PUBLIC VERSION

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 MERITS

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I. Introduction

1. In September 1995, Fireman's Fund Insurance Company ("Fireman's Fund") of Novato, California invested US $50 million in debentures issued by Grupo Financiero BanCrecer, S.A. de C.V. ("GFB" or "Grupo Financiero"), a Mexican financial holding company whose principal asset was the bank BanCrecer, S.A., Institución de Banca Múltiple, Grupo Financiero BanCrecer ("BanCrecer" or the "Bank"). A parallel set of debentures denominated in Mexican pesos was issued on the same day, and on the same terms, to Mexican purchasers. When BanCrecer faced financial difficulties requiring restructuring and recapitalization, a Mexican Government Working Group oversaw the process. That Working Group directed and approved the repurchase at full par value of the peso-denominated debentures, but concealed that repurchase from, and then, when discovered, refused equal treatment to, Fireman's Fund with respect to the dollar-denominated debentures.

2. Instead, the Mexican Government coerced Fireman's Fund into participating in the Working Group's recapitalization plan for BanCrecer—only to then cause that very plan to collapse, by unilaterally returning a portfolio of non-performing BanCrecer loans that had been

taken over by the Government, by refusing to execute a Memorandum of Intent required to pursue negotiations with new investors in BanCrecer, and ultimately by publicly repudiating the plan altogether in favor of a Government take-over and auction of the Bank.

3. The Mexican Government thus on the one hand discriminatorily blocked repurchase of Fireman's Fund's debentures, and then on the other hand brought about the collapse of the recapitalization plan and took over BanCrecer directly. These Government measures closed off all avenues by which Fireman's Fund's investment could have retained its value. The Government thus deprived Fireman's Fund of the use, enjoyment and value of its US $50 million investment.

4. Fireman's Fund hereby submits its Memorial on the merits of its claim against the Government of Mexico under Article 1110 (Expropriation and Compensation) of the North American Free Trade Agreement ("NAFTA"). Following a brief review of the procedural history of the dispute in Part II, Part III of this Memorial describes in detail Fireman's Fund's investment in Mexico and the Mexican Government measures that expropriated that investment. The legal bases for Fireman's Fund's claim of expropriation are set out in Part IV, followed by analysis of damages claimed in Part V. As set forth below, this Tribunal should find that the Government of Mexico has breached NAFTA Article 1110 by impermissibly expropriating Fireman's Fund's US $50 million investment in the GFB debentures.

II. Procedural History

5. Following the delivery of a notice of intent to seek arbitration under NAFTA on November 15, 1999 and a revised notice of intent on November 30, 2000, as well as numerous

failed efforts to negotiate a mutually agreeable resolution to its dispute with the Government of Mexico,[1] Fireman's Fund filed a Notice of Arbitration with ICSID on October 30, 2001.

6. ICSID registered Fireman's Fund's case under the Additional Facility rules on January 15, 2002, and this Tribunal was constituted on May 17, 2002. A first procedural meeting of the parties was held on July 22, 2002, at which Mexico indicated that it objected to the jurisdiction of the Tribunal over certain of Fireman's Fund's claims under Chapter Eleven of NAFTA.

7. Following briefing by the parties on Mexico's objections, and a hearing on those jurisdictional objections on February 6-7, 2003, the Tribunal on July 17, 2003 held that Fireman's Fund's dispute arises under NAFTA Chapter Fourteen (Financial Services) and that, by virtue of Article 1401(2), the Tribunal has jurisdiction to hear Fireman's Fund's claims that the Government of Mexico violated Article 1110 by expropriating Fireman's Fund's investment without adequate compensation. The instant Memorial sets forth those claims.

III. Statement of Facts

A. The Commercial Basis of Fireman's Fund's Investment in Mexico

8. Fireman's Fund is a United States insurance company founded some 150 years ago in California, whose principal business is the provision of various types of insurance, including in particular accident and fire insurance.[2] Fireman's Fund is dedicated to the insurance business; it

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[1] *See* Affidavit of Dr. Gerhart E. Reuss, December 16, 2002 at paras. 30-31, 35, 37-38 ("Reuss Affidavit") (C0037-38).

