

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT
DISPUTES

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FIREMAN'S FUND INSURANCE COMPANY,  :  
:  
      Claimant,                       :  ICSID Case No.  
:  
      v.                                :  ARB(AF)/02/01  
:  
THE UNITED MEXICAN STATES,          :  
:  
      Respondent.                      :  
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-- -- -- -- --X
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VOLUME I

Thursday, February 6, 2003

The World Bank
1818 H Street, N.W.
Room 13-121
Washington, D.C.

The hearing in the above-entitled matter
came on, pursuant to Notice, at 9:35 a.m. before:

PROFESSOR ALBERT JAN van den BERG,
President

PROFESSOR ANDREAS F. LOWENFELD,
Arbitrator

LIC. FRANCISCO CARRILLO GAMBOA,
Arbitrator

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C O N T E N T S

WITNESS	DIRECT	CROSS	REDIRECT
LUIS MANCERA	88	101	
EDUARDO FERNANDEZ GARCIA	141	180	226

E X H I B I T S

None.

16:15:32 1

P R O C E E D I N G S

2 THE SECRETARY: Thanks for being here.

3 Good morning. Just a couple of brief domestic
4 announcements, and we'll move on. As you know, we
5 have sound recording. This is going to be
6 recorded. We are having, as I agreed with counsel
7 for each party this morning, simultaneous
8 interpretation rather than consecutive
9 interpretation. I want to thank the interpreters
10 for helping us. The English version is going to be
11 on Channel 1. Spanish is going to be on Channel 2.
12 All of you have headphones available.

13 As you know, we have breakout rooms for
14 each party. I have already given the keys for each
15 room to represent--the counsel for each party.

16 We are going to have transcripts of this
17 hearing, which are going to be available for the
18 parties briefly after the end of the hearing in an
19 electronic format.

20 And, finally, we will be having a lunch
21 break from 1:00 to 2:00, hopefully.

09:37:36 1 Mr. President?

2 Sorry, Mr. President, one last
3 announcement. Please, when you speak, remember to
4 turn on the microphone and turn it off when you're
5 done, but for the podium. The podium will be
6 turned on and off by the sound technicians. Thank
7 you very much.

8 PRESIDENT van den BERG: Good morning,
9 ladies and gentlemen. I open here with the hearing
10 in the case of Fireman's Fund Insurance Company
11 versus United States of Mexico on the preliminary
12 question. You are all familiar with the Members of
13 the Tribunal. Also Gonzalo Flores, who is the
14 Acting Secretary in lieu of Claudia Frutos, who is
15 on maternity leave, and the Tribunal would first
16 like to invite the parties to introduce those who
17 are on their team. May I ask the claimants first.

18 And could you please also tell us in that
19 respect because I see that a number of lawyers have
20 responded according to the submissions who is lead
21 counsel and who is counsel of record.

09:38:54 1 MR. PRICE: Thank you, Mr. President. My
2 name is Daniel Price. We have two counsel of
3 record. I am one of those counsel of record, and
4 my colleague, Raymundo Enriquez, if you could
5 indicate, raise your hand, is also a counsel of
6 record.

7 During the course of the hearing you will
8 be hearing not only from me, but other members of
9 our legal team, whom I will introduce. To my left
10 is Stanimir Alexandrov, also counsel for the
11 claimant.

12 To his left is Judge Stephen Schwebel, who
13 is acting as counsel for claimant, as well, in this
14 matter.

15 As I have already introduced, to his left
16 is Raymundo Enriquez of the Mexico City office of
17 Baker & McKenzie. To his left is Katherine
18 Crocker, General Counsel of Allianz North America
19 and Fireman's Fund.

20 And to her left is Gerhart Reuss, Chairman
21 of Allianz Mexico and representative of Fireman's

09:40:10 1 Fund in Mexico.

2 I will introduce those behind as well, if
3 I might.

4 PRESIDENT van den BERG: Sure.

5 MR. PRICE: Behind me sit Marinn Carlson
6 and Jennifer Haworth McCandless of our legal
7 office, and to their left is Fernando Borja, who
8 will be acting as an expert witness in this matter.

9 Have I got everybody? I think that's it,
10 Mr. President. Thank you.

11 PRESIDENT van den BERG: I'm sorry to
12 speak in English, but it's easier for me. Thank
13 you. Mr. Perezcano.

14 MR. PEREZCANO: Thank you very much, Mr.
15 President. I am Hugo Perezcano, Legal Counsel for
16 Negotiations of the Ministry of Economy and I am
17 the leading Counsel for United Mexican States in
18 this proceeding. I am accompanied by Mr.
19 Christopher Thomas, of the office of Thomas &
20 Partners to my right. To his right is Steven
21 Becker from Shaw Pittman of the United States.

09:41:20 1 Also a consultant with the Secretary of
2 Economy, Mr. Cameron Mowatt, who is also with
3 Thomas & Partners in Canada. To his right is
4 Maximo Romero, who is the Legal Counsel of
5 Secretary of the Economy. To his right,
6 Mr. Salvador Bejar, who is also Legal Counsel to
7 the Secretary of the Economy, assigned to the
8 Mexican Embassy in Washington.

9 Behind me is Ms. Maria Teresa Fernandez
10 Labardini, representative of the Mexican Securities
11 Commission, and Mr. Luis Mancera Arrigunaga, to her
12 right, who is with the Ministry of Finance and
13 Public Credit.

14 Mr. Rolando Garcia, consultant with the
15 Thomas & Partners, Canada.

16 And behind is Mr. Humberto Guerrero, also
17 of Shaw Pittman of Washington, and behind me as
18 well is Mr. Sanjay Mullick, who advises the
19 Secretary of the Economy with Shaw Pittman of
20 Washington as well.

21 PRESIDENT van den BERG: There are also

09:42:38 1 representatives of the Government of Canada,
2 present according to the Article 1128. Could they
3 please identify themselves. We have received a
4 letter from the Government of Canada.

5 MR. THOMPSON: I'm Kevin Thompson from the
6 Department of Foreign Affairs and International
7 Trade of the Government of Canada, and I have with
8 me Mr. Dean Corno from the Department of Finance.

9 PRESIDENT van den BERG: Thank you. Then
10 from the United States of America.

11 MR. POLLACK: David Pollack with the
12 Office of the Legal Advisor with the U.S.
13 Department of State.

14 PRESIDENT van den BERG: Thank you. And
15 excuse me, you are alone because we received a
16 letter in which not only the Department of State
17 but also, I think, Commerce and the Treasury would
18 be represented here.

19 MR. POLLACK: Right. Those individuals
20 have not yet arrived, and we are not certain
21 they're going to be able to be here for the full

09:43:56 1 time, but we expect they might be here part of the
2 time. There are other individuals here with me
3 from the Department of State Office of the Legal
4 Advisor.

5 PRESIDENT van den BERG: Who is that?

6 MR. POLLACK: Jennifer Toole and Mark
7 McNeal.

8 PRESIDENT van den BERG: Okay, thank you.

9 Now, there's one thing about Article 1128.
10 The question is whether submissions on the
11 interpretation of the agreements include also oral
12 submissions. The Tribunal takes their own
13 practical view how is it to be interpreted. But we
14 also understand that most the Government of Canada
15 and United States would like to make a statement to
16 the effect that they would not make an oral
17 statement. It could at least be confirmed so that
18 we have dealt with the representatives of Canada
19 and the United States.

20 MR. THOMPSON: Yes, on behalf of the
21 Government of Canada, we would not--we will not be

09:44:46 1 making a statement today. But we would like to
2 reserve the right to file posthearing submissions
3 under Article 1128.

4 PRESIDENT van den BERG: Yes. That's
5 provided already in the order of the proceedings.

6 MR. POLLACK: The United States also
7 wishes to reserve its right to make a written
8 submission in accordance with the Tribunal's
9 schedule. We don't anticipate making any oral
10 statement today.

11 PRESIDENT van den BERG: Thank you. Then
12 as far as the submissions are concerned, the most
13 recent one is that we received last night, and
14 courtesy English translation for the United States
15 of Mexico of the statement by Mr. Mancera. I
16 simply inquire of the claimants whether they
17 received that document?

18 MR. PRICE: We have, Mr. President. Thank
19 you.

20 PRESIDENT van den BERG: Then as far as
21 schedule is concerned, we had the benefit of having

09:45:44 1 a pretrial conference last week by telephone on the
2 30th of January, and a large number of matters
3 could be resolved, even matters could be resolved
4 this morning on the scheduling. Simply to be all
5 on the same page, I would like to recapitulate the
6 schedule. We first will have this morning the
7 opening statement by respondents for maximum one
8 hour. Respondent then being in this case,
9 respondent being the United States of Mexico. Then
10 the opening statement by claimant for maximum one
11 hour. And then there is one small thing which we
12 would like to give to parties. Some guidance where
13 the Tribunal is at this point in time in its study
14 of the case; that is, the Tribunal has a few
15 questions. What we would like to do is submit to
16 both parties these questions, so that they can
17 address them either through the questions they want
18 to put to the witnesses, and/or the closing
19 statements.

20 Questions are nothing dramatic. Don't
21 worry about that too much. I see some concerned

09:47:01 1 faces.

2 Then we will probably have the lunch
3 break, depending on how far we have advanced.
4 After the lunch break, we will start with the
5 examination of the witnesses.

6 There is, as a general matter on the
7 witnesses, agreement that notwithstanding what has
8 been said in the minutes of the first session, that
9 the witnesses need not be sequestered, except
10 Mr. Fernandez, on his own volition, wishes not to
11 be present at the hearing outside of his witness
12 testimony. That's confirmed by the parties?
13 Mr. Price?

14 MR. PRICE: Yes, Mr. President. That's
15 our understanding.

16 MR. PEREZCANO: Yes, that is our
17 understanding, Mr. President, and insofar as
18 Mr. Fernandez stays away from the hearing as a
19 matter of his own will, we have no difficulty with
20 that.

21 PRESIDENT van den BERG: Thank you,

09:48:11 1 Mr. Perezcano. Also, we have agreement that all
2 witnesses will testify in the English language so
3 that we will have a simultaneous translation for
4 the record.

5 MR. PRICE: That's our understanding as
6 well, Mr. President.

7 MR. PEREZCANO: Yes, Mr. President, that
8 is the case.

9 PRESIDENT van den BERG: Then we have as
10 first witness Mr. Mancera. He's called by the
11 respondent, submitted a statement last week. He is
12 tendered as an expert within the meaning of the
13 facility, additional facility rules; is that
14 correct, Mr. Perezcano?

15 MR. PEREZCANO: No, Mr. President,
16 Attorney Mancera is appearing as the financial
17 authority in this case. We are not offering him as
18 an expert, but as the one who is the authority, the
19 representative of the Ministry of Finance and
20 Public Credit. Yes, Mr. President.

21 PRESIDENT van den BERG: Do you have any

09:49:27 1 observations in that respect simply to clarify for
2 the record the legal situation of Mr. Mancera.

3 MR. PRICE: I think it's been clarified,
4 and we would certainly agree he is not an expert or
5 presenting expert testimony.

6 PRESIDENT van den BERG: Okay, Mr. Mancera
7 will then be--the direct examination of Mr. Mancera
8 will be up to a maximum of 15 minutes as we have
9 agreed. Then the cross-examination will be up to
10 60 minutes, and then we have on redirect of
11 Mr. Mancera in which only questions may be asked
12 that relate to what he has testified in
13 cross-examination.

14 Thereafter we will have the questions of
15 the Tribunal, although the Tribunal might interject
16 questions on discrete points, but we try to refrain
17 ourselves from doing so, and after the Tribunal has
18 asked the questions to the witness, if any, then
19 both parties will have the opportunity to have
20 follow-up questions, relating to the questions that
21 the Tribunal has asked.

09:50:32 1 Then it may well be still today always it
2 will be tomorrow, we will have Mr. Borja called by
3 the claimant. For him the direct examination will
4 be 45 minutes, but only to the matters addressed in
5 the Mancera statement.

6 MR. PRICE: Mr. President, actually we
7 will be calling Mr. Fernandez before Mr. Borja.

8 PRESIDENT van den BERG: We didn't know
9 the sequence was still one of the things.

10 MR. PRICE: And just for the record, I
11 wish to reiterate my understanding that the direct
12 examination is really up to one hour, 15 minutes of
13 warmup and background, credentials, and then 45
14 minutes of--up to 45 minutes of direct.

15 PRESIDENT van den BERG: Mr. Price, your
16 mathematics are correct. 15 plus 45 makes one
17 hour, and that is also what we agreed.

18 We have also clarified the point here just
19 before the hearing started, Mr. Perezcano and
20 Mr. Price, about the question of whether also the
21 15 plus 45 rule would also apply to Mr. Fernandez.

09:51:47 1 The agreement is yes, but provided that
2 Mr. Perezcano has time then to review what
3 Mr. Fernandez has testified in direct, so that we
4 can have an appropriate cross-examination of
5 Mr. Fernandez.

6 MR. PRICE: Yes, Mr. President, that's our
7 understanding.

8 MR. PEREZCANO: Yes, Mr. President.

9 PRESIDENT van den BERG: Mr. Price, I'm
10 now under your guidance. I don't know who is
11 number two. Is that Dr. Borja or Dr. Reuss?

12 MR. PRICE: It is Mr. Borja.

13 PRESIDENT van den BERG: Okay, Mr. Borja.

14 MR. PRICE: And with respect, if I may
15 continue, Mr. President, with respect to Dr. Reuss,
16 at present we have no plan to call him for direct
17 examination. Depending on how matters unfold, we
18 may.

19 PRESIDENT van den BERG: Mr. Perezcano,
20 did you envisage--because have you reserved the
21 right for cross-examination of all the three

09:52:49 1 witnesses experts tendered by the claimant, whether
2 you envisage to cross-examine Dr. Reuss?

3 MR. PEREZCANO: We would like to reserve
4 the right to do so, particularly if he presents
5 direct evidence.

6 PRESIDENT van den BERG: Right. Then for
7 Mr. Fernandez, is it 15 to 45 rule., Dr. Reuss,
8 since there will probably not be a direct
9 examination of Dr. Reuss, so that doesn't apply.

10 There is also one other thing that's
11 contemplated, is that Mr. Mancera may be recalled
12 as a witness because that was also part of the
13 point we discussed this morning, that it should
14 also be a possibility for the respondent again to
15 rebut what may be said in the direct examination of
16 Mr. Fernandez.

17 MR. PRICE: Yes, Mr. President.

18 PRESIDENT van den BERG: Then we
19 have--that will carry over to tomorrow. We will
20 have see how it develops. We have lunch from one
21 to two, thanks that the interpreters have forgone

09:54:07 1 their right to a two-hour lunch; they have now a
2 one-hour lunch. We will go on then with
3 appropriate breaks until 5:30 this afternoon, more
4 or less, depending on where we are in the
5 questioning because I don't like to break off in
6 the middle of a question. We continue tomorrow at
7 9:30. We can finish that, I think, in the morning,
8 all the witnesses, and it is then contemplated that
9 the closing statements by each side of one half
10 hour max will be tomorrow afternoon. I think then
11 we have a schedule with which both parties can
12 live. The basic principle is equal time between
13 the parties, but we have to view with some
14 flexibility depending on the circumstances.

15 And, incidentally, the closing statement
16 is again that we have to be careful because in
17 certain common law settings that is the claimant
18 comes last, but here actually the respondent is
19 claimant. Tomorrow it will be that the respondent
20 comes first in the closing statement, and again the
21 claimant comes last.

09:55:18 1 That was as far as the schedule is
2 concerned. Transcripts, as a housekeeping matter,
3 the transcript will be--what is it--today's will be
4 delivered tonight. As far as corrections are
5 concerned, the Tribunal invites both parties to
6 consult with each other what is the procedure for
7 corrections of the transcript. Please only correct
8 errors in spellings and these kind of things. I
9 don't need to tell you this with seasoned counsel
10 on both sides, rewrite the transcripts in the sense
11 that I had in a recent case, where they said well,
12 wait a moment, yes, the witness said, A, but he
13 meant to say B, so that should be in the
14 transcript. But that's not the purpose of the
15 correction of the transcript.

16 Finalization of the transcript corrections
17 should be by next Wednesday, and I suggest you go
18 to the Secretary also for submitting the
19 corrections, and then they could go to the Court
20 Reporter.

21 There is one other thing--yeah, there's

09:56:21 1 one other small thing. In your presentations,
2 could you please refer, if possible, to the exhibit
3 numbers you have because that makes it later easier
4 to find back the exhibits.

5 There is one additional remark the
6 Tribunal wishes to make here; that is, that both
7 parties have done their best, but not completely
8 succeeded, in numbering the exhibits on the CD-ROM.
9 Claimant has done it best by giving the numbers,
10 but has forgotten, if I may say so, to precede the
11 01 through 09 by a zero, which means that simply 01
12 comes after, what is it, 28.

13 At this stage of the proceedings it
14 doesn't matter so much because there are not that
15 many exhibits, but in the future if you could
16 please take care of this.

17 And if I may also invite the respondents
18 also to put exhibit numbers on the CD-ROM. It was
19 somewhat difficult to find it, Mr. Perezcano, but
20 we found our way.

21 MR. PRICE: Mr. President, I'm sorry, just

09:57:21 1 on that housekeeping matter of documents, prior to
2 my opening statement, I will be giving to the
3 Tribunal the documents that I will be referring to
4 in that statement, and also in our examination of
5 witnesses. These are all documents that are in the
6 record. I just compiled them for ease of
7 reference, and I will supply them as well to the
8 respondent.

9 PRESIDENT van den BERG: And you have
10 identified each of these documents by reference
11 number to the exhibits?

12 MR. PRICE: That's correct.

13 PRESIDENT van den BERG: Okay. That
14 should not be a problem, Mr. Perezcano. Thank you.

15 MR. PEREZCANO: No problem.

16 PRESIDENT van den BERG: And incidentally
17 if you forget, that is permissible what we do for
18 transcript, if a reference has not been stated
19 because in your flow of argument or a witness
20 recommendation, that is permissible to insert in
21 the record references to exhibit numbers, because

09:58:15 1 it was my experience it was helpful to have it.

2 Incidentally, I have also asked the Court
3 Reporter to time stamp the records, the transcript.
4 The reason is that my own manner of working is I
5 take notes according to time, and it's easy for
6 later to find back on the transcript the relevant
7 passages of testimony or arguments, so it's every
8 15 minutes I think I asked to time stamp the
9 record.

10 Then there is some other
11 matter--terminology matter, and I apologize,
12 immediately beforehand for those who are not
13 lawyers in this room because we got here slightly
14 into legalese, even worse, we get academic
15 legalese, which is that the parties and the
16 Tribunal have interchangeably used the words
17 competence and jurisdiction.

18 Now, you may know that--the lawyers
19 amongst you--that there is some debate amongst the,
20 especially the academics that there is a difference
21 between competence and jurisdiction. Others deny

09:59:31 1 it, but to make matters more complicated in our
2 case, it is that Article 46 of the Additional
3 Facility Rules refer to the notion that the
4 Tribunal may rule on its competence, whereas
5 Article 16 of the International Commercial
6 Arbitration Act of Ontario, which is applicable in
7 this case since the legal place of arbitration is
8 Ontario, states that the Tribunal may rule on its
9 jurisdiction. And to make it even more confusing
10 there, if you look to the heading of Article 16 of
11 the International Commercial Arbitration Act, it is
12 the competence of the Tribunal to rule on
13 jurisdiction.

14 Now, I see a lot of lawyers have a lot of
15 great fun about this, the Tribunal also, but what
16 you would also like to preempt is that we are later
17 on, both parties and the Tribunal's, criticized in
18 the legal press, if we may call it that way. They
19 didn't get their act together. They can't
20 distinguish between competence and jurisdiction.
21 What the Tribunal invite both parties to do is

10:00:35 1 whether they could agree themselves on the
2 terminology, and if not, please present your views
3 on this matter in your closing statements, but
4 please do not exceed here five minutes. Otherwise,
5 we get sort of in law school all kind of all
6 wonderful academic debates. It's simply to clarify
7 the terminology.

8 There is another household matter. You
9 remember that at the first session we discussed the
10 confidentiality of this case. It was agreed to
11 between the parties that it would not be
12 confidentiality, and actually everything would be
13 on the Web site of ICSID. Now, for some technical
14 reasons that has not yet been accomplished, and I
15 would like to invite the parties to contact the
16 Secretary of the Tribunal during these days in
17 order to see to it that also that matter can be
18 finalized so that indeed the record of this case
19 can be on the Web site of ICSID.

20 Those were the introductory points of the
21 arbitrable Tribunal at this state, but we would

10:02:02 1 invite the parties to raise any other
2 organizational question or procedural question at
3 this point. Mr. Price, do you have any?

4 MR. PRICE: None at this time,
5 Mr. President. Thank you.

6 PRESIDENT van den BERG: Thank you.
7 Mr. Perezcano?

8 MR. PEREZCANO: No, sir.

9 PRESIDENT van den BERG: Thank you. It is
10 Mr. Perezcano who may start first with the opening
11 statement.

12 MR. PEREZCANO: Thank you, Mr. Chairman.
13 Unless the Tribunal has a preference, I would like
14 to be seated to offer my oral presentation.

15 PRESIDENT van den BERG: That's fine,
16 Mr. Perezcano.

17 MR. PEREZCANO: Thank you very much, sir.

18 Members of the Tribunal, thank you. First
19 of all, the Government of Mexico wishes to
20 reiterate that the only issue before this Tribunal
21 at this time is the exceptions of competence as

10:03:02 1 submitted by the Government of Mexico, and that
2 this lies only in establishing whether the measures
3 claimed are covered by Chapter 14, as it deals with
4 an investment in that Mexican financial institution
5 or whether if it is an investment in any ordinary
6 company. Now, questions that go to the substance
7 of the issue both as to facts as well as to law,
8 that Mexico has violated its duties as set forth
9 under the North American Free Trade Agreement, and
10 we've expressed these differences, and this would
11 not be the appropriate time to air them. The
12 President of the Tribunal and the parties agreed on
13 this matter when we approached it at the suggestion
14 of the Mexican Government by phone conversation
15 which was held last week.

16 Nonetheless, the Government of Mexico
17 wishes to stress this issue because in its
18 preliminary issues writings, the claimant has made
19 an obvious effort to confuse the substantive
20 matters with those that have to do with the
21 exception to competence, and deliberately distorts

10:04:27 1 the facts and the position of the Mexican
2 Government before this procedure.

3 The claimant states in his writing that
4 Mexico does not deny that there has been
5 discrimination and expropriation, nor has Mexico
6 denied that the claimant has rights under Chapter
7 11 of the treaty. There should be no doubt,
8 Members of the Tribunal, Mexico does dispute the
9 questions of law and fact of the claimant. It
10 categorically rejects having committed any act of
11 discrimination against the claimant. That is, to
12 have expropriated its investment or in any way
13 having violated its duties that derive from the
14 North American Free Trade Agreement.

15 Mexico has been very clear in its position
16 from the beginning, this is a preliminary phase,
17 and in its writings clearly expressed that for
18 purposes of exceptions of competence as we have set
19 forth and only for this purpose do we accept the
20 facts as described in the request for arbitration
21 without prejudice to our position on the same in

10:05:51 1 regard to the substance of the dispute.

2 And we have reserved ourselves here in
3 order to bring forth this argument during the
4 corresponding phase.

5 Now, the account of facts which was
6 submitted upon the request of the President to
7 provide greater information as to the facts does
8 not attempt to be a reply to a claim which we have
9 not yet seen. It is not an exhaustive or
10 definitive account. The Government of Mexico will
11 not approach during this phase questions of fact
12 nor arguments regarding the violation of the treaty
13 as established by the claimant, and nor should,
14 respectfully, the Tribunal do so.

15 Having established this preliminarily, I
16 would now like to go into my presentation.

17 Mexico agrees with the form as described
18 by the claimant in paragraph 43 of the document
19 submitted regarding competence on jurisdiction, and
20 we are referring to the question of exception, and
21 I cite from paragraph 43. This will be a

10:07:10 1 paraphrase without having the document in front of
2 me, Chapter 14, and the speaker quotes, paraphrase,
3 if this chapter prevails, then an investor such as
4 Fireman's Fund has a more limited scope for claims
5 that can be submitted directly against a party.
6 Article 1401 under paragraph 2 limits the private
7 right of action of an investor as under Chapter 14
8 to allege violations of Articles 1109, 1110, 1111,
9 1113, and 1114, end quote.

10 Mexico agrees the claimant does not
11 question that Chapter 14 of the treaty establishes
12 a special investment and service regime in the
13 financial sector. Nor does it dispute that Chapter
14 14, and again the speaker quotes paragraph 42,
15 special provisions for settlement of disputes, end
16 of quote, which limits the claims of private
17 investor which can be submitted to arbitration does
18 not dispute that this is the legal necessary
19 outcome when it is a matter of an investment of a
20 financial institution. The parties agree. Given
21 the nature itself of the financial sector, Chapter

10:08:57 1 14 only allows private investors to resort to
2 arbitration for claims of one party to the treaty
3 has violated only certain provisions of Chapter 11
4 under the terms incorporated in Chapter 14.

5 The Tribunal must bear in mind that both
6 parties agree that, one, Article 1102, which
7 establishes the general duties in terms of national
8 treatment to investments and investors, has not
9 been incorporated into Chapter 14. Consequently,
10 it's not applicable.

11 Two, Chapter 14 does not allow recourse to
12 arbitration for an investor to claim violation of
13 investments under Article 1405, which sets out the
14 duties under national treatment to investments and
15 investors as well as providers of service in the
16 financial sector.

17 Even though in this case one of the
18 parties of the treaty of which the investor is a
19 national can bring this forth in a procedure under
20 the provisions of Chapter 20 of the treaty itself.

21 Three, Article 1105 has not been

10:10:40 1 incorporated into Chapter 14, and thus does not set
2 forth duties for any of the parties in the area of
3 the financial sector. Thus, there can be no claims
4 to a violation of this when it is a matter of the
5 financial sector.

6 The claimant in this procedure has
7 submitted claims under Articles 1102 and 1405
8 regarding national treatment. Article 1105, which
9 puts forth the duty of a minimal treatment under
10 international law, and Article 1110, which sets
11 forth disciplines in terms of expropriation.

12 The only claim that could be submitted to
13 arbitration under Chapter 14 is the one on Article
14 1110 under the terms incorporated in Chapter 14.

