

# Law and Business Review of the Americas

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VOLUME 16

SUMMER 2010

NUMBER 3

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LAW AND BUSINESS REVIEW OF THE AMERICAS  
Southern Methodist University  
Dedman School of Law  
P.O. Box 750116  
Dallas, Texas 75275-0116  
ibra-eic@list.smu.edu.

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ISSN 1571-9537

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***(formerly SMU Centre for NAFTA and Latin American Legal Studies)\****

Established in 1952, the LAW INSTITUTE OF THE AMERICAS at Southern Methodist University Dedman School of Law was originally designed to promote good will and to improve relations among the peoples of the Americas through the study of comparative laws, institutions and governments respecting the American Republics, and to train lawyers in handling legal matters pertaining to the nations of the Western Hemisphere. Today, in reviving this institution, the Law Institute of the Americas comprises meaningful academic research, teaching and programs pertaining to the "NAFTA/FTAA processes" and other Western Hemispheric integration efforts; to Latin and Central American law and judicial reform, particularly focusing on Argentina, Brazil, Chile, Guatemala, Mexico, Peru and Venezuela; and, to a more limited extent, to Canadian legal issues, particularly as they interrelate to the NAFTA/FTAA. The Law Institute of the Americas also is concerned with increasing (regional and hemispheric) legal and economic interconnections between the "NAFTA/FTAA processes" and European and Asia-Pacific integration activities.

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\* From 1952 through the early 1970s, the name was the Law Institute of the Americas; in 1993, it was reactivated as the Centre for NAFTA and Latin American Legal Studies; and in 1998, it returned to its original name. For further detailed historical information on the Law Institute of the Americas, please refer to the Law Institute of the Americas' website at <http://www.law.smu.edu/lia>.





# **Perspective**



# THE END OF THE THIRD WORLD? MODERNIZING MULTILATERALISM FOR A MULTIPOLAR WORLD

*Robert B. Zoellick\**

## INTRODUCTION: THE END OF THE THIRD WORLD?

**F**OR decades, students of security and international politics have debated the emergence of a multipolar system. It's time we recognize the new economic parallel.

If 1989 saw the end of the "Second World" with Communism's demise, then 2009 saw the end of what was known as the "Third World": We are now in a new, fast-evolving multipolar world economy—in which some developing countries are emerging as economic powers; others are moving towards becoming additional poles of growth; and some are struggling to attain their potential within this new system—where North and South, East and West, are now points on a compass, not economic destinies.

Poverty remains and must be addressed. Failed states remain and must be addressed. Global challenges are intensifying and must be addressed. But the manner in which we must address these issues is shifting. The outdated categorizations of First and Third Worlds, donor and supplicant, leader and led, no longer fit.

The implications are profound: For multilateralism, for global cooperative action, for power relationships, for development, and for international institutions.

## MULTILATERALISM MATTERS

The global economic crisis has shown that multilateralism matters. Staring into the abyss, countries pulled together to save the global economy. The modern G-20 was borne out of crisis. It showed its potential by quickly acting to shore up confidence. The question now is whether this was an aberration, a blip?

Will historians look back on 2009 and see it as a singular case of international cooperation or the start of something new? Some now view Woodrow Wilson's attempt to create a new international system after World War One as an opportunity lost that left the world adrift amidst dangers. Will this be a similar moment?

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\* Robert B. Zoellick is President of The World Bank Group. Remarks were delivered at the Woodrow Wilson Center for International Scholars on April 14, 2010.

The danger now is that as the fear of the crisis recedes, the willingness to cooperate will too. Already we feel gravitational forces pulling a world of nation-states back to the pursuit of narrower interests.

This would be a mistake. Economic and political tectonic plates are shifting. We can shift with them, or we can continue to see a new world through the prism of the old. We must recognize new realities. And act on them.

## WHAT IS DIFFERENT? NEW SOURCES OF DEMAND

### WHAT IS DIFFERENT?

The developing world was not the cause of the crisis, but it could be an important part of the solution. Our world will look very different in 10 years, with demand coming not just from the United States but from around the globe.

Already we see the shifts. Asia's share of the global economy in purchasing power parity terms has risen steadily from 7 percent in 1980 to 21 percent in 2008. Asia's stock markets now account for 32 percent of global market capitalization, ahead of the United States at 30 percent and Europe at 25 percent. Last year, China overtook Germany to become the world's biggest exporter. It also overtook the United States to become the world's largest market for cars.

Import numbers tell a revealing story: the developing world is becoming a driver of the global economy. Much of the recovery in world trade has been due to strong demand for imports among developing countries. Developing country imports are already 2 percent higher than their pre-crisis peak in April 2008. In contrast, the imports of high-income countries are still 19 percent below that earlier high. Even though developing world imports are about half of the imports of high-income countries, they are growing at a much faster rate. As a result, they accounted for more than half of the increase in world import demand since 2000.

### NEW POLES OF GROWTH

The world economy is rebalancing. Some of this is new. Some represents a restoration. According to Angus Maddison, Asia accounted for over half of world output for 18 of the last 20 centuries. We are witnessing a move towards multiple poles of growth as middle classes grow in developing countries, billions of people join the world economy, and new patterns of integration combine regional intensification with global openness.

This change is not just about China or India. The developing world's share of global GDP in purchasing power parity terms has increased from 33.7 percent in 1980 to 43.4 percent in 2010. Developing countries are likely to show robust growth rates over the next five years and beyond. Sub-Saharan Africa could grow by an average of over 6 percent to 2015

while South Asia, where half the world's poor live, could grow by as much as 7 percent a year over the same period.

Southeast Asia has become a middle income region of almost 600 million people, with growing ties to India and China, deepening ties with Japan, Korea, and Australia, and continuing links through global sourcing to North America and Europe.

The Middle East region is an important source of capital for the rest of the world, and increasingly a business-service hub between Asia-East and South—and Euro-Africa. Gross official reserves of the Gulf Cooperation Council countries were over \$500 billion at the end of 2008, with estimates of sovereign wealth fund assets of as much as \$1 trillion. If the Maghreb can move beyond historical fault lines, it can be part of a Euro-Med integration linked to both the Mideast and Africa.

In the Latin American and Caribbean region, 60 million people were lifted from poverty between 2002-2008 and a growing middle class boosted import volumes at an annual rate of 15 percent.

#### AFRICA AS A POTENTIAL POLE OF GROWTH

Tectonic plates could shift further. Africa missed out on the manufacturing revolution that lifted East Asia's economies out of poverty and into prosperity. But Africa no longer needs to be left behind.

Today, in many African countries even small, inexpensive items, such as soap or slippers, or basic tools or consumer goods, are imported. If Africans remove the barriers to producing these goods domestically and to local entrepreneurship, while creating conditions for outside investors to shift production to Africa, then African development could begin to look very different. Unlike past failed efforts to favor import-substitution interests behind protectionism, this approach can capture benefits from regional integration within global markets.

What would it take? As a first step, the 80 percent of Africans earning \$2 a day or less need to earn enough income so they will be able to buy basic consumer goods. Agriculture is the main source of jobs and an early opportunity to boost productivity and income. To do so, investment is needed all across the agricultural value chain: property rights; seeds; irrigation; fertilizer; finance; basic technologies; storage and getting product to market. Since about two-thirds of African farmers are women, we need to help them get legal and property rights, and access to services.

With slightly higher incomes and living standards, local manufacturers can target or customize for the local market, and eventually for export.

To grow further, Africans need the things that Europe and Japan needed after World War Two: infrastructure; energy; integrated markets linked to a global economy; and the conditions for a vibrant private sector. These public goods will foster much more than local manufacturing.

Today's shifts open new opportunities. As the global crisis hit, some Chinese recognized that it was time to move beyond toys and footwear; China could move up the value chain, increase wages and consumption,

and expand its “harmonious society.” Chinese companies, in turn, could move lower value-added manufacturing elsewhere, including to Africa, following China’s resource developers and construction enterprises.

Chinese companies can be encouraged to relocate manufacturing for both domestic production and export. These manufacturers bring know-how, machinery, as well as access to marketing and distribution networks. The World Bank is working with Africans and Chinese to create industrial zones.

Early investors are sensing the promise in Africa and are not dissuaded by the risks—after Lehman Brothers and Greece, investors know developed markets can be risky, too.

Changes in government policies can create opportunities for private sector growth, which in turn offers services to other entrepreneurs. In the ten years to 2008, the private sector has invested more than \$60 billion in information and communications technology in Africa; 65 percent of Africans are now within reach of wireless voice services, and there are 400 million mobile phones in use in Africa.

IFC, the World Bank Group’s private sector arm, is helping catalyze this business revolution. A new IFC equity fund has attracted \$800 million from sovereign wealth and pension funds to invest in companies in Africa, Latin America and the Caribbean.

#### ECONOMIC SHIFTS MEAN POTENTIAL POWER SHIFTS

Increased income and growth in the developing world means increasing influence. The old world of fireside chats among G-7 leaders is gone. Today’s discussion requires a big table to accommodate the key participants, and developing countries must have seats at it.

Last year’s G-20 Summit at Pittsburgh recognized that change. But it will take more than words on paper. Woodrow Wilson’s words on paper did not realize their lofty ideals. Arranging a new sharing of responsibilities among mutual stakeholders in international systems will not be easy. But happen it must. The failure of 1919 led to countries that could not cooperate in 1929 and the start of a new war in Europe in 1939.

Today, we already see the strains. The Doha World Trade Organization round and the climate change talks in Copenhagen revealed how hard it will be to share mutual benefits and responsibilities between developed and developing countries. Those debates also exposed the diversity of challenges faced by different developing countries.

If it is no longer possible to solve big international issues without developing and transition country involvement, it is also no longer possible to presume that their biggest members, the so-called BRICs—Brazil, Russia, India and China—will represent all.

And this will be the case for a host of other looming challenges: water; diseases; migration; demographics; and fragile and post-conflict states.

In discovering a new forum in the G-20, we must be careful not to impose a new, inflexible hierarchy on the world. Instead, the G-20 should operate as a “Steering Group” across a network of countries and international institutions. It should recognize the interconnections among issues and foster points of mutual interest. This system cannot be hierarchical, and it should not be bureaucratic. It also must prove effective by getting things done.

#### THE DANGER OF GEO-POLITICS AS USUAL

The danger of the political gravity dragging countries back to the pursuit of narrow interests is that we address this changing world through the prism of the old G-7; developed country interests, even if well-intentioned, cannot represent the perspective of the emerging economies. We cannot afford geo-politics as usual.

Nor can we retreat into an “Old Multilateralism”—a 19th Century Metternichian Congress of Vienna solution—that seeks to resist change. A “New Geopolitics of Multipolar Economy” needs to share responsibility while recognizing different perspectives and circumstances, so as to build more mutual interests.

#### FINANCIAL REFORM

Take financial reform: the world has paid a big price for the breakdowns of the global financial system in lost jobs and ruined lives.

Of course we need better financial regulation, with stronger capital, liquidity, and supervisory standards. A new supervisory framework should consider systemic risks, reverse regulation that reinforces the ups and downs of cycles, consolidates supervision to avoid gaps, and considers inflation in asset prices as well as in goods and services.

But beware unintended consequences. We should not compound costs by encouraging financial protectionism or unfairly constraining financial services to the poor. Regulations agreed in Brussels, London, Paris or Washington might work for big banks in the developed world. But what about the smaller ones, whether in developed or developing countries?

These regulations could choke off the financial sector, innovation, and risk management in developing countries. They could make it harder to invest across national borders.

“Lend local” requirements could have the same effects as “buy local.” “Local physical presence” requirements could thwart services just as they can choke trade. “Local liquidity” requirements could fragment global liquidity management and add huge costs without strengthening safety.

Derivatives now have a bad name. This is understandable when one remembers AIG. But derivatives are used by farmers in the American Midwest to protect against volatility in grain prices. Mexico used energy options to lock in a price for the oil that pays for much of the government’s budget.

The World Bank pioneered currency swaps, and uses swaps to protect against foreign exchange and interest rate risk. Our loans offer hedging opportunities to protect borrowers from foreign exchange or interest rate risk and even other risks such as droughts and catastrophes. By helping to develop local currency borrowing, linked to global markets, we helped shelter developing countries from the financial tidal waves of the recent crisis.

Financial innovation, when used and supervised prudently, has brought efficiency gains and protected against risk: the World Bank has pioneered livestock insurance for Mongolian herders; a Malawi weather derivative against drought; and the Caribbean catastrophe insurance pool. The latter gave Haiti an immediate \$8 million in January when its earthquake struck—faster money than from any other outside source.

As former President Zedillo of Mexico has cautioned, the problem for poor people is not too many markets, but too few: We need markets for microfinance or small and medium-sized enterprises, especially if run by women; markets to move, store, and sell goods; markets to save, insure, and invest.

Wall Street has exposed the dangers of financial innovation, and we need to take heed and serious actions. But development has shown its benefits. A G-7 populist prism can undercut opportunities for billions.

#### CLIMATE CHANGE

Take climate change: The danger is that we take a rule book from developed countries to impose a one-size-fits-all model on developing countries. And they will say no.

Climate change policy can be linked to development and win support from developing countries for low carbon growth—but not if it is imposed as a straitjacket.

This is not about lack of commitment to a greener future. People in developing countries want a clean environment, too.

Developing countries need support and finance to invest in cleaner growth paths. 1.6 billion people lack access to electricity. The challenge is to support transitions to cleaner energy without sacrificing access, productivity, and growth that can pull hundreds of millions out of poverty.

Avoiding geo-politics as usual means looking at issues differently. We need to move away from the binary choice of either power or environment. We need to pursue policies that reflect the price of carbon, increase energy efficiency, develop clean energy technologies with applications in poorer countries, promote off-grid solar, innovate with geothermal, and secure win-win benefits from forest and land use policies. In the process, we can create jobs and strengthen energy security.

The developed world has prospered through hydro electricity from dams. Some do not think the developing world should have the same access to the power sources used by developed economies. For them,



thinking this is as easy as flicking a switch and letting the lights burn in an empty room.

While we must take care of the environment, we cannot consign African children to homework by candlelight or deny African workers manufacturing jobs. The old developed country prism is the surest way to lose developing country support for global environment goals.

#### MANAGING FOR CRISIS RESPONSE

Take crisis response: in a world in transition, the danger is that developed countries focus on summits for financial systems, or concentrate on the mismanagement of developed countries such as Greece.

Developing countries need summits for the poor. One lesson from this crisis is that effective safety nets prevented the loss of a generation—unlike the Asian crisis in the 1990s.

Hearing the developing country perspective is no longer just a matter of charity or solidarity: it is self-interest. These developing countries are now sources of growth and importers of capital goods and developed countries' services.

Developing countries do not just want to discuss high debt in developed countries; they want to focus on productive investments in infrastructure and early childhood development. They want to free markets to create jobs, higher productivity, and growth. Many are exploring how to use the innovation and efficiency of private markets to help provide and maintain public sector infrastructure and services.

#### NEW ROLE FOR RISING POWERS

But modernizing multilateralism isn't all about developed countries learning to adapt to the needs of rising powers. With power comes responsibility.

Developing countries need to recognize that they are now part of the global architecture. They have an interest in healthy, dynamic, flexible international systems for finance, trade, movement of ideas and people, the environment—and strong multilateral institutions.

We need to find points of mutual advantage, making reciprocal gain possible. At the same time, we must recognize domestic political constraints and local fears. We need accords that every leader can sell at home.

#### WHAT DOES THIS CHANGING WORLD MEAN FOR DEVELOPMENT?

##### WHAT DOES THIS CHANGING WORLD MEAN FOR DEVELOPMENT?

Development is no longer just North-South. It is South-South, even South-North, with lessons for all with open minds. It is conditional cash transfer programs in Mexico being studied around the world. It's Indians

in Africa explaining the so-called “white revolution” –that boosted milk production. It is a new world where developing countries are not only recipients but providers of aid and expertise. Nor is it about ideological panaceas, blue-prints, or one-size-fits all. In a multipolar economy, development is about pragmatism, learning from experience, recognizing how markets and business opportunities change, sharing ideas, and connecting knowledge, just as we connect markets, across innovative networks.

Nor is the future of development only about old concepts of aid: The sovereign and pension funds wanting to invest with the World Bank Group in Africa represent a new form of financial intermediation. This is not charity. This is investment looking for good returns. IFC is helping to lower information barriers and cut transaction costs. It is our aim to do nothing less than revolutionize financial flows to developing countries

#### MODERNIZING MULTILATERAL INSTITUTIONS

How will we manage a “new geopolitics for a multipolar economy” where all are fairly represented in Associations for the Many, not Clubs for the Few?

If the tectonic plates are shifting, multilateral institutions must shift too. The crisis has shown the possibilities of international cooperation, but it has also underscored the need to modernize and strengthen multilateral institutions to reflect a different world.

The new world requires identifying mutual interests, negotiating common actions, and managing differences across a much wider spectrum of countries than ever before.

It requires institutions that are fast, flexible, and accountable, that can give voice to the voiceless with resources at the ready.

It requires institutions that reach out to partners, with humility and respect, ready to learn from others, that can act as global connectors pioneering a new world of South-South and South-North learning and exchange.

It requires institutions that can demonstrate real results and can be held accountable when they falter.

The World Bank Group must reform to help play this role. And it must do so continually at an ever quicker pace. Government and public institutions tend to be slower to change than private organizations facing competition. We recognize this risk. To address it, we have launched the most comprehensive reforms in the institution’s history.

#### WE ARE REFORMING TO BECOME MORE REPRESENTATIVE AND LEGITIMATE

A modernized World Bank Group must represent the international economic realities of the 21st Century, recognizing the role and responsibil-

ity of growing stakeholders, but also their diversity and special needs, and provide a larger voice for Africa.

Reflecting these needs, we are urging our shareholders to keep their promise to move to 47 percent or more ownership by developing countries this month.

But we are not stopping there. In a model unique among International Financial Institutions, shareholdings will be reviewed every five years to allow for changes based on the continuing economic growth and evolution of our shareholders, with the goal of achieving equity over time. For the first time, shareholdings would be based on a formula specifically developed to reflect the needs and mandates of the World Bank Group: they will not only reflect economic power but also contributions to our fund for the world's poorest countries.

Senior management now includes a record number of executives from developing countries as well as women. And we need to do even more.

We need to work with developing countries as clients, not as objects of development models from textbooks. We need to help them solve problems, not test theories. Yet problems need resources to fix them.

#### WE ARE REFORMING BY ADDING RESOURCES

Since the full force of the crisis hit in mid-2008, the World Bank Group has committed more than \$100 billion to support developing countries.

This broke all historical records. And I want to especially thank the World Bank Group staff who have risen to this challenge.

We got money where it is needed—fast. Even though the World Bank Group has traditionally been a lender on long-term projects, our development disbursements have exceeded the IMF's crisis payments.

When the World Bank Group stepped up to confront dangers, we depended on the effective and efficient use of resources on hand.

We will need more resources to support renewed growth and to make a modernized multilateralism work in this new multipolar world economy. Should the recovery falter, we would have to stand on the sidelines.

The World Bank is therefore seeking its first capital increase in more than 20 years. Shareholders face a decision to strengthen the Bank Group, or allow it to wane in influence, losing an effective multilateral institution and leaving it poorly resourced to cope with whatever comes next.

In addition to providing critical financial resources, we have been demonstrating just how modernized multilateralism can work. We are building cooperation among 186 countries that are our members.

Over half the resources raised to strengthen our capital will come from developing countries, through price increases and greater capital investments. Agreement on this package of measures, if successful, would represent a multilateral success story that contrasts with recent stumbles in climate change and trade.

WE ARE REFORMING TO BECOME MORE EFFECTIVE,  
INNOVATIVE, AND ACCOUNTABLE

Representation and resources alone are not enough. We must also be more effective, responsive, innovative, flexible, and accountable.

We are reforming to sharpen our strategic focus where we can add most value—focusing on the poor and vulnerable, especially in Sub-Saharan Africa; on creating opportunities for growth; on promoting global collective action—such as in climate change, agriculture, water and health; strengthening governance; and preparing for crises.