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

is not in the business of financial intermediation, and has no business activities in the field of commercial or retail banking.[3]

9. Fireman's Fund is a part of the Allianz group of insurance companies, a global player in the property, life, and casualty insurance industry. Fireman's Fund is a wholly-owned subsidiary of Allianz of America, Inc., a Delaware corporation, which also owns Allianz México, S.A. ("Allianz México"), a Mexican entity likewise involved exclusively in the provision of insurance services.[4] Fireman's Fund and Allianz México are thus sister companies within the Allianz group.

10. Fireman's Fund subscribed to US $50 million in debentures issued by Grupo Financiero BanCrecer[5] as an investment vehicle, and to foster a closer relationship with the BanCrecer group with a view to promoting the sale of insurance products.[6] In Mexico, retail insurance products are typically marketed to individual consumers through their local bank branches. To market insurance products successfully in Mexico, therefore, Allianz México, Fireman's Fund's sister company, entered into a marketing joint venture with BanCrecer in 1995.[7] To cement the BanCrecer/Allianz México relationship, the Allianz group was invited to participate in capitalizing GFB. BanCrecer and GFB expressed a preference for that

[3] *See* Supplemental Affidavit of Dr. Gerhart E. Reuss, June 21, 2004 at para. 3 ("Reuss Supplemental Affidavit") (C0687).

[4] Allianz of America, Inc. is in turn owned by Allianz AG of Munich, Germany. *See* Reuss Affidavit at para. 1 (C0031); Reuss Supplemental Affidavit at para. 3 (C0687).

[5] *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).

[6] *See* Reuss Supplemental Affidavit at para. 6 (C0688).

[7] *See* Reuss Affidavit at para. 5 (C0032); Reuss Supplemental Affidavit at paras. 4-5, 7 (C0687-88).

participation to take the form of an equity stake, but as an insurance company Fireman's Fund opted instead for a debt instrument—the US $50 million in GFB debentures at issue in this case—instead.[8] Fireman's Fund's representative in Mexico, Chairman of Allianz México Dr. Gerhart Reuss, was elected to serve as a member of the Board of Directors of GFB and as a *miembro suplente* (alternate member) of the Board of Directors of BanCrecer in October 1995, and held those positions until GFB's dissolution at the hands of the Mexican Government in 1999.[9]

11. Subsequently, in 1996, BanCrecer decided to exit the insurance distribution joint venture with Allianz México, and the parties agreed that Allianz México would buy out BanCrecer for US $40 million, after which the parties would have a simple contractual relationship for the marketing of Allianz México insurance products through BanCrecer branches.[10] The result of the parties' negotiations was that the buyout payment would take two forms: US $30 million in another debt instrument (structured as an advance payment from Allianz México for commissions to be collected by BanCrecer on future insurance products sold through their branches), and, at GFB's insistence, US $10 million in the purchase of a 3.16% equity interest in GFB by Allianz of America.[11] This represented the only GFB-related equity position ever held by any Allianz entity during these events.[12]

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[8] *See* Reuss Supplemental Affidavit at paras. 6-7 (C0688).

[9] *See* Reuss Supplemental Affidavit at para. 8 (C0688); *see also* Reuss Affidavit at para. 3 (C0031).

[10] *See* Reuss Supplemental Affidavit at para. 13 (C0689).

[11] *See* Reuss Supplemental Affidavit at para. 14 (C0689).

[12] *See* Reuss Supplemental Affidavit at para. 14 (C0689).

B. The GFB Debentures

12. As noted, Fireman's Fund agreed to subscribe to US $50 million in debentures issued by GFB in September of 1995. Those dollar-denominated debentures were issued in parallel with US $50 million worth of debentures denominated in Mexican pesos (*i.e.* MXP $500 million). The two sets of debentures were issued on the same day, and under the same stock exchange key, with only the final character in that key distinguishing between the dollar-denominated (GFCRECE 95L-D) and the peso-denominated (GFCRECE 95L) debentures. The terms of the debenture issuing documents were also identical, save for provisions reflecting the different currency of denomination and making corresponding exchange rate adjustments.[13]

13. Fireman's Fund subscribed to the entire offering of dollar-denominated GFB debentures. The peso-denominated debentures were subscribed to by an assortment of Mexican investors, ranging from politically well-connected existing major shareholders of BanCrecer and GFB to unaffiliated Mexicans who subscribed through their local BanCrecer branches.[14]

14. The participation of Mexican investors in GFB's US $100 million debenture issuance was critical to Fireman's Fund's decision to invest in those debt instruments. Fireman's Fund drew reassurance from domestic nationals' involvement in the transaction, as it believed that the diversification of the population of debenture-holders would serve as insurance against any future risk of discrimination against foreign investors. Accordingly, Fireman's Fund even went

[13] *Compare* Debenture Issuing Document for Dollar Debentures (R0107-27) *with* 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).

