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Denial of Justice by Mexican Courts to Canadian Investment Fund under NAFTA: the First of its Kind

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Lion Mexico Consolidated v. Mexico[1)] represents the *first* positive finding of denial of justice in the history of NAFTA[2)] and one of the rearrest recent examples in investor-state arbitration.

On 20 September 2021, a NAFTA tribunal seated in Washington, D.C., held Mexico liable for denial of justice by the Mexican judiciary, ordering the State to pay US$ 47 million for "full reparation" (plus legal fees and arbitration costs) to Lion Mexico Consolidated L.P. ("**LMC**"), a Canadian entity incorporated in Quebec and domiciled in Texas, USA.

Background

LMC granted three loans totalling US$ 32.8 million to a Mexican businessman (the "**Debtor**") to acquire land and develop two skyscrapers and a luxury ocean-front resort in Jalisco and Nayarit, respectively, secured by three mortgages over the properties in question.

After LMC attempted to foreclose a mortgage to recover the unpaid loans, it discovered that all mortgages had been cancelled by a judge in Jalisco (at the Debtor's request) without its participation. This "**Cancellation Judgment**" was based on a Settlement Agreement allegedly signed by LMC, in which it accepted payment of the loans (and cancellation of the mortgages) in exchange of shares in the Debtor's companies (the "**Forged Document**"). LMC tried to revert the illegal cancellation of the mortgages for almost three years before the Mexican courts, and falling to do so, it lodged an investment arbitration against Mexico.

Jurisdictional phase

Back in 2018, the Tribunal was confronted with a novel issue: whether or not mortgages qualify as an investment under NAFTA. The Tribunal found that mortgages meet the two-fold requirement of Article 1139(g): being "intangible" real estate, "used for economic benefit". The Tribunal found that mortgages are *in rem* rights (*derechos reales*) under Mexican law, while treaty practice confirms the same understanding, as Mexico had concluded other 22 BITs where "mortgages" were expressly recognised as an investment (e.g., the Spain-Mexico BIT).[3)] In line with the

Tribunal's finding, the new NAFTA (known as "USMCA") signed by the US, Mexico and Canada – in force as of 1 July 2020 – expressly includes "mortgages" as a covered investment under Article 14.1(h).

The Parties' positions on the merits

LMC alleged it was not properly summoned in the proceedings that cancelled its mortgages *in absentia* ("**Cancellation Proceeding**") and then, it was deprived of its right of defense to revert said cancellation before higher courts, which repeatedly denied any opportunity to prove the forgery of the Settlement Agreement upon which its investment was cancelled.

Mexico alleged that Mexican courts acted in accordance with the law, while LMC was negligent in its legal defence. Mexico alleged that it was also the *victim* of a sophisticated fraud by the Debtor, while LMC had not exhausted all the available remedies, as condition precedent to denial of justice. In its view, LMC could obtain compensation from criminal proceedings against the Debtor.

The Tribunal's findings

1. **Standard of proof**

The Tribunal followed the *Mondev* standard as a "guide", albeit with some precisions. In its view, denial of justice involves an "objective test", which: "*requires a finding of an improper and egregious procedural conduct by the local courts (whether intentional or not), which does not meet the basic internationally accepted standards of administration of justice and due process, and which shocks or surprises the sense of judicial propriety.*"[4] In other words, the Tribunal clarified that a breach must be *procedural* and not substantive; rejected the need to prove an *intentional* conduct (e.g., bad faith); while required a level of gravity to *shock or surprise*, contrary to *basic* yet *internationally accepted* standards of justice.

2. **Denial of Justice**

The Tribunal recognised three types of denial of justice claims related to: i) the right to access justice (e.g., lodge an appeal); ii) the right to be heard (e.g., to present evidence); and iii) undue court delay.

The Tribunal found unanimously that Mexico denied "procedural justice" (and FET) to LMC, in breach of Article 1105 of NAFTA, for the first two types of claims (referred to above), while considering it needless to address the claim for undue delay.

The Tribunal first gave deference to and presumed that the municipal courts had acted properly, while it did not pass judgment on the propriety of the entire Mexican judicial system. It then accepted Mexican courts acted in good faith (i.e., without colluding with the fraudsters or

colluding in corruption, as this was not raised by LMC). However, the Tribunal held that the existence of a "sophisticated fraud" by the Debtor to cancel the mortgages, regardless how sophisticated this might be, did not excuse the State from its duty to have a properly functioning judicial system.

In particular, the Tribunal found that the courts of Jalisco failed to function properly during the first instance, appeal and *amparo* proceedings. First, the commercial judge cancelled the mortgages by default as a result of a "deeply flawed" service of process to LMC, and later foreclosed the possibility to appeal said judgment in disregard of municipal law. Second, the higher courts during *amparo, queja* and remand proceedings, denied LMC every opportunity to allege and submit relevant and material evidence to prove the forgery that resulted in the loss of its investment.

