest the US\$ 50 million from the debentures in the restructured Banco BanCreceer under certain conditions. Fireman’s Fund participated in that part of the Program.
55. According to Claimant, simultaneously, and without its knowledge, an alternative plan was developed to pay the holders of the peso-denominated debentures the full cash value of their debentures through a trust established by Banco BanCreceer. Claimant alleges that that repurchase was permitted and financially supported by the Mexican Government.
56. Claimant contends that it obtained knowledge of the alternative plan in April 1998 only but that its request for equal treatment was denied by the President of the

Commission (CNBV). The latter further denied a formal request of Claimant to that effect in April 1999.

57. In January 1999, the Instituto para la Protección al Ahorro Bancario (“IPAB” Institute for the Protection of Bank Savings) took over FOBAPROA’s responsibilities.
58. On 7 July 1999, Claimant requested GF BanCreceer to seek permission from Banco de México for it to acquire the dollar-denominated debentures on the same terms as the peso-denominated debentures had been acquired. GF BanCreceer forwarded the request to Banco de México. On 16 August 1999, Banco de México denied GF BanCreceer’s request.
59. On 3 November 1999, two shareholders’ meetings of GF BanCreceer resolved that (1) IPAB would take control of Banco BanCreceer, (2) Banco BanCreceer would cease to be a subsidiary of GF BanCreceer, and (3) GF BanCreceer would be dissolved and liquidated.
60. Claimant submitted to the Dirección General de Inversiones Extranjeras – Secretaría de Comercio y Fomento Industrial an amended Notice of Intent to Submit a Claim to Arbitration dated 29 November 2000 (replacing an earlier Notice dated 15 November 1999). The negotiations for a settlement of the dispute did not yield a result. On 30 October 2001, Claimant filed a Notice of Arbitration against Respondent with ICSID.

V. CONSIDERATION BY THE TRIBUNAL

A. Introduction

61. The Tribunal has considered all written and oral submissions of the Parties and the written and oral evidence produced by them as well as the submissions of the Government of Canada and the Government of the United States of America in the present phase of the proceedings. To the extent that they are relevant to the issues concerning the Preliminary Question, they are expressly or implicitly addressed below.
62. In addressing the issues below, the Tribunal will adhere to the principle set forth Article 1131 of the NAFTA according to which “A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and the applicable rules of international law.”
63. When interpreting the NAFTA, the Tribunal will follow the rules of interpretation set forth in Articles 31 and 32 of the Vienna Convention on the Law of Treaties of 1969. Accordingly, the text of the NAFTA is in the first place to be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. Recourse can be had to supplementary rules of interpretation under the conditions stated in Article 32 of the Convention.
64. Claimant submits that, as a general policy consideration, direct investor recourse to arbitration has become the rule in modern investment agreements, although there may be exceptions, and that the value of investor-state arbitral mechanism is so substantial that it should only be foreclosed when that result is unmistakably required by treaty provision. Whilst it is correct that there are more than 1,400

(some say more than 2,000) Bilateral Investment Treaties which contemplate investor-state arbitration (albeit under differing conditions) and that the value of investor-state arbitral mechanism is substantial, the Tribunal does not believe that under contemporary international law a foreign investor is entitled to the benefit of the doubt with respect to the existence and scope of an arbitration agreement.

65. The present dispute is one of the growing number of investor-state arbitrations under the NAFTA. The previous cases, so far as the Tribunal is aware, have all been brought under Chapter Eleven, the principal chapter of the NAFTA devoted to Investment. In the present case, the claim involves alleged default of some US\$ 50,000,000 worth of a debt security (convertible debentures) issued by a Mexican financial holding company, and the claim arguably belongs under Chapter Fourteen, a special chapter of the NAFTA devoted to Financial Services. As examined hereafter, Claimant contends that all of its claims are to be considered under Chapter Eleven, because the conditions for application of Chapter Fourteen are not met; Respondent contends that Chapter Fourteen is applicable, because the investment in question fits the definitions of that Chapter. In moving to dismiss for lack of jurisdiction all but one of the claims presented, Respondent points to Article 1101(3) of the NAFTA, which provides:

This Chapter does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Fourteen (Financial Services).