[14] *See* Reuss Affidavit at para. 7 (C0032); *see also* Affidavit of José Antonio García, June 15, 2004 at paras. 20-21 ("García Affidavit") (C0697); Affidavit of Rubén Acosta Carrasco, June 14, 2004 at para. 17 ("Acosta Affidavit") (C0725 and C0732 *PUBLIC*); Affidavit of Eduardo Fernández García, December 6, 2002 at para. 11(b) ("Fernández García Affidavit") (C0018); Discussion Note for IPAB Consultative Committee, September 9, 1999, Fernández García Affidavit Exhibit A (referencing "national holders" of peso debentures) (C0023 and C0027); Annex to Letter from BanCrecer to National Banking and Securities Commission, November 17, 1997 (grouping peso debenture holders by Mexican region of residence) (C0746-51).

so far as to condition its subscription to the dollar-denominated debentures upon proof of the subscription and payment of the peso portion of the debenture issuance.[15]

15. Also critical to Fireman's Fund's decision to invest in the GFB debentures was the financial condition of BanCrecer, GFB's principal asset, and the Government's measures intended to strengthen the Bank. Specifically, Fireman's Fund invested in the GFB debentures in reliance on measures carried out by the Fondo Bancario de Protección al Ahorro (Fund for the Protection of Bank Savings, hereinafter "FOBAPROA"),[16] that were taken concurrently with Fireman's Fund's investment.[17]

16. Like most Mexican banks, BanCrecer had been adversely affected by the Mexican financial crisis of 1994/1995, which resulted in a substantial volume of non-performing loans reflected on the Bank's books. The Government of Mexico through FOBAPROA worked to ameliorate these problems for Mexican banks by taking over tranches of the banks' non-performing loans and replacing them with Government-guaranteed notes.[18] While the terms varied from bank to bank, typically FOBAPROA would agree to take over such loans in conjunction with, and in some proportion to, infusions of fresh capital into the banks. These transactions improved the banks' financial condition by taking non-performing loans off the banks' balance sheets, and adding interest-generating Government notes to the asset side of the banks' books in their stead.[19]

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[15] *See* Reuss Affidavit at para. 7 (C0032); Reuss Supplemental Affidavit at para. 9 (C0688).

[16] 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).

[17] *See* Reuss Supplemental Affidavit at paras. 10-12 (C0688-C0689).

[18] *See* Acosta Affidavit at para. 7 (C0723 and C0730 *PUBLIC*); *see also* García Affidavit at para. 13 (C0695).

[19] *See* Acosta Affidavit at para. 7 (C0723 and C0730 *PUBLIC*).

17. GFB's issuance of the debentures subscribed by Fireman's Fund, which were intended to strengthen and capitalize BanCrecer, was part of just such a loan transfer transaction with FOBAPROA. Pursuant to an agreement negotiated between BanCrecer and [redacted], FOBAPROA, and the [redacted], FOBAPROA would take over a portfolio of the Bank's non-performing loans. They were to be replaced by Government-guaranteed notes, in specified proportions to infusions of new capital from, *inter alia* (i) [redacted] and (ii) the issuance of the US $100 million in GFB dollar- and peso-denominated debentures, [redacted].[20] For the latter, the Government expressly agreed to take over BanCrecer loans in a two-to-one ratio to the capital raised by the GFB debentures.[21] Ultimately, some MXP [redacted] in non-performing loans were removed from BanCrecer's books and transferred to FOBAPROA pursuant to this agreement.[22]

18. Just as FOBAPROA's removal and replacement of the non-performing loans was contingent on GFB raising additional capital for the Bank through Fireman's Fund's (and the Mexican investors') subscription of the GFB debentures, Fireman's Fund's subscription itself

[20] *See* Acosta Affidavit at para. 6 (C0723 and C0730 *PUBLIC*); García Affidavit at para. 16 (C0695-96); Affidavit of Eduardo Cepeda Fernandez, June 3, 2004, at para. 5 ("Cepeda Affidavit") (C0740); *see also* [redacted] (C0753 *RESERVED*); [redacted] (C0761-64 *RESERVED*).