We are reforming to modernize our products and services, fostering opportunities for innovation, and considering a new decentralization model that will enable us to apply cutting-edge skills closer to clients, while gathering, customizing and sharing knowledge and experience globally. We need global reach, but also local touch.

We are reforming to focus on results, strengthening our governance and anti-corruption efforts, including strong prevention, and leading other international institutions in becoming more transparent and accountable. We have a New Access to Information policy, based on the Indian and U.S. freedom of information laws, which will be the first—but we hope not last—of its kind among international institutions. We are launching a new open access policy for World Bank data. Just last week, we concluded an agreement with other multilateral development banks on the cross-debarment of corrupt individuals and companies.

And we are launching a corporate scorecard so we can be held more accountable.

We know we make mistakes; if overcoming poverty were easy, it would have been eliminated long ago. By opening the shades for others to see what we are doing, how we are doing it, and with what results, we will catch errors more quickly and improve faster.

Taken together, these reforms are transformational. This will no longer be your grandparents' World Bank. It won't even be your parents'.

## CONCLUSION

Reform cannot be a one-time effort. It must be a constant—adaptation and re-adaptation, with continuous feedback loops to meet changing realities.

We cannot predict the future with assurance. But we can anticipate directions—and one is that the age of a multipolar global economy is coming into view.

This is no aberration, no blip. We still live in a world of nation-states. But there are now more states wielding influence on our common destiny. They are both developed and developing, spanning all regions of the globe. This can be all to the good. But the contours of this new multipolar economy are still forming. It needs to be shaped.

The modern multilateral system needs to fit these changes.

Modern multilateralism must be practical. It must recognize that most governmental authority still resides with nation-states. But many decisions and sources of influence flow around, through, and beyond governments.

Modern multilateralism must bring in new players, build cooperation among actors old and new, and harness global and regional institutions to help address threats and seize opportunities that surpass the capacities of individual states.

Modern multilateralism will not be a constricted club with more left outside the room than seated within. It will look more like the global sprawl of the Internet, interconnecting more and more countries, companies, individuals, and NGOs through a flexible network. Legitimate and effective multilateral institutions, backed by resources and capable of delivering results, can form an interconnecting tissue, reaching across the skeletal architecture of this dynamic, multipolar system.

Woodrow Wilson wished for a League of Nations. We need a League of Networks.

It is time we put old concepts of First and Third Worlds, leader and led, donor and supplicant, behind us.

We must support the rise of multiple poles of growth that can benefit all.



# Articles





# THE “FAIR AND EQUITABLE TREATMENT” STANDARD PURSUANT TO THE INVESTMENT PROVISIONS OF THE U.S. FREE TRADE AGREEMENTS WITH PERU, COLOMBIA AND PANAMA

*Andrew P. Tuck\**

RECENTLY, foreign investors have brought actions against the United States pursuant to the North American Free Trade Agreement (“NAFTA”) Chapter 11 investor-state dispute mechanism, causing the United States to become the first capital-exporting state to break with investors’ interests.<sup>1</sup> The United States is evaluating foreign investment law both offensively and defensively. Indeed, the United States has tried to substantially limit Chapter 11 investment protection provisions to protect the country from NAFTA investment claims. This U.S. policy change is reflected in the investment provisions of the U.S. Free Trade Agreements (“FTAs”) with Peru, Colombia and Panama.<sup>2</sup>

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1. See North American Free Trade Agreement, U.S.-Can.-Mex. ch. 11, Dec. 17, 1992, 32 I.L.M. 639 [hereinafter NAFTA]; see also North American Free Trade Agreement, 19 U.S.C.A. §§ 3301-3473 (2008).
2. In 2006, the United States signed FTAs with both Peru and Colombia. In 2007, the United States signed an FTA with Panama. Each agreement is based on the text of NAFTA and the implementation experience of the United States, subject to the negotiating objectives in the President’s 2002 Trade Promotion Authority as modified by the 2007 Bipartisan Trade Deal. See Free Trade Agreement, U.S.-Peru, Apr. 12, 2006, Office of the U.S. Trade Representative, <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text> (last visited Sept. 14, 2009); see also Free Trade Agreement, U.S.-Colom., Nov. 22, 2006, Office of the U.S. Trade Representative, <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text> (last visited Sept. 14, 2009); Free Trade Agreement, U.S.-Pan., June 28, 2007, Office of the U.S. Trade Representative, <http://www.ustr.gov/trade-agreements/free-trade-agreements/panama-tpa/final-text> (last visited Sept. 14, 2009) [hereinafter Peru, Colombia, and Panama FTAs]. The Peru FTA was ratified and entered into force on February 1, 2009. Colombia’s Congress approved the free-trade agreement and a protocol of amendment in 2007. Colombia’s Constitutional Court completed its review in July 2008, and concluded that the Agreement conforms to Colombia’s Constitution. The U.S. Congress has not yet ratified the Agreement. President Obama tasked the Office of the U.S. Trade

An examination of how NAFTA Chapter 11 arbitral tribunals have applied and interpreted the precise scope of the concept of “fair and equitable treatment” and the requirements of minimum standards of international law and “customary international law” pursuant to the investment provisions of NAFTA in *S.D. Myers v. Canada*,<sup>3</sup> *Pope & Talbot v. Canada*,<sup>4</sup> *Mondev v. United States*,<sup>5</sup> and *Glamis Gold v. United States*,<sup>6</sup> is particularly helpful in understanding the U.S. struggle to find a balance between providing robust foreign investment protections based on international law and simultaneously avoid investment treaty disputes. This approach to “fair and equitable treatment” will not focus on the precise language of NAFTA Chapter 11 but rather on what “customary international law” really means.

An analysis of NAFTA Chapter 11 jurisprudence may also shed light on what the customary international law standard of treatment found in the Peru, Colombia and Panama FTAs requires of a state party vis-à-vis investors of another state party. If one understands how NAFTA has been applied and interpreted, subsequent U.S. FTAs can usually be understood as well.

The concerns of the NAFTA parties over *Pope & Talbot*, *S.D. Myers*, and other assumed deviations from the customary international law standard prompted the first and to date only binding “interpretation” of NAFTA Chapter 11, which applies customary international law to limit the scope of “fair and equitable treatment” under international law.<sup>7</sup> Arguably, however, the scope of “fair and equitable treatment” should be broader than the states’ interpretation. For example, Article 38 of the Statute of the International Court of Justice states that custom is only one of four sources of international law.<sup>8</sup> Nevertheless, Chapter 10 of the U.S. FTAs with Peru, Colombia, and Panama explicitly incorporate the NAFTA parties’ FTC Interpretation ensuring the applicability of “customary international law,” rather than “international law.”<sup>9</sup>

Congress’ decision in the Trade Act of 2002 also reflected Congress’ fear that the United States was about to lose one or more NAFTA dis-

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Representative with seeking a path to address outstanding issues surrounding the Colombia FTA. During a visit from Colombian President Alvaro Uribe in June 2009, however, Obama said he did not have a “strict timetable” to the agreement, presumably as controversy over the safety of Colombian labor leaders continue. See Press Release, The White House, Remarks by Obama and President Uribe of Colombia in Joint Press Availability (June 29, 2009), available at [http://www.whitehouse.gov/the\\_press\\_office/Remarks-by-Obama-and-President-Uribe-of-Colombia-in-Joint-Press-Availability](http://www.whitehouse.gov/the_press_office/Remarks-by-Obama-and-President-Uribe-of-Colombia-in-Joint-Press-Availability). Panama approved the free-trade agreement on July 11, 2007. The U.S. Congress has not yet ratified the agreement.

3. See generally *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408 (2001).

4. *Pope & Talbot, Inc. v. Canada*, 41 I.L.M. 1347 (2002).

5. *Mondev Int’l Ltd. v. United States*, 42 I.L.M. 85 (2003).

6. *Glamis Gold Ltd. v. United States*, NAFTA Arb. Trib. (2009), available at <http://naftaclaims.com/Disputes/USA/Glamis-USA-Award.pdf>.

7. Statute of the International Court of Justice, art. 38, June 26, 1945, available at <http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0>.

8. *Id.*

9. See Peru, Colombia, and Panama FTAs, *supra* note 2, at ch. 10.

putes. Indeed, two Chapter 11 actions against the United States, *Methanex v. United States*<sup>10</sup> and *Loewen v. United States*,<sup>11</sup> were particularly troublesome and ultimately led to the negotiating objectives for future investment provisions in international trade agreements and bilateral investment treaties as embodied in the 2002 U.S. "Trade Promotion Authority."<sup>12</sup>

Another example of the United States' defensive posture regarding foreign investment law is found in the 2007 Bipartisan Trade Deal, the so-called compromise between the U.S. Trade Representative's Office and the Democratic Party leadership. In this deal, the Trade Representative and the Democratic Party agreed that there would be language in the preamble of the newer FTA investment chapters, including those found in the Peru, Colombia, and Panama FTAs stating "that foreign investors in the United States will not be accorded greater substantive rights with respect to investment protections than United States investors in the United States" under the U.S. Constitution.<sup>13</sup>

Finally, the national treatment language found in the 2002 U.S. Trade Promotion Authority, and the preamble of the U.S. FTAs with Peru, Colombia and Panama is reminiscent of the Calvo Doctrine, a troubling development that further limits the scope of foreign investment protections.<sup>14</sup>

## I. THE ORIGINS OF NAFTA CHAPTER 11

The investment provisions of NAFTA Chapter 11 are not completely innovative, and, in fact, the entire chapter is based in large part on the U.S. Model Bilateral Investment Treaty ("BIT") and earlier treaties that required prompt, adequate, and effective compensation for expropriation as a response to economic nationalists' assertions that expropriated investors were entitled to no more than the same treatment that states afford their nationals.<sup>15</sup> Indeed, the U.S. Model BIT obligates a host state, at the request of the investor, to submit investment disputes to binding

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10. *Methanex Corp. v. United States*, 44 I.L.M. 811 (2003).

11. *Loewen Group, Inc. v. United States*, 42 I.L.M. 811 (2003).

12. Trade Act of 2002, 19 U.S.C. § 3801 (2002). The negotiating objectives directed the U.S. Trade Representative's Office to, *inter alia*, ensure that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than U.S. investors in the United States and to establish standards for expropriation and compensation for expropriation, consistent with U.S. legal principles and practice.

13. See *Trade Facts: Final Bipartisan Trade Deal on Investment*, OFFICE OF U.S. TRADE REPRESENTATIVE, May 11, 2007, [http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset\\_upload\\_file127\\_11319.pdf](http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file127_11319.pdf).

14. See R. Doak Bishop & James E. Etri, *International Commercial Arbitration in South America*, <http://www.kslaw.com/library/pdf/bishop3.pdf> (last visited June 8, 2010).

15. 2004 U.S. Model Bilateral Investment Treaty, Annex A (2004), available at <http://www.state.gov/documents/organization/117601.pdf>.

third-party arbitration.<sup>16</sup>

Specific aspects of NAFTA investor–state arbitration are, nonetheless, dissimilar to the American Model BIT. Most importantly, all of the earlier agreements with mandatory investor-state arbitration were with developing, capital importing nations, rather than a developed, capital exporting (as well as importing) nation like Canada. Indeed, the capital exchange between the United States and Canada is substantial, with more than \$ 610 billion of trade per year between the two nations.<sup>17</sup> The United States is also Canada’s largest investor, with \$289 billion being invested a year, while Canada’s \$159 billion trade per year with the United States ranks fifth.<sup>18</sup> Canada’s well-developed legal systems with independent judiciaries provide a high level of protection for both foreign and domestic investors against arbitrary actions by the governments.<sup>19</sup> Surprisingly, at least to the NAFTA negotiators, actions by U.S. investors against Canada or Canadian investors against the United States account for the majority of NAFTA Chapter 11 disputes. This litigation experience between Canada and the United States is reflected in the changes to the investment provisions of subsequent BITs and U.S. FTAs, including the FTAs with Peru, Colombia, and Panama, despite the fact that virtually none of the BITs or FTAs are with developed countries whose nationals are likely to be filing investment dispute claims against the United States.<sup>20</sup>

## II. NAFTA’S FAIR AND EQUITABLE TREATMENT STANDARD FOR FOREIGN INVESTMENT

NAFTA Chapter 11, entitled “Investment,” serves two purposes. First, it provides a set of mandatory substantive provisions, which include, *inter alia*, most-favored-nation treatment, performance requirements, nationality of senior management, and mechanisms for financial transfers.<sup>21</sup> Second, NAFTA Chapter 11 provides for binding arbitration of disputes between foreign investors and their host governments under the United Nations Commission on International Trade Law (“UNCITRAL”) arbitration rules, the World Bank’s International Centre for the Settlement of Investment Disputes (“ICSID”) Convention, or the ICSID’s “Additional Facility Rules.”<sup>22</sup>

If a NAFTA arbitral tribunal concludes that a host government has violated any of its Chapter 11 obligations, the tribunal may require that

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16. *Id.* art. 20. For additional information on Bilateral Investment Treaties (BITs) see K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards*, 4 INT’L TAX & BUS. L. 105, 112-129 (1986).

17. *Background Note: Canada*, U.S. DEP’T OF STATE, Feb. 18, 2010, <http://www.state.gov/r/pa/ei/bgn/2089.htm>.

18. *Id.*

19. *Id.*

20. *Id.*

21. See NAFTA, *supra* note 1.

22. *Id.* art. 1120.

government pay compensation to the foreign-investor complainant.<sup>23</sup> An investor, moreover, may seek enforcement of an arbitration award under the ICSID or the New York or InterAmerican Conventions.<sup>24</sup> Although NAFTA Chapter 11 contains a comprehensive set of mandatory substantive provisions, "fair and equitable treatment" is one of Chapter 11's most important and controversial provisions. As discussed *infra*, despite a series of arbitral tribunal decisions the scope of "fair and equitable treatment" has not yet been fully determined.

NAFTA Article 1105 states that "[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."<sup>25</sup> Since the "fair and equitable treatment" and "full protection and security" standards are connected with "international law," foreign investors asserting that the state had denied them fair and equitable treatment must demonstrate that the denial was a violation of international law.<sup>26</sup>

Unfortunately, there was little guidance regarding the definition of "fair and equitable treatment." NAFTA itself never defines the precise meaning of "fair and equitable treatment," and the U.S. Statement of Administrative Action, which accompanied NAFTA to Congress in 1993, never mentions Article 1105.<sup>27</sup> But the Canadian Statement on Implementation of NAFTA explained that Article 1105(1) "provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law."<sup>28</sup>

The difference between "international law" and "customary international law" has been a primary source of contention in investor-state arbitration proceedings. Under Article 1105, the term "international law" suggests a broader scope than "customary international law."<sup>29</sup> Indeed, one possible interpretation of the "fair and equitable treatment" language is the following: Article 38 of the Statute of the International Court of Justice defines international law to include: (a) international conventions, (b) international custom, (c) "the general principles of law recognized by civilized nations," and (d) "judicial decisions and the teachings of the most highly qualified publicists of the various nations."<sup>30</sup> In other words, customary international law is merely a subset of international

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23. *Id.* art. 1135.

24. *Id.* art. 1136(6).

25. *Id.* art. 1105(1).

26. See Daniel M. Price & P. Bryan Christy, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement*, 27 INT'L L. 727, 729 (1993).

27. North American Free Trade Agreement Implementation Act, Statement of Administrative Action, available at <http://www.naftaclaims.com/Papers/US%20Statement%20of%20Administrative%20Action.pdf>.

28. North American Free Trade Agreement: Canadian Statement on Implementation, Canada Gazette Part I (Jan. 1, 2004), available at [http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/N11\\_JAN1994.pdf](http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/N11_JAN1994.pdf).

29. *See id.*

30. *See* Statute of the International Court of Justice, art. 38.

law. Customary international law is “created and sustained by the constant and uniform practice of States,” and indicates “the mutual conviction that the recurrence is the result of a compulsory rule” or *opinio juris*.<sup>31</sup>

Still, the significance of Article 38 of the Statute of the International Court of Justice is unclear. Some commentators have argued that international conventions and custom are the only legitimate sources of international law, *i.e.*, “judicial decisions and the teachings of the most highly qualified publicists of the various nations,” are only opinion evidence of international law standards and do not constitute state practice; and “the general principles of law recognized by civilized nations” aren’t binding norms, but rather provide interpretive guidance.<sup>32</sup> But to argue that custom operates independently of treaties, including more than 2,000 bilateral investment treaties, many treaties of friendship and commerce, and several arbitral decisions, may be a much too narrow view of how to ascertain customary international law.

#### A. NAFTA CASE LAW PRIOR TO THE FTC INTERPRETATION

Since NAFTA became effective on January 1, 1994, several Chapter 11 tribunals have considered the scope of Article 1105 (“minimum standard of treatment”). Although “[a]n award made by a Tribunal shall have no binding force except as between the disputing parties and in respect of a particular case,” prior decisions may have persuasive authority.<sup>33</sup> Consequently, it is important to examine NAFTA case law. An examination of how NAFTA Chapter 11 arbitral tribunals have applied and interpreted the precise scope of the concept of “fair and equitable treatment” and the requirements of minimum standards of international law and “customary international law” pursuant to the investment provisions of NAFTA in *S.D. Myers, Pope & Talbot, Mondev*, and *Glamis Gold*, is particularly helpful in understanding the United States’ struggle to find a balance between providing robust foreign investment protections based on international law and simultaneously avoid investment treaty disputes.

The issue is whether the definition of “customary international law” is the same as the definition established in 1926 in *Neer v. Mexico*, where the arbitral tribunal stated that “the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wil[l]ful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.”<sup>34</sup> Has the standard evolved? If yes, what evidence of custom is there to determine

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31. See BARRY E. CARTER, PHILLIP R. TRIMBLE, & CURTIS A. BRADLEY, *INTERNATIONAL LAW* (4th ed. 2003) (1991).

32. James G. Apple, *Independence of the Judiciary*, *INT’L JUDICIAL MONITOR*, May 2006, [www.judicialmonitor.org/archive\\_0506/generalprinciples.html](http://www.judicialmonitor.org/archive_0506/generalprinciples.html).

33. See NAFTA, *supra* note 1, art. 1136(1).

34. See *Neer v. Mexico*, 4 R Int’l Arb. Awards 60, 61-62 (1926).

its current scope? In essence, are the hundreds of bilateral investment treaties containing similar "fair and equitable treatment" language part of an evolving body of "customary international law" and how egregious, unreasonable or shocking must government conduct be before it reaches the threshold of a violation of international law?

1. *S.D. Myers, Inc. v. Canada: "[F]air and equitable treatment" is Subsumed in International Law Requirements*

In *S.D. Myers, Inc. v. Canada*, S.D. Myers, an Ohio company engaged in remediation of hazardous waste, alleged that Canada's export ban of polychlorinated biphenyl (PCB) waste denied it fair and equitable treatment under Article 1105 and was enacted to benefit Chem-Security, Canada's only PCB treatment facility located in Alberta, Canada.<sup>35</sup> S.D. Myers entered the Canadian market to obtain PCB wastes for treatment in Ohio.<sup>36</sup> S.D. Myers enjoyed a significant cost advantage over Chem-Security: it was cheaper for Ontario PCB producers to ship their waste a few hundred miles to Ohio rather than 1500 miles to Alberta.<sup>37</sup> In 1995, however, the Canadian Minister of the Environment issued interim and final orders that temporarily banned PCB exports from Canada.<sup>38</sup> Canadian companies had to treat their PCB wastes at Chem-Security.<sup>39</sup>

Canada argued, however, that the ban was enacted in order to comply with the Basel Convention, an international environmental agreement developed under the auspices of the United Nations Environment Programme.<sup>40</sup>

The tribunal held that because the "[m]inimum [s]tandard of [t]reatment" encompasses the international law requirements of due process, economic rights, and obligations of good faith and natural justice,<sup>41</sup> Canada had violated Article 1105 through blatant discrimination with its hazardous waste processing facility in Alberta and in S.D. Myers's similar facility in Ohio.<sup>42</sup> The tribunal asserted that Article 1105(1)'s "fair and equitable treatment," and "full protection and security" language must be read in conjunction with the introductory phrase "treatment in accordance with international law."<sup>43</sup> Consequently, an Article 1105 breach occurs only "when . . . an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable

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35. *S.D. Myers, Inc.*, 40 I.L.M. at 1422.