66. Several provisions of Chapter Eleven are incorporated into Chapter Fourteen, including, as here relevant, Article 1110 concerning Expropriation and Compensation, and Articles 1115-1138 concerning the procedural aspects of dispute resolution by a tribunal such as the present one. Article 1102 on National

Treatment and Article 1105 on Minimum Standard of Treatment are not incorporated into Chapter Fourteen. Accordingly, if the measures alleged to have been taken on behalf of the Government of Mexico are covered by Chapter Fourteen, this Tribunal lacks jurisdiction of the claims under Articles 1102 and 1105. Chapter Fourteen contains no counterpart to the Minimum Standard of Treatment provision of Chapter Eleven; it does contain, in Article 1405, a counterpart to the national treatment provision in Chapter Eleven, and indeed a claim for breach of Article 1405 is made in the present arbitration. However, Article 1405 is not included among the provisions to which the procedural provisions of Chapter Eleven apply (Articles 1115-1138), and Article 1414 makes clear that claims under Article 1405 are subject to state-to-state dispute settlement pursuant to Chapter Twenty, not to investor-state dispute settlement under Chapter Eleven.

67. In sum, if the measures challenged in this arbitration are covered by Chapter Fourteen, the claims brought under Articles 1102, 1105, and 1405 must be dismissed, and only the claim for expropriation pursuant to Article 1110 remains to be decided by this Tribunal. If, on the other hand, the conditions for application of Chapter Fourteen are not met, the claims under Article 1102 (National Treatment) and Article 1105 (Minimum Standards of Treatment) remain before this Tribunal, along with the expropriation claim under Article 1110.

B. Background: NAFTA and Financial Services

68. Though the title of the Agreement among Canada, Mexico and the United States of America speaks of “free trade,” it was understood from the outset of the negotiations that transborder investment would be an important component of any plan to link the economies of the three state Parties. Furthermore, the trade to be

liberalized would not be limited to goods, but would apply, with somewhat different rules, to services as well.

69. The objectives of the NAFTA, set out in Article 102, include:

(a) [to] eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;

(c) [to] increase substantially investment opportunities in the territories of the Parties.

70. A particular concern of the architects of the NAFTA was the field of financial services. On the one hand, the Parties were anxious to open up the transborder exchange of financial services, particularly with Mexico, and to integrate Mexico more fully into the international financial system; on the other hand, the architects of the NAFTA understood that the principles of open access and national treatment were not suitable in all respects for the financial sector, which is subject to regulation on prudential and macroeconomic grounds by each of the state Parties. Accordingly, the negotiators of the NAFTA from the beginning contemplated a separate chapter on financial services, and for the most part the negotiations of what became Chapter Fourteen were carried on by separate teams drawn from the Finance/Treasury ministries rather than from the trade and commerce ministries of the respective governments.

71. The result is that Chapter Fourteen “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” (Article 1401(1)),

and that the structure of the NAFTA is such that Chapter Fourteen does not simply refer to Chapter Eleven, but rather incorporates certain of its provisions (Article 1401(2)). Chapter Fourteen has its own Annexes, including Annex VII which establishes exceptions and commitments towards liberalization. It is also to be noted that Chapter Eleven contains an override clause in Article 1112(1) according to which in the event of any inconsistency between Chapter Eleven and any other Chapter, the other Chapter shall prevail to the extent of the inconsistency.

72. In regard to dispute settlement, the drafters of Chapter Fourteen drew on the two provisions for dispute settlement contained in the NAFTA. Disputes concerning prudential regulations, including allegations of violation of national treatment, were committed to state-to-state dispute settlement pursuant to Chapter Twenty; disputes about alleged expropriation as well as denials of transfers of payments and certain other prohibitions (Articles 1109 – 1111 and 1113 – 1114) were committed to investor-state dispute settlement pursuant to Chapter Eleven.
73. Here again, the provisions relating the investor-state dispute settlement (Article 1115 – 1138) are “incorporated into and made a part of this Chapter [Fourteen] *solely* for breaches by a Party of Articles 1109 through 1111, 1113 and 1114, as incorporated into this Chapter.” (Article 1401(2), italics supplied).
74. The overall principles of the NAFTA are maintained in Chapter Fourteen, including the principle that an investor of one state Party should be permitted to establish a financial institution in the territory of another state Party (Article 1403(1)), and the principle that each state Party is to accord national treatment to investors of another Party (Article 1405). But only an investor engaged in financial services in its home country is entitled to establish a financial institution in the territory of

another state Party (Article 1403(5)), and each of the three state Parties adopted significant reservations to Chapter Fourteen, reflecting differences in legislation and regulations in force at the time the NAFTA was negotiated, as well as different distribution of regulatory authority between the national governments and the respective state or provincial governments. Moreover, the reservations permitted to be taken by Mexico reflected Mexico's insistence that its financial sector not be overwhelmed by the major banks and other financial institutions based in the United States of America.