15 The claimant alleges that Mexican holding
16 companies, holding companies of financial groups
17 are not financial institutions under Article 1416
18 of the treaty. Nonetheless, and this is important,
19 it does not indicate that the treaty itself
20 dissipates any question in this regard because
21 Chapter 14 encompasses them expressly and regulates

10:12:23 1 them expressly. Chapter 14 of the Free Trade
2 Agreement has specific provisions of Mexican law
3 which are applicable to holding companies in the
4 case of financial groups, and this is fatal to the
5 claimant's case, and it is sufficient for this
6 Tribunal to dismiss without any further ado its
7 arguments.

8 However, the other interpretations put
9 forth by the claimant have no foundation. As to
10 the treatment of holding companies under Mexican
11 legislation, the claimant maintains an entire
12 argument based on terminological minutiae which is
13 artificial and impossible to sustain.

14 The provisions of Mexican financial
15 legislation which are reflected in Chapter 14 and
16 the legal reforms by which Mexico implemented its
17 duties under Chapter 14 make clear that holding
18 companies of financial groups such as BanCrece are
19 and have been financial institutions. The claimant
20 admits, and the witnesses--the witness for the
21 claimant has corroborated, first of all, that the

10:14:01 1 holding companies of financial groups are part of
2 the Mexican financial system; two, that they are
3 subject to Mexican financial laws; three, that they
4 are regulated and supervised by Mexican financial
5 authorities; and four, that they require
6 authorization of these same financial authorities
7 in order to do business in Mexico.

8 Nevertheless, an attempt is made at
9 convincing the Tribunal that financial law that
10 creates and regulates these does not consider them
11 to be financial institutions.

12 The arguments do not, with all due
13 respect, admit analysis. First of all,
14 terminological rules is used which is artificial
15 and unsustainable.

16 Secondly, it points to the fact that they
17 are subject to the regulation and supervision even
18 though these are considered to be by minor, they
19 are argued to be minor, but does not deny that they
20 are regulated and supervised by financial
21 authorities.

10:15:31 1 Three, the claimant recognizes that they
2 require authorization to do any business, but
3 argues that the type of business that can be
4 undertaken is limited.

5 Four, claimant points out that it
6 undertakes a different function than that of other
7 institutional--financial institutions, and to
8 explain this argument begins by stating that all
9 financial institutions by law carry out different
10 functions and that they are not allowed to carry
11 out the functions that are attributed to others.

12 And lastly, points out that the holding
13 companies do not undertake operations with the
14 public. The Tribunal will note that the treaty
15 does not define "financial institution" as those
16 that undertake activities with the public.

17 The question of investment confirms this.
18 The treaty regulates much more than the simple
19 provision of financial services to the public.

20 Chapter 14, the treaty does not define
21 financial institutions in terms of the greater or

10:16:59 1 lesser degree of regulation or supervision to which
2 they are subject. It does not define them in terms
3 of the type of businesses they can be engaged in,
4 whether this is broad or narrow, nor does it
5 provide a catalog of the functions that can or do
6 take place. The catalog defines them under the
7 terms which are incorporated into the financial
8 system of the corresponding portion of the treaty.
9 And this is the fundamental issue.

10 Now, in the case--the case of the claimant
11 focuses almost exclusively on the question of
12 whether the holding companies are financial
13 institutions under Chapter 14 or not, and does not
14 question the nature of the duties acquired in 1995
15 by Fireman's Fund, and limits itself to saying that
16 the nature of its duties is irrelevant. And this
17 shows the weakness of the argument, and is the
18 equivalent of an admission that the obligations,
19 object of this dispute, are objectively considered,
20 as the respondent has demonstrated, as capital for
21 regulatory effects, and represent an investment

10:18:34 1 under the terms of Chapter 14 of the treaty.

2 Marginally, the proposed witness of the
3 claimant, Mr. Borja, makes an effort to indicate
4 that Mexican law does not put forth minimum
5 requirements of capitalization for holding
6 companies of financial groups. Nevertheless, this
7 has nothing to do with the concept of capital for
8 regulatory effects as established under the Free
9 Trade Agreement.

10 And it seems that Mr. Borja was unable to
11 even convince the claimant because, in the
12 submission under preliminary issues, this is
13 ignored. The treaty does not define the term
14 "capital" for regulatory effects or purposes. But
15 the Tribunal will note that the treaty says nothing
16 about minimal capital in relation to this concept.
17 The concept of capital for regulatory purposes
18 arises exclusively in regard to debt instruments
19 exactly of the type which are those that are
20 mandatorily converted into shares, as what occurred
21 with Fireman's Fund.

10:20:16 1 These subordinate debts acquired by
2 Fireman's Fund give a perfect example, and I quote,
3 a debt instrument issued by a financial institution
4 dealt with as capital for regulatory purposes, and
5 here the treaty is cited by Mexico; Article 1416
6 defines as an investment for purposes of--in
7 Article--of Chapter 14 of the treaty. The claimant
8 has demonstrated undeniably, incontrovertibly, that
9 given the relationship established by means of
10 different admissions of the Banking Commission,
11 Mexico deals with capital as a debt instrument.
12 The Tribunal must admit the evidence of the
13 respondent and ignore the arguments of the
14 claimant.

15 According to the Government of Mexico,
16 financial matters are regulated exclusively by
17 Chapter 14 of the treaty. It is not true that the
18 different elements are regulated in different parts
19 of the treaty in a matter that's diffused, as
20 suggested by the claimant.

21 Now the structure of the treaty: The fact

10:22:01 1 that both services as well as investments in the
2 financial sector are regulated by a special chapter
3 is evidence of this. First of all, the interaction
4 of Chapters 11 and 14, including a mechanism for
5 settlement of conflicts between investor and state,
6 provide us with a good example. The Tribunal will
7 recall that the treaty does not simply remit to
8 Chapter 11, but rather incorporates provisions,
9 carefully selected provisions, making them an
10 integral part of the treaty and establishing the
11 effects of these.

12 Chapter 14 has its own Annexes, including
13 Annex 7, which establishes exceptions and
14 commitments towards liberalization which are
15 specific to the financial sector. Chapter 14 is so
16 specific that it modifies general provisions of the
17 treaty to harmonize these with the regime of
18 financial services.

19 It is sufficient to see Article 1411,
20 which alters the provisions of transparency under
21 Chapter 18, or we can look to Article 1414 which

10:23:54 1 also modifies the provisions of Chapter 20, which
2 put forth the general system for the settlement of
3 disputes among the parties to the treaty.

4 Now, the claimant believes that there has
5 been a dissection of Article 14, and that certain
6 elements can be analyzed to give them a different
7 treatment. Nevertheless, there is no question that
8 here we are talking about the Mexican financial
9 system. The claimant and its expert, Mr. Borja, so
10 admits. They themselves referred to the financial
11 group BanCreceer as a financial holding company.
12 They admit that there are elements of the Mexican
13 financial system, that they are subject to Mexican
14 rules, that they are regulated and supervised by
15 Mexican financial authorities, and that they
16 require the authorization of the same financial
17 authorities to do business.

18 The claimant also states that as a
19 financial holding company, Grupo Financiero
20 BanCreceer was also owner of other financial
21 institutions and, in effect, that was the

10:25:39 1 principal, the only objective.

2 However, the Tribunal should not lose
3 sight of the fact that Fireman's Fund is a
4 financial institution that is devoted to insurance.
5 Fireman's Fund is at the same time a subsidiary of
6 Allianz, a company that is--that describes itself
7 as a global company of financial services.

8 Thirdly, that investments made by
9 Fireman's Fund in Mexico were into the holding
10 company that held several financial institutions,
11 including two banks and that are purported to
12 establish an insurance company within that
13 financial company.

14 Fireman's Fund and Allianz only work in
15 financial issues. They work in financial
16 operations, activities that are subject to
17 regulations of the financial sector in any country
18 where they carry out operations.

19 However, it is not believable that in this
20 case it made an investment that was devoted
21 explicitly to be outside of the financial

10:27:10 1 regulatory framework.

2 Members of the Tribunal, looking at it
3 from any side, we are examining businesses that
4 work exclusively in the financial sector, both in
5 Mexico, the United States, or any other region of
6 the world.

7 The Tribunal should also be aware that the
8 issue that is of concern to us today at this phase
9 is not merely limited to a dispute between
10 Fireman's Fund and the Mexican Government. The
11 parties signatory to the treaty were extremely
12 careful to establish a specific regulatory
13 framework for the financial sector because in
14 Mexico, Canada, as well as in the United States, as
15 in the rest of the world, the financial sector is a
16 sector of specific importance, and the issues that
17 may arise could have repercussions, significant
18 repercussions in each of the nation's economies. A
19 clear example to illustrate this would be the
20 financial crisis that Mexico experienced in the
21 mid-1990s and which the claimant and witnesses have

10:28:52 1 already made reference to, linked to this case in
2 particular.

3 The Free Trade Agreement established an
4 opening in the financial market and as a result of
5 this, we are seeing the consolidation of
6 international intermediary entities in which most
7 of the foreign investments and financial
8 institutions in Mexico have been carried out
9 through holding companies and financial groups and
10 specifically based on the stipulations of Chapter
11 14 contained in the treaty.

12 Despite this, all three parties reserve
13 the right in this chapter to maintain control not
14 only of foreign investment, but in addition all of
15 the developments involved in the financial sector
16 and the authority to take measures in case of
17 emergencies or any needs that may arise or with
18 regard to the financial institutions individually.
19 The interpretation that the claimant has brought
20 forth has repercussions not only with regard to the
21 authority for the parties to take these measures,

10:30:13 1 but also the capacity to monitor the proper
2 development and undertaking of the financial
3 system.

4 Thank you very much.

5 MR. PRICE: Thank you, Mr. President. If
6 I could distribute to you now these little binders.

7 Thank you very much, Mr. President, and
8 Members of the Tribunal.

9 Mr. Perezcano has made a number of points,
10 that I will be referring to during the course of
11 examination of witnesses and will probably address
12 during the closing as well.

13 I would like to focus, if I might, on what
14 we think is the precise question before the
15 Tribunal, and that is only whether or not a holding
16 company, a controladora, is a financial institution
17 within the meaning of Article 1416 of NAFTA. The
18 Tribunal must resolve this question by NAFTA and
19 Mexican law to which NAFTA directs the Tribunal.

20 It must also assess this question in the
21 light of the differential treatment accorded to

10:33:52 1 claims under Chapter 11 and Chapter 14.

2 The Tribunal must assess whether this is
3 the type of claim and these are the type of
4 circumstances giving rise to a dispute that must be
5 resolved under the exceptional state-to-state
6 procedures for disputes arising from investment in
7 financial institutions or whether it is the type of
8 claim that is properly subject to Chapter 11, which
9 applies generally to all investments.

10 Now, because the decision of the Tribunal
11 cannot be made in a factual vacuum, our written
12 submissions provide the factual context for this
13 dispute, which I will now just briefly review.

14 In 1995, Fireman's Fund acquired one half
15 of a hundred million dollar issuance of convertible
16 bonds that were issued by a controladora, a Mexican
17 holding company. 50 million were acquired in
18 dollars, and 50 million were denominated in pesos
19 and acquired by Mexican nationals.

20 The holding company, the controladora,
21 controlled a bank, BanCreceer, and also controlled a

10:35:18 1 majority interest in a factoring company and a
2 leasing company. Claimant's investment was thus 50
3 million in dollar-denominated bonds.

4 In the mid to late nineties, the Mexican
5 financial sector was undergoing a crisis, and the
6 Mexican Government began a program to resuscitate
7 failing banks. A Working Group was established to
8 establish the circumstances of BanCreceer, which had
9 also been weakened by the financial crisis. The
10 Working Group developed a Recapitalization Program
11 to restructure the bank.

12 The program envisioned using claimant's
13 bonds to recapitalize the bank. Claimant agreed to
14 participate in the Recapitalization Program because
15 it was made quite clear to Fireman's Fund by
16 Mexican financial authorities that it had no choice
17 but to participate or it would lose the value of
18 its investment.

19 Now, at the time these discussions were
20 going on with Fireman's Fund and without Fireman's
21 Fund knowledge, an alternative plan was developed

10:36:36 1 for Mexican nationals who held the peso-denominated
2 bonds issued by the holding company. Under that
3 plan Mexican bondholders, in contrast to the
4 foreign investor, were to be redeemed at full
5 value. This repurchase was made through BanCrecer
6 with monies guaranteed by the Mexican Government.

7 Without the Mexican Government's
8 participation, endorsement, financial support, and
9 approval, those debentures could not have been
10 re-purchased. When claimant first learned that the
11 Mexican Government had treated the peso-denominated
12 bondholders in this more favorable way, it
13 requested but was denied that same treatment.
14 Instead, the Mexican Government used the leverage
15 of claimant's bonds to keep claimant in the
16 Recapitalization Program. We have testimony in
17 which a senior government official responsible for
18 this plan indicated that, yes, this was leveraged
19 to induce their continued participation. By
20 leverage, I mean the official made clear that we
21 are not going to buy you off. We are not going to

10:37:55 1 redeem these bonds. If you want them to have any
2 value, you will participate in this new program.
3 That's what I mean by leverage.

4 ARBITRATOR LOWENFELD: Pressure?

5 MR. PRICE: Pressure. In the witness's
6 own statement, that's what he meant as well. He
7 will be here, and I will be able to ask, as will
8 you.

9 That same official testified that the
10 request by Fireman's Fund for equal treatment was
11 denied. During the course of 1999, it became clear
12 to all participants, the financial authorities with
13 whom Fireman's Fund was negotiating, and to
14 Fireman's Fund, this recapitalization plan would
15 not be carried out. Thereafter, Fireman's Fund
16 renewed its request for equal treatment; that is,
17 to be bought out, and that request was denied. It
18 was denied with the full knowledge, as reflected in
19 testimony, that the refusal to repurchase
20 effectively rendered the investment worthless.

21 It was also understood by the Mexican

10:39:03 1 Government at that time that it had treated
2 Fireman's Fund and the Mexican investors
3 differently, and that such different treatment
4 could and would give rise to an international
5 claim.

6 Fireman's Fund entered into settlement
7 discussions with the Government in late 1999, but
8 after the presidential elections it was clear that
9 the administration was on its way out and would not
10 be willing to reach an agreement with Fireman's
11 Fund. After subsequent discussions and
12 consultations failed to resolve the problem,
13 claimant filed this claim.

14 Mexico never disputed prior to this
15 litigation that it discriminated against a foreign
16 investor, or that its actions deprived the claimant
17 of the value of its investment. Rather, it is now
18 for the purposes of this litigation that respondent
19 is attempting to shield its actions behind a
20 technical defense.

21 Respondent is arguing now that Chapter 14

10:40:12 1 governs this dispute, and thus places these
2 allegations of discriminatory and unfair treatment
3 beyond the reach of this Tribunal. There is
4 apparently no dispute between the parties that all
5 relevant jurisdictional requirements of Chapter 11
6 have otherwise been met. The only dispute between
7 the parties is whether or not Chapter 14 or Chapter
8 11 will govern certain of the claims in this
9 dispute.

10 Now, that question turns on whether or not
11 claimant's investment in the controladora is an
12 investment in a financial institution. Article
13 1416 of NAFTA defines financial institution as, and
14 I'm quoting, any financial intermediary or other
15 enterprise that is authorized to do business and
16 regulated or supervised as a financial institution
17 under the law of the party in whose territory it is
18 located.

19 It's our view that this definition is
20 properly read as follows: In order to be a
21 financial institution, the enterprise must not only

10:41:33 1 be authorized to do business, but authorized to do
2 business as a financial institution. Likewise, it
3 must not only be regulated or supervised by
4 financial authorities, but regulated or supervised
5 as a financial institution.

6 Respondent appears to adopt a contrary
7 reading and suggests that this definition is
8 satisfied if an entity is merely authorized to do
9 any kind of business and is merely regulated by
10 financial authorities.

11 Now, before getting into the questions of
12 Mexican law and NAFTA that must be addressed, I
13 want to address for a moment the competence or
14 jurisdiction of this Tribunal to decide this
15 preliminary question. The Government of Mexico has
16 suggested in its recent pleading that a statement
17 by an official of the Ministry of Finance is
18 dispositive of this issue. In our view, the
19 decision on the jurisdiction of this Tribunal is to
20 be made by the Tribunal, not by the Mexican
21 Government. It cannot be the case that respondent

10:42:58 1 can simply assert the answer to the question to be
2 decided and dictate that the Tribunal must accept
3 it. In our view, this is incorrect.

4 The Finance Ministry which submitted this
5 most recent pleading is a constituent part of
6 respondent. The official who signed that document
7 is an employee of the party. It is quite clear
8 when one reads the submission of Mr. Mancera, that
9 his statement is simply more legal argument by the
10 respondent. It is, as we suggested, nothing more
11 than a reply submission.

12 Accordingly, that document, Mexico's
13 reply, should be given no more weight than any
14 other submission by a party. It is for the
15 Tribunal to determine the question in the light of
16 the evidence and argument of both parties.

17 I would like to return to Article 1416.
18 That directs the Tribunal to Mexican law, so that
19 is where we start. Now, the Tribunal has testimony
20 before it written testimony of persons far more
21 knowledgeable than I about the Mexican financial

10:44:19 1 system. You have testimony from an individual who
2 spent 18 years as principal regulatory counsel of
3 the Bank of Mexico, and who for six years served as
4 the President of the Banking and Securities
5 Commission. You have testimony by an individual,
6 Mr. Borja, who spent years with the Ministry of
7 Finance, who was responsible for the implementation
8 of Chapter 14, for the regulation of controladoras,
9 for the regulation of banks. He was Mexico's
10 representative to the Technical Committee on
11 Chapter 14. He was also, after leaving the
12 government, in recognition of his expertise and
13 experience, appointed by Mexico to the roster of
14 arbitrators who would resolve disputes under
15 Chapter 14.

16 They will be providing their views later
17 in this hearing, and are available to respond to
18 the Tribunal's questions. I won't repeat their
19 testimony. What I would like to do now is simply
20 highlight a few key points.

21 The principal relevant law to which the

10:45:31 1 Tribunal's attention ought to be directed by NAFTA
2 is the Financial Holding Company Act. Adopted in
3 1990, this law regulates and governs the formation
4 of holding companies. I'm going to refer to
5 Article 7 of that law, which is set forth in Tab D
6 of the binder. Article 7 of the Financial Holding
7 Company Act makes clear that holding companies and
8 financial institutions are not the same. The
9 Article separately identifies holding companies and
10 the financial institutions that the holding company
11 owns. A financial group under this law consists
12 of, one, a holding company; and two, two or more of
13 a long list of financial institutions. And let's
14 take a look at those financial institutions. They
15 are banks, broker-dealers, insurance companies,
16 investment companies, in short, the type of entity
17 that none would dispute is a financial institution.

18 The Holding Company Act further describes
19 the types of activities that a holding company can
20 engage in, and these activities contrast sharply
21 with the types of activities undertaken by

10:47:01 1 financial institutions. I refer the Tribunal,
2 please, to Tab F and Article 16. Under Article 16
3 of the Act, the object and purpose of a holding
4 company is specified as acquiring and holding
5 shares of the financial institutions in its group.
6 That same Article expressly provides that a holding
7 company may not engage in the activities of the
8 financial institutions that it owns. This is
9 reinforced by regulation 18 promulgated under this
10 Act, which is set forth at Tab K.

11 That regulation states that it is
12 prohibited for a holding company to take
13 administrative steps or exercise management over
14 the operations of a financial institution. Thus, a
15 controladora can't engage in the management of
16 financial institutions or the provision of
17 financial services.

18 If a company is barred from managing or
19 operating a financial institution, how, then, can
20 that company be a financial institution?

21 Now, this distinction between holding

10:48:30 1 companies and financial institutions is also
2 evident in the Mexican legislation which
3 implemented NAFTA and amended the Holding Company
4 Act. These provisions also draw a distinction
5 between financial holding company affiliates on the
6 one hand and financial institution affiliates on
7 the other. And it's no surprise that the
8 legislation implementing NAFTA contains a
9 distinction between a holding company and a
10 financial institution because NAFTA itself makes
11 the same distinction, and that distinction is found
12 in the very Annexes prepared by Mexico and attached
13 to Chapter 14.

14 I refer to Tab B of the hearing binder.
15 Under Annex VII (B), paragraph 14, Mexico
16 essentially commits to permit an American or U.S.
17 or Canadian financial institution to acquire or
18 establish in Mexico the same type of financial
19 institution that it, that is, the U.S. or Canadian
20 institution, is.

21 In other words, Mexico is granting market

10:50:03 1 access to financial institutions of another party
2 to acquire or establish like financial institutions
3 in its territory.

4 ARBITRATOR LOWENFELD: A bank, security
5 company, an insurance company?

6 MR. PRICE: Exactly. A securities firm, a
7 securities firm. And that's what Section B,
8 paragraph 14 means. It means a financial
9 institution engaged in "service A" may acquire or
10 establish in Mexico a financial institution engaged
11 in "service A." We turn, then, to Annex VII(C)(5).
12 Now, it says that a financial institution that is
13 permitted under NAFTA to establish in Mexico a bank
14 or a securities firm may also establish a
15 controladora, a holding company, and thereby be
16 granted the right to establish other kinds of
17 financial institutions; that is, types of financial
18 institutions other than the type that it is.

19 What this means is that Mexico, in
20 preparing these Annexes, understood quite clearly
21 that there was a difference between a financial

10:51:33 1 institution on the one hand and the holding company
2 on the other. The first, a financial institution,
3 actually provided financial services; while the
4 second, a holding company, merely served as a
5 vehicle for establishing or holding the interests
6 of financial institutions. If holding companies
7 and financial institutions were the same, this
8 provision and the carefully negotiated
9 market-access provisions and the legislation of
10 Mexico implementing these market-access provisions
11 would be meaningless.

12 And there is additional support under
13 Mexican law for the view that financial
14 institutions are only those entities that are
15 actually engaged in the provision of financial
16 services to the public. I refer the Tribunal to
17 Tab D. I'm returning to Article 7 of the Holding
18 Company Act which designates Tab D.

19 That Article designates as financial
20 entities only those companies that are involved in
21 the provision of financial services. It

10:52:58 1 distinguishes them from holding companies.

2 Second, if I could refer the Tribunal to
3 Tab L.

4 Second, the letter of the President of
5 Mexico transmitting to Congress NAFTA's
6 implementing legislation is quite clear that the
7 nature, that the legal nature of financial entities
8 entails the provision of financial services.

9 I would like to return now to the central
10 question under Article 1416 of whether--

11 ARBITRATOR LOWENFELD: I don't understand.
12 Could you please restate it.

13 MR. PRICE: Yes. This letter indicates
14 the understanding of the Government of Mexico that
15 the legal nature of financial institutions, the
16 legal nature of financial entities, entails, is
17 characterized by the provision of financial
18 services.

19 I would like to return now to
20 Article 1416, and the question of whether or not
21 Mexican law authorizes holding companies to do

10:54:27 1 business as financial institutions, and whether it
2 regulates or supervises holding companies as
3 financial institutions. We submit it does neither.

4 First, holding companies are not
5 authorized to do business as financial
6 institutions. They are merely vehicles for common
7 ownership of financial institutions.

8 By law holding companies are prohibited
9 from carrying out the activities of the financial
10 institutions they own. Their activities are
11 strictly limited to owning shares, issuing
12 debentures convertible into equity, and engaging in
13 very limited short-term borrowing.

14 Financial institutions, by contrast, do
15 much more. They engage in transactions with the
16 public. They take deposits. They lend money.
17 They provide insurance. They provide mortgages.
18 They engage in credit card services, exchange
19 operations, factoring, execute securities trades,
20 act as broker-dealers.

21 The essence of a financial institution is

10:55:34 1 that it provides financial services to the public,
2 and because of these functions, they require the
3 type of prudential regulation that is meant by the
4 phrase "regulated or supervised as a financial
5 institution."

6 Mexico essentially argues that because
7 holding companies are regulated by the same
8 financial authorities that regulate financial
9 institutions, they must themselves be financial
10 institutions. But in our submission, the issue is
11 not who regulates or supervises them. The issue is
12 how they are regulated and supervised. Let us take
13 a look, and we will see that it is the activities
14 of the institutions that dictate the type of
15 regulation or supervision.

16 Now, the essence of financial institutions
17 is, as I have said, that they engage in the
18 provision of financial services to the public.
19 Because financial institutions do engage in those
20 operations, they entail commercial risk to the
21 public. Their stability, that is, the stability

10:56:50 1 and solvency of financial institutions, is
2 important to the well-being and functioning of the
3 financial system.

4 The corollary of engaging in those
5 functions is that these institutions face extensive
6 prudential regulation and supervision of their
7 operations and solvency. Thus, for example,
8 financial institutions face minimum capital
9 requirements, capital adequacy requirements,
10 requirements for deposit reserves or loan loss
11 reserves. They face limits on credit
12 concentration, limitations on related-party
13 transactions. They are examined to ensure they
14 have allocated risk appropriately. There is
15 mandatory credit evaluation for debtors, there are
16 foreign exchange restrictions, there are money
17 laundering regulations, all backed up by specific
18 criminal sanctions relative to financial
19 institutions. They are likewise subject to
20 comprehensive in situ inspection and examination of
21 their policies, books, records relating to their

10:57:58 1 financial service operations with the public.

2 This type of regulation and close
3 supervision of a financial institution's soundness
4 is the hallmark of regulation and supervision of an
5 entity as a financial institution. Critically, no
6 such regulation or supervision is imposed on
7 holding companies merely because they own financial
8 institutions. Indeed, under Article 30 of the
9 Holding Company Act, which I've reproduced at Tab
10 I, under Article 30 of the Holding Company Act,
11 supervisory responsibility for a holding company is
12 given to the agency which supervises the financial
13 institution that is the preponderant member of the
14 group. This reinforces the view that it is the
15 financial institution and not the holding company
16 that attracts regulatory interest as a financial
17 institution.

18 Respondent has not in any of its
19 submissions established and cannot establish that
20 this type of regulatory regime which is applicable
21 to financial institutions exists for the holding

10:59:22 1 company themselves. In our view, this is
2 dispositive of the question before the Tribunal.

3 Now, it has been suggested that because
4 holding companies are required to enter into
5 something called a Convenio, a guarantee agreement
6 in respect of their regulated subsidiaries, that
7 this requirement somehow makes the holding company
8 a financial institution.