The Tribunal concluded that LMC was denied procedural justice in three respects:

a) LMC was denied access to justice: LMC was never given the opportunity to defend itself in the Cancellation Proceeding, due to a "deeply flawed" service of process that resulted in the cancelation of its mortgages *in absentia*. While this was the basis of the denial of justice claim, it was not the only defective act. The Judge also failed to examine *ex officio* and exhaustibly, whether the service was properly performed, before declaring respondent *en rebeldía*. This omission was "shocking" in view of the implications at stake: the cancellation of multi-million dollar mortgages of a US-based company over well-known and highly valuable real estate, when the Judge had before him evidence that LMC was US-domiciled and incorporated in Canada. Moreover, this was exacerbated by the unusual swiftness of the Cancellation Proceeding (which lasted only 170 days). As the Tribunal put it, the Mexican judiciary never corrected this situation, despite LMC's multiple requests.

b) LMC was denied the right to appeal: A few weeks later, the same Judge arbitrarily precluded any opportunity of appeal, by giving a *res judicata* effect to its Cancellation Judgement (at the Debtor's request), which constituted a second denial of justice. By doing so, the Judge barred any possibility of LMC, once it became aware of the Cancellation Judgement, to lodge an appeal. The Judge based its declaration of *res judicata* on an inapplicable procedural rule under which low-amount disputes are not subject to appeal (i.e., lower than 500,000 MXP (USD 25,000). This decision was unjustified as the evidence before the Judge showed the mortgages (cancelled by him) secured US$ 32.8 million loans.

c) LMC was denied the right to allege in *amparo* proceedings the "forgery" of the document upon which the mortgages were cancelled: LMC tried in multiple occasions and under different motions – for 3 years – to bring the relevant evidence that could easily prove the illegality of the service and justify the annulment of the Cancellation Judgement. However, the Mexican courts consistently refused LMC's right to be heard and to present evidence, as follows:

i) *Ampliación de demanda*: A request to extend its *amparo* claim to include the highly relevant forgery was dismissed by the *amparo* court under the "wrong" argument that "*these acts have already been specified*" and failed to admit the key evidence.

ii) *Queja*: An incidental motion against the decision above, also rejected LMC's *ampliación de demanda* as inadmissible, alleging that it was not properly signed on LMC's behalf (as it should have been signed by LMC's legal representative and not by the attorney empowered to act on its behalf in the *amparo* proceedings). LMC was not even allowed to cure the alleged procedural defect (when it submitted a new power of attorney), despite the *ampliación de demanda* aimed at proving that LMC, an alien company operating in Mexico, had been the victim of an elaborate fraud.

iii) *Incidente de falsedad de documento*: A separate motion to prove the forgery, was dismissed on the grounds that the allegedly false document was not related to the subject-matter of the *amparo* proceeding. As a result, the *amparo* court assumed the Settlement Agreement was valid and binding, thereby reducing the scope of the *amparo* to the question of whether the service of process had or not been properly executed in accordance with Mexican law. And – congruently with this reduced scope of investigation – all evidence in the file seeking to prove the forgery was eliminated.

iv) *Amparo*: Notwithstanding a previous finding by the *amparo* court that at least on one occasion LMC's signature had been forged (and that the Debtor was in prison for alleged forgeries of documents) the *amparo* judgement did not even discuss LMC's argument that the Settlement Agreement was also forged, since the *ampliación de demanda* had been dismissed. The *amparo* judgement consequently assumed that the Settlement Agreement was validly executed by LMC.

v) *Recurso de Revisión* (Remand *amparo*): finally, LMC sough the revocation of the *amparo* judgment for the same reason that the *amparo* court erroneously disregarded its claim that the Settlement Agreement had been forged as it considered "unrelated to the dispute". However, LMC was once again barred from claiming the forgery as expressly ordered by the *Queja* tribunal, which forbade the remand court to examine the issue.

Conclusion

As stated by the Tribunal, Mexican courts had four opportunities to address the question of the forgery of the Settlement Agreement but failed to do so. This constituted a denial of justice, by restricting its access to justice and its right to defend itself and present evidence. The Tribunal found that LMC had exhausted the reasonable available remedies that could have reversed the cancellation of the mortgages.

The implications of the LMC case may open new debates and may lead to the adoption of new approaches and decisions to contour the notion of denial of justice in the coming years.

Notably, in December 2020, Mexico received a notice of a new NAFTA legacy dispute alleging

denial of justice by the State courts' failure to recognise "mortgages" as collateral held by US creditors (AMERRA and JPMorgan) under insolvency proceedings. Another case initiated by US investors (B-Mex) in 2016, is calling a NAFTA tribunal to assess due process by Mexican *amparo* courts, as the investors claim they were "effectively and practically *denied* an appeal".

References

?1 *Lion Mexico Consolidated L.P. v. United Mexican States* (ICSID Case No. ARB(AF)/15/2).

?2 In 1999, a NAFTA tribunal analysed and rejected for the first time a claim for denial of justice in *Robert Azinian v. Mexico.*

?3 Decision on Jurisdiction, 30 July 2018, paras. 229, 233, 240.

?4 Award, 20 September 2021, para. 299.

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