75. Each country's reservations to Chapter Fourteen are contained in separate schedules set out in Annex VII, as provided in Article 1409 of the principal text. Article 2201 of the NAFTA confirms that the Annexes constitute an integral part of the Agreement, and in the view of the Tribunal, the definitions and classifications there set out are useful in construing the provisions of the Agreement.

C. Is a sociedad controladora a financial institution?

76. Claimant takes the position that Chapter Fourteen is not applicable, because Article 1401 limits the scope of the chapter (so far as here relevant) to measures relating to investors of another Party, and investments of such investors, in *financial institutions* in the Party's territory (italics supplied). Article 1416 of the NAFTA defines Financial Institutions as:

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

77. The convertible debentures in question in the present case were issued by GF BanCreceer, which, as is not disputed, was a financial holding company or “sociedad controladora.” Claimant asserts that a sociedad controladora does not meet the definition of financial institution, because under the law applicable to financial groups (Ley para Regular las Agrupaciones Financieras, herein LRAF) it is not “authorized to do business,” and because it is not regulated as a financial institution. Claimant points, *inter alia*, to Article 16 of the LRAF, which expressly prohibits financial holding companies from carrying on operations for which its financial subsidiaries are qualified, such as taking deposits if the subsidiary is a bank, or issuing insurance policies if the subsidiary is an insurance company.
78. Respondent for its part asserts that a financial holding company such as GF BanCreceer is subject to approval and licensing by the Banco de México, the Secretariat of Finance and Public Credit (Secretaría de Hacienda y Crédito Público, herein SHCP) and the National Banking and Securities Commission (Comision Nacional Bancaria y de Valores, herein CNBV), and thus easily passes the second test. Further, while acknowledging that the LRAF distinguishes between holding companies such as GF BanCreceer and banks or insurance companies authorized to engage in transactions directly with the public, Respondent contends that what financial holding companies are authorized to do constitutes doing business as a financial institution within the meaning of the definition of financial institution in Article 1416.
79. The Tribunal has approached the question of whether GF BanCreceer is a financial institution within the meaning of Article 1416 of the NAFTA from the three points of view.

80. *First*, the Tribunal notes that the definition of “financial institution” in Article 1416 is circular, except that it leaves the dispositive classification up to each State in which the enterprise in question is located. However, the Tribunal observes that the NAFTA contains chapters addressed to several distinct sectors, including energy, agriculture, telecommunications, intellectual property, and financial services. It would be strange indeed to conclude that a financial holding company such as GF BanCreceer, devoted to investing in banks and insurance companies, does not belong to the financial services sector. If it is an institution or entity, then surely GF BanCreceer must be a financial institution. Again, since it is not contested that GF BanCreceer was regulated and licensed by one or more financial regulatory agencies of the Government of Mexico, and since the task of those agencies is to regulate financial institutions, under any interpretation based on “plain meaning” GF BanCreceer could not fall into any category other than that of “financial institution.”
81. Claimant stresses that in order to qualify as a financial institution under Article 1416, the entity in question should be authorized to do business as a financial institution. Claimant interprets this as meaning being able to render financial services to the public. That is, in the Tribunal’s view, too narrow a construction of the definition of financial institution given in Article 1416 which does not contain the language suggested by Claimant. Rather, under Mexican law, a specifically authorized financial holding company must have a majority holding in banks, insurance companies and other financial service providers. That is its very purpose and in that sense it is authorized to do business as a financial institution.
82. It should further be noted that Chapter Fourteen is not only focused on intermediaries. It also includes the organizations referred to in Article 7 LRAF, which is in itself not all inclusive (see also Ley de la CNBV). Furthermore, it is

common ground between Claimant and Respondent that Mexican law does not define specifically the term financial institution. Here, notwithstanding Claimant's arguments to the contrary, it appears that financial institutions are the same as financial entities. Each financial entity is subject to regulations that are different and the requirements differ depending on what type of financial entity is involved. Common denominators are that all of them work within the framework of the financial regulations and that there is an authorization to do business. *Sociedades controladoras* appear to meet those common denominators. The legislation to implement Mexico's financial services undertakings under the NAFTA does not lead to a different conclusion.