9 But let's take a look at the Convenio. A
10 Convenio is basically an undertaking that runs from
11 a controladora to its subsidiaries in which the
12 holding company says that it, the holding company,
13 is liable up to the extent of the assets of the
14 holding company when one of its subsidiaries gets
15 into financial trouble. But this is not prudential
16 regulation. There is no requirement that the
17 controladora maintain a minimum level of assets.
18 The only requirement is 50,000 pesos for
19 incorporation, as for any other company. If the
20 Convenio were the functional equivalent of a
21 capital adequacy or a reserve requirement, then the

11:00:46 1 Banking Commission surely would, before giving its
2 approval to a company, a holding company to become
3 incorporated, ascertain whether or not the holding
4 company had assets sufficient to come to the rescue
5 of the subsidiary, but that doesn't happen. A
6 controladora could have a bank that has a bad loan
7 portfolio of \$20 billion. The only other assets of
8 the controladora could be the shares of the two
9 other financial institutions in its group, which
10 share values could be could be a million dollars
11 each.

12 If the Convenio were true prudential
13 regulation, there would be some requirement that
14 the financial worth of the other two subsidiaries
15 were sufficient to guard against the risks that
16 would be attendant upon the failure of the
17 institution the parent was supposed to rescue, but
18 the holding company isn't regulated that way. The
19 point is, the Convenio is a commitment of limited
20 value and limited recourse. It is limited to the
21 assets of the controladora, the level of which is

11:02:02 1 not regulated. If the Mexican regulators were
2 concerned about the ability of the controladora to
3 safeguard the financial well-being of the
4 institutions it held, they would impose capital
5 adequacy or reserve requirements on the
6 controladora similar to those that they impose on
7 financial institutions.

8 Respondent also suggests that mere
9 ownership of a financial institution is sufficient
10 to transform the majority shareholder into a
11 financial institution itself. This is not the
12 case. Under current Mexican law, any
13 corporation--not just a controladora--any
14 corporation--can own a financial institution, and
15 Mexican financial authorities do not contend that
16 those corporations are regulated as financial
17 institutions or that such regulations are required
18 to protect the public for safety and soundness of
19 the financial system.

20 The point here is that controladoras are
21 not authorized to do business as financial

11:03:22 1 institutions; that is, engage in financial services
2 with the public, and therefore they cannot be
3 regulated or supervised as financial institutions.
4 In our view, a controladora, thus, fails both parts
5 of the test in Article 1416.

6 I would now like to invite my esteemed
7 colleague Judge Schwebel to address the Tribunal on
8 certain policy considerations that ought to be
9 borne in mind when deciding this jurisdictional
10 question.

11 PRESIDENT van den BERG: Judge Schwebel,
12 please proceed.

13 JUDGE SCHWEBEL: Mr. President, Members of
14 the Tribunal, may I conclude the opening
15 presentation of the claimant by stepping back a bit
16 to look at the broader picture, to recall the
17 policies that are the foundation of the sort of
18 proceeding in which we are engaged today.

19 I respectfully suggest that, in
20 considering the jurisdictional issue before you,
21 you may wish to take account of these policy

11:04:32 1 considerations. Whether a wronged investor is
2 enabled to maintain a direct right of action
3 against a host government is no small matter.
4 Whether an investor is entitled to invoke that
5 right in pursuance of a claim of discriminatory
6 treatment is no small matter, and it's a matter of
7 importance to more than the parties to this
8 dispute.

9 As this Tribunal appreciates, NAFTA is far
10 from unique in providing an avenue for the direct
11 arbitral resolution of controversies between
12 foreign investors and host country governments.
13 There are more than 2,000 Bilateral Investment
14 Treaties in force. I'm unaware of any other area
15 of international law and life that has been the
16 subject of so many treaties, and by such a range of
17 states: North, south, east, west. This remarkable
18 accumulation of Bilateral Investment Treaties is
19 complemented by a far smaller but in some respects
20 even more significant number of multilateral
21 investment agreements such as NAFTA. Over 170

11:05:55 1 states are parties to bilateral and multilateral
2 investment agreements.

3 The concordant terms of this extraordinary
4 network of international investment agreements
5 reflect an international consensus on the core
6 rights of foreign investors under contemporary
7 international law. That is conventional, and I
8 would say, customary international law.

9 Now, of particular pertinence to our
10 immediate concerns is that the majority of
11 investment treaties today embody direct arbitral
12 resolution between foreign investors and host
13 states. No longer does the enforcement of treaty
14 obligations depend exclusively on one government's
15 espousal of the claim of its national against the
16 other government. Rather, countries around the
17 world are of virtually every economic and political
18 persuasion accept that direct arbitrable resolution
19 of disputes between investors and host governments
20 is the preferred means of addressing governmental
21 actions that are alleged to contravene the

11:07:14 1 essential legal protections secured by an
2 investment agreement. That modern mechanism of
3 dispute resolution is, of course, the type of
4 proceeding for which we are gathered today. Our
5 presence in this room is unremarkable in view of
6 ICSID's large and burgeoning docket, but what may
7 be remarked on is why this mechanism exists in the
8 first place.

9 A principal virtue of the investor state
10 mechanism for the direct settlement of investment
11 disputes is that it depoliticizes them.
12 Arbitration between the investor and the host
13 government directs the dispute away from the
14 diplomatic arena and towards an impartial neutral
15 forum in which questions at issue may be resolved
16 exclusively on the basis of law. This feature
17 benefits not only the investor, but the governments
18 concerned as well.

19 For the investor, provision for direct
20 investor recourse to arbitration ensures that the
21 investor's case will be heard. The investor need

11:08:30 1 not worry that unrelated concerns may cause its
2 government to decline to bring forward its claims
3 or to compromise them for other objectives.

4 Even if the state-to-state dispute ends up
5 in a third-party arbitral tribunal, it may import
6 political considerations not present in an
7 investor-state arbitral proceeding.

8 For governments, direct investor-state
9 arbitral recourse helps to clear the bilateral
10 agenda. It ensures that the web of issues that
11 characterized diplomatic relations is not
12 encumbered with disputes that at their core are
13 commercial in character. Once channeled down the
14 arbitral track, such disputes need no longer roil
15 relations between governments, nor attract the
16 public spotlight. The outcome of the dispute can
17 remain limited to the particular facts and the
18 particular company involved.

19 There is a third beneficiary of the
20 investor-state arbitral mechanism: The
21 adjudicators. They benefit from having before them

11:09:49 1 the real parties in interest. The matter will be
2 presented by the persons closest to the facts of
3 the dispute. By those, government and investor
4 alike directly involved in the investor
5 relationship which has given rise to the problem.

6 For these considerable reasons, direct
7 investor recourse to arbitration has become the
8 rule in modern investment agreements. There may be
9 exceptions, limited circumstances in which
10 governments believe that special policy concerns
11 justify use of another medium of dispute
12 settlement. NAFTA Chapter 14 is recognized to be
13 one such example. But like many exceptions, it is
14 to be construed carefully, especially when the
15 compelling policy benefits to all parties of direct
16 investor arbitral recourse are at risk if the
17 exception expands beyond its circumscribed
18 boundaries.

19 It's important to secure the policy
20 benefits of direct arbitral recourse to the full
21 right up to the edges of the exception. It's

11:11:11 1 important to ensure that the reach of the exception
2 is not overextended beyond its boundaries.

3 It's submitted that it is no answer to say
4 that one of the delineators of those boundaries,
5 the Government of Mexico, is before you today,
6 enunciating an authoritative view as to where the
7 boundaries lie. The present position of that
8 distinguished party must be reconciled with the
9 boundaries provided for by the terms of NAFTA
10 itself.

11 The parties to NAFTA identified the metes
12 and bounds of Chapter 14. In doing so, they must
13 be understood to have carefully balanced with a
14 long-term view their interests and the direct and
15 effective protection of their own investors on the
16 one hand with their interests on the other hand of
17 shielding governmental measures affecting
18 particular types of investment here, investment in
19 financial institutions from direct arbitral
20 challenge by the foreign investor. That balancing
21 of considerations cannot be reconsidered simply

11:12:41 1 because one party now has the short-term
2 perspective of a litigant anxious to immunize
3 itself from international liability.

4 Now, it's recognized that these policy
5 concerns for the vitality of direct investor
6 recourse to arbitration cannot determine the legal
7 issues before this Tribunal. However, it's
8 submitted that they should be weighed. The value
9 of the investor-state arbitral mechanism is so
10 substantial that it should only be foreclosed when
11 that result is unmistakably required by treaty
12 provision. For the reasons just presented by
13 Mr. Price, we believe that this is not the case
14 today. The respondent's jurisdictional objections,
15 accordingly, should be denied, and claimant
16 permitted to proceed with the full range of its
17 claims. Thank you.

18 PRESIDENT van den BERG: Thank you, Judge
19 Schwebel. I think that completes your presentation
20 by the claimants as far as the opening statement is
21 concerned?

11:13:55 1 MR. PRICE: Yes, it does, Mr. President.

2 PRESIDENT van den BERG: We will recess
3 until 11:30.

4 (Brief recess.)

5 PRESIDENT van den BERG: Mr. Price, your
6 side ready?

7 MR. PRICE: Yes, we are, Mr. President.

8 PRESIDENT van den BERG: Mr. Perezcano,
9 your side ready?

10 MR. PEREZCANO: Yes, sir.

11 PRESIDENT van den BERG: As usual, the
12 Tribunal apologizes for the slight delay, but that
13 was due to the phrasing of the questions.

14 The questions are the following: The
15 first question is of the Tribunal, and I would like
16 to preface this by that the questions should not be
17 taken by any means as prejudging the case or a
18 current state of the minds of the arbitrators of
19 the Tribunal, except for confusion or
20 predisposition in the case. The questions, we
21 would like counsel to simply explore with the

11:47:03 1 witnesses and/or address in the closing statements
2 to the extent that it is developed.

3 Right. Question number one is: What were
4 the reasons why a special Chapter 14 devoted to,
5 "financial services," was included in NAFTA? In
6 connection with this question, you may look in
7 particular to Article 31 and possibly Article 32 of
8 the Vienna Convention referred to by both parties.

9 So, I repeat. The first question was:
10 What were the reasons why a special Chapter 14
11 devoted to, "financial services," was included in
12 NAFTA?

13 Question number two: What are the
14 statutory and/or regulatory differences between an
15 ordinary (holding) company and a financial holding
16 company (sociedad controladora) between records
17 under Mexican law?

18 And a question related to that is: What
19 is the reason for these differences, if any?

20 I will repeat the question.

21 What are the statutory and/or regulatory

11:49:06 1 differences between an ordinary (holding) company
2 and a financial holding company (sociedad
3 controladora) under Mexican law? What are the
4 reasons for the difference, if any?

5 Question number three: Under NAFTA, is it
6 not correct that only companies engaged in the
7 financial services sector in their home country can
8 become a financial holding company (sociedad
9 controladora)?

10 I repeat the question: Under NAFTA, is it
11 not correct that only companies engaged in the
12 financial services sector in their home country can
13 become a financial holding company (sociedad
14 controladora)?

15 MR. PRICE: Mr. President, I'm sorry, the
16 last phrase, "can become a financial"?

17 PRESIDENT van den BERG: Yes, financial
18 holding company, sociedad controladora in Mexico.

19 Question number four: What is the scope
20 of the limitations of Article 16 of the Ley para
21 Regular las Agrupaciones Financieras, and we

11:51:27 1 abbreviated it as the LRAF? In particular--still
2 the same question four--is the offering between
3 records (convertible) those records, bonds,
4 debentures by the financial holding company
5 engaging in financial services to the public, and
6 therefore characteristic for a financial
7 institution?

8 I will repeat the question, so you can
9 check it: What is the scope of the limitations of
10 Article 16 LRAF? In particular, is the offering of
11 (convertible) bonds by the financial holding
12 company engaging in financial services to the
13 public and, therefore, characteristic for a
14 financial institution?

15 Please stop me if you can't keep up with
16 the pace.

17 Question five: What is the influence of,
18 or interaction with, if any, the 1988 capital
19 accord (in particular, paragraph 10) of the Basel
20 Committee: (A) Mexican law, (B) definition of
21 financial institution in Article 1416 of the NAFTA.

11:54:02 1 Question five goes on: The same question for the
2 proposed new Basel accords of January 2001 (in
3 particular paragraph 2). The question is raised by
4 the Tribunal for the information of the parties.
5 In view of what has been said by respondent in its
6 counter memorial in paragraphs 51 through 56, and in
7 the Borja opinion at paragraph 30.

8 So, I will repeat the question: What is
9 the influence of, or interaction with, if any, the
10 1988 capital accords (in particular paragraph 10)
11 of the Basel Committee on: (A), Mexican law, (B),
12 definition of financial institution in Article 1416
13 of NAFTA? And the question then continues, The
14 same question for the proposed new Basel capital
15 accords of January 2001 (in particular paragraph
16 2).

17 Question six.

18 MR. BECKER: Could you just repeat the
19 paragraphs of the--you just said the
20 counter memorial end of witness statement.

21 PRESIDENT van den BERG: Of the United

11:55:57 1 Mexican States. It's 51 to 56, and the Borja
2 opinion at Paragraph 30.

3 MR. BECKER: 30, 3-0?

4 PRESIDENT van den BERG: 30. The proposed
5 new Basel accords is also in the records as well as
6 the exhibits by the respondent.

7 Question six: Would an investment fall
8 under the definition of Article 1416 of the NAFTA,
9 if the same facts applied in a reverse situation:
10 Fireman's Fund Insurance Company is a Mexican
11 company that has acquired debentures of a financial
12 holding company in the United States of America?
13 And, of course, for good measure, we add then and
14 in Canada.

15 I repeat it. Would an investment fall
16 under the definition of Article 1416 of the NAFTA,
17 if the same facts applied in the reverse situation:
18 Fireman's Fund Insurance Company is a Mexican
19 company that has acquired debentures of a financial
20 holding company in the United States of America?
21 And then follow-up question within the same

11:57:46 1 question six: And in Canada?

2 Question seven: Can "rights to do
3 business," as referred to in Article 1416 of the
4 NAFTA includes the situation where a
5 special-purpose company holds the majority shares
6 in other companies that are engaged in rendering
7 financial services?

8 I repeat question seven: Can, "rights to
9 do business," as referred to in Article 1416 of the
10 NAFTA includes the situation where a
11 special-purpose company holds the majority shares
12 in other companies that are engaged in rendering
13 financial services.

14 And then comes the last question.
15 Question eight: Leaving aside narrow definitions,
16 is there a rationale for distinguishing a financial
17 group from a financial intermediary for purposes of
18 investor protection under the NAFTA?

19 I repeat question eight: Leaving aside
20 narrow definitions, is there a rationale for
21 distinguishing a financial group from a financial

12:00:49 1 intermediary for purposes of investor protection
2 under the NAFTA?

3 These are, for the time being, the
4 questions of the Tribunal, and now the Tribunal
5 wonders whether the parties would first want to
6 reflect for a brief moment on the questions before
7 it by the Tribunal before proceeding to the
8 examination of the witnesses.

9 Mr. Price--or do you believe you can go
10 over--we could go on with the examination of the
11 witnesses?

12 MR. PRICE: If you will give me 30 seconds
13 to consult, Mr. President.

14 PRESIDENT van den BERG: Mr. Perezcano?
15 Also to consult?

16 MR. PEREZCANO: I will take the same, 30
17 seconds.

18 (Pause.)

19 PRESIDENT van den BERG: I see counsel for
20 both sides signaling that they are ready after
21 having consulted amongst themselves and with each

12:11:13 1 other, I saw.

2 Mr. Price, what's the position of the
3 claimant in respect of the timing regarding the
4 questions?

5 MR. PRICE: I think we are ready to
6 proceed now.

7 PRESIDENT van den BERG: Mr. Perezcano?

8 MR. PEREZCANO: We are also ready to
9 proceed.

10 PRESIDENT van den BERG: Then we will
11 continue now with the examination of the witnesses.

12 Mr. Mancera, welcome to these proceedings,
13 to this hearing. Could you please give your full
14 name and domicile for the record.

15 THE WITNESS: Luis Mancera.

16 PRESIDENT van den BERG: You appear here
17 as a witness, as a party witness called by the
18 respondent, United States of Mexico and Mexican
19 states. And I understand you are going to testify
20 in the English language; is that correct?

21 THE WITNESS: Yes.

12:12:20 1 PRESIDENT van den BERG: That is a
2 language other than your mother tongue which is, I
3 understand, Spanish.

4 THE WITNESS: Yes, that's correct.

5 PRESIDENT van den BERG: You feel capable
6 and comfortable in testifying in English?

7 THE WITNESS: Yes. I will refer, if I
8 don't understand something specifically.

9 PRESIDENT van den BERG: Could you speak
10 up.

11 THE WITNESS: If needed.

12 PRESIDENT van den BERG: That's my next
13 point. If any questions are unclear because of
14 language or content or other--some other reason,
15 please seek a clarification of the question. If
16 you don't do so, the Tribunal assumes that you
17 fully understood the question.

18 THE WITNESS: Thanks.

19 PRESIDENT van den BERG: I am sure you are
20 familiar with the manner in which the examinations
21 will be conducted in these proceedings because you

12:13:04 1 were there this morning?

2 THE WITNESS: Yes.

3 PRESIDENT van den BERG: So, I don't need
4 to explain it to you.

5 Now, you understand that appearing as a
6 witness before a court or an arbitral tribunal is a
7 serious business, and for that reason the Tribunal
8 requests you to give a declaration which I think is
9 in front of you.

10 THE WITNESS: Yes.

11 PRESIDENT van den BERG: And could you
12 please repeat what is stated in the declaration,
13 and I will read it out to you: I solemnly declare
14 upon my honor and conscience that I shall speak the
15 truth, the whole truth, and nothing but the truth.

16 LUIS MANCERA DE ARRIGUNAGA, RESPONDENT'S WITNESS,

17 SWORN

18 PRESIDENT van den BERG: Thank you,
19 Mr. Mancera.

20 Mr. Perezcano, could you please enter the
21 statement of Mr. Mancera into the record, in the

12:13:57 1 sense that you see the date and signature. I will
2 do that first so you understand what I mean.

3 Mr. Mancera, could you please take in
4 front of you your statement 29 January 2003.

5 THE WITNESS: Yes.

6 PRESIDENT van den BERG: Do you have it in
7 front of you?

8 THE WITNESS: Yes.

9 PRESIDENT van den BERG: Could you turn to
10 the last page of 24. Can you please confirm for
11 the record that's your signature?

12 THE WITNESS: Yes.

13 PRESIDENT van den BERG: Thank you. Then
14 please proceed. You have 15 minutes.

15 MR. PEREZCANO: Thank you, Mr. President.

16 PRESIDENT van den BERG: Counsel examining
17 the witnesses will sit next to the Tribunal, in the
18 wings.

19 MR. PEREZCANO: Thank you very much,
20 Mr. President.

21 DIRECT EXAMINATION

1 BY MR. PEREZCANO:

2 Q. Mr. Mancera, could you explain, please,
3 what comprises the Mexican financial system.

4 A. The Mexican financial system is composed
5 or comprised by a set of laws and regulations, the
6 financial authorities, the different financial
7 entities, and the other entities that enter in
8 close contact with the financial service.

9 Q. What exactly do the financial laws and
10 regulations you referred to regulate?

11 A. They regulate financial entities, the
12 activities, their corporate governance, their
13 relationship at risk or not to the public, and how
14 that risk relates to the soundness and stability of
15 the system.

16 Q. Mr. Mancera, you referred to financial
17 entities. How does the Mexican laws and how do the
18 Mexican laws and regulations define the concept of
19 financial institution?

20 A. There is not a single law that would allow
21 you to answer that specifically. Financial

12:17:21 1 institutions specifically like that, it appears
2 only in one law, and that would be the Condese
3 law, the law for the protection of services of
4 users of financial services. It's a bureau for
5 protection of the users, a consumer bureau. That's
6 the only one that refers to institutions, financial
7 institutions.

8 You have financial entities defined
9 clearly under the Banking Commission law.

10 You have Article 7 of the Holding Act
11 which refers to those entities that are members of
12 a group. It's not a definition.

13 The only one that holds a definition would
14 be the Banking Commission law or that you would
15 refer to it as a comprehensive definition, but it
16 really depends on the type of activity or subject
17 that's being regulated. They have to look at--for.
18 There is new law enacted for savings and loans
19 institutions, for example, lately or for the rescue
20 of the old caja de ahorro.

21 So, it depends on how you look at the

12:18:58 1 different sectors in which you can oversee fully
2 what comprehends all the financial entities.

3 Q. Mr. Mancera, let me see if you could
4 clarify something for me. You referred to--

5 ARBITRATOR LOWENFELD: Would you speak up.

6 MR. PEREZCANO: Yes, I'm sorry,
7 Mr. Lowenfeld.

8 BY MR. PEREZCANO:

9 Q. Mr. Mancera, you referred to Article 7 of
10 the Financial Holding Company Act, the Ley. This
11 is the Ley para Regular las Agrupaciones
12 Financieras; correct?

13 A. Yes.

14 Q. And you referred to the term "financial
15 entities" there. If you could please turn--the
16 claimant earlier on gave us a copy of several
17 documents and excerpts of the law.

18 Do you have a copy of that, or can we
19 provide?

20 A. I have it here.

21 Q. In Tab D, we have Article 7. And you

12:20:11 1 referred to "financial entities." Can you explain
2 the--the claimant has been referring to financial
3 institutions. Can you explain that, please.

4 A. I understand this is an unofficial
5 translation, but the word "entidades financieras"
6 has not been properly translated here. It should
7 read "financial entity."

8 As you can see in the second line, it says
9 "entidades financieras." When you look at the
10 second line of their translation, they're
11 translating it as "financial institution."

12 Now, this is a key issue. I mean,
13 distinguishing between a financial institution and
14 the financial entity and the financial intermediary
15 is going to be key for this.

16 If you do the analogy in which you
17 translate "entity" into "institution," then we are
18 going to get a little bit mistaken about how
19 Mexican law regulates these facts and these
20 entities.

21 Q. So, Mr. Mancera, I note in the following

12:21:45 1 tab that the term "entidades financieras" appears
2 there twice in Tab E. You would disagree with that
3 translation as well?

4 A. Yes. As a matter of fact, this is
5 something that's repeated in their statements where
6 they don't make the distinction between "entity"
7 and "institution."

8 Q. So, how are financial entities comprised
9 in the Mexican financial system?

10 A. The only law that would give you guidance
11 on this, maybe not fully, would be the National
12 Banking Commission law. If I may turn to the law
13 itself, because it's rather important. The law of
14 the Commission has a definition of what they call
15 entidades financieras, "financial entities sector,"
16 or "entities of the financial sector," or
17 "financial entities." They call them either
18 "entities of the financial sector" or "financial
19 entities." In that definition, which is in Article
20 3, paragraph 4 of the law.

21 MR. PEREZCANO: It is the source of law.

12:23:24 1 I don't--I assume it is.

2 ARBITRATOR LOWENFELD: I'm not suggesting
3 it's not admissible. I just want to follow the
4 testimony.

5 MR. PEREZCANO: I will check that for you,
6 Professor Lowenfeld, in a minute.

7 MR. PRICE: Mr. President, we too would
8 like to follow the testimony.

9 PRESIDENT van den BERG: I think that it
10 would be useful, Mr. Perezcano, if everybody is
11 reading the same page, including the claimants and
12 the Tribunal, if we would have a copy of that law.

13 And I think you are referring to the
14 Banking Commission law? That's what you are
15 referring to?

16 THE WITNESS: Yes.

17 MR. PEREZCANO: Mr. President, the text
18 appears at page 14 of the statement given by
19 Mr. Mancera. I believe that's the Article he's
20 referring to. It's page 14 in the Spanish version.
21 I'm sorry, I don't have the page in the English

12:24:59 1 version.

2 PRESIDENT van den BERG: It's page 13, if
3 we go to the English one. That's page 13 of the
4 English.

5 MR. PEREZCANO: Thank you, Mr. President.

6 PRESIDENT van den BERG: Would you please
7 proceed, then.

8 MR. PEREZCANO: I believe I interrupted
9 Mr. Mancera.

10 THE WITNESS: Okay. As can you see,
11 paragraph 4 of Article 3 states that the entities
12 of the financial sector are financial entities, and
13 the first ones to be named are the sociedades
14 controladoras de grupos financieros, financial
15 holding companies.

16 You will also see if we compare this
17 paragraph 4 of Article 3 against Article 7 of the
18 financial group's law, that many of the entities
19 that appear here do not coincide with the holding
20 company's Article 7, the reason being that the
21 holding company sets out what are the entities that

12:26:44 1 can integrate a financial group. Integration of a
2 financial group is not the definition of financial
3 entity.

4 BY MR. PEREZCANO:

5 Q. Mr. Mancera, let me ask you a slightly
6 different question. Can you explain to me what the
7 general responsibilities of the financial
8 authorities are?

9 A. Okay. The financial authorities are
10 divided in basically three sets of
11 responsibilities. I would say governing the
12 entrance, when you get in and out of the game, let
13 me put that in technical aspects, governing the
14 corporation's life through the sole nature of its
15 constitution, its incorporation, its dissolution,
16 its revocation, supervising that, their activities,
17 and also overseeing the soundness of the system.

18 Now, with respect to the first part, it is
19 crucial to understand that the authorization
20 between corporate and financial group or to
21 incorporate a bank or to incorporate a

12:28:22 1 controladora, it's in nature what gives life to
2 that corporation. If you revoke that authority by
3 Minister of Law, the company goes into dissolution.
4 It cannot continue doing, for example,
5 manufacturing cars. In other words, the
6 authorization gives life to the corporation as
7 such, as a financial entity.

8 Q. Mr. Mancera, how do these responsibilities
9 that you were describing relate to the financial
10 responsibilities of the authorities? How do they
11 relate to the financial entities or the national
12 institutions?

13 A. Well, every entity has a different degree
14 of regulation. You might find that the mostly
15 regulated will be probably banks. And then you
16 will go to stock houses or stockbrokers, and you
17 will end up with other intermediaries such as
18 SOFOLES, or these savings and loans, these ASAPS
19 which do not have higher degree of regulation, what
20 would be asset diversification or portfolio
21 management credit risk management. So, there is

12:30:14 1 different degree of regulation of each of these
2 entities, depending on its purpose and its
3 activity, and how they play a role in the system.

4 Q. Thank you, Mr. Mancera.

5 My question was, and this may complement
6 what you just said, how do the responsibilities of
7 the financial authorities relate to financial
8 entities, not just the regulation, but the
9 responsibility of the financial authorities.