36. *Id.* at 1415.

37. *Id.* at 1448.

38. *Id.* at 1419.

39. *Id.*

40. *See id.* The Basel Convention prohibits the export and import of hazardous waste to and from states that are not party to the Agreement. At the time, the United States had signed but not ratified the Convention. *See* The Basel Convention, 1992, available at <http://www.basel.int/index.html>.

41. *See S.D. Myers, Inc.*, 40 I.L.M. at 1481.

42. *See id.* at 1448-50.

43. *Id.* at 1438.

from the international perspective.”<sup>44</sup> Discriminatory and unfair treatment is also a denial of good faith under Article 1105 as foreign investors should not lack the protection and security afforded to nationals.<sup>45</sup>

Thus, it is clear that the *S.D. Myers* tribunal broadly interpreted the “fair and equitable treatment” standards under Article 1105 in favor of foreign investors: “fair and equitable treatment” is subsumed in the international law standard and since international law includes rules designed to protect investors, a denial of national treatment under Article 1102 can also be a violation of article 1105.<sup>46</sup>

2. *Pope & Talbot, Inc. v. Canada: “[F]air and equitable treatment” is an Autonomous Standard That is not Limited to Customary International Law*

In *Pope & Talbot, Inc. v. Canada*,<sup>47</sup> a U.S. corporation alleged that Canada’s enactment of an export quota system under the 1996 Softwood Lumber Agreement with the United States discriminated against its Canadian subsidiary in violation of article 1105’s “minimum standard of treatment” clause.<sup>48</sup>

Canada asserted, however, that according to international law, an article 1105 minimum treatment standard violation required “egregious” state conduct (the standard elucidated in *Neer*).<sup>49</sup> Canada’s enactment of a lumber export control regime merely reallocated quotas among Alberta, British Columbia, Ontario, and Quebec and reduced Pope & Talbot’s exports to the United States.<sup>50</sup> Canada argued, therefore, that its actions did not rise to the level of “egregious” conduct under international law.<sup>51</sup>

The arbitral tribunal held that Canada’s Softwood Lumber Division of the Department of Foreign Affairs and International Trade failed to provide Pope & Talbot’s investment fair and equitable treatment.<sup>52</sup> The tribunal also held that the NAFTA right to “fair and equitable treatment” was independent of, rather than limited by, the phrase “treatment in accordance with international law.”<sup>53</sup> In other words, the minimum standard of treatment’s “fair and equitable treatment” component is an autonomous standard that is not limited to customary international law.<sup>54</sup>

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44. *Id.*

45. *See id.*

46. *See id.*

47. *See Pope & Talbot, Inc. v. Canada*, Award on the Merits of Phase 2, Apr. 10, 2001, available at [http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Award\\_Merits-e.pdf](http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Award_Merits-e.pdf).

48. *See id.* at ¶ 106.

49. *Id.* at ¶ 108.

50. *Id.* at ¶¶ 20-21, 92-93, 121.

51. *See id.* at ¶¶ 108-09.

52. *Id.* at ¶ 181.

53. *Pope & Talbot v. Canada*, Award on the Merits of Phase 2, *supra* note 47, ¶ 111.

54. This approach (the autonomous standard) to identifying the content of the minimum standard of treatment is generally preferred by arbitrators since it gives them maximum discretion and rule-making authority. For example, an “autonomous”



B. THE FTC INTERPRETATION AND ITS IMPACT ON FUTURE  
CHAPTER 11 TRIBUNALS

NAFTA article 1131(2) permits the trade ministers from each party, acting as the Free Trade Commission ("FTC"), to issue interpretations of NAFTA, which is binding on Chapter 11 tribunals.<sup>55</sup> After the *Pope & Talbot* tribunal held that Canada breached article 1105, the NAFTA governments issued their first, and to date, only NAFTA Chapter 11 "interpretation," to narrow the scope of "fair and equitable treatment" to what customary international law provides.<sup>56</sup> This interpretation of article 1105(1) states the following:

B. Minimum Standard of Treatment in Accordance with International Law

1. Article 1105(1) prescribes the *customary* international law minimum standard of treatment to be afforded to investments of investors of another Party.

2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the *customary* international law minimum standard of treatment of aliens.

3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).<sup>57</sup>

The "customary international law" standard under section B(1), as opposed to article 1105's "international law" language, substantially limits Chapter 11 investment protection provisions.<sup>58</sup> Simply put, the interpretation does not require that the concepts of "fair and equitable treatment" and "full protection and security" be ignored, but rather that they be subsumed in the minimum standard of treatment of aliens.

Section B(2) effectively overrules the then pending *Pope & Talbot* award, clarifying that "fair and equitable treatment" and "full protection and security" are afforded only to the extent required by customary international law.<sup>59</sup> Finally, in response to the *S.D. Myers* holding that Canada had violated the minimum standard of treatment provisions of article 1105 through blatant discrimination between its hazardous waste processing facility in Alberta and *S.D. Myers*' similar facility in Ohio,<sup>60</sup> paragraph 3 prohibited a claimant from basing an article 1105 violation

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interpretation of "fair and equitable treatment" would prohibit government action that is arbitrary, even if not so egregious as to violate the *Neer* standard.

55. NAFTA, *supra* note 1, art. 1131(2).

56. NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions § B (July 31, 2001), [http://www.naftaclaims.com/files/NAFTA\\_Comm\\_1105\\_Transparency.pdf](http://www.naftaclaims.com/files/NAFTA_Comm_1105_Transparency.pdf).

57. *Id.* (emphasis added).

58. *See id.*

59. *See id.*

60. *S.D. Myers, Inc.*, 40 I.L.M. at 1438-39.

largely on a finding of an article 1102 national treatment violation.<sup>61</sup>

The FTC Interpretation, however, immediately sparked controversy. The *Pope & Talbot* tribunal even suggested that the parties' interpretation was actually a back-door effort to amend NAFTA without the approval of each party's constitutional processes.<sup>62</sup> Indeed, the FTC had effectively amended article 1105(1) by inserting the word "customary" before "international law," thus, limiting the scope of article 1105 protections. The United States defended the interpretation and criticized the *Pope & Talbot* tribunal arguing that treaty law and arbitral decisions were not relevant in determining "customary international law" unless there was evidence of a general practice, and agreement in the literature or previous court cases.<sup>63</sup> As noted previously, Canada urged the *Pope & Talbot* tribunal to award damages pursuant to a violation of customary international law only if the tribunal found Canada acted egregiously or otherwise failed to meet internationally required standards (*Neer*).<sup>64</sup>

In the end, the *Pope & Talbot* tribunal held that the interpretation was binding, but it refused to accept the static version of customary law advanced by Canada and the other parties.<sup>65</sup> Instead, the tribunal believed that the range of actions subject to international concern included the concept of fair and equitable treatment,<sup>66</sup> which was recognized by the OECD,<sup>67</sup> and was central to the 1,800 BITs negotiated to protect foreign-owned property.<sup>68</sup> This clearly evidenced state practice towards the formation of customary international law.<sup>69</sup> The tribunal, nevertheless, did not decide the applicable customary international law standard because Canada's Softwood Lumber division violated article 1105 by treating *Pope & Talbot* in an egregious manner.<sup>70</sup>

Several subsequent Chapter 11 tribunals have struggled with these same issues. In fact, many have backed away from the idea that the interpretation was an attempt not to interpret, but to indirectly amend, NAFTA.

One final note regarding *Pope & Talbot*: the NAFTA parties were bothered by the tribunal's holding that the content of contemporary customary international law reflects the concordant provisions of many hundreds of BITs, particularly, the tribunal's failure to consider whether the parties to very large numbers of BITs have acted out of a sense of legal obligation (*opinio juris*) when they include "fair and equitable treatment" provisions in those treaties, a necessary element of the establishment of a rule of customary international law. The United States, in particular,

61. Notes of Interpretation of Certain Chapter 11 Provisions, *supra* note 56.

62. *Pope & Talbot, Inc.*, 41 I.L.M. at ¶ 47.

63. *Id.* at ¶ 112.

64. *Id.* at ¶ 108.

65. *See id.* at ¶¶ 114-15.

66. *Id.* at ¶ 109.

67. *Id.* at ¶ 112.

68. *Id.* at ¶ 111.

69. *Pope & Talbot, Inc.*, 41 I.L.M. at ¶ 111.

70. *Id.* at ¶ 181.

would continue to argue in subsequent disputes that evidence of state practice alone is not enough to establish a rule of customary international law.

1. *Mondev v. United States: "[C]ustomary International Law" Includes Bilateral Investment Treaties Concluded Since NAFTA Came into Force*

In *Mondev v. United States*,<sup>71</sup> the arbitral tribunal also examined whether the content of customary international law providing for "fair and equitable treatment" and full protection and security in investment treaties was any different than it was in the 1920s. *Mondev*, a Canadian real-estate development corporation, alleged that the Boston Redevelopment Authority's statutory immunization from intentional tort liability is incompatible with international law, and that the decisions of the Massachusetts courts amounted to a denial of justice in violation of article 1105(1).<sup>72</sup>

Like *Pope & Talbot*, *Mondev* argued that the interpretation was effectively an amendment to NAFTA, permitted only with the applicable legal procedures of each Party.<sup>73</sup> Finally, *Mondev* argued that if customary international law was the appropriate standard "that law had to be given its current content, as it had been shaped by the conclusion of hundreds of bilateral investment treaties, including NAFTA, and by modern international judgments and arbitral awards."<sup>74</sup>

While the United States recognized the significance of the jurisprudence of state practice and arbitral tribunals, it again contended that BITs were not relevant in a customary international law analysis unless it could be shown that they reflected evidence of a general practice, agreement in the literature or previous court cases. A tribunal cannot "adopt its own idiosyncratic standard of what is 'fair' or 'equitable,' without reference to established sources of law."<sup>75</sup> Both Canada and Mexico argued that although the customary international law standard could evolve over time, the threshold for finding a violation of customary international law required "arbitrary action substituted for the rule of law" for a violation.<sup>76</sup>

The arbitral tribunal held that the "substantive and procedural rights of the individual in international law have undergone considerable development, "[t]o the modern eye, what is unfair or inequitable need not equate with the outrageous or egregious," and that "a State may treat foreign investment unfairly and inequitably without necessarily acting in bad faith."<sup>77</sup> The tribunal reasoned that the interpretation's reference to

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71. *Mondev Int'l Ltd.*, 42 I.L.M. at ¶ 116.

72. *See generally id.*

73. *Id.* at ¶ 102.

74. *Id.*

75. *Id.* at ¶ 119.

76. *Id.* at ¶ 108.

77. *Id.* at ¶ 116.

“customary international law” meant that status of that body of law no earlier than 1994, when the NAFTA came into force.<sup>78</sup> This includes “more than two thousand bilateral investment treaties and many treaties of friendship and commerce” that “provide for ‘fair and equitable’ treatment of, and for ‘full protection and security’ for, the foreign investor and his investments.”<sup>79</sup> The tribunal felt the question was not to show *opinio juris* or to amass sufficient evidence demonstrating it, but rather, what is the content of customary international law providing for “fair and equitable treatment” and full protection and security in investment treaties.

2. *Glamis Gold v. United States: Threshold for a Violation of International Law in the “Fair and Equitable Treatment” Area is the Neer Case*

More recently, an arbitral tribunal constituted under Chapter 11 of NAFTA, resolved a protracted dispute between the United States and Glamis Gold Ltd. (*Glamis Gold v. United States*).<sup>80</sup> As noted below, *Glamis Gold* is a new interpretation of customary international law (at least because it represents a departure from what other Chapter 11 arbitral tribunals have said about the minimum standard of treatment) that, to the dismay of investment arbitrators and private sector investment lawyers, further narrows the scope of “fair and equitable treatment.”

Glamis, a Canadian mining company, alleged that certain U.S. federal government actions and California state measures with respect to open-pit mining (including regulations requiring backfilling and grading operations in the vicinity of Native American sacred sites) resulted in an Article 1105 fair and equitable treatment violation.<sup>81</sup> The Tribunal noted that “[t]here is no disagreement among the State Parties to the NAFTA, nor the Parties to this [case], that the requirement of fair and equitable treatment in Article 1105 is to be understood by reference to the customary international law minimum standard of treatment of aliens.”<sup>82</sup> Accordingly, the tribunal characterized the Article 1105 issue before it as one requiring a determination of the precise scope of “fair and equitable treatment” and the requirements of minimum standards of customary international law owed by a NAFTA State Party to an investor of another State Party.<sup>83</sup>

Glamis argued “that the duty to accord investors fair and equitable treatment and the minimum standard of treatment are dynamic standards informed by the proliferation of more than 2,000 bilateral investment treaties and many treaties of friendship and commerce.”<sup>84</sup> Consequently,

78. *Id.* at ¶ 125.

79. *Mondev Int’l Ltd.*, 42 I.L.M. at ¶ 125.

80. See *Glamis Gold Ltd., v. United States*, Award, May 16, 2009, available at <http://www.naftaclaims.com/Disputes/USA/Glamis/Glamis-USA-Award.pdf>.

81. *Id.* at ¶ 537.

82. *Id.* at ¶ 599.

83. *Id.* at ¶ 600.

84. *Id.* at ¶ 548.

the tribunal could consider prior arbitral decisions to establish that the threshold for a violation of "fair and equitable treatment" is "something less than the 'egregious,' 'outrageous,' or 'shocking' standard as elucidated in *Neer*."<sup>85</sup>

The United States, however, attacked Glamis' use of treaties and prior interpretations of "fair and equitable treatment" by arbitral tribunals. Arbitral awards, the United States argued, do not constitute State practice and cannot prove customary international law.<sup>86</sup> Thus, parties to bilateral investment treaties are not legally obligated to include "fair and equitable treatment" provisions in those treaties.

Ultimately, the tribunal accepted the view of the NAFTA parties that the threshold for a violation of international law in the "fair and equitable treatment" area is the *Neer* case. The tribunal explained that to determine the scope of customary international law, one must consider not only questions of law but also questions of fact. "[C]ustom is found in the practice of States regarded as legally required by them."<sup>87</sup> The tribunal held that although State practice may be readily identifiable, the intent behind those actions is not.<sup>88</sup> Consequently, custom is effectively frozen at the 1926 conception of egregious.<sup>89</sup>

#### C. CHAPTER 10 OF THE UNITED STATES' FTAs WITH PERU, COLOMBIA AND PANAMA

The United States, Peru, Colombia and Panama structured Article 10.5(1) to ensure the applicability of "customary international law," rather than "international law" in their respective agreements. Each requires that the parties "accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security."<sup>90</sup> Similarly, the parties clarified that "customary international law" as referenced in Article 10.5 "results from a general and consistent practice of States that they follow from a sense of legal obligation."<sup>91</sup> The inclusion of a definition of customary international law may reflect the United States' apparent frustration with the *Pope & Talbot* tribunal's failure to consider whether the parties to numerous BITs have acted out of a sense of legal obligation when they include provisions for "fair and equitable treatment" of foreign investment in those treaties.

The impact of these provisions is unclear, however, since neither agreement addresses the current scope of customary international law. In addition, there have been no investment disputes in post-NAFTA FTAs that have reached the stage of investor-state arbitration. Consequently, future

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85. *Id.*

86. *Glamis Gold Ltd.*, at ¶ 554.

87. *Id.* at ¶ 21.

88. *Id.* at ¶ 603.

89. *Id.* at ¶ 604.

90. *See* Peru, Colombia and Panama FTAs, *supra* note 2, art. 10.5(1).

91. *Id.* at Annex 10-A.

Chapter 10 arbitral tribunals will be required to determine what this customary international law standard of treatment found in the Peru, Colombia and Panama FTAs requires of a State Party vis-à-vis investors of another State Party.

More likely than not, they will look to NAFTA jurisprudence to see how NAFTA Chapter 11 arbitral tribunals have interpreted the precise scope of the concept of “fair and equitable treatment” and the requirements of minimum standards of customary international law. Several Chapter 11 arbitral tribunals have determined that the hundreds of bilateral investment treaties containing similar “fair and equitable treatment” language evidence an evolving body of customary international law. Nevertheless, the *Glamis Gold* tribunal accepted the view of the NAFTA parties that the threshold for a violation of international law in the “fair and equitable treatment” area is the 1926 *Neer* case with no development since then.<sup>92</sup> This interpretative approach further narrows the scope of “fair and equitable treatment.”

### III. TRADE ACT OF 2002

United States concerns about NAFTA Chapter 11 investor-state arbitration mostly pertain to legitimate government regulatory actions (many that are designed to protect the environment) and measures that would not be compensable under the Fifth Amendment of the U.S. Constitution, but would give rise to liability under international investment treaties;<sup>93</sup> NAFTA tribunal review of national court decisions; and the possibility that foreign citizens bringing NAFTA investment claims may have greater rights than American citizens facing the same governmental action would have pursuant to the Fifth Amendment or a specific statute authorizing court action.<sup>94</sup>

Particularly relevant are *Methanex v. United States*<sup>95</sup> and *Loewen v. United States*,<sup>96</sup> two post-interpretation Chapter 11 actions against the United States, which ultimately led to the negotiating objectives for future investment provisions in international trade agreements and bilateral investment treaties as embodied in the 2002 U.S. “Trade Promotion Authority.”<sup>97</sup>

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92. *Glamis Gold Ltd.*, at ¶ 612.

93. DAVID A. GANTZ, *REGIONAL TRADE AGREEMENTS: LAW, POLICY AND PRACTICE* 123 (2009). The Takings Clause of the 5th Amendment of the U.S. Constitution states that, “[N]or shall private property be taken for public use, without just compensation.” U.S. CONST. art. V. The controlling U.S. case is *Penn Central Transportation Co. v. New York City*, which requires a fact-based inquiry of every alleged taking, considering, *inter alia*, the economic impact of the government action, the extent to which it interferes with reasonable investor expectations, and the character of the government action. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978).

94. *Id.*

95. *Methanex Corp. v. United States*, 44 I.L.M. 1345 (2005).

96. *Loewen Group, Inc.*, 42 I.L.M. at ¶ 28.

97. Trade Promotion Authority (fast track) provides that U.S. Congress must, generally speaking, vote trade agreements up or down in their entirety.

A. METHANEX V. UNITED STATES: PROHIBITION OR RESTRICTED  
USE OF CHEMICAL COMPOUNDS FOR ENVIRONMENTAL AND/OR  
HEALTH REASONS IS PERMISSIBLE

In *Methanex v. United States*,<sup>98</sup> Methanex, a Canadian producer and marketer of methanol, alleged that California's ban of the gasoline additive, methyl tertiary butyl ether (MTBE), because of the perceived risks of MTBE pollution of the underground water supply, constituted "unfair and inequitable treatment" and was "tantamount to expropriation." Methanex argued "the California measures were intended to discriminate against foreign investors and their investments, and intentional discrimination is, by definition, unfair and inequitable."<sup>99</sup>

Methanex asserted that the FTC Interpretation binds the parties if and only if it is not an amendment of Article 1105(1).<sup>100</sup> Methanex recognized the FTC's ability to issue binding interpretations of NAFTA provisions but asserted that it lacks the power to amend NAFTA. Consequently, any interpretation limiting the scope of investment protection, including the interpretation suggested by the United States, would be an impermissible amendment.<sup>101</sup> Methanex argued, therefore, that the tribunal must interpret Article 1105's fair and equitable treatment provision in accordance with its ordinary meaning.<sup>102</sup>

In support of its proposition, Methanex cited rules of treaty interpretation, NAFTA jurisprudence, international law, and domestic law. First, Methanex asserted that the Vienna Convention on the Law of Treaties required the tribunal to interpret Chapter 11 in light of its purpose, which is to provide investment protection. Therefore, the words fair and equitable treatment should be interpreted by their plain meaning.<sup>103</sup> Second, Methanex contended that the *Loewen* tribunal had previously ruled that Chapter 11 should be given a liberal interpretation in order to provide investment protection.<sup>104</sup>

Third, Methanex rejected the United States' argument that the definition of fair and equitable treatment is too "unknown" or "subjective" to be given its ordinary meaning. Methanex asserted that the definition of fair and equitable treatment is well-known in both international and domestic law.<sup>105</sup> "While the fair and equitable treatment standard may not

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98. *Methanex v. United States*, 1st Partial Award, Aug. 7, 2002, available at <http://www.state.gov/documents/organization/12613.pdf>.