83. *Second*, looked at from the design of the NAFTA, it is evident that the drafters carved out the financial sector from significant portions of the general provisions, because none of the state Parties was prepared to engage in the kind of harmonization and deregulation that would have been necessary to treat banks, insurance companies, and securities firms (as well as other participants in the financial sector) in the same way as, say, the soft drink, retail trade, or shoe manufacturing industries. As noted above, Chapter Fourteen and the Annexes applicable to that Chapter contain significant differences from the general provisions on national treatment, omit a provision on "fair and equitable treatment," and limit resort to investor-state arbitration. All of these differences, it is clear, are designed to leave room for national decision-making rather than harmonization, and to limit the opportunity of investors from another state Party to resort to international dispute settlement to challenge regulatory measures taken by the respective national authorities.

84. As regards Mexico, financial holding companies were expressly provided for in the LRAF, adopted prior to conclusion of the NAFTA, and were expressly provided

for in the Annex to the Agreement (see below). If the Parties had intended to exclude investment in financial holding companies from the scope of Chapter Fourteen, one would have expected them to do so explicitly. No such exclusion appears either in Chapter Fourteen itself or in the corresponding Annex; in contrast, when they wanted to make other protections of the NAFTA available to investors of another Party in the financial sector, the drafters did so directly, for instance by providing that Article 1110 (as well as several other provisions of Chapter Eleven) are incorporated into Chapter Fourteen.

85. The result, as the Tribunal understands it, is that complaints by investors of another Party in the financial sector concerning regulations imposed by agencies of the host country are governed by Chapter Fourteen, and may be raised by the foreign investor only if supported by the investor's home state. If, on the other hand, a foreign investor in a financial institution claims expropriation, the standards and procedures of Chapter Eleven would be available, as they are in the present case.² There is no indication that financial holding companies were intended to be left out of this scheme, and to be lumped instead with investments in non-financial sectors.

86. *Third*, the definitions and classifications set out in the Schedule of Mexico to Annex VII do not support Claimant's case. Following the outline of Annex VII applicable to all three state Parties, Section A defines the Sector as "Financial Services," and sets out a series of reservations to Article 1403 (Establishment of Financial Institutions) and Article 1405 (National Treatment), linked to particular

² To avoid any possible misunderstanding, the Tribunal states that nothing in this Decision is intended to construe the scope of Article 1110 and the possible distinction under that article between a compensable taking and a non-compensable regulatory measure.

laws or regulations. The first reservation, linked to Article 18 of the LRAF as well as to Articles 11 and 15 of the LIC (Ley de Instituciones de Crédito) concerns two Sub-Sectors – Holding Companies (Sociedades Controladoras) and Commercial Banks (Instituciones de Banca Múltiple). In particular, Section A of Annex VII limits aggregate foreign investment in holding companies (as well as in commercial banks) to 30 percent of common stock capital, subject to further qualification in Sections B and C. Several of the other reservations set out in Section A are applicable only to financial institutions in other Sub-Sectors, but one additional reservation is applicable to holding companies as well as to all the other Sub-Sectors – the prohibition of investment by foreign governments and foreign state enterprises, which but for the reservation would come within the definition of “investor of a Party” in Article 1416.

87. In respect of both of these reservations, the Schedule recognizes Holding Companies as distinct in certain aspects from other Sub-Sectors – for instance Industry Classification is not applicable. But there is no doubt that the reservations set out in Section A are expressly made applicable to foreign investors in holding companies, and that these reservations are directed to Article 1403 – “Establishment of Financial Institutions.”
88. Section B of Mexico's Schedule to Annex VII, entitled “Establishment and Operation of Financial Institutions,” confirms both the distinction between holding companies and other financial institutions and the understanding that both types of institutions come within the rubric of financial institutions. Paragraph 2 sets out maximum individual capital authorized for foreign financial affiliates of commercial banks, securities firms and insurance companies, respectively, and paragraphs 5-7 set out limits on the aggregate foreign capital in these and other

specified financial institutions. No corresponding limits on foreign capital are placed on financial holding companies in Section B.