[21] *See* Acosta Affidavit at paras. 5-6 (C0722-23 and C0729-30 *PUBLIC*); Cepeda Affidavit at para. 5 (C0740); [redacted] (C0753 *RESERVED*); [redacted] (C0761 *RESERVED*).

[22] *See* Acosta Affidavit at para. 6 (C0723 and C0730 *PUBLIC*); García Affidavit at para. 16 (C0695-96); Mancera S.C./Ernst & Young Report to BanCrecer, BanOro, National Banking and Securities Commission and FOBAPROA, September 20, 1996 (reporting on portfolio of loans transferred) (C0765-77); *see also* [redacted] (C0073 *RESERVED*); [redacted] (C0754 *RESERVED*); [redacted] (C0761 *RESERVED*); [redacted] (C0785 *RESERVED*).

was made in reliance upon the FOBAPROA loan take off agreement.[23] Fireman's Fund was aware of the agreement and of the beneficial effects that it would have on BanCrecer's financial condition, and Fireman's Fund relied upon that transaction in making its investment.[24] Without the FOBAPROA portfolio take off, BanCrecer's financial position would have been far less secure, and an investment in the debentures issued by BanCrecer's holding company would have been substantially more risky. Fireman's Fund's investment in the GFB debentures was thus made in reliance on the Government's pledge to take off loans corresponding to the capital raised by that Fireman's Fund investment.[25]

19. The September 1995 loan take off agreement was the first such transaction arranged for BanCrecer. FOBAPROA subsequently took over additional portions of BanCrecer's non-performing loan portfolio [redacted],[26] ultimately totaling approximately MXP $20 billion.[27] All of the loans transferred to FOBAPROA were fully documented, transferred to, and accepted without reservation by FOBAPROA.[28] In addition, the September 1995 portfolio was audited by Mancera, S.C./Ernst & Young, [redacted].[29]

[23] *See* Reuss Supplemental Affidavit at para. 12 (C0689).

[24] *See* Reuss Supplemental Affidavit at paras. 10-12 (C0688-89).

[25] *See* Reuss Supplemental Affidavit at para. 12 (C0689).

[26] *See* [redacted] (C0788-94 *RESERVED*); [redacted] (C0795-98 *RESERVED*).

[27] *See* García Affidavit at para. 16 (C0695-96).

[28] *See* Acosta Affidavit at para. 8 (C0723 and C0730 *PUBLIC*).

[29] *See* Acosta Affidavit at para. 9 (C0723 and C0730-31 *PUBLIC*); Mancera, S.C./Ernst & Young Report to BanCrecer, BanOro, National Banking and Securities Commission and FOBAPROA, September 20, 1996 (C0765-77); [redacted] (C0799 *RESERVED*).

C. The Government Working Group

20. FOBAPROA's ongoing takeovers of tranches of non-performing loans served to improve the financial conditions of the banks involved, but in most cases, more comprehensive restructuring and recapitalization efforts were required. To this end, a Working Group of Mexican Government officials representing all of the relevant financial authorities worked to develop "rescue" plans tailored to the circumstances of each bank.[30]

21. The agencies involved in the Working Group included:

- the National Banking and Securities Commission, represented by the Commission's President, Eduardo Fernández García, Commission Vice President for General Supervision Patricia Armendariz, and Commission Vice President for Special Supervision Alejandro Vargas Durán;[31]
- the Secretaría de Hacienda y Crédito Público ("Finance Ministry"), represented by Minister of Finance José Angel Gurría Treviño, the Undersecretary of Finance Dr. Martín Werner Wainfeld, Director General for Banking and Savings Vicente Corta, and General Director of Commercial Banks Fernando Borja Mujica;[32]
- FOBAPROA, represented by its Director General Javier Arrigunaga Gómez del Campo, Director of Commercial Bank Recovery Mauricio Naranjo, and Gabriel Reyes Oroña, Secretary to the Technical Committee;[33] and

[30] *See* García Affidavit at paras. 4-7 (C0693-94); Cepeda Affidavit at para. 3 (C0739); Reuss Affidavit at para. 9 (C0032).