99. *Id.* at ¶ 11.

100. *Methanex Corp. v. United States*, Claimant Methanex Corp., Reply to the Resp. of Resp't, United States of America, Oct. 26, 2001, to Methanex's Submission Concerning the NAFTA Free Trade Comm'n's July 31, 2001 Interpretation, at 2, Nov. 9, 2001, available at <http://www.naftaclaims.com> [hereinafter *Methanex Reply Submission*].

101. *Id.*

102. *Id.* at 3.

103. *Id.* at 4.

104. *Id.*

105. *Methanex Corp. v. United States*, Methanex First Submission Concerning the NAFTA FTC Statement on Article 1105, at 19, Sept. 18, 2001, available at <http://www.state.gov/s/l/c5823.htm>.

be reducible to a single formulation applicable to every set of circumstances, the standard is routinely applied by international and U.S. judges in a variety of different contexts. There is no reason why this Tribunal cannot apply the same standard to the California measures.”<sup>106</sup> Finally, Methanex argued that the text of NAFTA must be given its ordinary meaning: “international law” under Article 1105 must be read expansively to include both customary and treaty law.<sup>107</sup>

The United States, however, asserted that the interpretation negated Methanex’s arguments based on Article 1105(1),<sup>108</sup> the scope of “customary international law” as defined in the interpretation was consistent with “thirty years of State practice.”<sup>109</sup> The United States also argued that “fair and equitable treatment” did not encompass broad “concepts of ‘equity, fairness, due process and appropriate protections.’”<sup>110</sup> Finally, the United States argued that Article 1105 did not permit “claims based on violations of WTO or other conventional international obligations.”<sup>111</sup>

The tribunal rejected all of Methanex’s Chapter 11 substantive claims, including those based on Article 1105(1). The tribunal applied the FTC Interpretation’s restrictive “fair and equitable treatment” standard and held that the United States did not violate Article 1105.<sup>112</sup> Although earlier cases indicated an increasingly expansive view of NAFTA’s investment protection provisions, the interpretation directs Chapter 11 arbitral tribunals to narrow the scope of “fair and equitable treatment” to what customary international law provides.<sup>113</sup> Even if the FTC Interpretation was a substantive change, “[a] treaty may be amended by agreement between the parties,”<sup>114</sup> and “any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions” shall be taken into account.<sup>115</sup>

The tribunal also held that California’s ban was a permissible regulation—a non-discriminatory action, for a public purpose, in accordance with due process of law, and fair and equitable treatment—and not an expropriation.<sup>116</sup> Methanex entered the US market aware that government environmental and health protection institutions “continuously

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106. *Id.* at 5.

107. *Id.*

108. Methanex Corp. v. United States, Resp. of Resp’t, United States of America, to Methanex’s Submission Concerning the NAFTA Free Trade Comm’n’s July 31, 2001 Interpretation, at 1, Oct. 26, 2001, available at <http://www.state.gov/documents/organization/6028.pdf>.

109. *Id.* at 4.

110. *Id.* at 6.

111. *Id.* at 7-8.

112. Methanex v. United States, Final Award on Jurisdiction and Merits at Part IV, Chapter C, at ¶ 27, Aug. 3, 2005, available at <http://www.state.gov/s/1/c5818.htm>.

113. *Id.* at ¶¶ 9-10. Discrimination between nationals and aliens contravenes customary international law only by way of exception—Methanex failed to establish that a specific customary rule required equal treatment under the circumstances.

114. *Id.* at ¶ 21.

115. *Id.*

116. *Id.* Part IV, Chapter D, at ¶¶ 9-10.



monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons."<sup>117</sup>

B. LOEWEN V. UNITED STATES: NAFTA TRIBUNAL REVIEW OF NATIONAL COURT DECISIONS IS NOT PERMISSIBLE UNLESS LOCAL LEGAL REMEDIES ARE EXHAUSTED

In *Loewen v. United States*, a Mississippi state court trial alleged to have been conducted in an intentionally prejudicial manner resulted in a jury verdict of \$500 million against Loewen (a Canadian operator of funeral homes), of which \$400 million represented punitive damages, even though the disputed contracts were worth less than \$10 million.<sup>118</sup> Loewen subsequently brought a NAFTA Chapter 11 claim against the United States arguing that Article 1105(1) and the interpretation prescribe the customary international law standard of treatment of aliens as the minimum standard of treatment to be afforded to the investment property of nationals of the other party.<sup>119</sup> The introduction of anti-Canadian testimony and counsel comments during the trial was prejudicial and violated the "fair and equitable treatment" standard.<sup>120</sup> Loewen argued, "[u]nder international law, an alien is entitled to an impartial trial untainted by invidious discrimination."<sup>121</sup>

In response, the United States argued, *inter alia*, that the treatment accorded to Loewen by the Mississippi state courts could not be shown to be "below the international minimum standard required by Article 1105."<sup>122</sup> The fact that "the Tribunal must consider the entirety of the United States' system of justice stems from the nature of the customary international law obligation that gives rise to State responsibility for denial of justice."<sup>123</sup> The United States ultimately prevailed.

The Tribunal agreed that the Mississippi court decision was "clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment."<sup>124</sup> Yet, the tribunal added: "[n]o instance has been drawn to our attention in which an international tribunal has held a State responsible for a breach of international law constituted by a lower court decision when there was available an effective and adequate appeal within the State's legal sys-

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117. *Id.*

118. *See generally* Loewen Group, Inc. v. United States, Notice of Claim, Oct. 30, 1998, available at <http://www.state.gov/documents/organization/3922.pdf>.

119. *Id.*

120. *Id.* at ¶ 7.

121. *Id.* at ¶ 141.

122. *Loewen Group, Inc. & Raymond L. Lowen v. United States, Counter-Memorial of the United States*, ICSID Case No. ARB (AF)/98/3, ¶ 142 (2003), available at <http://www.state.gov/documents/organization/7387.pdf>.

123. *Id.*

124. *Loewen Group, Inc. & Raymond L. Lowen & United States, Award*, ICSID Case No. ARB (AF)/98/3, ¶ 137 (2003), available at <http://www.state.gov/documents/organization/22094.pdf>.

tem.”<sup>125</sup> In other words, a NAFTA Chapter 11 tribunal cannot find a violation of international law unless local legal remedies have been exhausted (the finality requirement via exhaustion of domestic judicial remedies).<sup>126</sup>

Notwithstanding the fact that NAFTA has an election (a foreign investor must waive his right to “initiate or continue” domestic court proceedings prior to initiating NAFTA arbitration), not an exhaustion requirement,<sup>127</sup> the NAFTA parties must have been relieved by the *Loewen* tribunal’s holding because NAFTA negotiators probably never intended for domestic courts to be subject to NAFTA actionable claims,<sup>128</sup> which would effectively subject domestic judicial decisions to review by international tribunals, notwithstanding the possible absence or inadequacy of domestic judicial remedies. Indeed, many Americans would likely find this troubling. Allowing foreign investors to challenge judicial decisions under Chapter 11 would give foreign investors greater rights than domestic investors, whose only recourse is the domestic legal system.<sup>129</sup>

The *Methanex* and *Loewen* cases ultimately led to the negotiating objectives for future investment provisions in international trade agreements and bilateral investment treaties as embodied in the 2002 U.S. “Trade Promotion Authority,” which states:

[T]he principal negotiating objectives of the United States regarding foreign investment are to reduce or eliminate artificial or trade-distorting barriers to foreign investment, *while ensuring that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in*

125. *Id.* at ¶ 154.

126. The tribunal incorrectly held that under the exhaustion requirement, *Loewen* was required to appeal to the U.S. Supreme Court before the NAFTA arbitral panel had jurisdiction. A foreign investor must only waive his right to “initiate or continue” domestic court proceedings prior to initiating NAFTA arbitration. *Loewen Group, Inc.*, 42 I.L.M. at ¶ 145.

127. See NAFTA, *supra* note 1, art. 1121. Beginning with the Singapore and Chile FTAs, the United States has included an election requirement compared to NAFTA Chapter 11’s waiver approach in subsequent FTAs, which significantly narrows an investor’s options. Chile FTA Article 10.17, for example, requires a claimant’s written waiver of any right to initiate or continue suit against the party in any other court or under any other dispute resolution procedure. See Free Trade Agreement, U.S.-Chile art. 10.17(2), June 6, 2003, Office of the U.S. Trade Representative, <http://www.ustr.gov/trade-agreements/free-trade-agreements/chile-fta/final-text> (last visited Sept. 22, 2009) [hereinafter Chile FTA]. Consequently, an American investor in Chile may not seek arbitration under Chapter 10 if she has already alleged the breach of Section A or Annex 10-F in a national court or administrative tribunal. *Id.* Except for interim injunctive relief, once an action is filed in the national courts, etc., no waiver is possible (the investor may seek interim injunctive relief from a domestic court, provided that the action is brought for the sole purpose of preserving the investor’s investment pending the arbitration, rather than monetary damages). *Id.* art. 10.17(3).

128. Stefan Matiation, *Arbitration with Two Twists: Loewen v. United States and Free Trade Commission Intervention in NAFTA Chapter 11 Disputes*, 24 U. PA. J. INT’L ECON. L. 451, 468 (2003).

129. *Id.* at 461.

*the United States*, and to secure for investors important rights comparable to those that would be available under United States legal principles and practice, by . . . reducing or eliminating exceptions to the principle of national treatment. . . . *seeking to establish standards for expropriation and compensation for expropriation, consistent with United States legal principles and practice.* . . . seeking to establish standards for fair and equitable treatment consistent with United States legal principles and practice, including the principle of due process. . . .<sup>130</sup>

By explicitly limiting protection for foreign investors in the United States to the rights guaranteed to U.S. citizens, the United States appears to be abandoning the application of minimum standards of international law and the availability of international arbitration for its own version of national treatment in the case of takings. This is eerily similar to the Calvo Doctrine discussed *infra*. Still, the U.S.-Chile FTA for example, which was designed in significant part to comply with the TPA objectives, solidified the applicability of international law to foreign investment disputes (the U.S. FTAs with Peru, Colombia and Panama have similar provisions).<sup>131</sup>

Compared to NAFTA Article 1105, Chile FTA Article 10.4 provides more detail with respect to the standards of treatment of aliens and their property found in customary international law.<sup>132</sup> Indeed, Chile FTA Article 10.4(2) avoids reducing “fair and equitable treatment” to no more than non-discriminatory treatment, where national treatment does not meet minimum standards of customary international law.<sup>133</sup> A “minimum standard” provision is necessary to avoid harsh, injurious, and unjust treatment to foreign investors, even if a government did not act in a discriminatory manner.<sup>134</sup> Article 10.4(2) also equates fair and equitable treatment under customary international law with U.S. standards of due process, so the former is not broader than the latter.<sup>135</sup> The due process language advocates the United States’ position in *Loewen* (customary international law does not require the United States to provide a perfect justice system only one that is “fundamentally adequate”).

Although Chile FTA Article 10.9 addresses the concerns expressed by governments and environmental groups regarding the distinction between compensable expropriation and valid regulation,<sup>136</sup> the Chile FTA provisions with the most significant changes related to expropriation appear in Annex 10-D. Annex 10-D provides that Article 10.9 not go beyond customary international law for investment protection and limits expropriation claims to interference with tangible or intangible property

130. Trade Act of 2002, 19 U.S.C. § 3802(b) (emphasis added).

131. U.S. FTAs available at <http://www.ustr.gov/trade-agreements/free-trade-agreements> (last visited Aug. 10, 2010).

132. See Chile FTA, *supra* note 127, art. 10.4.

133. *Id.* art. 10.4(2).

134. *Pope & Talbot, Inc.*, 41 I.L.M. at ¶ 10.

135. *Loewen Group, Inc.*, 42 I.L.M. at ¶ 144.

136. See Chile FTA, *supra* note 127, art. 10.9.

rights.<sup>137</sup>

Annex 10-D(4) also stresses the need for the “equivalency” of indirect takings to direct takings, absent only the formal transfer of title or outright seizure.<sup>138</sup> Accordingly, a case-by-case approach is necessary to determine whether government interference is reasonable. Factors to consider include the economic impact of the government action. Even though an action by a party has an adverse effect on the economic value of an investment, this effect by itself does not establish that an indirect expropriation has occurred.<sup>139</sup> “[T]he extent to which the government action interferes with distinct, reasonable investment-backed expectations”<sup>140</sup> and “the character of the government action”<sup>141</sup> is also considered.

Finally, Chile FTA Annex 10-D states that non-discriminatory actions protecting “legitimate public welfare objectives, such as public health, safety, and the environment” are not actionable expropriations “except in rare circumstances.”<sup>142</sup> Consider the *Methanex* case; California’s MTBE ban would not be an actionable expropriation, because it is a non-discriminatory action, for a public purpose, in accordance with due process of law, and fair and equitable treatment.

## V. THE BIPARTISAN TRADE DEAL OF 2007

As previously noted, the changes incorporated into the investment provisions of U.S. FTAs subsequent to NAFTA, as required by the President’s now expired Trade Promotion Authority (TPA expired June 30, 2007),<sup>143</sup> largely reflect experience in litigation between Canada and the United States. In addition, there have been no investment disputes in post-NAFTA FTAs that have reached the stage of investor-state arbitration.<sup>144</sup> Nevertheless, Congress apparently remained concerned that foreign investors bringing actions against the United States will receive better legal treatment than U.S. national investors bringing similar claims (U.S. investors do not have recourse to international arbitration against the United States Government or its agencies although they have full access to the U.S. courts). Accordingly, in May 2007, U.S. Trade Representative Susan Schwab and the Democratic Congressional leadership

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137. *See id.* Annex 10-D(4).

138. *Id.*

139. *Id.* at Annex 10-D(4)(a)(i).

140. *Id.* at Annex 10-D(4)(a)(ii).

141. *Id.* at Annex 10-D(4)(a)(iii).

142. *Id.* at Annex 10-D(4)(b).

143. Lee Hudson Teslik, *Fast-Track Trade Promotion Authority and Its Impact on U.S. Trade Policy*, Backgrounder, Council on Foreign Relations, COUNCIL ON FOREIGN RELATIONS, June 25, 2007, <http://www.cfr.org/publication/13663/>.

144. As of March 2008, however, arbitrators were being chosen for a dispute between a U.S. firm, Railroad Development Corp. and the Government of Guatemala. *See* Rosella Brevetti, *Arbitration Panel in First CAFTA-DR Investor-State Case Awaits Arbitrator*, 25 Int’l Trade Rep. (BNA) 350, Mar. 3, 2008.

negotiated the Bipartisan Trade Deal.<sup>145</sup>

While the May 2007 BTDA did not change the now-standard investment protection language found in U.S. FTAs, beginning with the Singapore and Chile FTAs, the preamble to the U.S. FTAs with Peru, Colombia and Panama has been changed to explicitly provide that foreign investors will not be accorded greater substantive rights regarding investment protections than U.S. investors in the United States. Under the new preambular language the Parties:

AGREE that foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investor rights under domestic law equal or exceed those set forth in this Agreement . . .<sup>146</sup>

The BTDA limits the applicability of domestic law to situations, explicitly including those in the United States, where protection of investor rights are allegedly equal to or greater than those set out in the Agreement (those provided by customary international law and the explicit rights under Section A of the investment chapter).<sup>147</sup> The issue is whether under U.S. law foreign investors possess all the legal rights guaranteed by international law as U.S. domestic investors under the U.S. Constitution. If yes, this clause has no substantive impact. In blatant cases of uncompensated expropriation such as have occurred recently in Argentina and Venezuela (Argentina's nationalization of Aerolíneas Argentinas and Venezuela's taking of Exxon's production licenses for example), an arbitral tribunal could probably dismiss the argument that protections under local law were at least equal to those provided under the investment chapter of the Agreement.<sup>148</sup> More interesting, however, would be if and when FTA member governments defending against foreign investors assert that their local law also meets or exceeds the requirements of the particular FTA's investment chapter. In an alleged regulatory takings case arbitrators could presumably ask the parties to the investment dispute to brief and argue the intricacies of U.S. expropriation law in the arbitration proceeding.<sup>149</sup>

In addition, the preambular language, like the national treatment language found in the 2002 Trade Deal, is also reminiscent of the Calvo Doctrine (named after the Argentinean diplomat Carlos Calvo), which, as discussed *infra*, Latin American jurisdictions traditionally embraced, espousing nonintervention in Latin American affairs and absolute equality of foreigners and Latin American nationals by providing that foreigners could only seek redress for grievances before local courts.<sup>150</sup>

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145. See *Trade Facts: Final Bipartisan Trade Deal on Investment*, *supra* note 13.

146. See Peru, Colombia and Panama FTAs, *supra* note 2, at Preamble.

147. See GANTZ, *supra* note 93, at 101-02.

148. *Id.*

149. *Id.*

150. Bernardo M. Cremades, *Disputes Arising Out of Foreign Direct Investment in Latin America: A New Look at the Calvo Doctrine and Other Jurisdictional Issues*,

## VI. AMERICANIZATION OF THE CALVO DOCTRINE

A lot has been made of Latin America's traditional hostility towards international arbitration embodied in the Calvo Doctrine. Although the region has engaged in extensive bilateral commitments to encourage foreign direct investment in their countries, economic instability and populist politics have again had unexpected consequences for the rights of foreign investors to arbitrate investment disputes. Several South American states, including Venezuela, Bolivia, Ecuador, Peru, and Argentina are withdrawing from ICSID or simply ignoring the terms of the bilateral investment treaties made with their trading partners. The Calvo Doctrine and intimations are reawakening.<sup>151</sup>

Although the United States has historically rejected the Calvo Doctrine, in an ironic change of policy it now appears to be implementing what all Latin American states would recognize as the Calvo Doctrine in an effort to limit its exposure to investment treaty claims.<sup>152</sup> Indeed, governments in South and North America are now similarly reluctant to be bound by international standards.<sup>153</sup>

In the Trade Act of 2002, Congress mandated a treaty-negotiating objective "that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States."<sup>154</sup> This national treatment is a central feature of the Calvo Doctrine. And while the 2004 version of the U.S. Model BIT still requires treatment in accordance with customary international law, the State Department's explanation indicates that the

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59 DISP. RESOL. J. 78, 80 (2004). "The Calvo Doctrine gave rise to the Calvo clause, which precluded arbitration and instead required disputes to be resolved in national courts. Latin American countries and State-owned companies included a Calvo clause in their investment contracts and agreements with foreign investors." *Id.*

151. See Andrew P. Tuck, *Investor-State Arbitration Revised: A Critical Analysis of the Revisions and Proposed Reforms to the ICSID and UNCITRAL Arbitration Rules*, 13 *LAW & BUS. REV. AM.* 885, 905-06 (2007) (discussing the threat of non-enforcement of ICSID arbitral awards in Latin America).

152. Ironic, for example, because Mexico's experience with the Calvo Clause was especially problematic to the NAFTA negotiations of investment provisions. Indeed, Mexico was one of the Latin American countries that most adamantly adhered to the Calvo Clause and the principle of the Calvo Doctrine. If a party (Canada or the United States) could not take up the cause of one of its citizens with an investment in Mexico, who was aggrieved at the action of the Mexican government, party-to-party dispute resolution would be impossible. Accordingly, Mexico agreed to change its view, and adopted a new arbitration regime based upon the UNCITRAL Model Law on International Commercial Arbitration. See Ernesto Aguirre, *International Economic Integration and Trade in Financial Services: Analysis from a Latin American Perspective*, 27 *LAW & POL'Y INT'L BUS.* 1057, 1063 (1996). See also Denise Manning-Cabrol, *The Imminent Death of the Calvo Clause and the Rebirth of the Calvo Principle: Equality of Foreign and National Investors*, 26 *LAW & POL'Y INT'L BUS.* 1179 (1995). NAFTA still represents the first and only time Mexico has entered into an international agreement providing for investor-state arbitration.