89. In paragraph 14 of Section B, Mexico reserved the right to limit eligibility to establish a foreign financial affiliate in Mexico to an investor of another Party engaged in the same general type of financial service in its home country, so that, say, a Canadian insurance company could establish an insurance affiliate in Mexico, but not a bank or securities firm. Paragraph 5 of Section C, however, provides that an investor of another Party that has established or acquired a commercial bank or a securities firm in accordance with Section B may establish a financial holding company to get around the restriction in paragraph 14 of Section B. Since Claimant argued vigorously that paragraph 5 of Section C supports its contention that a financial holding company is not a financial institution within the meaning of the NAFTA, *see, e.g.,* Borja Opinion at ¶ 37, the complete text of paragraph 5 is set out both in English and Spanish:

An investor of another Party that in accordance with Section B is authorized to establish or acquire, and establishes or acquires, a commercial bank or securities firm in Mexico may also establish a financial holding company in Mexico, and thereby establish or acquire other types of financial institutions in Mexico, under the terms of Mexican measures.

Un inversionista de otra Parte que conforme a la Sección B sea autorizado a establecer o adquirir, y establezca o adquiera en México, una institución de banca múltiple o una casa de bolsa, también podrá establecer una sociedad controladora de agrupaciones financieras en México, y por ese medio establecer o adquirir otros tipos de instituciones financieras en México, de conformidad con las medidas mexicanas.

90. Claimant argues that “other types of financial institutions” refers to the right of the holding company (if the other conditions are met) to acquire a bank or an insurance company or a securities firm – an interpretation with which the Tribunal has no difficulty. It does not follow, as the Tribunal interprets this paragraph, that

a financial holding company is not a financial institution. As noted above, Section B sets out a series of maximum capital restrictions applicable to investors of another Party in specified financial institutions, as well as the right to limit eligibility of establish foreign affiliates to investors of another Party with experience in the same Sub-Sector. What paragraph 5 of Section C does, is to liberalize that restriction, so that by use of a financial holding company a qualified investor of another Party is able to diversify its participation in the financial services sector of Mexico. Nothing in paragraph C-5 suggests that it is designed to contradict or limit the classification of a sociedad controladora as a financial institution, as stated in Section A.

91. In sum, the Tribunal understands that financial holding companies are governed somewhat differently under Mexican law from the kinds of financial institutions that deal directly with the public, such as commercial banks, insurance companies, and securities firms. The Tribunal concludes, however, that financial holding companies (sociedades controladoras) established in Mexico are financial institutions under the law of Mexico, and thus are within the meaning of Article 1416 of the NAFTA, since they are authorized to do business as a financial institution and are regulated and supervised as a financial institution under Mexican law.

D. Do the debentures in question constitute regulatory capital?

92. The conclusion that a sociedad controladora is a financial institution within the meaning of Article 1416 of the NAFTA, however, does not suffice to bring it under the coverage of Chapter Fourteen since paragraph 7 of the same article requires:

investment means “investment” as defined in Article 1139 (Investment–Definitions), except that, with respect to “loans” and “debt securities” referred to in that Article:

(a) 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;

93. Respondent takes the position that the convertible debentures in question are treated as regulatory capital in Mexico. Claimant, on the other hand, submits that, assuming the GF BanCreceer is a financial institution, they were not treated as regulatory capital because the sociedad controladora faced no capital adequacy requirements. The Tribunal holds that the convertible debentures in question are regulatory capital within the meaning of Article 1416(7)(a) for the following reasons.
94. At the outset, the Tribunal notes that, as it is common ground between Claimant and Respondent, the NAFTA does not provide a definition of “regulatory capital.” Nor do the available travaux préparatoires. The Tribunal therefore has to interpret that term, as required by Article 31(1) of the Vienna Convention of 1969, “in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.”
95. The object and purpose of the NAFTA in general and the particular concern regarding the field of financial services were reviewed in Section B above. The context in which the term appears is “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” (Article 1401(1)).