10 A. Okay. Well, generally there's--the
11 financial authorities split the responsibility,
12 depending on the type of financial entity and
13 depending on the risk involved. You will see
14 basically the Banking Commission taking over banks
15 and stockbrokers, and then you will see the
16 Insurance Commission over insurance and bonding
17 companies, no?

18 The Bank of Mexico plays a key role in the
19 soundness of the system, whereas the Ministry of
20 Finance generally is the one that allows you to be
21 in the game or orders you to withdraw from the

12:31:39 1 game. It authorizes you to incorporate or to
2 revoke. So, that's basically--

3 Now, some of this might be different. In
4 some cases the Commission authorizes you to
5 incorporate yourself as one of these entities, so
6 there is no specific rule. There are certain
7 divisions of responsibilities.

8 PRESIDENT van den BERG: Mr. Perezcano,
9 one more minute?

10 MR. PEREZCANO: Yes. Thank you, sir.
11 That will be enough.

12 BY MR. PEREZCANO:

13 Q. And do these responsibilities in the
14 regulation that you talked about, to what entities
15 do they apply? Or what institutions do they apply?

16 A. The three of them. The three of them
17 regulate or supervise financial holding companies
18 in the same way that other entities in their
19 different aspects, each special purpose.

20 MR. PEREZCANO: Thank you, sir.

21 PRESIDENT van den BERG: Thank you,

12:32:45 1 Mr. Perezcano.

2 Mr. Price, please proceed with
3 cross-examination. I think also you wish to sit on
4 this side of the table.

5 Mr. Price, we are counting the minutes.
6 But please proceed until 1:00 and then we break.

7 The witness is done under testimony, which
8 means, Mr. Mancera, that you may not discuss
9 everything this--the persons, the party who
10 requested you to be here except this case, meaning
11 there are no testimony. The best thing is simply
12 to go out for lunch on your own.

13 MR. PRICE: I'm sorry, Mr. President. I
14 don't think I understood what you were asking of
15 Mr. Mancera. He's still on the stand.

16 PRESIDENT van den BERG: I'm asking. I'm
17 instructing him that if we break at 1:00, he is
18 still under testimony because we go on at 1:00.
19 You have 60 minutes. I haven't looked at the
20 clock, so he could have 25 to 1:00 or something
21 like that. So 35 still left after lunch, which

12:34:34 1 means that during lunch, Mr. Mancera is under
2 testimony, which means he may not discuss this case
3 with the party that retained him.

4 MR. PRICE: He may not discuss this case
5 with any representative of respondent?

6 PRESIDENT van den BERG: Yeah, because
7 he's under testimony.

8 THE WITNESS: I have a question.

9 PRESIDENT van den BERG: You have a
10 question about that?

11 THE WITNESS: Does this include this type
12 of the table?

13 PRESIDENT van den BERG: Yes. It means
14 you are under testimony. You may discuss
15 everything, whatever you like, except this case.

16 ARBITRATOR LOWENFELD: Have lunch alone.

17 PRESIDENT van den BERG: Or with somebody
18 else, let's put it that way.

19 MR. PRICE: Mr. President, in view of
20 that, would the Tribunal prefer to break now and
21 have our cross-examination uninterrupted? That

12:35:28 1 would be fine with us.

2 PRESIDENT van den BERG: Let's break,
3 then, if that's agreeable with Mr. Perezcano, if
4 that's agreeable to you.

5 MR. PEREZCANO: We're happy to continue,
6 sir.

7 PRESIDENT van den BERG: I think we should
8 go on, then, until 1:00 because we also have
9 redirect afterwards, and the questions of the
10 Tribunal.

11 MR. PRICE: Okay.

12 PRESIDENT van den BERG: Please proceed.

13 CROSS-EXAMINATION

14 BY MR. PRICE:

15 Q. Mr. Mancera, my name is Dan Price. I will
16 be asking you a few questions.

17 Mr. Mancera, how long have you been in
18 your current position at the Ministry of Finance?

19 A. Eight months.

20 Q. And what job did you have immediately
21 prior to this appointment?

12:36:30 1 A. After I was in the presidency, I went to
2 the telecom industry.

3 Q. Thank you.

4 Mr. Mancera, you were not involved--you
5 were not a negotiator of Chapter 14; correct?

6 A. Correct.

7 Q. You were not responsible for the
8 implementation into Mexican law of Chapter 14
9 following the entry into force of NAFTA; is that
10 correct?

11 A. That's partially correct, but yes. I was
12 involved a little bit while I was in the
13 presidency, yes, an attorney there.

14 Q. While you were in the private sector and
15 after NAFTA entered into force, did Mexico appoint
16 you to the panel of arbitrators, to the roster of
17 arbitrators having experience in financial matters
18 to sit on possible Chapter 14 panels?

19 A. No.

20 Q. Mr. Mancera, did you prepare this
21 submission yourself? Did you write it yourself?

12:37:41 1 A. No.

2 Q. Does this letter reflect your personal
3 views?

4 A. No, it reflects the interpretation under
5 an authority of law granted to me that concurs with
6 the interpretation of the Bank of Mexico and the
7 National Banking Commission and all my colleagues
8 that work at my bureau, or the group that
9 immediately worked with me in drafting this
10 dictatum.

11 Q. So, this letter, this letter reflects the
12 views of various financial regulatory authorities
13 in Mexico?

14 A. It contains the opinions expressed by the
15 Banking Commission and the Bank of Mexico, yes.

16 Q. So, is it fair to state that this letter
17 states the position of the Government of Mexico on
18 these issues?

19 A. Yeah, the dictatum sets the interpretation
20 under an article of law that allows us to interpret
21 the Ley para Regular las Agrupaciones Financieras.

12:38:53 1 Q. Let me ask the question again: This
2 letter states the position of the Government of
3 Mexico on these questions of interpretation?

4 A. It states a dictatum under an
5 interpretation of Article 5 of the Ley para Regular
6 las Agrupaciones Financieras.

7 Q. Thank you.

8 In your letter, you state that an entity
9 can meet the definition of Article 1416 if it is
10 one element authorized to do business, period; is
11 that correct?

12 PRESIDENT van den BERG: Mr. Price, could
13 you please refer us to a page.

14 MR. PRICE: Yes. This is pages--I'm going
15 to have to locate it in English.

16 PRESIDENT van den BERG: I'm up to the
17 Spanish text.

18 MR. PRICE: It's Section C of
19 Mr. Mancera's letter.

20 BY MR. PRICE:

21 Q. You state there that it is sufficient to

12:40:16 1 be brought within the definition of Article 1416
2 that an enterprise merely be authorized to do
3 business; is that correct?

4 A. Yes, when that authorization also involves
5 that. When it's withdrawn, you disappear.

6 Q. Okay. But your interpretation is that
7 1416 is satisfied, in part, merely by an
8 authorization to do business of any kind, not
9 authorization to do business as a financial
10 institution; is that correct?

11 A. No, that's a different question. That
12 would be known.

13 Q. That would be known?

14 A. Because I meet the elements that it is to
15 do business as a financial institution. In that
16 specific paragraph it refers to why it happens to
17 be an enterprise.

18 Q. I see.

19 A. So it follows on to mention why it's
20 authorized to do business as a financial
21 institution.

12:41:25 1 Q. So, then you agree that to be within that
2 definition, an enterprise must be authorized to do
3 business as a financial institution?

4 A. Yes.

5 Q. Thank you.

6 Is a holding company authorized to do
7 business as a financial institution?

8 A. Yes.

9 Q. Would you agree that financial
10 institutions can pose a risk to the public?

11 A. Yes.

12 Q. And that is the reason Mexico has
13 prudential regulation and supervision of financial
14 institutions?

15 A. One of other reasons, yes.

16 Q. Are there minimum capital requirements for
17 financial institutions?

18 A. Not in all of them.

19 Q. Are there capital adequacy requirements
20 for financial institutions?

21 A. Not in all of them.

12:42:34 1 Q. Are financial institutions subject to
2 money laundering regulations?

3 A. Not all of them.

4 Q. Mr. Mancera--

5 A. By the way, that is an issue that is being
6 discussed under GAFI, how to incorporate every
7 single one into money laundering provisions.

8 Q. Thank you. How would you, Mr. Mancera,
9 would you characterize minimum capital requirements
10 as prudential regulation?

11 A. In part.

12 Q. Would you characterize capital adequacy
13 requirements as prudential regulation?

14 A. Yes. It's not everything.

15 Q. I understand. I understand.

16 Would you categorize requirements on
17 credit concentration limits as prudential
18 regulation?

19 A. Yes, in banks which--by the way, banks and
20 stockbrokers of all the entities are the only ones
21 that have that.

12:43:56 1 Q. And, Mr. Mancera, would any of those
2 prudential regulations that I've just described, do
3 they apply to holding companies as well?

4 A. No.

5 Q. Thank you.

6 A. It does not in a foreign, and it does not
7 in a savings and loan, and it does not in any other
8 of the financial entities.

9 Q. Thank you.

10 A. The issue at hand is whether or not it is
11 regulated or supervised as a financial entity.

12 Q. I'm sorry, as a financial entity?

13 A. As a financial institution.

14 Q. Mr. Mancera, is there a difference between
15 a financial entity and a financial institution?

16 A. Yes, there is.

17 Q. Mr. Mancera, I would like to hand you
18 something from the record, and the record cite here
19 is C0302, and what this is is a Dictionary of Free
20 Trade published by the Mexican Ministry of the
21 Economy's predecessor. I would like you to read

12:45:16 1 the definition of "financial institution" that's
2 contained there.

3 A. Okay. A financial institution is
4 institucion financiera, entidades financieras,
5 empresa financiera. However, I may add, this is
6 not law.

7 Q. I understand.

8 A. It's from the dictionary.

9 Q. I understand.

10 A. And we have a very specific provision for
11 what "financial entities" is. I've referred to it
12 very clearly.

13 Q. Thank you. I'm aware of what you referred
14 to.

15 Mr. Mancera, may I also refer you to the
16 Holding Company Act, Article 27-A. The record cite
17 is R0438. Mr. Mancera, do you have that?

18 A. Um-hmm.

19 Q. All right. Now, if you will bear with me
20 I will ask you this question: Does Article 27-A
21 define a foreign financial institution as an

12:46:52 1 entidad financiera, a party?

2 A. That's correct, but that's not the only
3 place you are going to find it in the law. You--

4 Q. I understand that, Mr. Mancera.

5 A. If I may.

6 Q. Actually, this is my opportunity to ask
7 questions. And I will--

8 PRESIDENT van den BERG: Mr. Price, I
9 understand it, of course, and the game in town is
10 that you ask the questions and the witnesses
11 answer, but the witness should not be too long.
12 But, nevertheless, if the answer cannot only be a
13 yes-or-no, then there could be some explanation,
14 then the witness would be able to do so.

15 So please finish what you wanted to say,
16 Mr. Mancera, but try to be brief.

17 THE WITNESS: This is not the only
18 provision of a financial law that would use the
19 word "institution." The other provision that uses
20 the word "institution," as I referred, is the
21 Condeseef law. There the financial groups are

12:47:46 1 included within that definition. There is a
2 registry of financial entities in that Condese
3 that you could check on-line. Financial groups
4 appear there.

5 BY MR. PRICE:

6 Q. Thank you, Mr. Mancera.

7 Mr. Mancera, in your statement, you give
8 as an example of regulation as a financial
9 institution, the fact that a controladora must
10 enter into a convenio, but isn't it the case--

11 A. Where are you?

12 Q. It's page 9. But isn't it the case,
13 Mr. Mancera, that there is no requirement that a
14 controladora have assets sufficient to cover the
15 liabilities of the financial institutions in the
16 group?

17 A. That depends on the amount of capital that
18 there is. Currently there is a controladora paying
19 (Speaking in Spanish) IPAB under the convenio
20 responsabilidades for one financial group.

21 Q. But there is no capital adequacy or

12:49:24 1 reserve requirement that ensures that a
2 controladora has assets sufficient to cover the
3 liabilities of the group?

4 A. That's true, as well as it's true that
5 many financial entities, their capital requirement
6 would not be sufficient to cover their activities,
7 in many other cases. The most stringent regulation
8 on that would be the banks. The less would be for
9 foreign or savings and loan. So, that alone would
10 not define whether or not it's a financial
11 institution.

12 Q. Mr. Mancera, does a controladora have any
13 capital requirement other than the minimum capital
14 of 50,000 pesos that any other corporation has?

15 A. No.

16 By the way, that's not the only reason why
17 you regulate a controladora. A controladora is
18 also regulated because it manages--it manages--the
19 financial entities. It does not only hold capital.
20 In that sense, I refer to Article 15 of the Ley
21 para Regular las Agrupaciones Financieras which

12:50:47 1 clearly states--and maybe I could read it out loud
2 in Spanish.

3 Q. Mr. Mancera, I just want to make sure I've
4 understood you. You said that holding companies
5 manage financial institutions?

6 A. Yes. Let me quote that. It says, Article
7 15, the control of general assembly of shareholders
8 and the administration meetings and of the
9 administration of every single member of the group
10 shall be under one single asociacion controladora.
11 We are not only looking at capital here.

12 Q. Mr. Mancera, I refer you to regulation 18
13 set forth at Tab K.

14 A. Of what law?

15 Q. The holding company law.

16 A. Okay.

17 Q. It's the implementing regulations.

18 A. Okay.

19 Q. That law states clearly, does it not, that
20 it is prohibited for a holding company to exercise
21 management over the operations of the financial

12:52:07 1 institutions, does it not?

2 A. Let me read it. It's 8 or 18?

3 Q. It is at Tab K.

4 A. The paragraph of the law. I prefer to use
5 my Spanish.

6 Q. 18, paragraph three.

7 A. It's not talking about management. It
8 talks about entering into direct business.

9 MR. FLORES: Excuse me, Mr. Mancera,
10 Article 8, not 18.

11 THE WITNESS: Okay. Article 8, I'm sorry,
12 it's 18.

13 ARBITRATOR LOWENFELD: How do you
14 interpret the question?

15 THE WITNESS: Tramitar.

16 ARBITRATOR LOWENFELD: It's not
17 management?

18 THE WITNESS: It's not management. Let's
19 be totally honest. Article 15 is the law. This is
20 secondary regulation, so it would override it, to
21 be very clear. Article 15 of the Ley para Regular

12:53:18 1 las Agrupaciones Financieras talks about
2 management. This talks about gestion and tramites.
3 Tramites, that is when you go before a window and
4 piece of paper and say, "I want this service."
5 That's very different from management.

6 BY MR. PRICE:

7 Q. Mr. Mancera, your conclusion that
8 controladoras manage financial institutions is
9 based on the fact of their majority ownership;
10 correct?

11 A. No, it's based on the provision of law
12 that expressly says that it manages it.

13 If I may, referring to my previous telecom
14 experience, that was subsidiary of a financial
15 group called Banamex, and to be totally honest, I
16 know what management of a financial group knows,
17 and they did manage. If you want me to expand on
18 that, I could.

19 PRESIDENT van den BERG: Please limit
20 yourself to answering the questions. Undoubtedly,
21 counsel for the United Mexican States will explore

12:54:32 1 further with you in redirect.

2 Mr. Price, would you allow a question of
3 Professor Lowenfeld?

4 ARBITRATOR LOWENFELD: I would like to ask
5 a follow-up question to a question that Mr. Price
6 put to you a few minutes ago.

7 He said, or he asked and you answered,
8 that there is no capital requirement for capital
9 adequacy or capital minimum requirement above
10 50,000 pesos for holding companies. You confirm
11 that now.

12 Now, is that just as a matter of policy
13 choice? That is, if you look at Article 30 of the
14 LRAF, which is, I guess, page--Tab I, it says
15 (speaking in Spanish). Does that give you
16 authority to impose a capital requirement, or does
17 that exclude it?

18 THE WITNESS: You could have authority if
19 you want it. It's not under this provision.
20 Article 30 goes on to say that the Commission can
21 establish other prudential regulation, and/or you

12:55:53 1 could issue rules by the Ministry of Finance, if
2 necessary.

3 ARBITRATOR LOWENFELD: Well, you said
4 earlier, yes, it's prudential, and some do and some
5 don't have requirements, capital requirements. The
6 question is: Is there a lack of authority which
7 would suggest that the holding company is a
8 different animal, or is it simply a matter of
9 current discretion as to when you impose these
10 requirements?

11 THE WITNESS: Capital requirements are
12 very different, depending on the entity you are
13 talking about, and it depends on the risks
14 involved.

15 Now, with respect to authority, I would
16 believe there would be authority to issue there.
17 If you require the specific provision, I would be
18 able to get it.

19 Now, that doesn't mean that that would be
20 the only requirement that would treat you as a
21 financial entity. There are many other entities

12:57:01 1 that have just a minimum capital, and that's the
2 only requirement they need, and you could look at
3 the savings and loans and at the special purpose
4 credit vehicles called sociedades financieras de
5 objeto limitado. So, it's not really an ingredient
6 that would allow you to define the concept.

7 Moreover, when you have even the
8 possibility by the Banking Commission to intervene
9 and take the management of a group, that's far more
10 important. The Commission has total authority to
11 take the management of a financial group.

12 ARBITRATOR LOWENFELD: Thank you, sir.

13 PRESIDENT van den BERG: Mr. Price, is
14 this an opportune moment to break or you have five
15 more minutes? I think that's optimum.

16 MR. PRICE: No, that's fine.

17 PRESIDENT van den BERG: Your count is 20
18 minutes I think to now in the questioning, so we
19 will stop for a recess, so you still have 40
20 minutes to go.

21 Mr. Mancera, as I told you before, you are

12:58:17 1 under testimony. So I think we will see each other
2 again at 2:00. Thank you. Adjourned.

3 (Whereupon, at 12:58 p.m., the hearing
4 was adjourned until 2:00 p.m., the same day.)

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AFTERNOON SESSION

2 PRESIDENT van den BERG: Mr. Price. Are
3 you ready? Then I reopen the hearing.

4 Mr. Price, you may continue your
5 cross-examination of Mr. Mancera. You have 40
6 minutes left.

7 BY MR. PRICE:

8 Q. Thank you. Good afternoon, Mr. Mancera.

9 A. Good afternoon.

10 Q. I would like to pick up where we left off,
11 where I think we left off.

12 I understood you to say, Mr. Mancera, that
13 a holding company manages financial institutions;
14 is that correct?

15 A. Yes.

16 Q. And you cited in support of that
17 proposition Article 15 of the Holding Company Act;
18 is that correct?

19 A. That's correct.

20 Q. I would like to direct your attention to
21 Article 15 of that Act and the Tribunal's

14:12:00 1 attention. It's in the record R0432, and I would
2 like you to read the first sentence of that
3 Article, Mr. Mancera.

4 A. The control of the general assembly of
5 stockholders and administration of all of the
6 members of each group should be under the same
7 holding company.

8 Q. Doesn't that mean, Mr. Mancera, not that
9 the administration or rather management is
10 undertaken by the holding company, but rather that
11 the holding company controls? It doesn't manage.
12 It controls; is that correct?

13 A. I wouldn't necessarily read it that way.

14 Q. Well, but there is that troublesome word
15 "de."

16 A. It simply says, you have to have control
17 of the administration.

18 Q. Okay. I would turn, then, to Article 21,
19 record cite R0380, on the law of institution--of
20 credit institutions.

21 A. Talking about banking institutions; right?

14:13:40 1 Q. Correct. It's in the record.

2 ARBITRATOR LOWENFELD: Is it in the
3 hearing binder?

4 MR. PRICE: It is not in the hearing
5 binder. I apologize, Professor Lowenfeld. I
6 hadn't realized until Mr. Mancera's answers that I
7 would be referring to it.

8 BY MR. PRICE:

9 Q. Mr. Mancera, if you could read Article 21.

10 A. All of it?

11 Q. Yes. It's only one sentence.

12 PRESIDENT van den BERG: Can you read it
13 into the record because it would make easier
14 reading of the record. Could you please read it
15 into the record. It's only one sentence or only
16 two lines.

17 PRESIDENT van den BERG: In Spanish,
18 please.

19 THE WITNESS: I have five paragraphs here
20 for Article 21. (speaking in Spanish).

21 Yes. I have Article 21, I have five

14:14:44 1 paragraphs.

2 PRESIDENT van den BERG: But mine, which
3 comes from the record in this case, has only one
4 paragraph consisting of two lines. I don't know,
5 Mr. Price has the same?

6 MR. PRICE: I have the same one. This was
7 submitted by the Government of Mexico.

8 THE WITNESS: I have another publication
9 here, and I'm sure my publication is right.
10 Article 21 has one, two, three, four paragraphs.

11 PRESIDENT van den BERG: Can you please
12 look to your publication. If you go to Article 1
13 of that publication, does it say what is the latest
14 revision of that law?

15 THE WITNESS: This is published by the
16 Commission, and it's the latest.

17 PRESIDENT van den BERG: What's the date?
18 The text says (speaking in Spanish) 23 May 2000.

19 THE WITNESS: From July 2001.

20 PRESIDENT van den BERG: So, you have a
21 more recent version?

14:15:40 1 THE WITNESS: Yes.

2 PRESIDENT van den BERG: Mr. Perezcano,
3 can you repair this lack of time in the records.

4 MR. PEREZCANO: Mr. President, the copy
5 that we have here in the record as part of the
6 documents provided by the Government of Mexico
7 appears to be an earlier version. There was an
8 update afterwards. This is the current law in the
9 year 2000, and I'm terribly sorry for any confusion
10 that this may have caused.

11 MR. PRICE: As it proposes, the first
12 sentence of the new law is the same as the first
13 sentence of the old law.

14 PRESIDENT van den BERG: If that's the
15 case, then I would suggest you pursue the question,
16 but the Tribunal would appreciate receiving the
17 most recent version of this law. And that question
18 is directed to respondent.

19 Please proceed with your question.

20 And if, Mr. Mancera, there is any three
21 remaining paragraphs something which changes the

14:17:36 1 meaning of the first paragraph, please let us know,
2 but let's start, continue with the first paragraph.

3 MR. PRICE: Thank you, Mr. President.

4 BY MR. PRICE:

5 Q. Mr. Mancera, if you could read the first
6 sentence.

7 A. Administration of multiple banking
8 institutions would be tasked to an administrative
9 commission and to an executive director for their
10 respective areas of responsibility.

11 Q. Thank you very much.

12 Mr. Mancera, is a financial group a legal
13 entity?

14 A. Yes.

15 Q. Does it have legal personality?

16 A. Yes.

17 Q. It does.

18 Does the group have officers and
19 directors?

20 A. It acts through the financial holding
21 company.

14:18:34 1 Q. I see. So, the group itself has no legal
2 personality?

3 A. That's correct. As you're talking about
4 not the financial holding company, but you're
5 talking about the concept of grupo itself,
6 integration of the grupo.

7 Q. Right. So, the financial group has no
8 legal personality.

9 A. I want to understand your question
10 correctly, that's fine.

11 Q. Thank you.

12 Is a financial group an enterprise under
13 NAFTA?

14 A. I would have to go back to the definition
15 of "enterprise."

16 Q. We could look at Article 201.

17 A. I wouldn't know. That's a very open
18 definition of "enterprise" for me.

19 Q. Okay. I accept that answer.

20 A. I can tell you there are trusts in Mexico
21 that can be portrayed as being a financial

14:20:05 1 institution sometimes, specifically public trusts.

2 Q. My question had to do with the grupo, but
3 thank you.

4 A. I'm sorry.

5 Q. Mr. Mancera, you cite at note nine, page
6 19 of your letter, a book by a Senor Francisco
7 Borja Martinez. Do you regard this book, this
8 work, as an authoritative source on questions
9 relating to Mexican financial law?

10 A. In some aspects, yes.

11 Q. In respect of controladoras?

12 A. It's a general description of the Mexican
13 financial system. It's a very general description
14 of the Mexican financial system.

15 Q. I see, but one of sufficient authority
16 that the lead authority of the Mexican financial
17 system in a dictamin would cite? Thank you.

18 A. I didn't say that.

19 PRESIDENT van den BERG: No comments.

20 What was your question?

21 MR. PRICE: That was my question.

14:21:22 1 THE WITNESS: I think the dictamin cites
2 are provisions of law. That piece of--that
3 language there is only to provide the policy aspect
4 of the importance of the group.

5 BY MR. PRICE:

6 Q. I see.

7 A. Rather than something that you could call
8 it a principle of law or something like that.

9 Q. Thank you.

10 Mr. Mancera, do you now occupy the same
11 position that Fernando Borja occupied in the
12 Ministry?

13 A. No. The position that he occupies is
14 within my department now. They have merged
15 departments. It used to be banco multiple only.
16 Now I control money laundering, savings, and
17 commercial banking and financial groups. It's a
18 little bit larger.

19 ARBITRATOR LOWENFELD: What is banco
20 multiple?

21 THE WITNESS: Multiple banking

14:22:32 1 institution.

2 ARBITRATOR LOWENFELD: Is it branch banks?
3 I know the words, but it was translated somewhere
4 as a "deposit warehouse." That didn't mean
5 anything to me.

6 THE WITNESS: No. A deposit warehouse is
7 Almacen General de Deposito. That's different.

8 ARBITRATOR LOWENFELD: What is banca
9 multiple? Is it branch banking?

10 THE WITNESS: It's a bank that allows you
11 to provide different services under one roof. We
12 used to have mortgage banking, and we used to have
13 commercial goods banking. When basically mortgage
14 banks merged with other type of credit banks, they
15 called it multiple banking institutions.

16 ARBITRATOR LOWENFELD: Okay.

17 MR. PRICE: Mr. Mancera, I am finished. I
18 will wait here in the event Mr. Perezcano has
19 redirect.

20 MR. PEREZCANO: I have no questions for
21 Mr. Mancera, Mr. President. Thank you.

14:26:37 1 PRESIDENT van den BERG: We have one
2 question for you, Mr. Mancera. At pages--I don't
3 know where it starts--at page 17 and 18 of the
4 original version of your statement, you described
5 the development of banking bajo un solo techo.

6 THE WITNESS: Yes.

7 PRESIDENT van den BERG: There's one very
8 simple question I have there. That apparently is
9 only in the figurative sense.

10 THE WITNESS: Yes.

11 PRESIDENT van den BERG: Because if I look
12 at Article 8, last paragraph of the LRAF, there is
13 (speaking in Spanish).

14 Could you please explain to the Tribunal
15 why that provision is inserted in the law, if you
16 have the concept of bajo un solo techo.

17 THE WITNESS: Okay. Mexico did not adopt
18 what you could call universal service banking as it
19 is now. When you read a little bit of history of
20 how financial groups came to be, it was the answer
21 for universal banking, through an entity.