153. See Michael J. Bond, *The Americanization of Carlos Calvo*, 22-8 *MEALEY'S INT'L ARBI. REP.* 19 (2007).

154. 19 U.S.C. § 3802(3).

international minimum standard of treatment is expected and nothing more.<sup>155</sup> Finally, the preambular language found in the Peru, Colombia and Panama FTAs also provides for national treatment: "foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investor rights under domestic law equal or exceed those set forth in this Agreement."<sup>156</sup> Still, while the preambular language in recent FTAs incorporates Calvo Doctrine elements, it's important to remember that the other element of the Calvo Doctrine, resolution of disputes solely in the tribunals of the host country, has not been seriously advocated in the United States.

## VII. CONCLUSION

The United States' well-developed legal system and independent judiciary provide a high level of investment protection for both foreign and domestic investors against arbitrary government action. In 2008, despite the turbulence in financial markets that originated in the United States and led to the sharpest downturn of its economy in decades, the United States remained the largest FDI recipient worldwide.<sup>157</sup> Consequently, the United States will be a defendant in more investment treaty disputes, especially NAFTA Chapter 11 investor-state disputes, causing it to continually struggle to balance robust investment protections based on international law and simultaneously avoid investment treaty disputes.

Future NAFTA investment litigation, and to a lesser extent, potential investment disputes in post-NAFTA free trade agreements, including the FTAs with Peru, Colombia and Panama, will likely help shape U.S. policy regarding foreign investment law in the future much like the changes incorporated into the investment provisions of U.S. FTAs subsequent to NAFTA largely reflect experience in litigation between Canada and the United States. But there is a strong likelihood that investment protections will continue to regress.

How much more the United States will limit investment protection provisions is unclear. The U.S. Trade Representative and the State Department have begun to consider modifications to the 2004 U.S. Model BIT. The State Department recently released a report that reflects the lack of a consensus in the United States regarding the appropriateness of investor-state arbitration of BIT claims.<sup>158</sup> Critics expressed strong concerns about the potential for investor-state arbitration claims to undermine public-spirited policies, and to detract from the vitality of domestic judicial institutions.

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155. See REPORT OF THE S. COMM. ON INVESTMENT OF THE ADVISORY COMM. ON INT'L ECONOMIC POLICY REGARDING THE MODEL BILATERAL INVESTMENT TREATY, Sept. 13, 2009, available at <http://www.state.gov/e/eeb/rls/othr/2009/131098.htm>.

156. Peru, Colombia, and Panama FTAs, *supra* note 2.

157. See U.N. Conference on Trade and Dev., *World Investment Report 2009*, available at [http://www.unctad.org/en/docs/wir2009\\_en.pdf](http://www.unctad.org/en/docs/wir2009_en.pdf).

158. See REPORT OF THE S. COMM., *supra* note 155.

In addition, some sub-committee members suggested that home and host governments be given wider latitude to jointly screen or filter some investor claims on the grounds that they might cause serious public harm (such filtering is currently permitted under the 2004 U.S. Model BIT).<sup>159</sup> This “self-judging” exception, however, has been the subject of a lot of scrutiny following Argentina’s financial crisis earlier this decade and the government’s 2002 emergency monetary policy that froze local tariffs and abolished U.S. dollar-to-Peso convertibility. Argentina was subsequently named as a respondent in dozens of ICSID arbitrations and actively sought to suspend the arbitrations claiming that the monetary measures were necessary to maintain Argentina’s “essential security.”<sup>160</sup> Governments should probably not apply the “essential security” exception against foreign investors for “predominantly economic objectives.”

Others also questioned the extent to which protections such as “fair and equitable treatment” for foreign investors should be tied expressly to the minimum standard of treatment under customary international law rather than some more expansive treaty-specific obligations.<sup>161</sup> Whereas the 2004 U.S. Model BIT grounds key protections to customary international law, critics urged that customary international law standards be defined more clearly in order to provide greater certainty and to clarify that customary international law prescribes very narrow demands.<sup>162</sup> By contrast, however, other committee members called for a return to the language used in the 1994 U.S. Model BIT, which provided broader protection for investors since it was not bound to customary international law standards.<sup>163</sup> Consequently, several years may pass by before the United States actually modifies the 2004 U.S. Model BIT, and that model may not be much better for U.S. investors abroad than nothing at all.

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159. *Id.*

160. Jean E Kalicki, *ICSID Arbitration in The Americas*, *ARB. R. AM.* 2007, available at <http://www.arbitralwomen.org/files/publication/4911201000239.pdf>.

161. *See* REPORT OF THE S. COMM., *supra* note 155.

162. *Id.*

163. *Id.*



# I

  

## THE UNCERTAIN FUTURE OF ICSID IN LATIN AMERICA

Ignacio A. Vincentelli\*

### ABSTRACT

*The purpose of this article is to research the historical interaction of the International Centre for Settlement of Investment Disputes (ICSID) and Latin America in an effort to suggest that the recent ICSID-unfriendly measures taken by some Latin American countries might not be an aberrational phenomenon in the region.*

*If, moved by the engine of ideology, the rest of Latin America follows the example of Bolivia and Ecuador (the most radical of the ICSID-hostile countries) and denounces the Washington Convention, instead creating a new forum to resolve FDI disputes at the regional level (as was recently proposed), the future of ICSID in Latin American becomes uncertain.*

### I. INTRODUCTION

THE story of State-investor dispute resolution is one that relates to the process of decision-making that transnational corporations undertake in risk factor analysis when considering whether to invest capital in a particular country (jurisdiction). In this sense, the international community has created a variety of international dispute or resolution methodologies, including the Washington Convention for Settlement of Investment Disputes (“Washington Convention or the ICSID Convention”),<sup>1</sup> and the International Centre for the Settlement of Investment Disputes (“ICSID”), that enable less developed countries (“LDCs”) to signal the Community of Nations, particularly, and perhaps most significantly, capital-exporting countries, that they have embraced a system of protection of foreign direct investments (“FDI”).<sup>2</sup> Once sent, these sig-

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1. See Int’l Ctr. for Settlement of Inv. Disputes, List of Contracting States and Other Signatories of the Convention, 2010, <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&language=English> [hereinafter *ICSID List*] (for a comprehensive list of the 156 contracting states signatories of the Washington Convention (as of Nov. 4, 2007)).
2. Thomas L. Brewer, *Int’l Inv. Dispute Settlement Procedures: The Evolving Regime for Foreign Direct Inv.*, 26 *LAW & POL’Y INT’L BUS.* 633, 634 (1995); see also

nals transform into ‘credible commitments’ to treat foreign investors fairly.<sup>3</sup>

The attitude of Latin American countries toward the Washington Convention and the ICSID has been convoluted throughout time and meaningfully disconcerting. During the first decades of its existence virtually all Latin American countries stayed away from the ICSID, preferring to adopt a system of “internationalization” of foreign investment contracts, to ensure foreign investors’ respect for their investments.<sup>4</sup> In the 1990s these countries radically changed their policies. In just a few years the vast majority of Latin American countries became signatories of the Washington Convention, and entered into several bilateral investment treaties (“BITs”) with other nations.<sup>5</sup> These steps were taken as essential means in the competitive effort of attracting foreign capitals.<sup>6</sup>

But recent political events and foreign policy precepts suggest that the Latin American attitude towards ICSID could be changing again. The most critical examples of recent hostility against ICSID in Latin America are found in the cases of Bolivia, Ecuador, and Venezuela. In fact, in 2007 Bolivia became the first country ever to denounce the Washington Convention, thus formally withdrawing from ICSID.<sup>7</sup> Ecuador followed Bolivia’s path and became the second country to denounce the Washington Convention,<sup>8</sup> and the Venezuelan Supreme Court issued an opinion limiting the reach of the country’s consent to submit to the Centre’s jurisdiction.<sup>9</sup>

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*OECD Benchmark Definition of Foreign Direct Inv.*, (3d ed., 1996), available at <http://www.oecd.org/dataoecd/10/16/2090148.pdf> (foreign direct investment refers to “direct control of either assets or an enterprise in a foreign country through ownership of a substantial portion of the assets or enterprise.”).

3. See Zachary Elkins, et al., *Competing for Capital: The Diffusion of Bilateral Inv. Treaties*, 2008 U. ILL. L. REV. 265, 277 (2008).
4. See generally M. SORNARAJAH, *THE PURSUIT OF NATIONALIZED PROPERTY* Chap. 2, Vol. 8. (1986).
5. United Nations Conference on Trade and Development, *Inv. Instrument Online—Bilateral Inv. Treaties*, <http://www.unctadxi.org/templates/DocSearch779.aspx> (last visited May 15, 2010).
6. See Elkins et al., *supra* note 3, at 266 (once sent, these signals transform into “credible commitments”).
7. See *Venezuela and Bolivia Threaten to Leave ICSID*, *LATIN LAWYER ONLINE*, May 3, 2007, <http://www.latinlawyer.com/news/article/24086/venezuela-bolivia-threaten-leave-icsid/>.
8. Joshua M. Robbins, *Ecuador Withdraws from ICSID Convention*, *PRACTICE LAW COMPANY*, Aug. 12, 2009, <http://arbitration.practicallaw.com/2-422-1266> (Ecuador formally notified the World Bank of its decision to withdraw from ICSID on July 6, 2009; in accordance with the Article 71 of the Convention, the denunciation took effect six months after the receipt of Ecuador’s notice on January 7, 2010. Similarly, since 2009 Ecuador has denounced the vast majority of its BITs).
9. Another important example, albeit omitted in this paper, of the difficult interaction between the ICSID system and the Latin American region is Argentina. Argentina’s approach towards ICSID has changed back and forth in the past decade; currently, it is still unclear whether the country would be willing to honor and enforce an ICSID arbitral award. Conversely, recent positive examples in the Latin American region are found in Haiti, which notified ICSID of its ratification of the Washington Convention (a.k.a., deposit) on October 27, 2009, and Colombia, which entered into a BIT with India on January, 2009.

The purpose of this article is to research the historical interaction of ICSID and Latin America in an effort to suggest that these “opt-out” countries may not be a mere aberrational phenomenon in the region subject to surface dismissal. For this reason, Section one of this paper explores the roots of the initial Latin American rejection and subsequent acceptance of the ICSID as an effective protection for foreign investors. The first part of the section provides a brief summary of the Centre’s jurisdictional requirements with a special emphasis on the doctrinal issue of consent and the BITs as a form of expressing consent in advance.

Section two of this paper analyzes the general growing hostility against ICSID in the region. The first part of this section summarizes the origins and history of the ICSID, analyzes how Latin American countries initially approached the ICSID initiative, and explores the rise of the ICSID in the region during the 1990s. The second part of this section contains an analysis of the implications and consequences of Bolivia’s withdrawal from ICSID, and also discusses the repercussions of Ecuador’s exclusion, its subsequent denunciation, and Venezuela’s hostile approach.

Finally, the article concludes by suggesting that the system of protection of FDI in Latin America may be on the eve of a drastic change. If, moved by the engine of ideology, the rest of Latin America follows the examples of Bolivia and Ecuador and denounces the Washington Convention in favor of a new “regionalized” forum to resolve FDI disputes, the future of the ICSID in Latin America will become uncertain.

## II. ICSID AND LATIN AMERICA: FROM SOUR TO SWEET. . .

### A. ICSID CLAIMS & ARBITRATION WITHOUT PRIVILEGE

ICSID is an autonomous institution established by the Washington Convention in 1965, under the auspices of the World Bank.<sup>10</sup> The stated purpose of this institution is “to provide facilities for conciliation and arbitration of investment disputes between Contracting States and nationals of other Contracting States.”<sup>11</sup> According to ICSID, the core of the

10. The World Bank, *About Us*, <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,pagePK:50004410~piPK:36602~theSitePK:29708,00.html> (last visited July 17, 2010) (Notwithstanding its “autonomy” and its own governing body, the ICSID is still considered an affiliate of the World Bank group. This close relationship may better appreciated by taking into account: (i) that all of ICSID’s members are also members of the World Bank [indeed, §67 of the Washington Convention establishes that it may only be adopted by countries members of the World Bank, or at least, party to the Statute of the International Court of Justice]; (ii) the World’s Bank Governor sits ex officio on ICSID’s Administrative Council; and (iii) the ICSID Secretariat’s expenses are financed out of the World Bank’s budget, although costs of individual proceedings are borne by the parties involved as per Chapter VI of the Washington Convention).

11. *See* Int’l Ctr. for Settlement of Inv. Disputes, Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Art. 1 § 2, Oct. 14, 1966, 575 U.N.T.S. 160 [hereinafter Washington Convention]; *see also* ICSID, *About ICSID*, [http://icsid.worldbank.org/ICSID/ICSID/AboutICSID\\_Home.jsp](http://icsid.worldbank.org/ICSID/ICSID/AboutICSID_Home.jsp) (last visited July 7, 2010) [hereinafter *About ICSID*] (on its webpage, the Centre states that: “ICSID was created by the Convention as an impartial international

Washington Convention was to ease the flow of capitals between nations<sup>12</sup> by: (a) removing barriers to “private investment posed by non-commercial [mainly political] risks,” and (b) establishing a “specialized international method” to resolve investment disputes, which did not then exist, thus maximizing microeconomic conditions for capital-exporting countries and entrepreneurs and capital-importing nations.<sup>13</sup>

Once a country signs and ratifies the Washington Convention, it becomes a member of the ICSID. But becoming a member is not enough to provide foreign investors with sufficient and efficient protection. The country must act further by actually *consenting* to the Centre’s jurisdiction. This consent may be effectuated in different ways, but the most important way is known as “arbitration without privity.” Professor Jan Paulsson introduced this term in 1995 to explain a new “world” in international arbitration, which relates to the investor-state system of protection that, in his own words: “is one where the claimant need not have a contractual relationship with the defendant and where tables could not be turned: the defendant could not have initiated arbitration, nor is it certain of being able even to bring a counterclaim.”<sup>14</sup> In his work, Professor Paulsson describes different initiatives in the investor-state system of protection arena, in which the investor may resort to arbitration notwithstanding the absence of a prior arbitration agreement. Among these devices are: national investment protection laws, BITs, the Central American Free Trade Agreement (CAFTA), and the North American Free Trade Agreement (NAFTA).<sup>15</sup>

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forum providing facilities for the resolution of legal disputes between eligible parties, through conciliation or arbitration procedures. Recourse to the ICSID facilities is always subject to the parties’ consent”).

12. See Ibiroanke T. Odumosu, *The Antinomies of the (Continued) Relevance of ICSID to the Third World*, 8 *SAN DIEGO INT’L L.J.* 345, 359 (2007) (citing *Amco v. Indonesia*, 23 *I.L.M.* 351, 369 (1984)) (actually, the main goal was, and still is, to facilitate investment flows with a view to economic development. This position was further expanded in the case *Amco Asia Corp v. Indonesia*, “where the [ICSID] Tribunal cited the ICSID’s Convention’s preamble with approval and went on to argue that protecting investments amounts to the protection of the general interest of development and developing countries”).
13. See *About ICSID*, *supra* note 11.
14. See Jan Paulsson, *Arbitration Without Privity*, *FOREIGN INV. L. J.*, VOL. 10. N. 2 (1995).
15. North American Free Trade Agreement, Arts. 1138, 1201, U.S.-Can.-Mex., Dec. 17, 2003 32 *I.L.M.* 289 (1993); see also LUCY REED, JAN PAULSSON, & NIGEL BLACKABY, *Guide to ICSID Arbitration* 66 (2004); Bayview Irrigation Dist. v. United Mex. States, ICSID case No. ARB (AE)(05/1)(2007), available at [http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowDoc&docId=DC653\\_En&caseId=C246](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowDoc&docId=DC653_En&caseId=C246) (under §1201, Chapter 11 of the North America Free Trade Agreement, which entered into effect in 1994, by Canada, the United States, and Mexico, an investor from one of these countries may elect to sue a host country either under the UNCITRAL rules, or under the ICSID Additional Facility Rules. However, a condition precedent to select the latter path is that the investor, or the country where the investment has been made, must be a member of the Washington Convention; and, as of November 4, 2007 only the United States had ratified the Convention (Canada, for instance, signed the Convention in 2006, but has not ratified it, and consequently, it has not entered into force in that country). Another interesting aspect about the procedural framework

## B. JURISDICTIONAL REQUIREMENTS OF AN ICSID CLAIM

Prior to perfecting a claim [on the merits] before the ICSID, certain jurisdictional criteria must be met: (i) the investor bringing the claim must be a national of a State member of the Washington Convention [jurisdiction *ratione personae*]; (ii) similarly, the investment must have been made in a Contracting State of the Washington Convention [also jurisdiction *ratione personae*]; (iii) the dispute must be a legal dispute arising directly out of an investment, in the terms established by caseload of the ICSID Tribunals readily available [jurisdiction *ratione materiae*]; and (iv) perhaps most importantly, express ‘consent’ to arbitrate must be given in writing by both parties.<sup>16</sup> While it is not the aim of this paper to provide an extensive exegesis on these jurisdictional elements, it is critical to discuss their contours as a conceptual predicate to the development of this analysis.

The first two criteria relate to the nationality of the harmed investor and place of investment;<sup>17</sup> the former, the nationality–membership requirement includes the exception of cases arising under the additional facility rules. For instance, in disputes arising under the NAFTA, the only cases that can be decided by an ICSID Tribunal are those involving a party related to the United States. This would be the case of a claim filed by U.S. investors against Canada or Mexico; and the case of a claim filed by Canadian and/or Mexican investors against the U.S. as well. Another interesting discussion on this topic that has been particularly relevant in Latin America is the so-called practice of “treaty shopping” and corporate engineering.<sup>18</sup> These terms refer to a practice common in the field,

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of NAFTA arbitration to comment is that the only parties entitled to bring a claim and assert jurisdiction under NAFTA, are investors from a State party. And, the term ‘investment’ has been broadly defined by §1139 of NAFTA, thereby widening the jurisdictional reach of a NAFTA claim. Similarly, a panel of arbitrators, headed by Mr. Bernardo Cremades, established in *Bayview Irrigation District v. Mexico*, that “in order to determine whether the claims fall within Articles 1115 and 1116 it is therefore necessary to determine whether the Claimants are ‘investors’, and whether their claims are within the scope and coverage of Chapter 11.”).

16. Washington Convention, *supra* note 11, art. 25; *see generally*, REED, PAULSSON, & BLACKABY, *supra* note 15.
17. *See* Washington Convention, *supra* note 11, art. 25(2)(a)-(b) (however, it should be noted that for purposes of determining the nationality of a juridical person the Convention introduces the concept of “foreign control.” §25(b)(2) of the Convention establishes that National of Another Contracting State means, “any juridical person which had the nationality of a Contracting State other than the State party [ . . . ] and any juridical person which had the nationality of the Contracting State party to the dispute [ . . . ] and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.”).
18. *Aguas del Tunari v. Bol.*, ICSID Case N.ARB/02/3 (2005); *see also* Jean Kalicki & Suzana Medeiros, *Investment Arbitration in Brazil: Revisiting Brazil’s Traditional Reluctance Towards ICSID, BITs, and Investor-State Arbitration*, 24 *ARB. INT’L* 423, 482 (2008), available at <http://www.arnoldporter.com/professionals.cfm?u=JeanEngelmayerKalicki&action=view&id=254&viewpage=publications> (these terms refer to a practice common in the field, where sophisticated attorneys seek to structure deals by using different corporate forms, with the intention to extend to investors the protection of a third country BIT, when their own home country

where sophisticated attorneys seek to structure transactions by using different corporate forms, with the intent to extend to investors the protection of a third country BIT, where their own home country lacks BIT protection status.