96. Two questions then need to be addressed. First, are the convertible debentures in question treated as “capital” in Mexico? Second, if the answer to the first question is affirmative, is the capital in question subject to regulation by the relevant financial authorities in Mexico?
97. The answer to first question is indeed affirmative. The treatment of the debentures in question as capital of GF BanCreceer appears to be in conformity with Circulares 1158 and 1384 issued by the CNBV, which constitute prudential measures.
98. From copies of the audited financial statements of GF BanCreceer for the fiscal years 1995 through 1999, submitted as evidence by Respondent (Exh. R0257 – R0373), it appears that the Mexican financial holding company in reference presented the debentures as a component of its stockholders’ equity (capital contable) during such periods. These statements also show that they were prepared pursuant to accounting rules and practices applicable to Mexican financial holding companies as set forth by the Commission in the Circulares, which rules and practices, as stated by the duly authorized auditors of GF BanCreceer in some cases differ from Generally Accepted Accounting Principles (GAAP) as applicable in Mexico.³
99. If the Basle Accord of 1988 were to be taken into account, it may be that the debentures in question cannot be counted as capital as they do not exactly meet the

³ Further references to these differences, specifically to the inclusion of the debentures in question as a component of the stockholders’ equity (capital contable) of GF BanCreceer are detailed by the auditors in the notes to each of the audited financial statements of the Mexican financial holding company in reference for fiscal years 1995 (Note 6), 1996 (Note 8), 1997 (Note 17), 1998 (Notes 5 and 8) and 1999 (Notes 2, 5 and 8). *See* Exh. R0272, R0293, R0326, R0347, R0349, R0366, R0369 and R0371.

requirements of hybrid (debt/equity) capital instruments as defined in Annex 1(C)(d) to that Accord. In particular, the “Acta de emisión de obligaciones subordinadas denominadas en dólares estadounidenses convertibles forzosamente en títulos representativos del capital del Grupo Financiero BanCreceer, S.A. de C.V.” does not state that interest payments are to be deferred where the profitability of the financial institution would not support payment (as required by the fourth bullet point of Annex 1(C)(d)). However, they fulfill to a large extent the description given. This is reinforced by the reference in the Basle Accord of “mandatory convertible debt instruments in the United States” as an example of instruments eligible for inclusion. It is also to be noted that the debentures in question were not convertible at the option of the holder (i.e., Claimant), but rather mandatorily convertible into shares of GF BanCreceer after five years (with the option of conversion by Claimant after four years). In any event, whilst the Basle Accord appears to have been a source of inspiration of the Mexican legislator, Mexico was not a Party to that Accord. Thus, the Basle Accord cannot be viewed as a measure within the meaning of Article 201(1) of the NAFTA (“measure includes any law, regulation, procedure, requirement or practice”).

100. With respect to the second question, as it is correctly pointed out by the Claimant, regulation by authorities of capital of financial institutions is ordinarily understood to refer to capital adequacy requirements in the sense of tier 1 and tier 2 capital, spread of capital, deductions, risk asset ratios, market risk, etc. These requirements do not appear to exist as such for capital of a sociedad controladora in Mexico.
101. However, the lack of those requirements does not mean that the convertible debentures in question are not “regulatory” within the meaning of Article 1416(7)(a) of the NAFTA viewed in conjunction with the Mexican regulation of

sociedades controladoras. In the context of Chapter Fourteen, the term “regulatory” is to be interpreted in a wider sense. Such interpretation is permitted since the carefully negotiated text of the NAFTA in general and Chapter Fourteen in particular do not refer in any manner to capital adequacy requirements in the sense described above. Rather, Article 1410(1) of the NAFTA points to the wider notion of prudential measures which are the underlying rationale of regulatory capital:

1. Nothing in this Part shall be construed to prevent a Party from adopting or maintaining reasonable measures for prudential reasons, such as:

(a) the protection of investors, depositors, financial market participants, policy-holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution or cross-border service provider;

(b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border service providers; and

(c) ensuring the integrity and stability of a Party's financial system.

102. The LRAF requires that financial groups be constituted by a holding company which holds at least 51% of the paid up capital of and has control over the subsidiaries (LRAF, Articles 7 and 15). It also requires that financial groups have the authorization of the SHCP following the opinion of the Banco de México and the CNBV (or, as the case may be, the Comisión Nacional de Seguros y Fianzas) (LRAF, Article 6). Financial accounting of the financial groups is subject to rules issued by the relevant supervising authority as determined by the SHCP considering the dominant entity within a specific financial group (LRAF, Article 30). The Circulares applicable to financial institutions, including a sociedad controladora,

which are subject to the supervision of the CNBV provide for the manner in which financial institutions have to conduct their financial accounting and to present their annual accounts.