[31] *See* García Affidavit at para. 9 (C0694); Cepeda Affidavit at paras. 3, 4, 8 (C0739-41); Reuss Affidavit at para. 9 (C0032).

[32] *See* García Affidavit at para. 9 (C0694); Cepeda Affidavit at paras. 3, 4, 8 (C0739-41); Reuss Affidavit at para. 9 (C0032).

[33] *See* García Affidavit at para. 9 (C0694); Cepeda Affidavit at paras 3, 4, 8 (C0739-41); Reuss Affidavit at para. 9 (C0032).

- the Banco de México ("Central Bank"), represented by Governor Guillermo Ortíz Martínez, and Director General for Financial Intermediaries Angel Palomino.[34]

The National Banking and Securities Commission, as the principal regulatory agency overseeing the condition of Mexican banks, functioned as the lead agency for the Working Group.[35] Most meetings of the Working Group took place in the Commission's offices.[36]

22. The Working Group met on a near-weekly basis, supplemented by numerous *ad hoc* meetings, to consider and develop rescue plans for the Mexican banks.[37] Typically a rescue plan for a bank would include three components: (i) transferring or confirming the prior transfer of non-performing loans to FOBAPROA, as discussed above, (ii) writing off capital deficits against existing equity capital, and (iii) securing infusions of fresh capital from new investors and/or existing shareholders.[38] The scale and scope of each component, and the process by which each was to be effected, varied from bank to bank.

23. Representatives of each bank were frequently invited to attend the Working Group meetings in which plans for their banks were discussed.[39] Once developed and agreed to by the Working Group, each plan was presented to the Technical Committee of FOBAPROA for official approval. Formally, the rescue plan would be put forward to FOBAPROA in the form of a proposal from the bank in question; as a practical matter, however, the terms of each plan were

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[34] *See* García Affidavit at para. 9 (C0694); Cepeda Affidavit at paras. 3, 4, 8 (C0739-41); Reuss Affidavit at para. 9 (C0032).

[35] *See* García Affidavit at para. 7 (C0694).

[36] *See* García Affidavit at para. 8 (C0694).

[37] *See* García Affidavit at para. 8 (C0694).

[38] *See* García Affidavit at para. 5 (C0694).

[39] *See, e.g.*, García Affidavit at paras. 7, 11 (C0694-95).

painstakingly negotiated with, and in many cases (including BanCrecer's) dictated by, the Government Working Group.[40]

24. The series of rescue plans developed by the Working Group were largely successful in restoring most Mexican banks to sound financial footing. In late 1996, the Working Group turned its attention to the last bank in the queue: BanCrecer.[41]

D. The BanCrecer Recapitalization Program

25. BanCrecer's financial position had been strengthened by the takeovers of tranches of non-performing loans by FOBAPROA—the September 1995 transfer expressly linked to the GFB debentures, and subsequent transfers in 1996.[42] But in the face of the still-struggling Mexican economy, BanCrecer, like most of the Mexican banks already aided by the Government's Working Group, was in need of a recapitalization plan to complement the FOBAPROA transactions.

26. As the Working Group wrestled with the terms for a recapitalization throughout 1997, the Bank's financial position was weakening. By the end of 1997, BanCrecer was turning to the interbank market to cover daily shortfalls.[43] BanCrecer was able to obtain this interim financing from the interbank market only because the President of the National Banking and Securities Commission issued verbal guarantees to the lending banks to reassure them and persuade them to cover BanCrecer's shortfalls.[44]

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[40] *See* García Affidavit at para. 5 (C0694).

[41] *See* García Affidavit at para. 7 (C0694); Cepeda Affidavit at para. 12 (C0742).

[42] *See* García Affidavit at para. 16 (C0695-96).

[43] *See* Acosta Affidavit at para. 20 (C0725 and C0733 *PUBLIC*); García Affidavit at para. 25 (C0697-98).

[44] *See* Affidavit of Eduardo Fernández García, December 6, 2002 at para. 11(c) ("Fernández García Affidavit") (C0018); *see also* Acosta Affidavit at para. 20 (C0725 and C0733 *PUBLIC*); García Affidavit at para. 25 (C0697-98).