Likewise, the third criterion poses the difficulty of the definition of the term “investment.”<sup>19</sup> But there is sufficient precedent<sup>20</sup> set by ICSID awards that sets the grounds to define this term that provides for useful conceptual guidance.<sup>21</sup> For instance, in contractual claims,

[t]ribunals have found ‘disputes arising directly out of an investment’ to include disputes over capital contributions and other equity investments in companies and joint ventures, as well as non-equity direct investments via service contracts, transfer of technology, natural resource concession agreements, and projects for the construction and operation of production and service facilities in the host State.<sup>22</sup>

Meanwhile, in non-contractual claims the tribunals have traditionally applied an even broader definition of “investment,” to cover “the laying out of money or property in business ventures, so that it may produce a revenue or income.”<sup>23</sup>

Finally the last criterion, the consent, as seen above, is deemed to be fundamental for the assertion of the jurisdiction of ICSID. Consent is “the explicit expression of both parties’ acceptance of ICSID arbitration.”<sup>24</sup> According to §25 of the Convention, the consent must be given

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does not have one protecting their investment. In *Aguas del Tunari*, ICSID Case N.ARB/02/3, Decision on Respondent’s Objections to Jurisdiction (2005), an ICSID Tribunal found that national routing was a valid and legitimate exercise of the Corporation that changed its ownership structure, in order to be able to claim jurisdiction under the Bolivia-Netherlands BIT. However, Kalicki notes that such a practice is now being taken care of by recent developments in BIT drafting, in which “Contracting States include a provision allowing a party to deny the benefits of the agreement to investors that have no ‘substantial business activities’ in their putative home country.”

19. REED, PAULSSON, & BLACKABY, *supra* note 15 (regarding the meaning of the phrase “legal dispute” in contractual investment disputes Reed, Paulsson & Blackaby held that “ICSID Tribunals have generally used the phrase to refer either to disputes regarding the existence or scope of a legal right or obligation, or to disputes regarding the nature or extent of the reparation to be made for the breach of a legal obligation.” A classical example of this would be an expropriation of FDI made without just compensation, or a denial to honor payments of promissory notes (bonds)).
20. Notably, in the international arena, such as in the majority of Civil Law jurisdictions, judicial “precedent” is distinguishable from “stare decisis” in the sense that it does not refer to any binding authority of judicial/arbitral decisions or awards.
21. See *Autopista Concesionaria de Venez. v. Venez.*, ICSID Case No.ARB/00/5 (2001) (Decision on Jurisdiction); *Mihaly Int’l v. Sri Lanka*, ICSID Case No. ARB/00/2, Award (2002).
22. See REED, PAULSSON, & BLACKABY, *supra* note 15.
23. *Id.* (citing *Fedax v. Venez.*, ICSID Case No.ARB/96/3 (1997) (finding that the issuance of bonds/promissory notes by Venezuela, and the subsequent acquisition of them in the secondary markets by a Netherlands investor, constituted an investment in the territory under the Netherlands-Venezuela BIT).
24. *Id.* at 22, 38; see also Jason Webb Yackee, *Do We Really Need BITs? Toward a Return to Contract International Investment Law*, 3 ASIAN J. WTO INT’L HEALTH L. & POL’Y 121 (2008) (arguing investment contracts are more convenient than

in written format.<sup>25</sup> The investor normally expresses his consent to arbitrate disputes under a particular investment by submitting it to the Centre along with his request for arbitration, in accordance with §36(2) of the Convention.<sup>26</sup> On the other hand, even though states may also do this, expressing thereby their consent on a case-by-case basis, they normally give their anticipated consent through BITs and investment protection laws.

Moreover, the importance of consent was underlined on the famous Report of the Executive Directors of the World Bank on the ICSID Convention, prepared in 1965 at the origins of the Centre.<sup>27</sup> They referred to consent of the parties as being “the cornerstone of the jurisdiction of the Centre.”<sup>28</sup> Similarly, in relation to consent, the Directors stated that consent must exist prior to a request for arbitration or a request for conciliation. Some of the forms of consent permitted to satisfy the requirements of §25(1) are: (i) a clause included in an investment agreement providing for the submission to the Centre of future disputes arising out of that agreement; (ii) a *compromise* regarding a dispute which has already arisen; or (iii) a provision in the host state’s investment promotion legislation offering to submit disputes arising out of certain classes of investments to the jurisdiction of the Centre, which would still require the investor’s acceptance in writing.<sup>29</sup> The great academic discussion in this field arises from the third form of consent; specifically from the BITs, which once in force could be considered part of the country’s internal legislation.<sup>30</sup>

A parallel classification of the form of consent permitted is based on the source of the consent, whether contractual or not. Sometimes investors and states enter into ‘investment contracts,’ including an arbitration clause that grants jurisdiction to the Centre.<sup>31</sup> Conversely, in the vast majority of the cases, the states, in racing to get foreign capital, have consented in advance to the ICSID jurisdiction by including an arbitration

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BITs for the International business Community, because with these contracts developing countries may provide investors with credible commitments, and at the same time they would be able to bargain for a suitable special treatment).

25. Washington Convention, *supra* note 11.

26. Washington Convention, *supra* note 11, art. 36(2).

27. Int’l Ctr. for Settlement of Inv. Disputes, Report of the Executive Directors of the World Bank on the ICSID Convention Ch. V, ¶ 23 (1965), available at <http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/partB.htm>.

28. *See id.*

29. *Id.* at ¶ 24.

30. *See generally* CHRISTOPHER C. JOYNER, INTERNATIONAL LAW IN THE 21ST CENTURY: RULES FOR GLOBAL GOVERNANCE (2005) (in fact, this would depend in whether the particular country adopts a Monistic or a Dualistic theory of International Law. The former refers to countries that assume International law and their municipal law as a unity equally applicable. While the latter refers to countries that highlights the differentiation between domestic and International law, and require the conversion of International law into domestic laws, through the enactment of internal laws).

31. *See* Int’l Ctr. for Settlement of Inv. Disputes, Model Clauses, <http://icsid.worldbank.org/ICSID/StaticFiles/model-clauses-en/main-eng.htm> (for a comprehensive list of model clauses on the Centre’s webpage).

clause in BITs or multilateral investment treaties (“MITs”) entered with other nations,<sup>32</sup> or even by including the sovereign’s consent to arbitration in foreign investment legislation. As explained in this section, the latter would constitute cases of arbitration without privity.

### C. WHY COUNTRIES ENTERED INTO BITS

A BIT is an agreement entered into by two nations with the purpose of stimulating the investment and trade between both nations by offering a framework of protections available to investors. Usually, the process of entering into a BIT makes sense when there is a prospect that the commercial relations among one state (a capital-importer State) and the nationals of the other state (capital-exporter) may improve.<sup>33</sup>

In part, this assertion may explain why the vast majority of the BITs bear a similar structure. According to one author, most BITs mimic two unsuccessful attempts to create a uniform approach to FDI in the international community, *i.e.*, the 1959 *Abs-Shawcross Convention*, and the 1967 *OECD Draft Convention on the Protection of Foreign Property*.<sup>34</sup> The structure of a typical BIT is formed by a set of substantive protections that states offer to investors and by a clause granting jurisdiction to foreign tribunals to solve the claims that may arise under the treaty (whether considered to be consent, or a mere unilateral offer to consent).<sup>35</sup> The substantive protections usually contained in BITs are: (i) fair and equitable treatment; (ii) nondiscriminatory treatment; (iii) non-arbitrary or unreasonable treatment; (iv) full protection and security treatment; (v) treatment as favorable as that provided to national investors; (vi) ability to repatriate proceeds of the investment to home country; (vii) no expropriation without compensation; and (viii) the host country will honour its contractual and other legal obligations owed to the foreign investor (a.k.a., the umbrella clause).<sup>36</sup>

32. United States Model BIT Clause (2004), art. 24, available at [http://ustraderep.gov/assets/Trade\\_Sectors/Investment/Model\\_BIT/asset\\_upload\\_file847\\_6897.pdf](http://ustraderep.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf) (for instance, §24 of the U.S. Model BIT clause grants jurisdiction, though not exclusive, to the ICSID).

33. See Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT’L L. 639, 644 (1998) (Professor Guzman explains the BIT explosion by inferring that the confidence that investors felt that their investments will not be opportunistically expropriated by the host State, was caused by the fact that BITs “allow potential investors to negotiate for whatever protections and safeguard they feel are needed. In other words, BITs provide the investors with protections that are superior, in all forms of investor-host conflicts, to those of customary international law.”).

34. See Jason Webb Yackee, *Conceptual Difficulties in the Empirical Studies of Bilateral Investment Treaties*, 33 BROOK. J. INT’L L. 405, 415 (2008).

35. Perhaps this fact explains why the drafters of ICSID Rules devised a scheme of proceedings that are often bifurcated into separate phases to address the merits and the jurisdiction.

36. See Arif Hyder Ali & Alexandre Gramont, *ICSID Arbitration in the Americas*, GLOBAL ARB. REV AM., 2008, at 7, available at <http://www.globalarbitrationreview.com/handbooks/4/sections/7/chapters/50/icsid-arbitration-americas>.



What we witnessed during the 1990s was an explosion of LDCs, in particular Latin American countries, embracing the Washington Convention, entering into hundreds of BITs, and also modifying their foreign investment legislation. We also experienced a plethora of claims against Latin American countries before this forum. When the trend commenced, BITs became “the preferred method of governing the relationship between foreign investors and host governments in developing countries.”<sup>37</sup> Professors Elkins, Guzman, and Simmons provide interesting and detailed data about the advent and spread of BITs.<sup>38</sup> They hold that competition among similarly situated countries explain, both theoretically and empirically, the spread of the BITs.<sup>39</sup> They also found an empirical basis for the assertion that the most important drivers of the spread of BITs are also factors that heavily impacts investment decisions.<sup>40</sup> For instance, they found that BITs are more valuable where political risk is endemic.<sup>41</sup>

For these reasons, in order to attract capital, Latin American countries in the 1990s needed to enter into these treaties, or modify their internal legislation, waiving part of their immunity by agreeing beforehand to the jurisdiction of a third party,<sup>42</sup> in most cases, the ICSID. With this system of protection, investors sought to effectively de-politicize investments disputes.<sup>43</sup> Indeed, they would be able to mitigate political risks normally associated with the functioning of business in Latin America by removing these disputes from the internal (and sometimes compromised) judiciaries, as well as “traditional diplomatic channels” by directly submitting them to arbitration.<sup>44</sup>

#### D. THE NO-DE-TOKYO

The ICSID Convention was not initially adopted by *any* of the Latin American countries. In fact, when the Convention was first discussed in different regional meetings of the World Bank,<sup>45</sup> Latin American coun-

37. See Guzman, *supra* note 33, at 642.

38. See ELKINS ET AL., *supra* note 3, at 291-98.

39. *Id.* at 207.

40. *Id.*

41. *Id.*

42. Guzman, *supra* note 33, at 688 (Professor Guzman criticizes the way LDCs massively entered into BITs. In his conclusions he states that “Although BITs improve the efficiency of foreign investment, they may not increase the welfare of developing countries. BITs give an individual country the ability to make credible promises to potential foreign investors. As a result, the country is more attractive to foreign investors and will receive a larger volume of investment than it would without the ability to make such promises. The increase in investment, however, is likely to come in large part at the expense of other developing countries. *Developing countries as a group, therefore, will enjoy gains from an increase in total investment that is relatively modest. It is probable that this gain will be outweighed by the loss those countries will suffer as they bid against one another to attract investment.*”) (emphasis added).

43. See generally IBRAHIM F.I. SHIHATA, TOWARDS A GREATER DEPOLITICIZATION OF INVESTMENT DISPUTES: THE ROLES OF ICSID AND MIGA (1993).

44. See Kalicki & Medeiros, *supra* note 18, at 58.

45. These regional meetings took place in Ethiopia, Chile, Switzerland, and Thailand.

tries, in bloc, opposed the idea of establishing a specialized forum for governments and foreign investors.<sup>46</sup> Professor Lowenfeld (along with other scholars) called this posture of Latin American countries to the Convention a “No-de-Tokyo.”<sup>47</sup> This posture could probably have been precipitated by a misunderstanding of the Latin American nations who never considered that the Convention, as explained above, “contained no substantive obligations, but merely an opportunity to submit in advance (or after a dispute has arisen) to international dispute settlement between an investor and a host state.”<sup>48</sup> If no further consent (either contractually or not) was granted, it was impossible for a state to be subjected to ICSID’s Jurisdiction.

Furthermore, back in 1971 Professor Paul Szasz, a former Secretary General of the ICSID, identified the main reasons why Latin American countries had yet to adhere to the Convention.<sup>49</sup> First, Professor Szasz recognized that “not all governments [were] uniformly eager to attract” FDI.<sup>50</sup> Second, Latin American countries feared that by adopting the Convention they would be undermining the well-established principle of international law of no-intervention.<sup>51</sup> Third, by allowing only “foreign”

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46. See Paul C. Szasz, *The Investment Disputes Convention and Latin America*, 11 VA. J. INT’L L. 256, 257 (1971).

47. See ANDREAS F. LOWENFELD, INT’L ECONOMIC LAW 541 (2d ed., Oxford Univ. Press 2008) (according to Professor Lowenfeld, “when the report of the regional meetings on the proposed [ICSID] convention came before the Board of Governors of the World Bank (*i.e.*, the full membership), at the Annual Meeting of the Bank in Tokyo in 1964, all Latin American States voted ‘no’—the first time in the Bank’s history that a final resolution had met with substantial opposition on a final vote.”).

48. Andreas F. Lowenfeld, *Inv. Agreements and Int’l Law*, 42 COLUM. J. TRANSNAT’L L. 123, 125 (2003) (citing Aron Broches, *The Convention on the Settlement of Investment Disputes*, 136 RECUEIL DES COURS 331, 349 (1972)); Aron Broches, *The Convention on the Settlement of Investment Disputes*, 136 RECUEIL DES COURS 331, 349 (1972), available at <http://www.ppl.nl/plinklet/?sid=Bibliographies&ppn=250600919&genre=article&issn=&isbn=&title=The%20Convention%20on%20the%20Settlement%20of%20Investment%20Disputes%20between%20States%20and%20Nationals%20of%20Other%20States%20/%20by%20Aron%20Broches&aulast=Broches&aufirst=Aron&au2last=&au2first=&au3last=&au3first=&edlast=&edfirst=&ed2last=&ed2first=&ed3last=ed3last&ed3first=&source=recueil%20des%20cours&year=1972&volume=136&issue=II&spage=331-410&bibliography=recueil&table=recueil&download=&scharnier=&extensie=&id=344&url=&keyword1=&keyword1ppn=&brillid=19824>.

49. Szasz, *supra* note 46, at 260.

50. *Id.* at 260 (Professor Szasz remarked that “Whether such reluctance is based on a general *anti-capitalist*, or on a suspicion or fear of any foreign penetration, or merely on unfortunate experiences with particular foreign investors, it is enough to say that such a reaction by its nature cannot be refuted in relation to the Convention. That instrument *assumes that private international investment plays a significant role in international cooperation for economic development* [as stated in the first paragraph of the Preamble of the Convention].”) (emphasis added).

51. *Id.* at 260; see also CARLOS CALVO, DERECHO INTERNACIONAL TEÓRICO Y PRÁCTICO DE EUROPA Y AMÉRICA, 191 (1st ed. Durand & Pedone-Lauriel 1868); William Burke-White & Andreas Von Staden, *Investment Protection in Extraordinary Times*, 48 VA. J. INT’L L. 307, 310 (2008) (Szasz’s second and third identified reasons are extremely related to the Calvo Doctrine. This doctrine establishes that jurisdiction in cases arising out from foreign investment in a country falls in the country, providing that foreigners may not be given a different treatment than the

investors (as opposed to nationals) to arbitrate their disputes against host states, they were breaching the well-established principle of international law regarding equal treatment of foreigners and nationals.<sup>52</sup> Fourth, the Latin American countries rejected the argument that their domestic courts were not ideal (in terms of efficiency and fairness) fora to try these claims.<sup>53</sup> Last, Latin American countries were suspicious of arbitral proceedings as opposed to judicial proceedings, primarily because of the “past association with foreign intervention, of arbitration and a private person.”<sup>54</sup>

Meanwhile, FDI was not left unprotected in Latin America. Investors and nations bargained for tailored solutions in order to limit the exposure of the former to political risks. The result of these contractual solutions was the “internationalization” of investment contracts<sup>55</sup> by systematically including in these contracts sophisticated arbitration, choice-of-law, and stabilization clauses.<sup>56</sup>

#### E. GRADUAL ACCEPTANCE<sup>57</sup>

A few decades after the birth of the Convention, the Latin American countries modified their approach to it and gradually decided to embrace it. In the 1980s the first Latin American countries to join the Convention were Ecuador, Honduras, and El Salvador. In the 1990s the rest of the Latin American countries, with the exceptions of Mexico and Brazil, joined the Convention.<sup>58</sup>

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one given to nationals. Initially this doctrine was created as a legal answer of the Latin American Nations to insulate themselves from pressure and attacks of foreign countries on behalf of foreign investors. However, several decades later this doctrine was revitalized in the context of an international effort to protect foreign investment. According to a recent paper in the subject: “for investors in Latin America, the possibility of direct arbitration against a government represented a significant change from the Calvo Doctrine, according to which a government’s liability toward foreigners can be no greater than that owed to nationals. As a result, disputes between foreigners and a host country could only be decided by the country’s own legal system.”)

52. Szasz, *supra* note 46, at 261 (The same comments made on footnote 15 apply here).

53. *Id.* at 262.

54. *Id.* at 263.

55. See M. SORNARAJAH, *supra* note 4 (for a lengthy discussion of the internationalization of investment contracts).

56. *Id.* at 80 (it shall be noted that the theory of internationalization of investment contracts also presented some difficulty at its early stages, especially given the fact there was no body of laws governing a relationship in which one of the parties was not subject to International law. However, the adoption of the Restrictive Theory of Sovereign Immunity by the American legal system, favored the trend of Internationalizing Investment Contracts. This legal phenomenon began with the famous Tate letter, see 26 DEP’T OF STATE BULL., 984 (1952), which was later codified in 1976 in the Foreign Sovereign Immunities Act, 28 U.S.C. §§1602-1611, 28 U.S.C. §330. For a marvelous explanation about the absolute and restrictive theories of sovereign immunity see PEDRO MARTINEZ-FRAGA, *THE NEW ROLE OF COMITY IN PRIVATE PROCEDURAL INTERNATIONAL LAW*, 164 et seq. (2007).

57. Lowenfeld, *supra* note 48, at 121.

58. Charity L. Goodman, *Uncharted Waters: Financial Crisis and Enforcement of ICSID Awards in Argentina*, 28 U. PA. J. INT’L ECON. L. 450, 471 (2007).

Along with this significant adoption of the Convention, in the 1990s several Latin American States modified their internal legislation, and/or entered into numerous Bilateral Investment Treaties.<sup>59</sup> This “modification” completed the required consent (as explained above) in several cases, bringing to the ICSID an unprecedented number of claims. For instance, as of 2007, fifteen percent of the concluded matters concerned claims against Latin American States.<sup>60</sup> As of the present, fifty-two percent<sup>61</sup> of the pending matters at the ICSID involve Latin American States.<sup>62</sup> For this reason, one could argue that the booming of ICSID in Latin America in the 90’s, preceded by the so-called “No-de-Tokyo,” contributed to the ICSID, and the investor-State system of protection in general, earning the cognomen of “sleeping beauty.”<sup>63</sup>

This gradual acceptance of the Latin American region to the ICSID system of protection could be explained by the theory of credible commitments. In support of this theory Professor Vanvelde analyzed the results of different studies on the correlation between FDI and the number of BITs signed by a particular LDC, to conclude that:

While large arbitral awards against host states could dampen the enthusiasm of host states, . . . for these agreements, they might also signal to investors the value of the agreements and lead to increased investment flows . . . *Any enhanced investment flows as a result of the investment agreements are likely to be in the direction of developing countries.* Thus, concerns by developing countries about the issuance of large arbitral awards could be more than offset *by the belief that investment agreements had contributed to increased investment flows.*<sup>64</sup> (emphasis added).