14:28:10 1 Now, regulation does provide--and let me
2 cite rule six of the financial groups--that the
3 financial entities--I will translate or maybe first
4 in Spanish and than in English. (Speaking in
5 Spanish) Financial entities may claim to be an act
6 as a group once the statutes of the controladora
7 are properly registered in the public records.

8 It means that after it is authorized
9 incorporation, then the entities within the grupo
10 can provide services from one to the other. Now,
11 this excludes the offices of the finance holding
12 company, but you can sell insurance at the bank or
13 the bank can provide credit services to the
14 insurance. This is the only way in which you can
15 interact providing services from one entity to the
16 other. If you're not incorporated as a grupo, you
17 cannot do this by law.

18 PRESIDENT van den BERG: I understand it,
19 the concept is that you have one window where you
20 can sell different things as a bank. You can buy
21 some loans and you can--

14:29:39 1 THE WITNESS: Yes.

2 PRESIDENT van den BERG: --sell insurances
3 at the same time. But the Act itself says, fine,
4 you may do that, except that the Grupo Financiero,
5 the financial holding company, like controladora,
6 may not be in the same building. What is the
7 reason for that information? It is in Article 8.

8 THE WITNESS: Right. The basic reason is
9 that the controladora object is limited to
10 management control and ownership of the entities.
11 And it's precisely through that management in which
12 it would direct each of the entities how to provide
13 services.

14 So, that's the basic reason because its
15 object is limited to that.

16 So, if you read Article 16 and 15
17 together, it has a purpose and that purpose is to
18 manage, control, and issue debentures for the
19 market and use the proceeds of those debentures for
20 the entities.

21 If you were going to use the proceeds of

14:30:58 1 any debentures issues directed to an intermediary,
2 and the intermediary was to loan those proceeds
3 outside of this financial group scheme, that would
4 be a criminal offense under the banking law.

5 So, the purpose there, it's important and
6 how it interacts and how it uses the proceeds gets
7 in the market.

8 PRESIDENT van den BERG: And that
9 connection did not become entirely clear to me what
10 you testified earlier today, the difference between
11 administration and gestion, if I recall it
12 correctly, and you translated, what you just
13 translated in management and question. I don't
14 know exactly translation you used for it.

15 THE WITNESS: It says tramite and gestion.

16 Tramite is the continuous act when you
17 file something. Let's suppose you file for a
18 permit or a license.

19 ARBITRATOR LOWENFELD: Paperwork?

20 THE WITNESS: Paperwork to drive. This
21 refers to the paperwork of getting a financial

14:32:09 1 service. So, you file--so, the finance holding
2 company cannot do in its offices the paperwork for
3 the insurance or the paperwork for the checking
4 account. That's what it refers to. And that's
5 very different--cannot open the checking account in
6 its premises. That's very different than directing
7 the executives that sell mortgage credit and
8 assigned quotas of how much mortgage credit they
9 get or how much insurance, the insurance they sell
10 or how much of the product, financial product.
11 Those quotas are generally assigned by the one that
12 manages and oversees all of the entities.

13 PRESIDENT van den BERG: So, that's where
14 you make the distinction. You mentioned your
15 experience is Banamex.

16 THE WITNESS: I have experience in which I
17 have seen quotas for salesperson are set out in
18 that way.

19 PRESIDENT van den BERG: You mean sales
20 targets?

21 THE WITNESS: Sales targets, yes, and that

14:33:12 1 case was set out by the general director of the
2 financial group.

3 PRESIDENT van den BERG: More on the level
4 of the concept of a group, when an authorization is
5 being given, and does the authorization apply to
6 the entire group or only to the financial holding
7 company, depending probably on which type of
8 authorization you're talking about. But now under
9 the group concept, if you give the authorization,
10 is that only for a financial holding company to
11 function as a group, or does it also apply to the
12 subsidiaries?

13 THE WITNESS: It applies to both. The
14 reason being is that subsidiaries cannot provide
15 services interchangeably without the scheme, and
16 they cannot act under the others' branches. So, if
17 you revoke the group authorization, then it gets
18 dissolved, and then the leasing company has to act
19 on its own.

20 So, it is a vehicle, but it is also a
21 vehicle which is really important for, let's call

14:34:24 1 it, the Mexican answer for universal banking. You
2 could--I mean, categorize it as that way,
3 basically.

4 PRESIDENT van den BERG: Follow-up
5 questions to the parties. Mr. Perezcano, do you
6 have any questions related to the follow-up by the
7 Tribunal?

8 MR. PEREZCANO: No, sir.

9 MR. PRICE: No, Mr. President.

10 PRESIDENT van den BERG: We will dismiss
11 the witness for the time being. Maybe you are
12 subject to recall as a witness, probably tomorrow
13 if at all. Thank you for your testimony.

14 THE WITNESS: Thanks.

15 (Witness steps down.)

16 PRESIDENT van den BERG: I think
17 Mr. Price, the next person is Mr. Fernandez?

18 MR. PRICE: That's correct, Mr. President.
19 We are just bringing him in now.

20 PRESIDENT van den BERG: Mr. Perezcano,
21 you could sit in the wings, but you start first.

14:36:00 1 15 plus 45?

2 MR. PRICE: That's correct, Mr. President.

3 PRESIDENT van den BERG: Mr. Perezcano,

4 you could sit there for the time being.

5 (Pause.)

6 PRESIDENT van den BERG: Welcome,

7 Mr. Fernandez. Could you please state your full

8 name for the record as well as your domicile.

9 THE WITNESS: Eduardo Fernandez Garcia.

10 PRESIDENT van den BERG: Where you're

11 domiciled.

12 THE WITNESS: Well, I work for 25 years

13 at--

14 PRESIDENT van den BERG: I only need your

15 address.

16 THE WITNESS: My address?

17 PRESIDENT van den BERG: Or where you

18 live.

19 THE WITNESS: I live in Mexico City.

20 PRESIDENT van den BERG: Is that clear for

21 the record?

14:38:19 1 You appear here as a witness of fact,
2 called by the claimant in this case, Fireman's Fund
3 Insurance Company.

4 You testify in a language that is
5 different from your mother tongue, which is
6 Spanish, I understand.

7 THE WITNESS: Um-hmm, yes.

8 PRESIDENT van den BERG: Are you
9 capable--do you feel capable and comfortable in
10 testifying in that language?

11 THE WITNESS: Well, I think so.

12 PRESIDENT van den BERG: Okay. But
13 anyway, if a question is unclear because of the
14 language or for some other reason, the Tribunal
15 expects you to seek a clarification of the
16 question.

17 THE WITNESS: Okay.

18 PRESIDENT van den BERG: If you don't do
19 so, the Tribunal assumes that you have understood
20 the question.

21 THE WITNESS: Okay.

14:39:03 1 PRESIDENT van den BERG: Are you familiar
2 with the manner in which witnesses are examined in
3 this case?

4 THE WITNESS: Well, no, not in particular.

5 PRESIDENT van den BERG: Not in
6 particular. Very briefly, you will be asked
7 questions in what is called direct examination by
8 Mr. Price, counsel for the claimant, Fireman's
9 Fund, and that will last approximately 15, plus 45
10 minutes, 60 minutes. We have fun with the
11 mathematics as far as the minutes are concerned.
12 Don't worry about it. It's approximately 60
13 minutes.

14 Then you will have cross-examination,
15 which is that counsel for the respondent,
16 Mr. Perezcano, I assume, will ask you questions, if
17 any, because he has reserved the right to do so,
18 yet, but we don't know whether he will do so. But
19 if Mr. Perezcano asks you questions, there will be
20 a next round that Mr. Price may ask you questions
21 which relate to the questions of Mr. Perezcano.

14:40:07 1 And finally, you will not--you understand;
2 yes? The Tribunal may also ask you questions. If
3 that happens, then again, the lawyers for the
4 parties may ask you questions.

5 THE WITNESS: Okay.

6 PRESIDENT van den BERG: Is the system
7 understood, Mr. Fernandez?

8 THE WITNESS: Yes.

9 PRESIDENT van den BERG: Now, appearing
10 before the Tribunal is serious business, like it is
11 in the state courts, and for that reason we would
12 like to ask you to make the following statement,
13 and I think it is in front of you. I will read it
14 out loud to you, and could you please then repeat
15 it to me and the Tribunal.

16 I solemnly declare upon my honor and
17 conscience that I shall speak the truth, the whole
18 truth, and nothing but the truth.

19 EDUARDO FERNANDEZ GARCIA, CLAIMANT'S WITNESS, SWORN

20 PRESIDENT van den BERG: Thank you,
21 Mr. Fernandez.

14:40:54 1 Mr. Price, you will get the witness
2 statement in the record, as I did this morning.

3 MR. PRICE: Yes, I will, Mr. President.

4 DIRECT EXAMINATION

5 BY MR. PRICE:

6 Q. Mr. Fernandez, good afternoon. I will be
7 asking you some questions, but before I do that, I
8 want to enter into the record the affidavit that
9 you prepared. And so, I'm going to present you a
10 copy of your affidavit and ask you whether or not
11 the signature which appears at the bottom is your
12 signature.

13 A. Yes, it is.

14 Q. Thank you, Mr. Fernandez.

15 PRESIDENT van den BERG: For the record,
16 it's an affidavit dated 6 December 2002.

17 BY MR. PRICE:

18 Q. Mr. Fernandez, thank you for appearing to
19 testify here today.

20 Can you share with the Tribunal your
21 experience both as a regulator with Mexican

14:42:42 1 financial institutions and your experience as a
2 member of NAFTA's negotiating team for Chapter 14.

3 A. Now you want my expertise. I worked 25
4 years as a financial--well, not necessarily a
5 financial regulator of Mexico. I worked 18 years
6 in the Central Bank in the legal department in the
7 first years. Then after I was very close involved
8 with the regulation of the financial sector, and in
9 particular the Central Banking regulations, that
10 the Central Bank issued to the system, to the
11 banks, and other financial institutions.

12 And my last position at the Central Bank
13 was Director of Central Banking Regulations, and,
14 thereafter, I served for six-and-a-half years as
15 chairman of the Banking and Securities Commission
16 of Mexico during April '94 to November, year 2000.

17 With respect to Chapter 14, the financial
18 services chapter of NAFTA, I was appointed by the
19 Governor of the Central Bank at that time,
20 Mr. Miguel Mancera, as representative of the
21 Central Bank at the Working Group level in those

14:44:17 1 negotiations. I headed, indeed represented, the
2 financial authorities in that working group, and at
3 the policy level I report in my work and the
4 improvements to Mr. Guillermo Ortiz, who now is the
5 Governor of the Central Bank during the first part
6 of the Zedillo administration was Minister of
7 Finance.

8 I reported to him at the time NAFTA was
9 negotiating improvements and at the policy level
10 with my participation. He headed a group where
11 decisions and representation of Mexican Government
12 were taken.

13 Q. Thank you. Mr. Fernandez, I want to ask
14 you a somewhat sensitive question. Can you explain
15 for the Tribunal your motivation for becoming
16 involved in this case as a witness?

17 A. Yes, of course. Well, my main motivation
18 is that as I have the knowledge of the facts
19 involving in this claim, when I was Chairman of the
20 Banking Commission. I think that is useful for
21 this Tribunal that I can set the facts straight for

14:45:43 1 the record so that you can make or you can take a
2 further decision.

3 Also, as I know that some NAFTA
4 interpretations are part of the jurisdiction
5 debate, I think that my experience and knowledge
6 about what the Mexican Government thought by that
7 time could be useful for you.

8 Q. Mr. Fernandez, are you being compensated
9 for your testimony?

10 A. No. I expressly asked Fireman's Fund not
11 to compensate me for rendering this testimony.

12 Q. Mr. Fernandez, I want to ask you a series
13 of questions about the legal status of
14 controladoras under Mexican law.

15 To begin with, what is the function of
16 controladoras under Mexican law?

17 A. Well, the main function is to serve as the
18 owner, owners of the holding company or the owners
19 of the shares of the financial institutions that
20 form--that are part of the same financial group.
21 That's the function of a holding company, a

14:47:02 1 financial holding company, according to the Mexican
2 law.

3 Q. Mr. Fernandez, are controladoras
4 themselves financial institutions?

5 A. No, I don't think so.

6 I think that as I explained, the purpose
7 of the holding companies is to be the owners of the
8 shares of the financial institution, and they
9 should not be engaged in financial services to the
10 public. Just to hold the shares of the financial
11 institutions.

12 May I add something?

13 Q. I'm sorry.

14 A. They can perform very limited other
15 activities, but we cannot say that such activities
16 may constitute the holding company's control into
17 other financial institutions.

18 Q. Well, are they authorized to do business
19 as financial institutions?

20 A. No. I do not think that they fulfilled
21 that definition because, as I was saying, I think

14:48:08 1 that the key issue is that if an entity is
2 providing, or not, financial services to the public
3 at large, and that's not the function of the
4 holding companies.

5 Q. Are controladoras regulated by financial
6 authorities?

7 A. Yes, they are regulated because they are
8 part of the financial sector, and they are the half
9 of the group of the financial institutions, so they
10 have to regulate it, and they have to be supervised
11 by the financial authorities.

12 Q. And what, in your view, is the principal
13 purpose of the regulation of controladoras?

14 A. The principal purpose of the supervision
15 of the Banking Commission is to verify that these
16 holding companies are not engaged in financial
17 services to the public. I think that's the main
18 purpose of their role--and supervision.

19 Q. Are controladoras subject to prudential
20 regulation?

21 A. Well, probably there is, we would say, a

14:49:32 1 question in determining if the regulation that the
2 financial authorities impose on holding companies
3 or controladoras is prudential regulation. I don't
4 think that according to the wording generally
5 accepted between regulations, that kind of
6 regulation is prudential regulations because
7 prudential regulation is referred generally to the
8 risk that a financial institution is taking in
9 front of the public.

10 And even though you may call prudential
11 regulations some kind of regulations that may exist
12 at the holding company, I do not think that they
13 qualify those regulations as prudential. They are
14 regulations, not prudential regulations in the
15 wording generally accepted by regulators.

16 Q. Do controladoras present risks to the
17 public at large?

18 A. Not at all. They are prohibited to
19 present those risks.

20 Q. It has been suggested that the convenio
21 that a controladora is required to enter into is a

14:50:46 1 form of prudential regulation.

2 A. No. I don't think so. The prudential
3 regulation, as its name suggested, is trying--is
4 designed to prevent that a particular financial
5 institution may face risk that put in danger its
6 health, its liquidity, its solvency. It's
7 prudential, it's before. The convenio is triggered
8 in the case of the Mexican law after there are
9 significant losses in the financial institutions,
10 and then we would say the assets of the holding
11 company in other intermediaries they have to sell
12 to become part of the capital of the troubled
13 institution, but the size of the assets of the
14 holding company and other terms may not be related
15 at all with the risk involved in a particular
16 institution in trouble.

17 Let's say in a particular financial group
18 in Mexico, you may have, for example, a bank with
19 assets and liabilities, let's say, about
20 \$3 billion, and you may have a holding company with
21 other assets; that is, shares of other institutions

14:52:17 1 or some investment that may be worth no more than
2 \$2 million.

3 So, what's the relationship between \$2
4 million and a big loss of \$10 billion? Nothing.
5 And the holding company may be at the top of a bank
6 that big and other very small entities.

7 So, the capital that exists in the other
8 entities is not related at all with the risk that
9 may be involved in a particular financial
10 institution of the same group.

11 Q. So, in deciding whether a controladora may
12 be incorporated, in your experience, and to your
13 knowledge, the regulators do not look to see that
14 the assets of one financial institution are
15 sufficient to offset the losses that might be in
16 another financial institution?

17 A. You're right. There isn't any
18 relationship between the investment made by a
19 controladora in one institution and the risk and
20 the size of other institutions of the same group.
21 There is no such relationship.

14:53:36 1 Q. As a general matter, Mr. Fernandez, when
2 regulatory authorities, financial regulatory
3 authorities want to regulate as a financial
4 institution, is it customary to impose certain
5 capital adequacy or other financial requirements?

6 A. Yes, it's generally accepted that if you
7 work in front of the financial institution, there
8 should be prudential regulations. One typical
9 prudential regulation particularly to banks,
10 security firms, insurance companies, capital
11 adequacy, but not in all cases do you establish
12 capital adequacy. There could be other kinds of
13 prudential regulations for other kinds of financial
14 entities.

15 The capital of adequacy, the provisions,
16 reserves, et cetera, are typical prudential
17 regulation, but is not the only way to establish
18 prudential regulation, no?

19 Q. Mr. Fernandez, if controladoras are not
20 financial institutions, why are they regulated by
21 the Central Bank?

14:54:50 1 A. Well, they are regulated because the law
2 permitted on the very limited basis that they issue
3 bonds convertible into shares, and they receive
4 short-term loans, okay? That should be payable in
5 the short term, so that those loans be converted
6 also into capital.

7 So, it's a kind of bridge loan to capital.
8 Why? Because the healthiness of the holding
9 company is important, because if the holding
10 company does have, or should have, let's say, large
11 debts, then that may establish or create some
12 pressure to the financial institutions affiliate to
13 such holding company because they will have through
14 the dividends sent money, sent funds to the holding
15 companies so that these can pay these large amount
16 of debt.

17 So, is not, we would say, in principle
18 permitted, or the Central Bank will not permit a
19 holding company to take large debts in relationship
20 of the institution--the financial institutions that
21 form part of that group and will impose

14:56:14 1 requirements so that those funds will be converted
2 into the shares or the long term--or the short-term
3 loans will be payable in a healthy manner. That's
4 why the Central Bank is involved in those
5 transactions.

6 Q. Would you say that the Central Bank is
7 regulating that controladora as a financial
8 institution?

9 A. No. No, no, no. It's regulating the
10 holding company because they want to preserve, or
11 the Central Bank wants to preserve the healthiness
12 of the holding company, and for that reason, the
13 law and the Central Bank establishes some kind of
14 regulation. But it's not regulating the holding
15 company as a financial institution. It's
16 prohibited to operate as financial institution.

17 Q. Thank you.

18 It has been suggested that controladoras
19 provide financial services indirectly. Do you
20 agree with that?

21 A. Could you repeat that question?

14:57:17 1 Q. Yes.

2 It has been suggested that controladoras
3 provide financial services indirectly and are
4 therefore financial institutions?

5 A. No, no, no, no. Well, I don't agree with
6 that concept. Do you provide financial services?
7 Are you providing financial services, or you are
8 not providing financial services? Are you
9 financial institution or you are not financial
10 institution? In the Mexican law that concept does
11 not exist.

12 Q. The concept of indirect provision?

13 A. The concept of indirect.

14 Q. Does the fact that controladora holds a
15 majority of shares in a financial institution, does
16 that mean that the controladora manages that
17 financial institution?

18 A. No, no. No, because they are totally
19 independent between the two entities. The holding
20 company has its own board, its own regulation, and
21 its own legal life--we would say that.

14:58:24 1 And the financial entity's affiliates have
2 its own board, its own management, its own
3 commitments, and its very different
4 responsibilities of being, for example, a member,
5 for example, being a member of board of directors
6 of a bank and being member of a board of directors
7 of a holding company because the holding company is
8 not operating with the public.

9 ARBITRATOR LOWENFELD: Could the same
10 person be a member of both?

11 THE WITNESS: Yes, but even though they
12 are the same person, the responsibilities of such
13 person is different in any case.

14 By the time you are appointed member of
15 the board of directors, you are not representing
16 the company. You have a personal appointment as
17 member of the board of directors, let's say, in
18 this financial institution, the bank, and then the
19 law imposes upon you a lot of responsibilities,
20 different than those may be imposed to a member of
21 a controladora.

14:59:25 1 ARBITRATOR LOWENFELD: Well, excuse me,
2 but isn't a director of the bank representing the
3 shareholders, and the shareholder is the
4 controladora?

5 THE WITNESS: The director? A member of a
6 board?

7 ARBITRATOR LOWENFELD: Yes.

8 THE WITNESS: The member of a board is
9 appointed by the controladora, but at the moment
10 that he accepts that appointment, he has
11 responsibilities as member of the board of the
12 bank, independently that he has been appointed by
13 the controladora. He's representing in some way
14 the, obviously, the interest that the controladora
15 has in that affiliate, but the responsibilities are
16 very different.

17 PRESIDENT van den BERG: Subject to also
18 that aspect, the controladora appoints the
19 director, can also dismiss the director?

20 THE WITNESS: What you say? Sorry? I
21 didn't understand.

15:00:18 1 PRESIDENT van den BERG: You just said
2 that the controladora appoints the director.

3 THE WITNESS: Appoints the member of the
4 board--

5 PRESIDENT van den BERG: Member Of the
6 board.

7 THE WITNESS: Or some of them.

8 PRESIDENT van den BERG: They can also
9 fire the member of the board.

10 THE WITNESS: You are right.

11 PRESIDENT van den BERG: So, if--would it
12 then be fair to say if the financial institution,
13 in your terminology, does not follow the policies
14 of the holding company, that may be the end of the
15 career of this board member?

16 THE WITNESS: Yes. In the sense--

17 PRESIDENT van den BERG: At least that--

18 THE WITNESS: In the sense that it is the
19 owner. In the sense that it is the owner, you are
20 right, but only in that sense.

21 PRESIDENT van den BERG: I understand.

15:00:59 1 Mr. Price?

2 BY MR. PRICE:

3 Q. In this respect, though, Mr. Fernandez, a
4 controladora, which is a majority shareholder in a
5 bank no more manages that bank than a majority
6 owner of any other company manages that company.

7 A. You're right. Yes, that's true.

8 Q. Mr. Fernandez, it has been suggested that
9 the power of intervention--the power to intervene
10 at the controladora level means that controladoras
11 are financial institutions, or that they are
12 regulated as financial institutions.

13 A. Well, what happened is that intervention
14 is usually contemplated in our laws for financial
15 institutions, and probably that's why these
16 situations can be created. But the reason why the
17 power of intervention of the government is
18 established in the Mexican law is to assure that if
19 a financial institution affiliate or subsidiary of
20 the same group has to be declared intervened, then
21 we do not have legal contradiction between the

15:02:33 1 powers that may have the controladora as owner of
2 this financial institution, and the intervention of
3 this financial institution that by virtue of law
4 determines that the intervenor takes the whole
5 management of these financial institutions in
6 control.

7 So, you have to set probably the managers
8 for the same institutions, so that would be a mess.
9 That's the reason why it is necessary to establish
10 the possibility to intervene the holding company.

11 Q. Mr. Fernandez, are you aware of any
12 situation where the controladora itself has been
13 intervened but not any of the financial
14 institutions below it?

15 A. No. I do not know any case, or at least
16 during the time that I served for the Banking
17 Commission, and it was the time where interventions
18 took place in Mexico. I don't quite remember.
19 There wouldn't have been recent ones. The
20 controladora is a vehicle, and the financial
21 institutions are the ones that are really important

15:03:42 1 for the payment system, for the health of the
2 banking system or the financial sector. So, you
3 have to intervene this, the affiliates, and then
4 you intervene the controladora where at the same
5 time I haven't seen the intervention of a
6 controladora that would intervene in the
7 financial--any of the financial institutions.

8 MR. PRICE: Thank you.

9 ARBITRATOR LOWENFELD: Could I just follow
10 up that question. What about the reverse of the
11 question that Mr. Price asked; that is, that the
12 financial institution was intervened, and the
13 controladora was not? Have you seen that, sir?

14 THE WITNESS: Well, if it happened in
15 Mexico, but let's say for practical purposes, the
16 answer would be no. In both cases there should be
17 an intervention. But what happened is that as
18 FOBAPROA, which was in Mexico the institution for
19 protecting the depositors, okay, through some
20 supports to control--through supports of the Board
21 of Directors of controladora sometimes could happen

15:04:53 1 because the government have legal control of the
2 board of directors and sometimes the interventions
3 were not made in both levels, I would say. But for
4 practical purposes, it was intervened in both sides
5 of the question.

6 BY MR. PRICE:

7 Q. Mr. Fernandez, before we leave this
8 subject of controladoras and Mexican regulation, I
9 want to put to you the question that is before the
10 Tribunal: In your view, is a controladora
11 authorized to do business and regulated and
12 supervised as a financial institution under Mexican
13 law?

14 A. No, I don't think so. I think that it's
15 authorized to do business, but the business is
16 limited to own the shares of the financial
17 institutions. Some other very specific limited
18 activities, but not to provide services to the
19 public, then I do not think it's a financial
20 institution, according to Mexican law.

21 Q. And neither is it regulated or supervised

15:06:06 1 as a financial institution?

2 A. It's regulated and supervised, but not as
3 financial institution because, by nature, it cannot
4 be a financial institution.

5 PRESIDENT van den BERG: The question was
6 slightly leading.

7 BY MR. PRICE:

8 Q. Mr. Fernandez, I would like to move on to
9 the subject of NAFTA and the legal status of
10 controladoras under NAFTA.

11 You participated in the negotiation of
12 Chapter 14. The Tribunal this morning asked a
13 question which I would like to pose to you, which
14 is, what are the reasons--what were the reasons for
15 special Chapter 14, and if I could ask in your
16 answer, could you explain whether controladoras
17 were meant to be regulated in that chapter as
18 financial institutions?

19 A. Well, there was preoccupation, we would
20 say, at the level of the financial authorities of
21 the three countries--Canada, U.S., and Mexico--that

15:07:28 1 the financial institutions in case of may have a
2 claim or whatever, the financial authorities of
3 each country could revise the merits of such claim
4 and determine if, indeed, we were in front of a
5 prudential regulation that tried to prevent risk in
6 the financial institutions with the public, or we
7 were in front of a valid claim of an investor.

8 So, as prudential regulation may affect or
9 the regulation may affect the investor in some
10 cases, because if you determine, for example,
11 reserves in a bank, the investors may say, well,
12 now my investment value is less than the original
13 investment, then he may try to claim that situation
14 in front of, for example, a panel or whatever, and
15 the financial authorities have the preoccupation
16 that this was not something that, indeed, should be
17 a valid claim because that's our general
18 established prudential regulation, or because this
19 particular financial institution may have problems,
20 this is special requirements for reserves or other
21 measures that have to be taken in a particular

15:08:54 1 financial institution, and that shouldn't be a
2 valid claim.

3 So, let's say that the Mexican
4 authorities, the U.S. and Canada authorities, for
5 instance, will desire to revise that situation and
6 to determine if the investor of our country have
7 merit to present the claim against the other party.
8 That was, we would say, so the financial
9 authorities want to carve out all the regulations
10 that by its nature are proper for financial
11 institutions, and that that kind of a situation be
12 treated in a special way with the participation of
13 the financial authorities.