103. Article 2 of the CNBV Law (concerning “Mexican financial entities” as listed in Article 3 of said Law), which includes financial holding companies (“sociedades controladoras de grupos financieros”), sets out the objectives of the regulation and supervision undertaken by the CNBV over financial holding companies:

<p>... a fin de procurar su estabilidad y correcto funcionamiento, así como mantener y fomentar el sano y equilibrado desarrollo del sistema financiero en su conjunto, en protección de los intereses del público</p> <p>...</p>	<p>... procure their stability and due operation, as well as to maintain and promote the healthy and balanced development of the financial system taken as a whole, in protection of the interests of the public . . .</p>
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104. Article 4 of the CNBV Law grants the CNBV powers, among others, to:
- (a) issue prudential regulation within its competence, which shall be complied with by financial entities (sub-section II);
 - (b) issue accounting rules applicable to financial entities (sub-section III);
 - (c) establish rules for valuation of assets and, as appropriate, obligations and responsibilities of financial holding entities pursuant to applicable law (sub-section IV);
 - (d) issue rules applicable to the information that must be periodically submitted to the CNBV by financial entities (sub-section V);

- (e) issue generally applicable regulations setting forth the characteristics and requirements that must be fulfilled and complied with by auditors of financial entities and the opinions issued by such auditors (sub-section VI), and
- (f) issue all rules necessary for due exercise of the powers granted to the CNBV pursuant to the CNBV Law and other applicable legislation, for due compliance with said rules, and for due enforcement of regulations issued pursuant to the abovementioned rules (sub-section XXXVI).

105. Further, Article 6 of the CNBV Law expressly sets forth that the prudential regulation dictated by the Commission shall be oriented towards the preservation of the liquidity, solvency and stability of financial institutions, in accordance with the applicable law:

Para los efectos de la fracción II del artículo 4 la Comisión, de conformidad con lo que establezcan las leyes relativas al sistema financiero, emitirá normas de carácter prudencial orientadas a preservar la liquidez, solvencia y estabilidad de las entidades financieras.

For purposes of Section II of article 4, the Commission shall, pursuant to the laws relative to the financial system, issue prudential regulation designated to preserve the liquidity, solvency and stability of financial entities.

106. The capital of a sociedad controladora, which – as noted above – includes the convertible debentures in question, is subject to specific regulations and supervision, as is made clear in Article 23 of the LRAF:

El capital pagado y reservas de capital de la controladora se invertirá de conformidad con las disposiciones de carácter general que expida la Secretaría de Hacienda y Crédito Público, en lo

The paid-in capital and capital reserves of the holding company shall be invested in the following assets, pursuant to the rules issued by the Secretaría de Hacienda y Crédito

siguiente:

I.- Acciones emitidas por los demás integrantes del grupo. La controladora sólo podrá participar en el capital de sociedades distintas a las participantes del grupo, en casos de incorporación o fusión conforme a lo previsto en el artículo 10 de esta Ley;

II.- Inmuebles, mobiliario y equipo, estrictamente indispensables para la realización de su objeto, y

III.- Valores a cargo del Gobierno Federal, instrumentos de captación bancaria y otras inversiones que autorice la referida Secretaría.

IV. Títulos representativos de cuando menos el cincuenta y uno por ciento del capital ordinario de entidades financieras del exterior, previa autorización de la Secretaría de Hacienda y Crédito Público, en los términos y proporciones que dicha Secretaría señale.

La controladora solo podrá contraer pasivos directos o contingentes, y dar en garantía sus propiedades cuando se trate del convenio de responsabilidades a que se refiere el artículo 28 de esta Ley; de las operaciones con el Fondo Bancario de Protección al Ahorro o con el fondo de protección y garantía previsto en la Ley del Mercado de Valores, y con autorización del Banco de México, tratándose de la emisión de obligaciones subordinadas de conversión forzosa a títulos representativos de su capital y de obtención de créditos a corto plazo, en tanto se realiza la colocación de acciones con motivo de la incorporación o fusión a que se refiere el artículo 10 de esta Ley.

La emisión de obligaciones subordinadas se sujetará a lo dispuesto

Público:

I.- Shares issued by the other members of the financial group. The holding company may acquire shares of entities which are not part of the same financial group only in the event of mergers or incorporation of other entities into the financial group, pursuant to article 10 herein;

II.- Such immovables, movables and equipment as are strictly necessary for accomplishment of its purpose, and

III.- Securities issued by the Federal Government, banks and other investments as authorized by the Secretaría de Hacienda y Crédito Público.