The problem with this statement is found in its ideological component. In other words, if it can be demonstrated that the investment commerce has grown, investment agreements must have caused such incremental development. This recourse would be the only way that a country may be

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59. Stanimir Alexandrov et al., *Making Investment Treaties Work for Latin America*, *ARB. REV. OF THE AM.* 4 (2009), available at <http://www.globalarbitrationreview.com/reviews/13/sections/50/chapters/497/making-investment-treaties-work-latin-america/>.

60. See Jean Kalicki, *ICSID Arbitration in the Americas*, *ARB. REV. OF THE AM.* 5 (2007), available at <http://www.arnoldporter.com/professionals.cfm?u=JeanEngelMayerKalicki&action=view&id=254&viewpage=publications>.

61. This number excludes the four claims pending against Mexico, under the Additional Facility Rules. Otherwise, the percentage would rise up to fifty-five percent.

62. Int’l Ctr. for Settlement of Inv. Disputes, List of Pending Cases, <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListPending> (last visited July 7, 2010) (computation made with numbers provided by ICSID).

63. See NORBERT HORN AND STEFAN KRÖLL, *ARBITRATING FOREIGN INVESTMENT DISPUTES*, 269 (2004) (According to Professor Norbert Horn, “the ICSID regime has been referred as the ‘sleeping beauty’ of investment arbitration, as in its early years only one or two cases were filed annually” [in fact, during the first six years of ICSID no case was filed], while now two or three cases are filed monthly).

64. See Kenneth J. Vanvelde, *A Brief History of International Investment Agreements*, 12 *U.C. DAVIS J. INT’L L. & POL’Y* 157 (2005).

willing to offset the costs of large ICSID awards. Otherwise, if the credible commitments in favor of foreign investment (BITs, MITs and Investment Protection Laws granting Jurisdiction to ICSID) have not attracted significant investment to the host country, there would be no incentive for capital-importing nations to continue to assume these economic burdens.

### III. ICSID AND LATIN AMERICA: FROM SWEET TO SOUR

#### A. GENERAL OVERVIEW OF THE GROWING RESISTANCE

Along with the strong supporters of ICSID and the investor-state system of protection, there is also a growing number of detractors and criticism. While some of the critiques seem to have more scientific grounds,<sup>65</sup> others appear to contain an ideological component.<sup>66</sup> Because BITs and the investor-State system of protection pertains to a flow of capital from capital-exporters countries to capital-importers countries, it is possible to measure whether these efforts have succeeded in bringing wealth into a particular country within a specific period of time.

Although this article does not purport to draw conclusions on whether BITs and the investor-state system of protection have succeeded in each particular country of the region, it does analyze how different Latin American countries have recently reacted to the system. Today, the warm welcome to the ICSID system has largely disappeared and the relationship between the ICSID and Latin America has soured.

On April 29, 2007 in Caracas the Presidents of Bolivia, Venezuela, Cuba, and Nicaragua held the V Summit of the Bolivarian Alternative for the People of Our America (“ALBA”), which is an alternative agreement from these countries in bloc to the investor-state system of protection

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65. For instance, the United Nations Conference on Trade and Development conducted a study about BITs entered by LDCs with developed nations in the 1990s to conclude that BITs played a secondary and minor role in attracting foreign investment. See United Nations Conference on Trade and Development, *Bilateral Investment Treaties in the Mid-1990s*, at 8, 177, U.N. Sales No. E.98.II.D.8 (1998). In another study, a World Bank economist found that BITs ‘act more complements than as substitutes for good institutional quality and local property rights. See Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a BIT. . .and They Could Bite*, World Bank Policy Research Working Paper No. 3121 (2003), available at SSRN: <http://ssrn.com/abstract=636541>. However, in a more recent study, Salacuse and Sullivan conducted their own study, and reviewed both of these research studies, to conclude in the opposite direction, stating that “BITs have a particularly strong effect on encouraging FDI in developing countries. In short, the grand bargain between developing and developed countries that underlies BITs, the bargain of investment promotion in return for investment protection, seems to have been achieved, although the effect of the bargain is only realized slowly after the BIT is signed.” See Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs really work? An Evaluation of Bilateral Investment Treaties and their Grand Bargain*, 46 HARV. INT’L L.J. 67, 111 (2005).

66. See generally Odumosu, *supra* note 12, at 345 (arguing that ICSID is a Neo-liberal investment protection mechanism, and that its origins are routed to the interests of TNCs in third-world countries).

encompassing the different BITs and MITs.<sup>67</sup> At this meeting Presidents Morales and Chavez announced that the four countries in conjunction would withdraw from the ICSID and denounce all the BITs in force.<sup>68</sup> Consequently, on May 11, 2008, Ecuador's President Rafael Correa publicly stated that he "had no confidence in the World Bank arbitration branch [i.e., ICSID] that is hearing U.S. oil company Occidental's lawsuit against Ecuador."<sup>69</sup> He also explained that "Ecuador handed over its sovereignty when it signed international accords binding it to the bank's ICSID."<sup>70</sup>

These announcements have echoed some of the strongest criticism to the investor-state system of protection. Nonetheless, they can also be explained by the recent wave of nationalizations and expropriations of FDI undertaken in the region, which in most cases bears an ideological explanation.<sup>71</sup> The arguments against the ICSID and the investor-state system of protection that Latin American governments advanced are focused on the following reasons:<sup>72</sup> (i) ICSID awards are not subject to appeal;<sup>73</sup> (ii) the fact that a vast majority of ICSID awards have been decided in favor

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67. See Press Release, Presidential Press Notice, *Países del ALBA y TCP Denuncian Convención del Ciadi* (Apr. 29, 2007), available at [http://www.minci.gob.ve/noticias\\_-\\_prensa/28/13558/paises\\_del\\_alba.html](http://www.minci.gob.ve/noticias_-_prensa/28/13558/paises_del_alba.html) (however, please note that even when the announcement did not make any distinctions about a potential withdrawal of Cuba from the ICSID Convention, this is an absurdity, since Cuba has never been a Contracting State of the Convention).

68. *Id.* (Bolivia was the first country to denounce the Convention withdrawing from ICSID. In fact, it was unclear whether other countries would ever follow its path. However, Ecuador decided to withdraw as well); see Posting of Tolga Yalkin to Blog of the European Journal of International Law, July 30, 2009, <http://www.ejiltalk.org/ecuador-denounces-icsid-much-ado-about-nothing/>.

69. See Gabriela Molina, *Ecuador Wary of World Bank Arbitration in Occidental Case*, USA TODAY, May 11, 2008, [http://www.usatoday.com/money/economy/2008-05-11-3404362337\\_x.htm](http://www.usatoday.com/money/economy/2008-05-11-3404362337_x.htm).

70. *Id.*

71. *Id.* (for instance, on May Day, 2007, when President Chavez announced the expropriation of the private participation in the four major heavy crude oil upgraders located in the Orinoco Oil Belt, he justified his decision by stating "We can't have socialism if the state doesn't have control over its resources!"); see Tim Padgett, *Chavez's Not-So-Radical Oil Move*, TIME, May 1, 2007, <http://www.time.com/time/world/article/0,8599,1616644,00.html>. (however, on many other occasions President Chavez and his closest advisors have indicated that expropriations and de-privatizations are an essential part of his plan of taking Venezuela towards socialism. In his view FDI represents the interest of imperialism, and strengthens capitalism); see *Expropiación de Empresas está Sujeta al Compromiso Social*, BOLIVARIAN NEWS AGENCY, Mar. 22, 2007, <http://www.aporrea.org/ideologia/n92267.html> (former member of Chavez Cabinet explaining that companies reluctant to embrace the Socialism of the XXI Century would be expropriated).

72. See *Bolivia se va del CIADI*, The World Bank, Nov. 3, 2007, <http://go.worldbank.org/2L60H0X80> (these reasons are enumerated in the World Bank press release (in Spanish) announcing Bolivia's exit to ICSID).

73. See REED ET AL., *supra* note 15 (even though it is technically true that ICSID awards are not subject to appeal, the Washington Convention provides grounds for the interpretation (§50), revision (§51), and annulment of the award (§52). An award may not be amended through annulment. Annulment would erase the award entirely, thereby providing the parties with a chance to re-instate the claim. However, the annulment system is designed to safeguard the integrity and not the outcome of the award).

of the private investors shows that the system lacks neutrality and impartiality;<sup>74</sup> (iii) only private companies may sue at this forum; and (iv) the cost to litigate these claims is very high.<sup>75</sup>

These announcements are not galvanized by scientific or statistical data but by ideology. In other words, they are driven by a personal conviction that FDI, even if it does foster development and prosperity, is wrong, promotes imperialism, and thus deserves no effective protection. In this sense, an effective system of protection of FDI, such as ICSID, could be seen as an undue waiver of sovereignty. If this presumption proves to be true, it would be very hard, if not impossible, to predict what will be the future of ICSID in the region.

Argentina's case-study is also critical. Indeed, Argentina's still uncertain willingness to honor eventual final and binding ICSID awards will be determinative to ICSID's authority in the region.<sup>76</sup> After the Argentine financial crisis between 2001 and 2002,<sup>77</sup> dozens of claims were filed by

74. Although it is true, at least in theory, that in the majority of the ICSID cases (fifty-one percent) the tribunals have found for the investors, in practice a number of cases have significantly reduced the amounts of compensation sought by the investors. For instance, in *Autopista Concesionaria de Venez.*, ICSID Case No. ARB/00/5 (2003), the tribunal awarded the investors with the equivalent in Bolivars of \$12 million, when they were seeking relief for almost the equivalent of \$311 million.

75. The rationale of this argument is that given that prior consent is critical, and that in many cases, once a dispute has arisen, an investor is entitled to sue in ICSID due to the existence of a previous unilateral offer to consent to arbitration by the State (e.g., a BIT); but the converse would not be true, because once a dispute arises, if the State is seeking to sue the investor, it would be impossible to obtain its consent to arbitrate. However, this argument may be underestimating the bargaining power of the country, even when the dispute has arisen. Although §36 technically entitles a country to initiate an arbitration against a foreign investor, the only case in which a government might sue an investor under the Washington Convention, would be a case in which it contracted directly with the investor. This is what happened in *Tanz. Electric Supply v. Indep. Power Tanz., Ltd.*, ICSID Case No. ARB/98/8 (2001) (the award was published on ICSID's website). Presumably this was also the case in *Gov't of the Province of East Kalimantan v. PT Kaltim Prima Coal*, ICSID Case No. ARB/07/3, because notwithstanding there is little information publicly available about this case, one may infer from the fact that both parties are related to Indonesia (in fact, East Kalimantan is an Indonesian Province), that the basis of ICSID jurisdiction was also an investment agreement with an explicit arbitration clause granting jurisdiction to the Centre. Similarly, it is reported that years ago Nicaragua initiated an ICSID claim against an investor, but later withdrew the proceedings. No other case has ever been started by a country.

76. Even though Argentina has not paid the amount ordered in the final and binding decision (after annulment proceedings) of *Enron Corp. & Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, it is still uncertain whether the country has decided not to honor voluntarily pay the amounts. Yet, since no enforcement proceeding has been started before neither domestic nor international, one may presume that the country and the company could be currently negotiating a peaceful solution.

77. See generally, PAUL BLUSTEIN, AND THE MONEY KEPT ROLLING IN AND OUT, (2006) (the master of Argentina's liberalization and opening to free-markets in the 1990's was Domingo Cavallo, President Menem's Economy Minister. In 1991 Cavallo implemented a currency convertibility system, which fixed the Argentine Peso to the U.S. Dollar. This measure, along with many others, such as privatizations and liberalizations of interest rates, were successful in halting the hyper-inflation experienced in the 1980s, and boosting the economy. However, after a few years, and given the growing budget deficit the convertibility measure became a

foreign investors against Argentina. Needless to say these events caused Argentina the dubious distinction of breaking all records as the country with more claims filed in ICSID,<sup>78</sup> and potentially subject to the largest monetary awards entered against it.<sup>79</sup>

As a result of this trend, Argentina raised two defenses in most of the cases: the applicability of non-preclusive measures clause (NPM) contained in the BIT to object to such disputes; and the state-of-necessity as a doctrine of customary international law.<sup>80</sup> So far only two arbitral panels have dismissed the claims on the basis of the “necessity defense.”<sup>81</sup> In response to the cases in which the arbitral tribunals have found for the investors, Argentina has started annulment proceedings under §52 of the Convention, along with a request for stay of enforcement,<sup>82</sup> which has been granted by the respective ad hoc annulment committees in virtually all cases.<sup>83</sup> If these annulment proceedings end with results similar to the

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sort of general subsidy which emptied the country’s foreign currency reserves. For some time a chain of loans granted by multilateral institutions (principally the International Monetary Fund) provided the hard currency needed, but the country entered into an unprecedented crisis after the IMF refused to grant a \$1.7billion loan, which was essential to serve the country’s debt, and to maintain the levels of liquidity available to the banking sector stable); see DOMINGO CAVALLO, *THE FIGHT TO AVOID DEFAULT AND DEVALUATION* (2002), [http://www.cavallo.com.ar/wp-content/uploads/the\\_fight.pdf](http://www.cavallo.com.ar/wp-content/uploads/the_fight.pdf). (When the financial institutions tumbled, Cavallo—who was brought back in 2001 to the Ministry of the Economy, on an emergency basis, after his predecessor Lopez Murphy was fired eight days after being appointed—eliminated the convertibility (drastically reducing the people’s savings to a third of the original value) and imposed a restriction on withdrawals to the general public (the so-called corralito). This caused a sociopolitical turmoil in the country, which ended in the ousting of four Presidents in three weeks).

78. See Ali & Gramont, *supra* note 36 (approximately forty percent of all of the cases registered so far at ICSID have been against governments in the Americas. A very high number of those cases have been brought against Argentina (there are currently over thirty cases pending against Argentina at ICSID, in addition to a dozen or so cases previously filed against Argentina that have since been resolved). Most of the Argentine cases arose out of Argentina’s economic crisis in 2001-2002, its resulting currency devaluation and the policies adopted by the government in response to the crisis. But even if one discounted the Argentine cases entirely, a quarter of the cases at ICSID would still be against governments in the Americas). See Paolo Di Rosa, *The Recent Wave of Arbitrations against Argentina under Bilateral Investment Treaties: Background and Principal Issues*, 36 U. MIAMI INTER-AM. L. REV. 41, 73 (2004) (the explosion of cases against Argentina in the aftermath of the 2001 financial crisis was announced by Paolo Di Rosa in 2004).
79. See William W. Burke-White, *The Argentine Financial Crisis: State Liability Under BITs and the Legitimacy of the ICSID System*, 3 ASIAN J. OF THE WTO & INT’L HEALTH L. AND POL’Y 199, 202 (2008).
80. *Id.* at 205.
81. *LG&E Energy Corp. v. Argentine Republic*, ICSID Case No. ARB/02/1 (2007) (award on the merits July 25, 2008); and *Continental Casualty Co. v. Argentine Republic*, No. ARB/03/9 (2008) (award on the merits rendered Sept. 5, 2008).
82. See Harout Samra, *Five Years Later: The CMS Award Placed in the Context of the Argentine Financial Crisis and the ICSID Arbitration Boom*, 38 U. MIAMI INTER-AM. L. REV. 667, 693 (2008) (this has been called by an author in a scholarly paper on the topic as “an effort to prolong the final resolution”).
83. However, once the annulment proceedings end the stay for enforcement is lifted and, under §54 of the Convention the award becomes binding (as if it were rendered by a national court of the contracting state). In September 2008, Argentina’s Attorney General, in relation to the case *Enron Corp.*, ICSID Case no. Arb/



CMS case,<sup>84</sup> Argentina will end up facing the question of whether to honor its ICSID obligations. The specific issue will become whether Argentine courts are willing to enforce an award against their government.<sup>85</sup> A negative decision seems to be detrimental to both Argentina and the ICSID system in general. But a decision from Argentina to honor the entire amount potentially owed to prevailing claimants seems financially unfeasible in the near future.

#### IV. CASE STUDY: BOLIVIA, ECUADOR & VENEZUELA

##### A. BOLIVIA'S FORMAL WITHDRAWAL FROM ICSID: THE END OF A RELATIONSHIP<sup>86</sup>

On May 2, 2007 Bolivia formally notified the ICSID Secretariat of its formal withdrawal from the Centre and the Washington Convention.<sup>87</sup> This pronouncement raised a series of legal issues. At the core of the judicial discussion of Bolivia's withdrawal and its consequences, there is an underlying discussion about the reach of consent on ICSID claims. Even where the arguments may turn out to be highly scholastic, the po-

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01/3, stated that an ICSID award may not be enforceable prior recognition or validation of internal courts. A month later the ad hoc annulment committee of the case deciding a motion to lift the stay, gave Argentina a sixty-day period to reconsider its position about the "extent of its obligation to pay on the final award."

84. See Samra, *supra* note 82, at 693.

85. The question of enforceability of ICSID awards has been treated in different ICSID awards, and by several commentators. For instance, §54(1) establishes that member States shall recognize and enforce ICSID awards as if they were final judgments of a court in that State of the Convention. Likewise, in *Maritime International Nominees Establishment (MINE) v. Republic of Guinea*, Case No. ARB/84/4, Ad Hoc (1990), the Committee stated that the "ICSID Convention the ICSID Convention excludes any attack on the award in the national courts." But, the reality is different when dealing with sovereign nations. If a country arbitrarily decides not to enforce an adverse award a party may not do much, provided that such country does not have assets abroad. Some authors have argue that in such cases investors will be entitle to complain before the World Bank and the International Monetary Fund, and to trigger diplomatic protections, such as requesting their home State to start a claim on their behalf before the International Court of Justice. See Edward Baldwin et al., *Limits to Enforcement of ICSID Awards*, 23 J. OF INT'L ARB. 1, 3 (2006). The unlikelihood of obtaining these remedies due to financial feasibility and political considerations has caused these authors to call a victory of an investor in such position a "pyrrhic victory." *Id.* Probably, this explains why, even after all the trouble that Argentina has caused in enforcing ICSID awards no investor has resorted yet to these types of diplomatic protections. Investors may still have a last hope that Argentina will pay, especially, since it has recently acceded to negotiate commitment letters with claimants in annulment proceedings (e.g., Vivendi case), even if Argentina has made it clear that it will not enforce an award that does not comply with internal law. See Letter Number 109/AI/08, Letter from Osvaldo Cesar Guglielmino, General Counsel of Argentina's Secretary of the Treasury, to Mr. Frutos-Peterson, ICSID Secretary General (Nov. 28, 2008) available at <http://ita.law.uvic.ca/>.

86. Autopista Concesionaria de Venez., ICSID Case No. ARB/00/5 (2003) (title taken from a World Bank press release).

87. Marco Montanes, *Bolivia's Denunciation of the ICSID Convention*, INTERNATIONAL LAW IN BRIEF, May 16, 2007, <http://www.asil.org/ilib070727.cfm#r3>.

tential implications of adopting one posture over others may result in entirely different procedural consequences.