14 Q. Mr. Fernandez, in your view, does that
15 rationale, does that motivation apply to
16 investments in controladoras?

17 A. No, because controladoras are not
18 operating with the public at large. They are not
19 engaged in financial services with the public. So,
20 for me that rationale was not there in the
21 financial holding companies that the Mexican law

15:10:07 1 regulates or provides.

2 Q. So, when you were negotiating NAFTA,
3 Chapter 14, and the special rules for financial
4 institutions, was it your understanding and intent
5 that they would apply to controladoras?

6 A. No, it was not a worry at all, only to
7 financial institutions where prudential regulation
8 in these terms the understanding that we have the
9 regulators would apply.

10 Q. I want to ask you one more question,
11 Mr. Fernandez, not about NAFTA. I'm going to go
12 backwards because I see there was a question of the
13 Tribunal that you may be able to shed some light
14 on.

15 The Tribunal asked whether or not the
16 offering of convertible bonds by a holding company
17 is equivalent--whether the offering of those bonds
18 is equivalent to engaging in financial services to
19 the public, and therefore characteristic of a
20 financial institution.

21 A. No, no, no. No, because that's not

15:11:29 1 exclusive of financial holding companies, and any
2 issuer in the stock markets, in the markets in
3 Mexico may issue bonds in the public. That doesn't
4 consider that issuer a financial institution. It
5 is something that is not related.

6 Q. Thank you, Mr. Fernandez. I'm going to go
7 back to NAFTA for a moment.

8 A. Let me complete this thing. If, let's
9 say, in one side of the balance sheet, we may have
10 this issuance of bonds to the public, and in the
11 other side we have financial activity that consists
12 in making loans or whatever to the public, then we
13 would be in front of a financial institution. In
14 Mexico there are some examples of listing
15 companies, factoring companies that issues--that
16 they may be issue bonds in the market, but in the
17 asset side they have financial activity with the
18 public. If you only have the liability side with
19 the issuance of bonds, that company be determined
20 to say that this particular entity is a financial
21 institution. I don't know if I was clear.

15:13:02 1 Q. Thank you, Mr. Fernandez.

2 I want to ask you a couple of questions
3 that go to some historical facts, and I will try
4 ask these questions in such a way that their
5 relevance to the preliminary question, is evident.

6 Mr. Fernandez you were involved in the
7 Recapitalization Program of BanCreceer; correct?

8 A. Yes.

9 PRESIDENT van den BERG: I have a question
10 simply on this point.

11 MR. PRICE: Yes, please.

12 PRESIDENT van den BERG: The rescue plan
13 that applied to the holding company or the banco
14 BanCreceer?

15 THE WITNESS: No.

16 PRESIDENT van den BERG: Or to both? To
17 the grupo.

18 THE WITNESS: In the rescue plan--or the
19 purpose of the rescue plan was mainly to protect
20 the savings and the public that have invested in
21 the deposits at the level of the bank, and the risk

15:14:11 1 of the security firm that were part of the same
2 group, but to make the investment for the rescue
3 plan, it was envisaged to keep a holding company so
4 that the holding company may keep the bank and the
5 security firm, but that was a question that was not
6 finally solved, but it could be done only at the
7 level of the bank, which was, by that time, our
8 main preoccupation.

9 PRESIDENT van den BERG: But simply to
10 follow up, Mr. Price, if I may.

11 MR. PRICE: Yes.

12 PRESIDENT van den BERG: The rescue plan,
13 that would have been the result of the grupo.

14 THE WITNESS: Yes. Of course, of course.
15 And indeed--

16 PRESIDENT van den BERG: How would it then
17 have been restructured?

18 THE WITNESS: You could liquidate the
19 financial group, the holding, okay, and then you
20 recapitalize only the bank. And indeed, as far as
21 I remember, there was a structure of good bank and

15:15:09 1 bad bank, and Fireman's Fund would participate in
2 the good bank that will result from all the process
3 of help to make a clean bank of BanCreceer.

4 PRESIDENT van den BERG: In that context
5 because their bonds are in the holding company, how
6 was it, then, that it would go, in your
7 terminology, to the "good bank"?

8 THE WITNESS: Well, the conversations we
9 have to then recognize that the inversion--the
10 investment they have at the level of the home bank
11 would be recognized in the good bank that would be
12 created. Or let's say those \$50 million would be
13 considered capital of the good bank, but we were
14 requiring to them to put on another additional \$50
15 million, okay? And give an investor for two--at
16 least \$200 million. That was a requirement, so
17 that we--if they meet those requirements, we will
18 recognize the \$50 million that they have in bonds
19 be recognized as capital of the good bank.

20 ARBITRATOR LOWENFELD: Excuse me. Did you
21 say that Fireman's Fund could invest in the good

15:16:29 1 bank? I thought that you could only
2 invest--Fireman's Fund is an insurance company. It
3 can't invest in the bank except through the grupo.

4 THE WITNESS: Well, I think that we will
5 handle that at the moment. Okay, when we have the
6 investor, we have, indeed, the situation where we
7 will help legally to structure the operation.
8 Probably they will have to use another vehicle or
9 they will have to revise it.

10 ARBITRATOR LOWENFELD: Can you grant a
11 waiver?

12 THE WITNESS: No. In principle, NAFTA
13 provides that you would have to have a bank in
14 Mexico. According to NAFTA you have to be involved
15 in banking services in U.S., so we will have to
16 think about the vehicle if the transaction would be
17 completed. But the agreement in principle was
18 that, no?

19 MR. PRICE: If I could clarify something,
20 Professor Lowenfeld, I think the NAFTA provision
21 says if you want to establish or control a bank,

15:17:46 1 you must be a bank, not if you want to invest in a
2 bank.

3 THE WITNESS: Yes, but we will have to
4 revise at the end, for example, which kind of
5 investor they will attract and we would have to
6 revise all the characteristics of the transaction,
7 but you're right about the NAFTA requirements.

8 PRESIDENT van den BERG: Thank you.
9 Please proceed.

10 BY MR. PRICE:

11 Q. With respect to this Recapitalization
12 Program, it was an effort--was it an effort to save
13 the bank?

14 A. What you mean by that? It wasn't--

15 Q. This was an effort to save BanCreceer?

16 A. Yes, of course. That was an effort to
17 save the bank and to avoid intervention, and it was
18 a way of trying to reduce the fiscal cost of
19 cleaning up the balance sheet of the bank. Of
20 course.

21 Q. And how did the governmental authorities

15:18:51 1 deal with the two classes of bondholders?

2 A. Well, what happened is that BanCreceer, as
3 other Mexican banks issued bonds convertible into
4 shares, that after the crisis were not possible
5 because of the situation of the bank to repay all
6 the shares in which they could be converted would
7 be worthless.

8 So, as we were worried about to have a run
9 in BanCreceer--

10 MR. PEREZCANO: I think I'm going to
11 object. These questions are related to the merits,
12 and we have said time and again that we need to
13 focus on the preliminary question at this time. I
14 don't see how this relates to the objection to
15 jurisdiction that's been raised.

16 PRESIDENT van den BERG: The relationship
17 is related to how these holding companies relates
18 to their subsidiaries. That is done--exemplified
19 in this case. So, to that extent, it is relevant.

20 Please proceed, Mr. Price.

21 BY MR. PRICE:

15:20:09 1 Q. How were these classes of bondholders
2 treated?

3 A. I was telling that we were worried about
4 the possible run of BanCreceer because of the
5 weakness of the financial situation, and many
6 people have invested in the individuals mainly,
7 Mexican individuals who invested in these bonds
8 convertible into shares, but the principle that we
9 follow during the banking bailout was try to avoid
10 any failure in the payment of any obligation of the
11 banks. I think that was a general principle with
12 some exceptions. We made some exemptions in banks
13 that we intervened in which case; in some cases we
14 permitted limited losses, we would say, to some
15 creditors of the banks. But BanCreceer was not a
16 bank at that time intervened at all, and we wanted
17 to keep it--to keep the perception in the market
18 that there could be a reasonable plan to avoid its
19 collapse.

20 So, to have converted the shares, the
21 bonds into shares with no value would have created

15:21:31 1 the perception that the financial authorities were
2 no more committed with this kind of principles, and
3 then having a bank intervene and with a kind of
4 failure in the payment of an obligation would be
5 very risky, and you could not negotiate with
6 thousands of people that invested in bonds. They
7 were allocated in the branches of the BanCrecers
8 over the whole country. So, we decided that the
9 cheapest thing, the best thing to do was to repay
10 those bonds. Because any other problem, or the
11 knowledge even in the market that we are not going
12 to fulfill this obligation, and the credit--and the
13 bank holders--bondholders receive the payment, they
14 could have even created an increase in funding of
15 the bank that by that time it was funding a very
16 huge amount of money in the market.

17 So, an increase of one or two points or
18 whatever in the interest rate for that funding
19 would have been much more costly during the time
20 than having to pay these bonds. So, we decided to
21 permit--to permit the bank to do it. We take

15:22:52 1 notice of such payment, the whole financial
2 authorities. We did not impose any sanction to
3 BanCreceer for doing it, okay, and we started
4 negotiations with Fireman's Fund because we
5 thought, well, the other part of those funds
6 belonged to them, the other 50 million, in dollars
7 not in pesos, \$50 million, the others were in
8 pesos, and these were issued and allocated in
9 dollars, and we started negotiations with them
10 trying to convince them to participate in this
11 rescue plan of BanCreceer in the terms I explained a
12 little bit there.

13 Q. Thank you. And you've testified in your
14 statement that you knew that if this plan did not
15 go through you would have to pay Fireman's Fund,
16 and if you didn't pay Fireman's Fund, there could
17 be a claim of discrimination?

18 A. Yes. Indeed, I prepare a document--

19 MR. PEREZCANO: With all due respect,
20 Mr. President, what does this have to do with the
21 merits?

15:24:06 1 MR. PRICE: Can I explain why this is
2 relevant?

3 PRESIDENT van den BERG: This is, indeed,
4 out of scope.

5 MR. PRICE: Well, Mr. President, if I
6 could explain the scope.

7 PRESIDENT van den BERG: Sure, please.

8 MR. PRICE: The issue here, in part, is
9 whether or not the actions taken are regulatory
10 actions of the financial institution or not, are
11 prudential or not, one question.

12 Another question is whether or not in
13 dealing with this matter, the Government of Mexico
14 thought that it was insulated from a claim because
15 it was dealing with an investment in a financial
16 institution or not, and I would like to hear what
17 Mr. Fernandez has to say on that point.

18 PRESIDENT van den BERG: The first part I
19 think is relevant. The second part is not entirely
20 clear to me whether that's relevant what the
21 Government of Mexico thought at that time because

15:25:04 1 you have, as I can see it, neither party has said
2 anything about conduct in relation to the
3 investment of this preliminary question level.

4 MR. PRICE: Well--

5 PRESIDENT van den BERG: But I permit the
6 first one.

7 ARBITRATOR LOWENFELD: What paragraph were
8 you directing yourself to in the witness's
9 statement?

10 MR. PRICE: Paragraph 17.

11 BY MR. PRICE:

12 Q. Mr. Fernandez, if you would like to look
13 at paragraph 17 of your statement, I think those
14 matters are relevant to the jurisdictional issue.

15 PRESIDENT van den BERG: Only to the
16 extent what you presented in the first part. The
17 second part, as far as the Tribunal understands,
18 there is no argument made to this case that is
19 based on the thinking at the time of the Government
20 of Mexico or the authorities of Mexico.

21 MR. PRICE: I think--

15:26:40 1 PRESIDENT van den BERG: You can pursue
2 your questions in relation to the first one, so
3 please proceed.

4 MR. PRICE: Thank you.

5 BY MR. PRICE:

6 Q. Mr. Fernandez, was there--do you have
7 paragraph 17 in front of you?

8 A. Yes.

9 Q. Was there, at the time, a thought that
10 this--that these bondholders were being treated
11 differently because of the requirements of the
12 safety of the financial system and--or was it the
13 case that you had the leverage, as you've
14 indicated, so you thought you would try to keep
15 them in?

16 A. Well, yes. Indeed, what we wanted to
17 achieve is to give Fireman's Fund in the deal,
18 helping the financial authorities to get an
19 investor, and keeping that money, that \$50 million
20 in probably the capital of a new, clean bank. So,
21 that would be good for the government because we

15:27:50 1 would save the immediate payment of those \$50
2 million, okay?

3 Q. Thank you.

4 A. And at the end we will have a better
5 institution with a good foreign investor that
6 probably they will get to this day. That's what we
7 wanted to change.

8 MR. PRICE: Thank you.

9 Mr. Fernandez, thank you very much. I
10 have no more questions for you at this moment.

11 PRESIDENT van den BERG: Thank you,
12 Mr. Price. How much time do you need for cross,
13 Mr. Perezcano, if any? Because you are still at
14 the level of having reserved your rights.

15 MR. PEREZCANO: Yes, Mr. President, I
16 would like to cross-examine the witness, and I
17 would like to reserve the entire amount of time
18 that has been provided for us, one hour.

19 PRESIDENT van den BERG: We will break,
20 and after the break you could ask your questions
21 and reduce it to an hour.

15:29:03 1 Mr. Fernandez, I have to explain to you,
2 you are now under testimony, which means you may
3 discuss anything with Fireman's Fund's insurance
4 company representatives you like except this case.

5 THE WITNESS: Okay.

6 PRESIDENT van den BERG: I suggest you
7 take a cup of coffee.

8 MR. PRICE: Mr. President, how long is our
9 break?

10 PRESIDENT van den BERG: 15 minutes. So,
11 quarter to four we will resume. We have--the
12 Tribunal still wishes to apologize for the late
13 start, but that was absolutely force majeure since
14 Professor Lowenfeld was having a problem with his
15 spectacles because last night he sat on them. So,
16 they had to be repaired.

17 (Brief recess.)

18 PRESIDENT van den BERG: Mr. Fernandez,
19 now you will be cross-examined by counsel to the
20 United Mexican States. Mr. Perezcano, you will do
21 the examination?

15:51:50 1 MR. PEREZCANO: Yes, sir, I will.

2 PRESIDENT van den BERG: Please proceed.

3 MR. PEREZCANO: Thank you very much.

4 CROSS-EXAMINATION

5 BY MR. PEREZCANO:

6 Q. Mr. Fernandez, just to clarify one issue,
7 you were Chairman of the National Banking and
8 Securities Commission in 1999; is that correct?

9 A. Yes.

10 Q. And do you recall the intervention of
11 Grupo Financiero Arca in 1999?

12 A. Grupo Financiero Arca?

13 Q. Yes.

14 A. Well, I recall that it was intervened, but
15 I have not any accuracy about the dates.

16 Q. Well, have you--well, it has come to my
17 attention that it was intervened in January 1999.
18 Do you recall that?

19 A. Well, I remember the intervention, but
20 during my period in the Banking Commission took
21 place, I don't know how many intervention, but if

15:52:47 1 you consider entities, probably 50, 60. I don't
2 know, so...

3 Q. And Grupo Financiero?

4 A. And Grupo Financiero Arca was a very small
5 one. I'm telling a fact. It was very small one.

6 Q. And Grupo Financiero Arca was intervened
7 only at the holding company level, not at any of
8 the subsidiaries. None of the subsidiaries were
9 intervened. Do you recall that?

10 A. No, I don't recall that.

11 Q. You don't recall that?

12 A. No.

13 Q. Do you deny that it was?

14 A. No, but I don't recall that, but I don't
15 know why that's relevant if I recall or not one
16 particular case.

17 Q. Well, you testified earlier on that no
18 companies had ever been intervened at the financial
19 holding company level only.

20 A. Well, if you or your lawyers tell me
21 why--which was the situation of the Casa de Bolsa,

15:53:54 1 the security firm that was the main we would say
2 financial institution of that group, we could
3 probably find the answer there. I assumed that we
4 controlled by supports of Famival, the fund, that
5 it was a key willing to prop up for security firms.
6 I may imagine that we through Famival had previous
7 control of the security firm.

8 So, I'm pretty sure that something like
9 that happened.

10 Q. You're pretty sure that something like
11 that happened?

12 A. Yes. Yes, because I think that's the
13 logic. I don't imagine that we have intervened a
14 holding company, and we have left the financial
15 institution managed, let's say, by its prior--by
16 the prior owners. We have, for sure, taken
17 measures, Famival, I may assume, have supported
18 Grupo Arca, and then took prior control. If you
19 can tell me that the financial institution was
20 managed at the time we intervened the controladora
21 and would permit it would be managed by the private

15:55:11 1 owners, I don't think so.

2 Q. We will get that information for the
3 Tribunal later. Thank you, Mr. Fernandez.

4 Now, you testified earlier that the
5 National Banking and Securities Commission is one
6 of the Mexican financial authorities; correct?

7 A. The Banking Commission?

8 Q. Yes.

9 A. Yes.

10 Q. And you also confirmed that it is charged
11 with regulating and supervising financial
12 institutions; is that right?

13 A. Of course.

14 Q. Is it charged with regulating and
15 supervising financial holding companies?

16 A. Yes.

17 Q. And Grupo Financiero BanCreceer was one of
18 those controladoras; correct?

19 A. Yes.

20 Q. One of those financial holding companies?

21 A. Yes.

15:56:16 1 Q. Now, you have said earlier on that you
2 testified in this proceeding based on your personal
3 knowledge of the facts of this particular dispute;
4 is that correct?

5 A. Yes.

6 Q. And you were directly involved in this
7 case while you worked for the Mexican Government;
8 right?

9 A. Um-hmm.

10 ARBITRATOR LOWENFELD: Say yes or no, sir.

11 THE WITNESS: Yes. Sorry.

12 BY MR. PEREZCANO:

13 Q. And you found it appropriate to testify
14 for the claimant in this case, even though you were
15 involved in it as a government official?

16 A. Yes.

17 Q. And did you inform the Commission that you
18 were giving this testimony for the claimant in this
19 proceeding?

20 A. What do you mean by that?

21 Q. Did you inform the National Banking and

15:57:02 1 Securities Commission, the Commission you
2 previously worked for, that you would be giving
3 this testimony in this case?

4 A. I had no legal obligation to do it.

5 Q. You had no legal obligation to do so.

6 And did you inform any other agency of the
7 Mexican Government that you would be giving this
8 testimony?

9 A. No, I didn't--I don't have any legal
10 obligation to do.

11 Q. Now, in your statement, Mr. Fernandez--

12 A. Let me add something. That's why to avoid
13 any kind of critics I'm not being--I am not being
14 compensated at all for rendering this testimony.
15 Okay?

16 Q. Okay. So, and that is why you did not
17 notify any of agency of the Mexican Government or
18 the Commission?

19 A. I didn't have to do it, and I believe that
20 rendering that testimony before a court that is
21 established according to international agreements

15:58:02 1 and which Mexico is part is something that is not
2 in a conflict of interest of any kind.

3 Q. In your statement, Mr. Fernandez, you
4 referred to a note prepared by the Commission
5 attached to a letter of September 9th, 1999. Do
6 you recall that note?

7 A. Yes.

8 Q. And this note was prepared internally by
9 the Commission?

10 A. This note was prepared internally? Yes,
11 yes.

12 Q. And it was prepared at your instruction;
13 is that correct?

14 A. It was prepared under my instruction, yes,
15 that's correct.

16 Q. And it was meant for internal discussions
17 between the financial authorities; is that correct?

18 A. It was meant, yes.

19 Q. And do you know how it came to be in the
20 possession of the claimant in this proceeding?

21 A. Not at all.

15:58:58 1 Q. And I also note, Mr. Fernandez, in your
2 statement, at paragraph 10--do you have that before
3 you, sir?

4 A. Yes.

5 Q. I note that in your statement that you
6 were very careful to say that you had been shown a
7 document that was in the possession of Fireman's
8 Fund; is that correct?

9 A. Yes.

10 Q. But you did not provide this document to
11 Fireman's Fund?

12 A. No.

13 Q. And you did not provide it either when you
14 were President of the Commission; is that right?

15 A. Of course not.

16 Q. Of course not.

17 I take it that you did not inform the
18 Commission that the Fireman's Fund was in
19 possession of this note after you found out?

20 A. Could you repeat the question?

21 Q. After you found out that this note was in

15:59:53 1 the possession of Fireman's Fund, did you inform
2 the Commission?

3 A. No.

4 Q. And again, I note, Mr. Fernandez, that you
5 are very careful to emphasize--

6 A. It's important to say something. This
7 note was prepared, as you mentioned, for purposes
8 of the financial authorities, but it was shown and
9 agreed in a session where more or less 20 people
10 were present--okay?--by that time in 1999. It was
11 submitted to a consultative committee. So, this
12 was distributed, not we would say, with many people
13 that participated in that meeting, and it was not
14 trying to establish, you would say, what we could
15 call something that is confidential that could not
16 be read by all the members of that consultative
17 committee. We needed for them to know the facts
18 and the position that we have.

19 Q. And that consultative committee,
20 Mr. Fernandez, was comprised of government
21 officials?

16:01:05 1 A. It was comprised, yes, yes, fundamentally,
2 yes.

3 Q. Again, I do note, Mr. Fernandez, that you
4 were very careful to say--

5 A. Well, yes, I'm very careful.

6 Q. --that you had been shown a copy that was
7 already in the possession of Fireman's Fund.

8 A. Well, that's true.

9 Q. And was that because you did not want
10 to--you did not want it to appear that you had
11 given this note over to Fireman's Fund? Was that
12 the reason?

13 A. No, no, because that's the truth.

14 Q. Because that's the truth.

15 Let me turn now to a different subject
16 now, Mr. Fernandez. The law of the Commission--I
17 don't know, Nacional Bancaria y de Valores Comision
18 was enacted in 1995; is that correct?

19 A. Yes.

20 Q. And this is the law that governs the
21 Commission over which you presided; right?

16:02:19 1 A. Yes.

2 Q. And this new law is the legislative
3 initiate of the executive; is that correct?

4 A. Um-hmm, yes.

5 Q. Were you involved in preparing this
6 legislative initiative that was submitted to
7 Congress?

8 A. Yes.

9 Q. And were you involved--well, you know that
10 (Mark) when the Executive submits a legislative
11 initiative to Congress, he attaches generally a
12 document explaining the reasons of that law?

13 A. Yes.

14 Q. Called the Exposition de Motivos?

15 A. Yes.

16 Q. Were you involved in preparing the law
17 Exposition de Motivos as well at that time?

18 A. No, I was not involved because by that
19 time we were facing the collapse of the banking
20 system in Mexico, and then I have to attend more
21 important things we would say, but I trusted a lot

16:03:16 1 in my lawyers, and they revised and they prepared
2 some of the documents regarding that.

3 Q. And these lawyers were working directly
4 under your presidency of the Commission?

5 A. Yes, but it was not a task important at
6 that time to revise that kind of document.

7 Q. It was unimportant to revise a document
8 that the President would submit to Congress?

9 A. The Exposition de Motivos, no, because we
10 were facing, as I was telling you, the collapse,
11 probably the total collapse of the country, okay?

12 Q. But, nevertheless, you trusted your
13 lawyers--

14 A. I have always trusted the people that I
15 have worked with where I have participated in their
16 appointments, yes.

17 Q. Could we turn to the Exposition de
18 Motivos. You will find it--do we have
19 it--Mr. President, can I distribute a set of
20 binders containing the documents that I will be
21 referring to. These are the relevant parts of the

16:04:25 1 laws, the NAFTA, and where they come from the
2 record, it is so indicated.

3 BY MR. PEREZCANO:

4 Q. Do you have the binder, Mr. Fernandez?

5 A. The what?

6 Q. The binder, did you get a copy of the
7 binder?

8 A. Yes.

9 Q. You will find the Exposition de Motivos of
10 the law at Tab 3. Can we turn to that.

11 A. Yes.

12 Q. Would you turn to page two?

13 MR. PRICE: Mr. President, may we know
14 where this is in the record?

15 PRESIDENT van den BERG: It was just
16 represented that it was in the record. Could you
17 please give the exact page.

18 MR. PEREZCANO: I don't believe this is in
19 the record, Mr. President. This is the reasons
20 that accompanied the law that was submitted to
21 Congress for approval. The law that--this is again

16:05:25 1 not evidence. It's a source of law.

2 PRESIDENT van den BERG: As long as the
3 witness has no problem with it and he is familiar
4 with the document, I think there is not an
5 objection to have it in the record. It's part of
6 legal sources. It's ours to interpret the legal
7 sources.

8 If you feel impeded by this, you should
9 have time to examine it and to again ask questions
10 of Mr. Fernandez.

11 MR. PRICE: I understand your ruling on
12 the admission of this document, Mr. President, and
13 obviously I accept it. I would appreciate it if
14 Mr. Perezcano would indicate when he is referring
15 to a document, if it's not in the record or if it
16 is in the record, so we will know.

17 PRESIDENT van den BERG: The first point
18 was that it wasn't in the record, so I think,
19 Mr. Perezcano, is it fair to say it would be
20 helpful both to counsel for the claimant and for
21 the Tribunal to indicate which of these documents

16:08:50 1 is not presently in the record? Obviously Tab 1,
2 the affidavits in the record, Annexes to the
3 affidavits in the record. Exposition de Motivos
4 were apparently not in the records, LANCB is in the
5 record as I remember, and then you got capitulo 14
6 that's of course in the record. Then you have Ley
7 para Regular las Agrupaciones Financieras, that is
8 also in the record; is that correct? It's only Tab
9 3 we are talking about that is not to be found in
10 the record?

11 MR. PEREZCANO: Let me clarify,
12 Mr. President, first of all, I do apologize to the
13 Tribunal, and my counterpart for not having
14 identified these documents as not being on the
15 record.

16 Now, on the other hand, these are legal
17 sources and some of these are the laws referred to
18 the law as they were enforced prior to the law
19 currently in force. As you will see some of them,
20 we are--they are dated back in 1992, but,
21 nevertheless, they are legal sources.

16:08:52 1 Now, again I do apologize, but I also note
2 that Mr. Price referred to the Exposition de
3 Motivos this morning. Mr. Borja has referred to
4 it. Again, those are sources of law, and I'm not
5 sure whether we could properly say they are in or
6 out of the record, they are sources, sir.

7 PRESIDENT van den BERG: But originally
8 when you handed it out the binder that it was in
9 the records.

10 MR. PEREZCANO: I apologize for that, and
11 I will indicate it with clearly from now on. I
12 apologize to both the Tribunal and Mr. Price.