IV. Shares representative of at least fifty one per cent of the common capital of foreign financial entities, as may be approved by the Secretaría de Hacienda y Crédito Público.

The holding company may only incur direct or contingent liabilities and may only pledge its assets, in connection with its undertaking of responsibilities referred to in article 28 of this law; in connection with the Fondo Bancario de Protección al Ahorro, or in connection with the protection and guarantee fund contemplated in the Ley del Mercado de Valores, and with authorization from Banco de México, in the issuance of subordinated mandatory convertible debentures or pursuant to short term loans contracted in regard to the merger or incorporation of financial entities into a financial group referred to in article 10 of this law.

The issuance of subordinated debentures shall be made pursuant to

en el artículo 64 de la Ley de Instituciones de Crédito.

[article 64 of the Banking Law \(Ley de Instituciones de Crédito\).](#)

(italics supplied)

107. Article 64 of the LIC provides:

Las obligaciones subordinadas y sus cupones serán títulos de crédito con los mismos requisitos y características que los bonos bancarios, salvo los previstos en el presente artículo.

Subordinated debentures and their coupons shall be credit instruments with the same requirements and characteristics as applicable to banking bonds, except as set forth in this article.

En caso de liquidación de la emisora, el pago de las obligaciones subordinadas se hará a prorrata después de cubrir todas las demás deudas de la institución, pero antes de repartir a los titulares de las acciones o de los certificados de aportación patrimonial, en su caso, el haber social. En la acta de emisión relativa y en los títulos que se expidan deberá constar en forma notoria, lo dispuesto en este párrafo.

In the event of liquidation of the issuer, payment of subordinated debentures shall be made pro-rata after payment of all other debts of the institution, but before making any payments to shareholders. The pertinent acta de emission, and the debentures as issued shall clearly set out the provisions of this paragraph.

(...)

(...)

La inversión de los pasivos captados a través de la colocación de obligaciones subordinadas, se hará de conformidad con las disposiciones que el Banco de México dicte al efecto. Dichos recursos no podrían invertirse en los activos a que se refieren las fracciones I, II y III del artículo 55 de esta Ley, *salvo aquellos que provengan de la colocación de obligaciones subordinadas de conversión obligatoria a títulos representativos de capital.*

[The investment of monies obtained from the issuance of subordinated debentures shall be made pursuant to the applicable rules issued by Banco de México. Such monies may not be invested in the assets referred to in Sections I, II and III of article 55 of this law, except for those obtained from the issuance of subordinated mandatory convertible debentures.](#)

(italics supplied)

108. Article 55 LIC sets forth the rules to which paid-in capital contributions and reserves of credit institutions are subject.

109. The foregoing considerations lead to the conclusion that the capital of a sociedad controladora such as GF BanCreceer, and of which the debentures in question form part, is treated as “regulatory capital” in Mexico within the meaning of Article 1416(7)(a) of the NAFTA.
110. The Tribunal wishes to emphasize that it has reached the above conclusion in the rather specific context of Article 1416(7)(a) of the NAFTA, the manner in which financial holding companies (sociedades controladoras) are regulated and supervised in Mexico, and the nature of the mandatory convertible debentures in question.

VI. COSTS

111. As in the present phase of the arbitration no submissions on costs have been contemplated, the Tribunal reserves its decision on the costs of the present phase.

VII. DECISIONS

112. FOR THE FOREGOING REASONS, the Arbitral Tribunal renders the following decisions:

- (1) HOLDS that Claimant's claims brought under Articles 1102, 1105 and 1405 of the NAFTA are not within the competence of the Tribunal, but that claims brought under Article 1110 are within its competence;
- (2) RESERVES decision on the costs of the present phase of the arbitration;
- (3) DETERMINES that the further conduct of the arbitration will be determined by the Tribunal after consultation with the parties.

Made in Toronto, Ontario, Canada, being the place of arbitration, on July 17, 2003,

[SIGNED]
Professor Andreas F. Lowenfeld,
Arbitrator

[SIGNED]
Francisco Carrillo Gamboa,
Arbitrator

[SIGNED]
Professor Albert Jan van den Berg,
President