13 PRESIDENT van den BERG: But I will allow
14 Mr. Price the time to explore all this question of
15 the document. Take your time to study it because
16 you may not be familiar with it.

17 MR. PRICE: Thank you. I'm not. Not to
18 belabor this point, Mr. President, the Motivos that
19 we referred to this morning was in the record, and
20 I would just like an understanding because we've
21 got another day, is it the sense that anything

16:08:54 1 that's in the law may be referred to, whether or
2 note it's in the record, and I could use that in
3 argument or otherwise? I just want to get a sense
4 of...

5 PRESIDENT van den BERG: Basically, if it
6 is a legal source, yes, you can do so. If it's
7 something else other than the legal source, it
8 would be at this stage of the proceedings a
9 surprise document. So that would be excluded.
10 Unless parties make applications for whatever
11 reason, exceptional reason you may have, that you
12 say, look, I need this document, obviously that
13 will allow the other side to have sufficient time
14 to study the document.

15 In this case you could consider it the
16 source of law, but you will be caught by surprise,
17 if I may say so, so I will allow you time to study
18 it.

19 MR. PRICE: Prior to redirect?

20 PRESIDENT van den BERG: Yes.

21 MR. PRICE: Thank you.

1 PRESIDENT van den BERG: Mr. Perezcano,
2 you can please proceed.

3 MR. PEREZCANO: Thank you. Again, my
4 apologies.

5 BY MR. PEREZCANO:

6 Q. Now, at page 2, Mr. Fernandez, can you
7 take a look at the second full paragraph there, and
8 would you please read it out loud.

9 A. The second paragraph?

10 Q. The second full paragraph, yes.

11 A. Why don't you read it?

12 Q. Because I'm asking you to read it.

13 A. That's the question?

14 Q. If you would, please.

15 PRESIDENT van den BERG: It starts with a
16 new Commission.

17 THE WITNESS: The new National Banking
18 Commission will have as its purpose--

19 PRESIDENT van den BERG: When you read it
20 out, it's been translated and then you get minutes
21 in the record. That's the point of the exercise.

16:10:37 1 So, please--

2 THE WITNESS: You will have it in fronts
3 of you?

4 PRESIDENT van den BERG: If you read it
5 slowly in Spanish, then everything will be right
6 afterwards. Please continue reading.

7 THE WITNESS: The new National Banking and
8 Securities Commission has as its purpose to
9 supervise and regulate, according to its
10 jurisdiction, financial entities in order to assure
11 their stability and proper functioning as well as
12 to maintain and encourage a balance and healthy
13 development of the financial system as a whole and
14 to protect the interest of the public.

15 (Overlap in translation of question and
16 witness testifying.)

17 Q. --the object of the law in supervising and
18 regulating the financial entities in order to
19 maintain and promote the healthy and balanced
20 development of the financial system as a whole? Is
21 that what that refers to?

16:11:38 1 A. Yes.

2 Q. Would you please, sir, read the next
3 paragraph.

4 PRESIDENT van den BERG: Would you slow
5 down and have mercy with the translator.

6 THE WITNESS: This new Commission will
7 bring together the functions and faculties that now
8 fall under the National Banking Commission and the
9 National Securities Commission, and it will have
10 the scope of including the attributes of all of the
11 institutions of the financial system with the
12 exception of the insurance and bonding sector and
13 the--

14 BY MR. PEREZCANO:

15 Q. Thank you, sir.

16 A. --providing securities sector with all
17 other particularities and specialization--

18 ARBITRATOR CARRILLO: Insurance and
19 bonding.

20 THE WITNESS: Thank you very much. So, in
21 the insurance and bonding sector which is given its

16:13:32 1 particular characteristics and specialization need
2 to be maintained under the supervision of a
3 supervisory organ.

4 PRESIDENT van den BERG: Would you please
5 repeat the question.

6 MR. PEREZCANO: Yes. Thank you, sir.

7 BY MR. PEREZCANO:

8 Q. My question, Mr. Fernandez, was does this
9 reference to all institutions of the financial
10 system include financial holding companies?

11 A. When we are talking about institutions of
12 the financial sector or the financial system, we
13 are talking about also holding companies, financial
14 holding companies.

15 Q. Also financial holding companies?

16 A. Yes, and we are including also rating
17 agencies and many other institutions that nobody
18 could challenge or nobody could say they are
19 financial institutions. A lot of them.

20 Q. Now, Mr. Fernandez, the law itself as
21 enacted and currently enforced defines the term

16:14:41 1 entidades financieras or entidades del sector
2 financiero; is that correct?

3 PRESIDENT van den BERG: Can you refer to
4 the specific Article.

5 MR. PEREZCANO: Yes. The law is at the
6 next tab, Tab 4, which referred to Article 3,
7 Section 4, Roman numeral four.

8 THE WITNESS: What do you mean by that?

9 BY MR. PEREZCANO:

10 Q. I don't mean anything.

11 A. All of them are entities of the financial
12 sector, yes.

13 Q. Or financial institutions; is that
14 correct?

15 A. Well, I don't read financial institutions
16 here, but I don't know where you are reading that.

17 Q. Well, it does say entidades financieras.
18 Is that what it say?

19 A. Here it doesn't say that. Here it says
20 just entities. I don't know what is the actual
21 wording of the law in that part. Here it says

16:15:41 1 entities of the financial sector or entities, where
2 you say financial entities, where does it say that?
3 Probably it's bad, your copy. I think that that
4 was amended, and I know what you're saying, but I
5 note what is in the paper.

6 PRESIDENT van den BERG: Hold on a second,
7 Mr. Perezcano, because we got another piece of
8 legislation which has been entered into the record
9 because what has been just read by you, entidades
10 del sector financiero or entidades, a las
11 sociedades controladoras, et cetera, that is the
12 text you have submitted to the Tribunal as part of
13 the record at the time. But it appears now from
14 Mr. Fernandez that apparently this text has been
15 changed.

16 Is that your testimony?

17 THE WITNESS: I think so. Yes. I recall
18 that there was a change, but I believe that now
19 this part says entidades del sector financiero, or
20 entidades financieras, as he says, but this is not
21 what is in the paper that I have in front of me.

16:16:50 1 PRESIDENT van den BERG: Mr. Mancera,
2 could it be possible that you give a copy of
3 the--apparently you have the latest version of the
4 Act. Would you show that, A, to Mr. Fernandez,
5 first; and then B to Mr. Perezcano; and then C to
6 the Xerox machine for all of us.

7 MR. PEREZCANO: I will produce copies of
8 that for the Tribunal and the other parties.

9 THE WITNESS: The other parts are the same
10 here?

11 PRESIDENT van den BERG: Mr. Fernandez,
12 what you see now in front of you.

13 THE WITNESS: Yes.

14 PRESIDENT van den BERG: We just had a
15 question about this subsection IV of Article 3 of
16 the ley de la Comision Nacional Bancaria y de
17 Valores. Is that the text which has just been
18 handed over to you by Mr. Mancera? Is that the
19 same as the text which was read earlier by
20 Mr. Perezcano?

21 THE WITNESS: Well, yes, yes, I think so.

16:17:43 1 PRESIDENT van den BERG: So, there is no
2 difference in text?

3 THE WITNESS: Well, in this--in these
4 words, entidades financieras.

5 PRESIDENT van den BERG: So it's entidades
6 financieras.

7 THE WITNESS: Yes.

8 PRESIDENT van den BERG: Because the
9 present text doesn't have "entidades financieras."

10 THE WITNESS: I think so, yes.

11 If this is the one who is in force, it's
12 correct what he's saying, but what's the point?

13 BY MR. PEREZCANO:

14 Q. The point is, Mr. Fernandez, for the
15 purposes of the Commission, that you presided over,
16 where controladoras, for every purpose, entidades
17 financieras, or entidades financieras?

18 A. I explain the language of the wording of
19 this kind of paragraphs. This kind of paragraphs
20 in the law, and we use very frequently in the
21 financial laws try to agglomerate, to gather we

16:18:55 1 would say different concepts and try to avoid
2 repetition, unnecessary repetition of law, and they
3 are gathered. But they are gathered here for the
4 purpose to determine that these entities are
5 subject to the supervision of the Banking
6 Commission. This gathering has not the purpose to
7 define what is a financial entity or what is an
8 entity of the financial sector.

9 Moreover, let me explain you this. You
10 have in this catalog, for example, rating agencies,
11 (speaking in Spanish), okay. Nobody, nobody I
12 believe in this room could say that an institution
13 caja de valores is a financial entity, nobody.
14 That's why this article says entities of the
15 financial sector or financial entities. In some
16 cases there are just entities of the financial
17 sector. In some others they are financial
18 institution, and in some cases in many of them are
19 both categories, okay, but not necessarily an
20 institution of the financial sector is a financial
21 entity, okay?

16:20:10 1 And there are here in this paragraph a lot
2 of examples of that. Here you can--they are
3 together we would say a bank's security firms, and
4 we have institutions (speaking in Spanish), credit
5 bureaus; nobody believes that a credit bureau is a
6 financial entity. And it is in the definition.
7 Okay?

8 Q. Well, it is a definition of financial
9 entity for the purposes of this law; is that
10 correct?

11 A. No.

12 Q. It is not a financial entity?

13 A. It is a entity of the financial sector or
14 financial institution for purposes of this law.

15 Okay?

16 Q. Thank you.

17 A. Let me explain.

18 Q. Please.

19 A. To benefits of the Members of the
20 Tribunal.

21 I haven't seen any legislation in which

16:20:58 1 for the same thing we established two concepts if
2 they were the same thing. We have said that
3 entities of the financial sector, and then we
4 would--we listed all of them, or we have said
5 financial entities and we have listed all of them,
6 but if they are the same thing, I haven't seen many
7 laws which establish, we would say, synonymous, all
8 right? I don't think that's the legislative
9 technique that we use--at least in Mexico. If we
10 use both terms, it's because there are difference
11 between both terms. They are not the same. And
12 you can see the list.

13 Q. Yes, I can see the list, and again, the
14 definition for the purposes of this law does
15 contain financial holding companies?

16 A. And contains rating agencies, credit
17 bureaus, and many other companies, and public trust
18 that, for example, the public trust established at
19 the Central Bank that we also supervised in some
20 aspects, yes.

21 Q. That's correct. Thank you, sir, for the

16:22:18 1 explanation.

2 A. Okay.

3 Q. I will turn now to a different subject,
4 Mr. Fernandez. You told us earlier that you were
5 involved in the NAFTA negotiations; is that
6 correct?

7 A. Yes, that's correct.

8 Q. Now, the financial authorities that
9 participated in those negotiations insisted that
10 both services and investment in the financial--in
11 the financial sector be covered under a specific
12 chapter; is that not correct?

13 A. Again, please.

14 Q. Did the financial authorities that
15 participated in the NAFTA negotiations of Chapter
16 14 insist that both investment and services in
17 these financial sectors be covered by a single
18 chapter?

19 A. No. We insisted that the investment in
20 financial institutions be covered in Chapter 14.

21 Q. Okay.

16:23:34 1 A. That was the main preoccupation.

2 ARBITRATOR LOWENFELD: You said "we
3 insisted." You mean Mexico?

4 THE WITNESS: The Three countries, U.S.,
5 Mexico, and Canada. When I said "we," that was a
6 common preoccupation we would say between
7 regulators.

8 BY MR. PEREZCANO:

9 Q. Would all financial institutions be
10 covered by Chapter 14?

11 A. Yes.

12 Q. And Chapter 14 was very carefully
13 negotiated, was it not?

14 A. Well, it was negotiated, I believe, with
15 the proper care, but obviously we have a rush of
16 time at the end, but I believe it was negotiated in
17 good terms for Mexico.

18 Q. In good terms for Mexico. And carefully?

19 A. I think so.

20 Q. And this was because of the sensitivities
21 inherent to financial services in the three NAFTA

16:24:36 1 parties; is that correct?

2 A. Yes.

3 Q. And because financial authorities required
4 the ability to take measures that are specific to
5 the financial sector; is that correct?

6 A. Yes, and in particular to financial
7 institutions. Not necessary the whole financial
8 sector, okay. If you read your own definition that
9 we have in the law of the Banking Commission, there
10 are many institutions that are not financial
11 institutions, and they are part of the financial
12 sector. The main purpose of that chapter was to
13 carve out the powers, the faculties of the
14 financial authorities with respect to financial
15 institutions.

16 And if we--and the concept of financial
17 institution that we had on the table in the
18 negotiation, what that was engaged in financial
19 services to the public. That was the concept.

20 Q. Let me see about that, Mr. Fernandez.

21 Now--

16:25:51 1 A. Because there are the risk of the banking
2 system, the payment system, and the main
3 preoccupations of the Central Bank, and the
4 regulators all over the world.

5 Q. Now--

6 A. Not rating agencies, for example.

7 Q. Well, Mr. Fernandez, can you--can you tell
8 me where in the definition of "financial
9 institution" in Chapter 14--and you have that in
10 the next tab, that's Tab 5 of the binder--where
11 does it include the words "services" to the public?

12 A. Where is it?

13 Q. Article 1416. It's the page identified at
14 the bottom, 14-12.

15 A. Okay. "Financial institution" means? You
16 referred to that?

17 Q. Yes, I did.

18 A. The definition of "financial institution"?

19 Q. Yes, I did.

20 A. Means financial intermediary, it's clear,
21 no? Or other enterprise that is authorized to do

16:27:26 1 business, okay? And regulated or supervised as
2 financial institution. What's the problem with it?

3 Q. It does not contain the words "that
4 provide services to the public," does it?

5 A. Well, but is inherent to the nature of a
6 financial institution to provide services to the
7 public.

8 Q. Well, does it contain the words "to
9 provide services to the public" there?

10 A. Believe me that the regulators that know
11 these matters did not need to clarify that. It's
12 very clear that the financial institution has to be
13 involved in financial services to the public.

14 PRESIDENT van den BERG: The question as
15 such is such very simple. Do the words appear or
16 not in the definition?

17 THE WITNESS: Well, it does not appear.

18 BY MR. PEREZCANO:

19 Q. Thank you, sir. Now, the financial
20 services chapter--

21 A. May I say something?

16:28:22 1 PRESIDENT van den BERG: If you want
2 to--of course, the rules of the game are that you
3 only have to answer the questions, but if you want
4 to give a clarification of a question because I
5 think yes or no is not sufficient, you are free to
6 do that.

7 THE WITNESS: According to my view? I
8 free to do that, or it has to be according to the
9 view--

10 PRESIDENT van den BERG: No, your
11 knowledge of the facts.

12 THE WITNESS: That's what I was trying to
13 do.

14 PRESIDENT van den BERG: Okay, but only
15 yes or no will be sufficient.

16 THE WITNESS: Okay.

17 PRESIDENT van den BERG: But If you want
18 to expound on a point, feel free to do so.
19 Otherwise, I think Mr. Price will redirect and ask
20 you questions later.

21 THE WITNESS: Okay. Then the answer is

16:28:59 1 no, the word "public" word is not here.

2 PRESIDENT van den BERG: But it was
3 understood by all concerned.

4 THE WITNESS: It was understood by all
5 concerned that the financial institutions are
6 involved in--are engaged in financial services to
7 the public.

8 BY MR. PEREZCANO:

9 Q. But you can confirm that those words are
10 not in the text?

11 A. I said no.

12 Q. Okay, thank you.

13 Now, Mr. Fernandez, Chapter 14 regulates
14 more than just services, financial services to the
15 public, does it not?

16 A. What do you mean by that?

17 Q. Well, does it regulate investment in a
18 financial institution?

19 A. Yes.

20 Q. Is investing in a financial institution a
21 service to the public?

16:29:49 1 A. No, no, no.

2 Q. It is not?

3 A. It's regulated the investment in a
4 financial institution, and a financial institution
5 was understood in the terms that I explained.

6 Q. Is investing in a financial institution a
7 service to the public? Yes or no?

8 A. No.

9 Q. Okay. Now--

10 A. An investment in the financial
11 institution, what you say, is a service to the
12 public?

13 Q. Investing in a financial institution.

14 A. No. What is relevant is that the service
15 provided by the financial institution be provided
16 to the public. That's the relevant thing.

17 Q. Mr. Fernandez, investing in a financial
18 institution is not a service to the public, is it?

19 A. No.

20 Q. And investing in a financial institution
21 is regulated by Chapter 14, isn't it?

16:30:41 1 A. Yes.

2 Q. Thank you.

3 A. But it's regulated--let me explain, okay?
4 And to the benefit of the Tribunal, because the
5 nature of NAFTA was regulate in general the
6 investment in the other country territory, so--and
7 the Mexican authority, for example, had the concern
8 at that time that there would be determined in the
9 market share, so the way to determine the market
10 share for these foreign participation was to
11 regulate the investment, and the authorities that
12 were involved in the knowledge of the financial
13 sector were the financial authorities. That is the
14 reason why it was not regulated in other chapters.

15 Sorry to do that clarification, but it
16 seems to be that--

17 PRESIDENT van den BERG: Feel free if
18 you--

19 THE WITNESS: --the question implies
20 something that I think is wrong. That's why I'm
21 clarifying.

16:31:46 1 PRESIDENT van den BERG: Feel free to
2 expound if yes or no is in your opinion not
3 sufficient, but you should not go beyond that.

4 MR. PEREZCANO: I'm okay with that. My
5 only concern is with our time, but I don't have a
6 problem with further--if the witness feels the need
7 to give further explanations.

8 BY MR. PEREZCANO:

9 Q. Now, Mr. Fernandez, can you explain to the
10 Tribunal what does Annex 7 contain, Annex 7 to the
11 NAFTA Roman numeral seven.

12 A. Can you show it to me.

13 Q. Yes. You will find it in that same
14 section further along.

15 A. Different laws note we reserve, isn't it?

16 Q. And it is right after--begins right after
17 page 14-19. Can you explain to the Tribunal what
18 Annex 7 contains?

19 A. The listing of the financial institutions,
20 the listing of the laws that regulate financial
21 activities, the listing of the other activities

16:33:04 1 related to the financial sector that are regulated
2 by law. That is what is contained here.

3 Q. And the listing of Mexico's financial
4 institutions and regulations, that would have been
5 done--that would have been drafted by the Mexican
6 negotiators?

7 A. Yes, yes. Mainly, yes, I think so.

8 Q. And would you please turn a few pages
9 ahead to page 7-M-1. That is the schedule of
10 Mexico that contains the listings that you referred
11 to?

12 A. Excuse me? Again?

13 Q. Is that the list that--the schedule of
14 Mexico that contains the listings that you just
15 referred to?

16 A. Yes.

17 Q. Would you identify--well, you see that it
18 begins there with the term "sector"?

19 A. Yes.

20 Q. And it identifies financial services.

21 A. Yes.

16:34:07 1 Q. Is that the sector that this reservation
2 applies to?

3 A. Well, that's the name of the Chapter 14,
4 so it was to identify what we were referring to,
5 no?

6 Q. Okay. So, the subsector identified that
7 we were referring to, that includes holding
8 companies, sociedad controladora, does it not?

9 A. Yes, I see that.

10 Q. And these are the same sociedad
11 controladoras we have been discussing?

12 A. Yes.

13 Q. And Grupo Financiero BanCreceer would have
14 been one of those sociedades controladoras?

15 A. Yes.

16 Q. And you see a little further down there
17 the measures that are identified? Do you see that?

18 A. Where it says what?

19 Q. Where it says "measures."

20 A. Measures, where is that?

21 Q. Which is one, two--it's the fourth down

16:35:00 1 from the subsector.

2 A. It measures, okay. The law to--the law to
3 regulate holding financial holding companies, yes.

4 Q. The law to regulate financial holding
5 companies; is that correct?

6 A. Yes.

7 Q. And do you see that it refers to Article
8 18?

9 A. Yes.

10 Q. Was that the article in force back when
11 the NAFTA was being negotiated?

12 A. I assume that it is, no?

13 Q. Mr. Fernandez, if you could turn to the
14 next tab, Tab 6--I'm sorry, it's not Tab 6. I seem
15 to have lost my place, but it doesn't matter.

16 The measure contained in Article 18 would
17 have been reflected below in the description?

18 A. Yes.

19 Q. So the Ley para Regular las Agrupaciones
20 Financieras, Article 18, that was in force at the
21 time contained that limitation of 30 percent of

16:36:37 1 common stock in ownership in financial holding
2 companies?

3 A. Yes, yes, yes, yes, yes. Yes.

4 Q. Now, if you turn a few pages, just one
5 other question, Mr. Fernandez.

6 A. But may I clarify again that the
7 investment here, that what we were trying to do is
8 to limit the investment in institutions that were
9 not controlled by holding companies, okay? And we
10 were establishing a limit of up to 30 percent of
11 common stock, so it's--

12 Q. Mr. Fernandez, does this limitation apply
13 to holding companies?

14 A. Yes.

15 Q. And is this reservation to Articles 1405
16 and 1403 of the NAFTA, do you see there under "type
17 of reservation"?

18 A. 14 what?

19 Q. 1405 and 1403.

20 A. Um-hmm, yes.

21 Q. Yes.

16:37:48 1 A. Yes.

2 Q. And this reservation, there was no
3 reservation here to a Chapter 11 provision, is
4 there?

5 A. No, because we were referring only to
6 limited invested--limited investment in financial
7 holding companies or--in this case in financial
8 holding companies.

9 Q. In this case, in financial holding
10 companies, yes.

11 A. Yes.

12 Q. Now, would you turn a few pages forward,
13 please, Mr. Fernandez, to the page identified as
14 Roman 7-M-7.

15 A. Yes.

16 Q. Do you have that?

17 A. Yes.

18 Q. Now, do you recall these Annexes as a
19 former negotiator of the NAFTA?

20 A. Yes.

21 Q. And do you see there that the sector that

16:38:54 1 is identified is also the financial services; is
2 that correct?

3 A. Yes.

4 Q. And the first of these subsectors is
5 holding companies, sociedad controladoras?

6 A. Yes.

7 Q. So, the reservation there, if you turn the
8 page over, the limitation of foreign governments
9 and foreign state enterprises to invest directly or
10 indirectly in holding companies, that was a
11 provision of the law in force that was captured in
12 this Annex?

13 A. Yes.

14 Q. And do you see that under "type of
15 reservation" it is also a reservation to Articles
16 1403 and 1405; is that correct?

17 A. 1403 and 1405?

18 Q. Mr. Fernandez, if you look back at the
19 reservation where it says "type of reservation," do
20 you see there the references to Article 1403?

21 A. Yes.

16:40:44 1 PRESIDENT van den BERG: Same page as we
2 were. The penultimate paragraph.

3 THE WITNESS: Yes.

4 BY MR. PEREZCANO:

5 Q. What was that Article? 1403?

6 A. Establishment of financial institutions.

7 Q. That's right.

8 And it is also a reservation to
9 Article 1405?

10 A. Yes.

11 Q. And what is that Article, sir?

12 A. National treatment.

13 Q. In Chapter 14; is that correct?

14 A. Yes.

15 Q. And there was no reference there to
16 Article 1102 or any other provision of Chapter 11;
17 is that right?

18 A. Yes.

19 Q. You will see, sir, under subsector there
20 several other financial institutions; is that
21 right?

16:41:31 1 A. Again, please.

2 Q. Do you see under subsector that there
3 are--that other financial institutions there are
4 listed; is that correct?

5 A. Yes. We have the holding--financial
6 holding companies, and a lot of financial
7 institutions, yes.

8 Q. Okay. And are those financial
9 institutions included in Article 7 of the Ley para
10 Regular las Agrupaciones Financieras?

11 A. In Article--where is that Article?

12 Q. I could provide you with a copy. I don't
13 have it myself, but--

14 A. Of course, that Article includes the
15 concepts of the holding companies in a group, of
16 course.

17 Q. And it contains--it lists all the other or
18 several of the other financial institutions; is
19 that correct?

20 A. Yes.

21 MR. PEREZCANO: Okay. Thank you,

16:42:29 1 Mr. Fernandez. Mr. President, I have no further
2 questions.

3 PRESIDENT van den BERG: Mr. Price,
4 redirect? Or would you like to have time to study
5 the Exposition de Motivos.

6 THE WITNESS: Yes, we will have redirect,
7 but we would like some time to review the
8 Exposition de Motivos.

9 PRESIDENT van den BERG: How much time do
10 you need?

11 MR. PRICE: 15 minutes.

12 PRESIDENT van den BERG: 15 minutes also
13 for personal care.

14 (Brief recess.)

15 PRESIDENT van den BERG: All right, let's
16 proceed.

17 MR. PRICE: Thank you very much, Mr.
18 President.

19 REDIRECT EXAMINATION

20 BY MR. PRICE:

21 Q. Mr. Fernandez, I have just a few questions

17:01:20 1 for you.

2 Towards the end of Mr. Perezcano's
3 cross-examination, he was asking you questions
4 about how Annex 7 restricted foreign investment in
5 controladoras. Do you remember those questions?

6 A. Yes.

7 Q. Okay. Now, do controladoras own shares in
8 financial institutions?

9 A. Yes.

10 Q. If you wanted to limit foreign investment
11 in financial institutions, couldn't you only do
12 that if you also limited foreign investment in
13 controladoras?

14 A. Of course.

15 Q. Thank you.

16 A. And it's important to clarify that--this
17 for the Tribunal, as the questions were made with
18 respect to Schedule A, it's important to see that
19 Schedule A is referred to investment in holding
20 companies and financial institutions in Mexico but
21 not in a form of a controlling interest.

17:02:29 1 So, we wanted the Mexican Government,
2 that--in case there would be a controlling interest
3 in a financial institution, that controlling
4 interest be representative in the form of a
5 subsidiary or affiliate to a holding company, and
6 not in the form of minor investments that, by other
7 means, may control an institution. So, that's why
8 in Schedule A we establish some limit to
9 investments in holding companies and in financial
10 institutions.

11 But if you look at Schedule B, there we
12 have the market share restrictions for financial
13 institutions that may operate in Mexico. You will
14 not find any single reference in market share to
15 holding companies because, by nature, holding
16 companies are not financial institutions and do not
17 share any market in their operations, so it's
18 irrelevant. The relevant thing is the market share
19 of the commercial banks, the security firms, and
20 insurance company, but you will not see that we
21 tried to establish a market share for holding

17:03:47 1 companies.

2 If holding companies, according to our
3 review, have the nature of financial institutions,
4 we would have limited the market share of such
5 financial institutions, but they have no "market,"
6 by definition. They do not operate with the
7 public. They do not--are not engaged in financial
8 services with the public. That is the reasoning
9 behind this difference between Schedule A and
10 Schedule B.

11 I wanted to clarify this because if all
12 questions referred to Schedule A, you may have
13 impression that, through Schedule A, we were trying
14 to deal with the interest control in Mexican
15 financial institution, and that was not the case.
16 These are minor investors, portfolio investments,
17 but not with the objective of control of the
18 institutions, the financial institutions.

19 Q. Mr. Fernandez, just one or two more
20 questions.

21 You've heard by Mr. Perezcano's questions

17:05:11 1 that Mexico believes that controladoras and
2 investments in controladoras are regulated by
3 Chapter 14 and not Chapter 11.

4 A. Yes.

5 Q. In your opinion, do you think it's in the
6 interests of Mexico for controladoras to be
7 regulated by Chapter 14 or Chapter 11?

8 A. Well, it's obvious that the Mexican
9 officials are sustaining the idea that holding
10 companies or controladoras should be included in
11 Chapter 14--okay?--for many purposes, and
12 particularly the panels for settlement of disputes
13 or whatever. But the transaction regarding, or the
14 negotiations regarding Chapter 14 was focused on
15 financial institutions that provide--that are
16 engaged in services to the public, okay? The
17 controladoras, as are not engaged in that, in our
18 opinion at that time shouldn't be covered by
19 Chapter 14, and we believed that the investments in
20 holding companies, as there is not a link between
21 the holding companies and the risks that are taking

17:06:40 1 the financial institutions with the
2 public--okay?--there is no reason why that
3 carve-out to protect financial institutions should
4 apply to holding companies.

5 Even more, I believe that with our
6 long-term mission, this is not a correct position
7 of the Mexican Government looking for Mexico's
8 interest because Mexico needs to attract
9 investment, and if foreign investment in financial
10 institutions that already has been made in Mexico,
11 they believed that we are changing after the
12 inversion was made, rules or the interpretation of
13 the rules.

14 ARBITRATOR LOWENFELD: The investment?

15 THE WITNESS: Yes, it may harm the
16 credibility of the regulators and the credibility
17 of Mexico. I think the purposes by which we carved
18 out the financial institutions in Chapter 14 has
19 not any relationship with investment in a holding
20 company because the only thing in dispute there
21 could be, I think, if that investment should be

17:08:02 1 paid or not be paid or had been affected. But it
2 will not change at all the nature of the risk or
3 the prudential regulation that covers the risk of
4 the financial institutions of that
5 financial--particular financial group.

6 So, it was--it's not, I believe, in the
7 interest of Mexico to sustain the interpretation
8 that now is on the statement.

9 Q. Thank you.

10 MR. PRICE: Last question, Mr. President.

11 BY MR. PRICE:

12 Q. Mr. Fernandez, Mr. Perezcano suggested
13 that your appearance here today was improper, that
14 you shouldn't be here or you should have informed
15 people.

16 Let me ask you: What was there about the
17 way this foreign investor was treated that made you
18 feel you needed to be here?

19 A. Okay. As I dealt with this issue during
20 the times in which I was president or chairman of
21 the Mexican Banking and Security

17:09:12 1 Commission--okay?--we usually during those crisis
2 times in Mexico, we were involved in negotiations
3 with a great number of foreign participants because
4 we were trying to attract capital to the Mexican
5 banking sector in particular, or in general the
6 financial sector, but in particular the banking
7 sector because the payment system was at risk,
8 okay?

9 So, instead of taking measures like, for
10 example, Argentina, that established--exchange
11 control moratorium and what they called "Corralito"
12 to avoid deposits, we tried to do exactly the
13 opposite, to convince that we market that
14 with--with more participation and attraction of
15 capital to the banks and was feasible to turn out
16 the financial situation of the Mexican banking
17 sector and obviously have a way out from that
18 crisis. That strategy was very successful, but the
19 political battles in Mexico, the political
20 environment changed by the end of '97. By the end
21 of '97, the party that control Congress was the

17:10:45 1 same party of the executive branch. By the end of
2 '97, the control of Congress was no longer of the
3 same party of the executive branch, and that was a
4 situation that persists nowadays, okay?

5 As it happened, obviously the
6 decision-taking process began to suffer a lot
7 because the politicization of the banking bailout
8 and the establishment of some new laws that
9 restricted the capacity of the financial
10 authorities to take decisions and some other
11 issues, limited dramatically that decision-taking
12 process. And I think that that's a fact that has
13 happened nowadays in Mexico, okay?

14 What happened with the Fireman's Fund,
15 Fireman's Funds, as many other investors have had
16 conversations with the financial authorities, and
17 we really had a very good record in fulfilling our
18 verbal commitments with all the investors. The
19 nature of the crisis forced the Mexican authorities
20 to react very quickly to any possibility trying to
21 prevent any possibility of run at the banks.

17:12:11 1 So, when we had the opportunity to have an
2 investor interested, we initiated conversations.
3 Thereafter, they started doing things and we also
4 signed--we used to sign letters of intent, but
5 those letters of intent were not legally--legally
6 did not apply to the Mexican Government nor the
7 investors because they were subject to a lot of
8 ratifications by different authorities. But we
9 used to work simultaneously because we need
10 sometimes to announce to the public, to the
11 markets, that an arrangement was in course, okay?

12 The problem with the Fireman's Funds
13 vis-a-vis the success we had with our strategy of
14 most other investors is that the problems of
15 BanCreceer and the recapitalization plan was raised
16 to FOBAPROA in '98 after the control of the
17 Congress was lost by the party to which belonged
18 the Executive Branch at that time.

19 MR. PEREZCANO: Mr. President, with all
20 due respect, I think we are going to have the
21 opportunity to look at all of the substantive

17:13:34 1 issues and to recall the witness to--

2 PRESIDENT van den BERG: Your objection is
3 noted, but we will allow the answer.

4 THE WITNESS: So, as the political
5 environment changed, as I was telling you, the
6 possibility of the authorities, in particular, my
7 position and the position of the then-Governor of
8 the Central Bank, Guillermo Ortiz, were limited
9 because a new law that established the successor of
10 FOBAPROA, now called IPAB, establish that the board
11 of governors of that IPAB should be integrated by
12 the Minister of Finance, the Chairman of the
13 Banking Commission, the Governor of the Central
14 Bank, and some other independent persons, but by
15 law, and in a nonconstitutional law, Guillermo
16 Ortiz, the actual Governor of the Central Bank, and
17 I myself were prohibited to participate in the
18 Board of Governors of IPAB. So, we could not then
19 have enough capacity by that time to complete
20 our--the deal that we have in principle, not
21 legally, but as many other deals, in principle

17:15:00 1 agreed with Fireman's Fund. That was the case.

2 And as that happened and I testified, I
3 believed that situation in my own person, I
4 believed it's unfair that in this dispute these
5 situations couldn't be known by the Tribunal that
6 is going to decide this situation.

7 MR. PRICE: Thank you, Mr. Fernandez. I
8 think I have no further questions for you at this
9 time.

10 ARBITRATOR CARRILLO: Just one question,
11 Mr. Fernandez.

12 When you mentioned the Recapitalization
13 Program of BanCreceer, what was the underlying
14 policy interest? The debentures that were in the
15 market, the bank, or the holding company? Where
16 was the concern of the government in--

17 THE WITNESS: The concern of the
18 government was the bank in which we--we have--well,
19 there was allocated most of the liabilities with
20 the public of that financial group at the level of
21 the banks, so the security firm was very small, and

17:16:29 1 other entities did not present the same financial
2 conditions at the bank. The bank really had a
3 serious problem, and we needed to inject a lot of
4 money, of capital, trying to restore its health and
5 financial condition. That was my main
6 preoccupation.

7 ARBITRATOR CARRILLO: And the issue
8 whether it was a financial holding company, the
9 issuer of debentures was not a matter of concern,
10 or nonconcern? It was not an issue, in other
11 words?

12 THE WITNESS: It was not an issue. The
13 problem was that as we already had to pay the peso
14 bondholders, we knew we could be in breach of
15 international obligations, and we have to find a
16 solution for that. But we want to take advantage
17 of the leverage that we have to invite Fireman's
18 Fund to participate in the Recapitalization
19 Program. And if they helped the Mexican Government
20 to find an investor for BanCreceer, then we would
21 recognize, in the capital of the new bank, their

17:17:40 1 investment.

2 So, we believe it was a very good deal for
3 the Mexican Government, and it would be a way out
4 of the problems that we may have with Fireman's
5 Fund because of the payment of the peso bonds that,
6 indeed, were very similar to those that they have.

7 ARBITRATOR CARRILLO: Thank you very much.

8 PRESIDENT van den BERG: Professor
9 Lowenfeld has a question.

10 ARBITRATOR LOWENFELD: Yes.
11 Mr. Fernandez, testimony in the last hour has gone
12 back and forth between high history, politics,
13 economics, and small verbal questions. I'm just
14 wondering if Grupo Financiero is not a financial
15 institution, what is it? And I thought maybe the
16 answer is it's an Entidade Financiero. But if
17 that's true, then are we asked--is for us to decide
18 the difference between an entidade and a
19 "uticcione"? Or is there some other animal?

20 THE WITNESS: According to my knowledge
21 during the years that I have in the financial

17:19:05 1 sector and the regulation is not relevant. It's
2 irrelevant to try to distinguish between financial
3 entity or financial institution. It's not relevant
4 at all.

5 The holding company is not--the financial
6 entity is not a financial institution. Is it a
7 company that belongs to the financial sector
8 because the holding company is the owner of the
9 shares of the financial institutions? In that
10 sense, belongs to the financial sector, but try to
11 make difference. In Mexican law, saying, well, a
12 bank is a financial institution but it is not a
13 financial entity, that is completely irrelevant.
14 It could be both. Because in that case the bank, a
15 security firm, or whatever perform activities of
16 providing services, financing services to the
17 public.

18 ARBITRATOR LOWENFELD: Thank you.

19 PRESIDENT van den BERG: I'm still a bit
20 puzzled about how this recapitalization program
21 works, but prior to that I have a simple other

17:20:17 1 question.

2 To your knowledge, the 50 million bonds
3 that had been issued by the holding company, for
4 what purpose had it been used actually at the time
5 of 1995? Both the pesos and the dollar. So, a
6 hundred million at that time in equivalent to U.S.
7 dollars.

8 THE WITNESS: The holding company--the
9 Financial Holding Company Act in Mexico permits
10 under limited basis to the holding companies to
11 take borrowings, or in the form of the debentures
12 convertible into shares or short-term loans, okay?
13 The purpose of that was the acquisition or the
14 merge of a financial institution to the
15 group--okay?--or the capitalization of a natural
16 member of the group.

17 In the case of BanCreceer, there was a
18 mirror, we would say, a mirror issuance of bonds at
19 the level of the bank. So, the funds raised by the
20 holding company were down to the bank to capitalize
21 BanCreceer, both pesos and dollars.

17:21:46 1 ARBITRATOR LOWENFELD: Do you know who
2 purchased the peso-denominated bonds? Was that one
3 big group, or was it the public? Were they listed
4 on the market?

5 THE WITNESS: As there was--were a large
6 number of individuals, I could say it was the
7 public because some of them used to be shareholders
8 of the bank, but there was a bigger location in the
9 public through the branches of the bank. So,
10 that's why we have thousands of investors here in
11 the peso bonds.

12 PRESIDENT van den BERG: Now, simply to
13 understand correctly what happened, there was in
14 1995--I think it was, yes--the convertible bonds
15 were issued by the holding company; correct?

16 THE WITNESS: Yes.

17 PRESIDENT van den BERG: At the same time
18 you had actual back-to-back convertible bonds
19 issuance by BanCrecer?

20 THE WITNESS: Yes.

21 PRESIDENT van den BERG: The banco?

17:22:49 1 THE WITNESS: Yes.

2 PRESIDENT van den BERG: We should call
3 them the same terms, mirror as such.

4 THE WITNESS: Correct.

5 PRESIDENT van den BERG: Then in 1997,
6 BanCreceer, the subsidiary, got into financial
7 troubles; correct?

8 THE WITNESS: Yes. Well, indeed, since
9 '95.

10 PRESIDENT van den BERG: In '95 already?

11 THE WITNESS: And did--those efforts to
12 capitalize the bank were not enough.

13 PRESIDENT van den BERG: So, then the
14 recapitalization plan was to rescue the banco?

15 THE WITNESS: Of course, yes.

16 PRESIDENT van den BERG: Then you got
17 about to get the repurchase of the bonds?

18 THE WITNESS: Yes.

19 PRESIDENT van den BERG: And you talk
20 about that then on the level of the holding
21 company?

1 THE WITNESS: Yes.

2 PRESIDENT van den BERG: What did the
3 holding company do with the bonds at the level of
4 the banco?

5 THE WITNESS: That's a very good question.
6 Indeed, during the banking crisis we did not
7 enforce any Convenio Responsibilidades because the
8 perception of the public, if there will be a
9 failure at the level of the holding or another
10 subsidiary, not the bank, at the end, in those
11 circumstances, the contagious would be immediately.
12 And then if the main interest of the financial
13 authorities was to protect the integrity of the
14 payment systems and avoid a run against the banks,
15 it was not possible under that circumstances to
16 make difference between obligations or liabilities
17 of holding companies or liabilities of other
18 entities of the same group. Let's say if a
19 security firm had failed in fulfilling its
20 obligation, then next day they would have a lot of
21 people looking for withdrawal of deposits at the

17:24:37 1 level of the bank.

2 So, we, indeed, protected everything.

3 PRESIDENT van den BERG: So to avoid the
4 policy of the run on the bank?

5 THE WITNESS: Exactly.

6 PRESIDENT van den BERG: Which is what
7 you're saying here.

8 Doesn't that also answer the question,
9 Mr. Carrillo, that this was a policy involved
10 there, that you rescued the peso bonds at the
11 holding level?

12 THE WITNESS: If we were in front of a
13 bank, of a financial group that had not been
14 intervened and has been managed interim by the
15 Banking Commission and managed by the owners, the
16 policy was to protect everything through different
17 mechanisms--okay?--in case that the bank had been
18 intervened--okay?--and some limited losses were
19 permitted to be transferred to the public when we
20 believe that that may not contaminate the rest of
21 the banking system. But if we have a bank operated

17:25:45 1 under normal basis, it was not possible to deal
2 with that, and at the same time that bank fails
3 with its liabilities in any way. So--and as the
4 intervention of the banks proved to be many
5 reasons, legal reasons, and many aspects, very
6 expensive, much more expensive, when there was no
7 more than keeping the management of the banks and
8 trying to attract--attract capital, then this was
9 our preference.

10 In case there was a problem in management,
11 obviously we know that possibility because it
12 couldn't be we intervene the banks. When we
13 intervene the banks, we protected the deposits, the
14 public, but in some limited cases would have
15 permitted that the public suffer some kind of
16 losses. But just in that case. In regular--in
17 banks operated normally, that was not possible.

18 PRESIDENT van den BERG: Now the rescue
19 plan. Let's first address the peso-denominated
20 bonds.

21 THE WITNESS: Yes.

17:26:54 1 PRESIDENT van den BERG: What I understand
2 is that these were put, then, at the holding level.
3 They were first converted into the shares? What
4 happened? Because ultimately they came into a
5 trust. What was it? What came into trust?

6 THE WITNESS: The bank re-purchased the
7 bonds before the conversion. The bank, indeed, was
8 funding their liabilities in the market with the
9 implicit guarantee of the financial authorities and
10 the FOBAPROA, so it could fund 500 million pesos
11 and then pay to the bondholders, with the idea that
12 as soon as it would be possible, the bank will
13 reallocate again in the market some amount of such
14 debentures.

15 PRESIDENT van den BERG: Where would they
16 get the money from?

17 THE WITNESS: Excuse me?

18 PRESIDENT van den BERG: Where would they
19 get the money from? One of the things for the
20 arbitrators is follow the money.

21 THE WITNESS: From the market, because the

17:27:47 1 market knew that FOBAPROA were, in fact, the fact
2 of covering the whole liability. So, it was kind
3 of a government guarantee with the funding of the
4 bank.

5 Indeed, the intervened banks just very
6 recently have been out of the market. I don't
7 know, probably the past year they were still
8 funding liabilities in the market with this
9 implicit coverage of the Mexican Government.

10 PRESIDENT van den BERG: The
11 peso-denominated bondholders, they had actually
12 been paid?

13 THE WITNESS: Yes.

14 PRESIDENT van den BERG: They were?

15 THE WITNESS: Yes. They were paid in
16 1998.

17 PRESIDENT van den BERG: 1998?

18 THE WITNESS: Yes.

19 PRESIDENT van den BERG: At that time, the
20 value of the peso versus the dollar, it was
21 different at the time the bonds were issued?

17:28:34 1 THE WITNESS: No, indeed, both we would
2 say it would be worthless without the participation
3 of the government because it would have to be
4 converted into shares of a troubled bank that
5 obviously their capital, as soon as we determined
6 the whole reserves needs, the value of that capital
7 would be zero.

8 PRESIDENT van den BERG: The word
9 "peso-denominated bonds" now, the U.S.
10 dollar-denominated bonds are all in Fireman's
11 Funds.

12 THE WITNESS: Exactly.

13 PRESIDENT van den BERG: Purchased by
14 them.

15 THE WITNESS: We have another party to
16 talk about what to do.

17 PRESIDENT van den BERG: But that was
18 not--the idea at that time, even, was not to put
19 simply also any type of trust fund, but there were
20 some extra conditions added to it, wasn't it? You
21 have to find some more investors; otherwise, it

17:29:28 1 will be half.

2 THE WITNESS: Yes.

3 PRESIDENT van den BERG: The other
4 condition was you have to reinvest it--and here I
5 come also to my question--in banco, I think.

6 THE WITNESS: Yes. In the banco.

7 PRESIDENT van den BERG: But in different
8 form, again as bonds? Because that would be the
9 mirror.

10 THE WITNESS: No, because by the time we
11 would recognize them, the investment they have
12 made, it would be successful in the
13 Recapitalization Plan, we have not defined the
14 final form that that investment would have, but in
15 principle could be shares of the new bank.

16 PRESIDENT van den BERG: But there is at
17 least--let us put approach after using neutral
18 terms--the difference between the peso bondholders
19 and the dollar bondholders because the peso
20 bondholders would simply go to the Trust and get
21 their money back, whereas the dollar bondholders,

17:30:22 1 according to the plan you outlined, had first to
2 find either somebody abroad, other investors, or
3 seize half; is that correct?

4 THE WITNESS: Yes, because we believe two
5 things: First, that Allianz will not--well, it was
6 a counterpart that had large interest in Mexico,
7 and they will not bring, we would say, a scandal in
8 the markets that may affect the bank, so we
9 were--we do not have worries about that, but it was
10 very important.

11 Second, it's different the possibility to
12 negotiate with Fireman's Fund in this case because
13 they are sophisticated investor. They knew the
14 risks they were taking, so they could be more
15 reasonable than persons--the public that invested
16 in the windows or in the branches of the bank
17 believing that they were having in many cases a
18 deposit, but, indeed, it was not a deposit.

19 To be honest, during those times, it
20 happened to us in some cases. For example, in
21 Banco Confia, another intervened bank, claimed we

17:31:35 1 have a lot of trouble with investors because they
2 claimed that the officials of the bank misleading
3 them in some bonds convertible into shares, okay?
4 And after arbitral "arbiter" balance or whatever in
5 Mexico, we paid many of them when the investors,
6 the Mexican investors could prove, even though it
7 was an intervened bank, they could prove they were
8 misled by officials in the bank. So, it was very
9 complicated to try to negotiate with the public in
10 public having invested in the peso ones.

11 ARBITRATOR LOWENFELD: I have just a brief
12 follow-up or maybe clarification on your discussion
13 with the chairman.

14 You said you wanted to avoid a run by the
15 peso bondholders. I think you said run on the
16 bank, or is it run on the holding company? After
17 all, these were holding company bonds, weren't
18 they?

19 THE WITNESS: As I tried to explain, in
20 the environment where the whole financial system
21 was in trouble, we did not enforce the Convenio

17:32:50 1 Responsibilidades, and we could not distinguish
2 between the risk of the financial institutions,
3 different financial institutions, or even the
4 holding--

5 ARBITRATOR LOWENFELD: They had the same
6 name?

7 THE WITNESS: They had the same name. The
8 paper was sold in the branches of the bank. So, it
9 was very difficult to the public to distinguish
10 where probably that paper were not paid because it
11 is an issuance of a holding company, but my deposit
12 will be repaid with no problems. So, that culture
13 was not there, so we would protect everything in
14 benefit of the stability of the financial system.

15 ARBITRATOR LOWENFELD: That clarifies
16 things.

17 THE WITNESS: Okay.

18 PRESIDENT van den BERG: Mr. Price, you
19 have any follow-up questions?

20 MR. PRICE: Not at this time,
21 Mr. President.

17:33:44 1 PRESIDENT van den BERG: Mr. Perezcano, do
2 you have follow-up questions?

3 MR. PEREZCANO: If you will allow me a
4 second, sir.

5 (Pause.)

6 MR. PEREZCANO: We have no further
7 questions.

8 PRESIDENT van den BERG: Thank you. Then
9 we are right on schedule.

10 Of course, Mr. Fernandez, you are at this
11 stage excused as a witness, and on behalf of the
12 Tribunal we thank you for giving your testimony.

13 THE WITNESS: Thank you very much.

14 (Witness steps down.)

15 PRESIDENT van den BERG: We have arrived
16 at 5:30 on schedule. There are a couple of small
17 things outstanding.

18 Mr. Perezcano, I noted we'll still get the
19 new version of the law, and now I have to check
20 what it is, Instituciones Credito, we have the
21 version of 23 May 2000, and we heard today there is

17:35:43 1 version of 2001 from Mr. Mancera.

2 Then there is also a new law on the Ley
3 Comision Nacional Bancaria y de Valores. There we
4 have it in Tab 4 because that's the newer version
5 of what you have submitted as part of the exhibits
6 to your memorial.

7 I look to Mr. Price. Mr. Price, do you
8 accept the Tab 4 version?

9 MR. PRICE: Do I accept the Tab 4 version?

10 PRESIDENT van den BERG: I'm a little bit
11 short on it at this point in time. This is the
12 documents that have been put in a bundle for the
13 cross-examination of Mr. Fernandez by
14 Mr. Perezcano, and if you refer to Tab 4, we
15 discover today that is the newer version of the
16 law.

17 MR. PRICE: I don't object to them
18 submitting that, no.

19 PRESIDENT van den BERG: But do you accept
20 that this one is okay? We only have two pages of
21 this one. Although we only have two pages of this

17:36:55 1 one. It would be useful, Mr. Perezcano, if we
2 could get the full text like we have from you in
3 the original exhibits.

4 MR. PEREZCANO: Yes, sir. Both.

5 PRESIDENT van den BERG: And then I asked
6 Mr. Price, you have the reservation on the
7 Exposition de Motivos, and that was in Tab 3, I
8 think, and that was--now I have to check, it was
9 the same law we were talking about. Have you been
10 able to study it and to ask questions, or would you
11 still like to ask further questions of the witness
12 and others?

13 MR. PRICE: We may need to ask further
14 questions of Mr. Fernandez on that, but at this
15 moment, based on your decision that matters of law
16 could be submitted without introduction.

17 We would ask that new materials that come
18 in be given a document number so we know where they
19 are in the record.

20 PRESIDENT van den BERG: It would be
21 useful in general. Perhaps we could identify it

17:37:59 1 today. Can you do that in consultation with the
2 Secretary of the Tribunal? So, if we have the
3 document numbers, you could update the list of
4 exhibits.

5 MR. PEREZCANO: Yes, sir.

6 PRESIDENT van den BERG: The last thing is
7 we have submitted to you eight questions this
8 morning. However, there is a ninth question, and
9 the question, I see all these people who have
10 packed have to unpack again their pencils. This
11 question will be formulated by Professor Lowenfeld.

12 ARBITRATOR LOWENFELD: Thank you,
13 Mr. Chairman. The question was stimulated by the
14 remarks this morning of Judge Schwebel about
15 investment protection and the link between
16 investment protection and economic development and
17 so on.

18 My question is, is it correct to say that
19 if Chapter 14 and not Chapter 11 applies, that
20 investor protection is in some way impaired? We
21 understand the 60 days and the committee and so on,

17:39:18 1 but what I would like to hear both counsel on
2 tomorrow is whether there is really a lower level
3 of protection of an investment from essentially
4 unfair activity, as contrasted to potential
5 regulation.

6 PRESIDENT van den BERG: Mr. Price, the
7 question is clear to you?

8 MR. PRICE: Yes, Mr. President. I think
9 we understand.

10 PRESIDENT van den BERG: You think you
11 understand. Are you sure of yourself, because I
12 don't want misunderstanding?

13 MR. PRICE: That will be up to the
14 Tribunal to decide when you hear our answer.

15 PRESIDENT van den BERG: Mr. Perezcano?

16 MR. PEREZCANO: It's clear, sir.

17 PRESIDENT van den BERG: I think, then, we
18 could close the hearing for today. I thank
19 everyone present, and we see each other tomorrow
20 morning and we will start examination of Mr. Borja.

21 Incidentally, Mr. Price, do you anticipate

17:40:29 1 re-call of any of your witnesses?

2 MR. PRICE: I can't rule that out,
3 Mr. President. I need to reflect on the events of
4 the day. But it's possible that we would wish to
5 recall Mr. Fernandez or we may have another
6 question or two for Mr. Mancera, but I will
7 certainly know in the morning.

8 PRESIDENT van den BERG: The afternoon is
9 for closings.

10 MR. PRICE: Understood.

11 PRESIDENT van den BERG: Mr. Perezcano?

12 MR. PEREZCANO: We do not foresee bringing
13 back Mr. Fernandez, but we reserve our right for
14 Mr. Price.

15 (Whereupon, at 5:41 p.m., the hearing was
16 adjourned until 9:00 a.m. the following day.)

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1 CERTIFICATE OF REPORTER

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3 I, David A. Kasdan, RDR-CRR, Court
4 Reporter, do hereby testify that the foregoing
5 proceedings were stenographically recorded by me
6 and thereafter reduced to typewritten form by
7 computer-assisted transcription under my direction
8 and supervision; and that the foregoing transcript
9 is a true record and accurate record of the
10 proceedings.

11 I further certify that I am neither
12 counsel for, related to, nor employed by any of the
13 parties to this action in this proceeding, nor
14 financially or otherwise interested in the outcome
15 of this litigation.

16

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DAVID A. KASDAN, RDR-CRR

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