### 1. *Background*

Bolivia's decision to withdraw from ICSID arose in the midst of a drastic change in the hydrocarbons sector undertaken by the Bolivian government. Joining the trend of other Latin American Nations, President Jaime Paz Zamora (who served from 1989 to 1993), implemented in Bolivia a major legal reform in order to attract FDI.<sup>88</sup> During Paz Zamora's presidency, the Legislature enacted the first Investment and Privatization Acts, and the country became a member of the Multilateral Investment Agency (MIGA), the overseas Private Investment Corporation (OPIC), and ICSID.<sup>89</sup> Also, approximately thirty percent of the country's BITS were signed during Paz Zamora's presidency.<sup>90</sup>

In 1994 President Sánchez de Lozada (Paz Zamora's successor), who remembered well the hyper-inflation experienced in the country in the 1980s,<sup>91</sup> privatized several state-owned companies, including five of the largest companies in the country (through the Capitalization Act of 1994).<sup>92</sup> Because of Bolivia's vast reserves of non-associated natural gas, the most important of these privatizations related to the natural gas industry. The 1996 modification of the Hydrocarbons Law was essential to

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88. Jorge Quiroga, Minister of Finance of Paz Zamora's government (and later President of Bolivia), Speech for the Woodrow Wilson Center for Scholars in Washington D.C., (July 15, 1992) (transcript available in the Richter Library at the University of Miami). In his speech, Jorge Quiroga said:

"the Bolivian government wants the private sector to be perfectly aligned with the productive sector—hydrocarbons, mining, and services. That is a three-stage process. The government is selling all the productive enterprises, although there are more than sixty, such as ceramic, textiles, and small airlines. Joint ventures in hydrocarbons and mining are also being undertaken because, due to constitutional restrictions, the government cannot sell them. We are also moving into services, but regulatory framework must first be developed. Federal regulatory agencies, which we do not have, are good in certain instances. *The government does not want to transform public monopolies into private monopolies overnight, as has happened in other countries in Latin America. Subsidized credit has been eliminated in Bolivia. This will allow for an increase flow of resources from the private sector. If the government sends a signal to the private investors—This is your area, it is open to you, we will provide an Investment Law and the necessary regulatory framework, so come [to] invest'—then I think the private sector will react.*" (emphasis added)

89. See JULIUS SPATZ, *POVERTY AND INEQUALITY IN THE ERA OF STRUCTURAL REFORMS* 10 (2006).

90. United Nations Conference on Trade and Development, Country-Specific List of BITS, <http://www.unctad.org/Templates/Page.asp?intItemID=2344&lang=1> (last visited July 7, 2010).

91. See generally, Luis Breuer, *Hyperinflation and Stabilization: The Case of Bolivia 1984-1986*, (1989) (unpublished doctoral thesis) (on file with the University of Illinois at Urbana-Champaign).

92. See SPATZ, *supra* note 89, at 11.

the privatization of the hydrocarbons industry.<sup>93</sup> Among other controversial provisions, the new law established royalties for up to eighteen percent of the gas production.<sup>94</sup> Simultaneously, new contracts for the exploration and exploitation of non-associated gas were negotiated and entered into by the Bolivian government and private foreign investors, by-passing the Constitutional mandate of legislative approval. For this same reason these contracts would be invalidated some years later.<sup>95</sup> It is important to underscore, however, that FDI bloomed in Bolivia overall during the 1990s.<sup>96</sup>

Sánchez de Lozada's first term (1993-1997) was followed by a former dictator and retired General, Hugo Banzer (1997-2001).<sup>97</sup> President Banzer continued the trend of privatization and 'modernization,' and put a special emphasis on the eradication of coca plantations, until he had to resign because of a serious medical condition.<sup>98</sup> His Vice-President, Jorge Quiroga, took office and concluded the term a year later.<sup>99</sup> Sánchez de Lozada subsequently served a second term, in which he heavily raised taxes, after the adoption of an IMF program, and faced the turmoil of the so-called 'gas war.'<sup>100</sup> After fifteen days of riots President Sánchez de Lozada resigned and his Vice-President Carlos Mesa assumed office (2003-2005).<sup>101</sup> In 2004 President Mesa called for a National Referendum on a new Hydrocarbons Law, which was voted in his favor.<sup>102</sup> The new law proposed a raise in the taxes associated with production and increased the percentage of State participation in hydrocarbons activities, including the production of oil and gas.<sup>103</sup> It still did not receive the gen-

93. Eugenio Cerutti & Mario Mansilla, *Bolivia: The Hydrocarbons Boom and the Risk of Dutch Disease*, 4 (Int'l Monetary Fund, Working Paper No. 08/154, 2008), available at <http://www.imf.org/external/pubs/ft/wp/2008/wp08154.pdf>.

94. *Id.*

95. *Id.*

96. Julius Spatz, *FDI and Economic Growth in Developing Economies: How Relevant are Host-Economy and Industry Characteristics?*, 13 *TRANSNAT'L CORPS.* 52, 86 (2004).

97. Manuel E. Contreras & Maria Luisa Talavera Simoni, *The Bolivian Education Reform: Case Studies in Large-Scale Education Reform*, 2 *EDUCATION REFORM AND MANAGEMENT PUBLICATION SERIES* 1, 10 (2003), available at <http://www.oei.es/oeivirt/Bolivian.pdf>.

98. LARRY STORRS & NINA SERAFINO, *ANDEAN REGIONAL INITIATIVE (ARI): FYI2002 ASSISTANCE FOR COLUMBIA AND NEIGHBORS*, CONGRESSIONAL RESEARCH SERVICE REPORT FOR CONGRESS 1 (2001), available at <http://fpc.state.gov/documents/organization/65666.pdf>.

99. *Id.*

100. See Roberto Chacon de Albuquerque, *The Disappropriation of Foreign Companies Involved in the Exploration, Exploitation, and Commercialization of Hydrocarbons in Bolivia*, 14 *L. & BUS. REV. AM.* 21, 31 (in 1883, Bolivia lost its coastline to Chile in the War of the Pacific. The riots of the gas-war were a consequence of a plan to build a pipeline to pump gas to the Chilean coasts to be exported to Mexico and the United States. This turned out to be a terrible idea due to a historical rivalry with Chile).

101. Benjamin Dangl, *An Overview of Bolivia's Gas War*, *UPSIDE DOWN WORLD*, <http://upside-downworld.org/gaswar.htm> (last visited July 7, 2010).

102. Contreras & Simoni, *supra* note 97, at 32, 36.

103. Center for Energy Economics, *Appendix & Companion to: Chapter 16—Hydrocarbon Sector Regulation and Cross-Border Trade in the Western Hemisphere*, 2-3

eral approval of both the population and the investors.<sup>104</sup> A few days later President Mesa resigned and the Bolivia's Chief Justice, Mr. Eduardo Rodriguez, assumed office for a six month period (2005-2006) until the leftist leader Evo Morales was elected on a general election (2006-2009), and subsequently reelected (2009- present).<sup>105</sup>

In his inaugural speech Morales explicitly stated "it is true that Bolivia needs partners, not owners of our natural resources . . . We'll guarantee the foreign companies the right to recover what they invested, and also the right to have some profit; but, we just want the people to benefit from these resources."<sup>106</sup> In this sense, one of the first measures taken by President Morales' government was to issue Decree 28701 nationalizing the entire hydrocarbon industry.<sup>107</sup> The following day, May 1, 2006, President Morales militarized the oil and gas fields to ensure the decree's enforcement.<sup>108</sup> Exactly one year later Bolivia formally notified the ICSID Secretariat of its withdrawal from the Washington Convention.

On January 25, 2009 President Morales' proposal of a new constitution was passed by referendum with the approval of sixty-one percent of the population.<sup>109</sup> Bolivia's new constitution has been described as pro-indigenous and reluctant to FDI.<sup>110</sup> An important change that merits underscoring is the new Article 366, which states that in the hydrocarbons sector foreign companies will not be able to sue Bolivia in any foreign jurisdiction nor resort to international arbitration or diplomatic protection.<sup>111</sup> This provision reinforces Bolivia's reluctance to appear before

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(Univ. of Tex. at Austin, Working Paper 2007), available at [http://www.beg.utexas.edu/energyecon/documents/CEE\\_Hydrocarbon\\_Regulation\\_Appendix.pdf](http://www.beg.utexas.edu/energyecon/documents/CEE_Hydrocarbon_Regulation_Appendix.pdf).

104. See ELEODORO MAYORGA & ALEJANDRO TAPIA, *THE GAS ERA* 164 (2006).

105. *Election Tracker*, GLOBAL MONITOR, <http://www.angus-reid.com/tracker/view/8124> (last visited July 7, 2010).

106. See Lindsay Sykes Pinto, *Resolving the Bolivian Gas Crisis: Lessons from Bolivia's Brush with International Arbitration*, 39 GEO. WASH. INT'L L. REV. 947, 949 (2007).

107. *Id.* at 955 (noting that "Morales deployed soldiers to Bolivia's petroleum fields on the same day the Decree was issued, drawing international attention and prompting statements of concern from Bolivia's largest investors, Brazil and Spain. Although these investors renewed and strengthened their threats to take Bolivia to international arbitration, none followed through: all ultimately signed new contracts within the timeframe specified by Decree 28701 and remain operating in Bolivia today").

108. CLARE M. RIBANDO, *BOLIVIA: POLITICAL AND ECONOMIC DEVELOPMENTS AND RELATIONS WITH THE UNITED STATES*, CONGRESSIONAL RESEARCH SERVICE REPORT FOR CONGRESS, 10-11 (2007), available at <http://www.fas.org/sgp/crs/row/RL32580.pdf>.

109. Adam Kott & David Rosenblum Felson, *Chavez and Morales Force Sweeping Land Reform Measures*, LATIN AM. ON THE EDGE, May 5, 2009, <http://www.the-cuttingedge.com/index.php?article=11296&pageid=13&pagename=Analysis>.

110. See Fernando Cabrera, *Bolivian Voters Approve New Constitution as Government Continues to Nationalize Oil Assets*, INV. TREATY NEWS, Feb. 4, 2009, <http://www.investmenttreatynews.org/cms/news/archive/2009/02/04/bolivian-voters-approve-new-constitution-as-government-continues-to-nationalize-oil-assets.aspx>.

111. ADRIAN BARRENECHES & DANIEL MARIACA, *Bolivia*, *The International Comparative Legal Guide to: Gas Regulation* 35 (2010), available at <http://www.iclg.co.uk/khadmin/Publications/pdf/3388.pdf>.

ICSID.<sup>112</sup> But even with a constitutional provision outlawing ICSID and other foreign tribunals' jurisdiction, an ICSID panel will still be entirely independent to find jurisdiction in the case a claim arises in such forum.

## 2. *Bolivia Membership Status*

Given that Bolivia's withdrawal was formally communicated to the ICSID's Secretariat on May 2, 2007, in accordance with §72's six-month rule, the last day in which Bolivia was effectively considered a Contracting State of the Washington Convention was November 2, 2007.<sup>113</sup> Therefore, it was perfectly understandable why the ICSID Secretariat registered the case *E.T.I. Euro Telecom International N.V. v. Republic of Bolivia*,<sup>114</sup> on Wednesday October 31, 2007.

There are grounds to believe that by registering this case the ICSID did not take any posture on the following discussion about consent, since at that date, Bolivia was still technically a member State of the Washington Convention. The authors Tietje, Nowrot, and Wackernagel, however, believe otherwise. The ICSID Secretariat, by registering the case, found that the case was not 'manifestly outside the jurisdiction of the Centre,' in the sense established by §36(3) of the Convention.<sup>115</sup> According to these authors, by taking this action the ICSID Secretariat adopted a position contrary to the potential argument that Bolivia was not subject to the Centre's jurisdiction since the date of the notification of denunciation (May 2, 2007), and not six months later, as established in §72.<sup>116</sup>

## 3. *From 'Offer to Consent' to [just] 'Consent'*

The effects of a Bolivia's denunciation of the Washington Convention raise the topic of the interplay between §25(1), §72 and, §71 of the Convention. The first two articles contain references to the consent of the parties, while the third section relates to right to denunciation. But none

112. *See id.* (article 366 provides that all foreign companies with activities in the hydrocarbons productive chain on behalf of the State will be subjected to the Sovereignty of the State, the laws, and the authorities of the State. No foreign tribunal or jurisdiction will be recognized in any event, and [these companies] may not resort to any instance of international arbitration or diplomatic channels to resolve their disputes).

113. MIQUEL SOLANES & ANDREI JOURAVLEV, REVISITING PRIVATIZATION, FOREIGN INVESTMENT, INTERNATIONAL ARBITRATION, AND WATER, RECURSOS NATURALES E INFRAESTRUCTURA 9 (2007), available at <http://www.iatp.org/tradeobservatory/library.cfm?refID=101503>.

114. *See E.T.I. Euro Telecom Int'l N.V. v. Republic of Bol.*, ICSID Case No. ARB/07/28 (2008).

115. Washington Convention, *supra* note 11, at § 36(3) (section 36(3) of the Washington Convention establishes that "The Secretary-General shall register the request unless he finds, on the basis of the information contained in the request, that the dispute is manifestly outside the jurisdiction of the Centre. He shall forthwith notify the parties of registration or refusal to register").

116. *See* CHRISTIAN TIETJE ET AL., ONCE AND FOREVER? THE LEGAL EFFECTS OF A DENUNCIATION OF ICSID 12, INSTITUTE OF ECONOMIC LAW OF THE MARTIN LUTHER UNIVERSITY HALLE-WITTENBERG SCHOOL OF LAW (2007), available at [www.wirtschaftsrecht.uni-halle.de/Heft74.pdf](http://www.wirtschaftsrecht.uni-halle.de/Heft74.pdf).

of them explicitly defines what constitutes such consent. As part of the Chapter II of the Convention, regarding the jurisdiction of the Centre, §25(1) establishes that:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. *When the parties have given their consent, no party may withdraw its consent unilaterally.* (emphasis added).<sup>117</sup>

As part of Chapter VI of the Convention, which contains the final provisions, §72 establish that:

Notice by a Contracting State pursuant to Articles 70 or 71 shall not affect the rights or obligations under this Convention of that State or of any of its constituent subdivisions or agencies or of any national of that State arising out of consent to the jurisdiction of the Centre given by one of them before such notice was received by the depositary.<sup>118</sup> (emphasis added).

And, §71 of the same section establish that: “[a]ny Contracting State may denounce this Convention by written notice to the depositary of this Convention. The denunciation shall take effect *six months* after receipt of such notice.”<sup>119</sup> Then, the critical question is whether the effects of the protection contained in §71 may be extended due to the mandate of §25(1), even after the denunciation of the Washington Convention under §72. Any analysis in this area must pay special attention to the different sources of consent, whether contractual (through an investment agreement), or non-contractual (through Investment Protection Laws, BITs, or MITs). For instance, if a BIT is found to constitute consent in the meaning of §25(1), the denunciation of the Convention as per §72, may not affect the ability of investors who are nationals of the other contracting country of the BIT, to hail the host country before the ICSID, during the existence of such consent, which is also to say “during the validity of the BIT.”

The most controversial issue here is the legal nature of the arbitration clause contained in most BITs. In this particular issue there are some differing points of view. While some scholars believe that at most a BIT contains a unilateral offer to consent to the jurisdiction of the Centre which must be “perfected” by further acceptance by the investor, others believe that a BIT pledges the consent of the country to submit to the jurisdiction of the Centre during the validity of such instrument. The potential applicability of any of these views in Bolivia is clear: the supporters of the offer to consent theory believe that no other case could be filed by or against Bolivia before the ICSID, after November 2, 2007; while the

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117. Washington Convention, *supra* note 11, art. 25(1).

118. Washington Convention, *supra* note 11, art. 72.

119. Washington Convention, *supra* note 11, art. 71 (emphasis added).

detractors believe otherwise.<sup>120</sup>

#### 4. Offer to Consent

Professor Christoph Schreuer is of the opinion that “a provision on consent in a BIT is merely an offer by the respective States that requires acceptance by the other party . . . [which], may be accepted by a national of the other State party to the BIT.”<sup>121</sup> In this sense, “consent is only perfected after it has been accepted by both parties. Therefore, a *unilateral offer* of consent by the host State through legislation or a treaty before a notice under Arts. 70 or 71 would not suffice.”<sup>122</sup>

This line of reasoning implies that the only way an investor may sue the host state before ICSID after denunciation is by having given notice in writing of his consent as required by §25(1), and thus perfecting the consent. Under this theory, the investor must always “perform some reciprocal act to perfect consent.”<sup>123</sup> Consequently, if the country has withdrawn its unilateral offer to consent prior the perfection of such consent, the investor will no longer be able to sue before ICSID. The consequences of his position were recently reiterated by Professor Schreuer in relation to Bolivia’s case.<sup>124</sup> By the same token, perhaps the most cited text in this subject is a discussion between Aron Broches and various country representatives at the origins of the Washington Convention. This conversation certainly reflects the position of the founding fathers of the Convention. At some point, Broches explained that the effects of the Convention would be extended after denunciation. In contractual cases:

Mr. Broches replied that the intention of Article 73 [today’s §72] in the text submitted to the Directors was to make it clear that *if a State had consented to arbitration, for instance by entering into an arbitration clause with an investor, the subsequent denunciation of the Convention by that State would not relieve it from its obligation to go to arbitration if a dispute arise.*<sup>125</sup> (emphasis added).

. . .

120. I am of the opinion that by registering this case the ICSID did not take any posture on the following discussion about consent, since Bolivia was still technically a member State of the Washington Convention, at that date. However, the authors of a comprehensive study on the subject (discussed below) believe otherwise.

121. See CHRISTOPH SCHREUER, *THE ICSID CONVENTION: A COMMENTARY* 7 (2001).

122. *Id.* at 1286.

123. *Id.* at 206.

124. See *Bolivia Notifies World Bank of Withdrawal from ICSID, Pursues BIT Revisions*, INVESTMENT TREATY NEWS, May 9, 2007, [http://www.iisd.org/pdf/2007/itn\\_may9\\_2007.pdf](http://www.iisd.org/pdf/2007/itn_may9_2007.pdf) (Here, Professor Schreuer goes even further by stating that “If you look closer . . . the six month notice period offers very little comfort to investors and potential litigants.”); see Sebastian Manciaux, *La Bolivie se Retire du Cirdi* (Sept. 2007), available at [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com) (last visited on Nov. 23, 2008) (it is also important to add Professor Sebastian Manciaux of the University of Bourgogne to the list of proponents of the offer to consent theory).

125. INT’L CTR. FOR SETTLEMENT OF INV. DISPUTES, *HISTORY OF THE ICSID CONVENTION: DOCUMENTS CONCERNING THE ORIGIN AND THE FORMULATION OF THE CONVENTION ON THE SETTLEMENT OF INVESTMENT DISPUTES BETWEEN STATES AND NATIONALS OF OTHER STATES VOL II*, 1009 (1968).

Mr. Broches replied that *if the agreement with the company included an arbitration clause and that agreement lasted for say 20 years, that State would still be bound to submit its disputes with that company under that agreement to the Centre.*<sup>126</sup> (emphasis added).

The conversation touched upon the subject of subsequent application of the Convention after denunciation in non-contractual and indefinite cases. Here, the participants expressly discussed the drafting of the current §72, to ensure a correct outcome in the hypothetical case of a country withdrawal from the Convention, while having BITs in force, mentioning the Centre.

*Mr. Gutierrez Cano* said that Article 73 [today's §72] in the new text was lacking a time limit beyond which the Convention would cease to apply. Unless such time limit was introduced States would be bound indefinitely. *He had in mind the case in which there was no agreement between the State and the foreign investor but only a general declaration on the part of the State in favor of submission of claims to the Centre and a subsequent withdrawal from the Convention by that State before any claim had been in fact submitted to the Centre. Would the Convention still compel the State to accept the jurisdiction of the Centre?*<sup>127</sup> (emphasis added)

By answering Mr. Gutierrez-Cano's question, Broches, who is considered the father of the Convention,<sup>128</sup> establishes his position on the offer to consent discussion. It is important to remark that his answer was given in the context of explaining the scope and reach of §72, which is the source of this entire discussion. He said that:

A general statement of the kind mentioned by Mr. Gutierrez-Cano [a BIT with an ICSID arbitration clause] *would not be binding on the State which had made it until it had been accepted by the investor. If the State withdraws its unilateral statement by denouncing the Convention before it has been accepted by any investor, no investor could later bring a claim before the Centre.* If, however, the unilateral offer of the State has been accepted before the denunciation of the Convention, then disputes arising between the State and the investor after the date of denunciation will still be within the jurisdiction of the Centre.<sup>129</sup> (emphasis added).

With these words Aron Broches noted that the consent that may be contained in BITs is a mere offer to consent, subject to acceptance by the investor. In fact, in an early scholarly article about the Centre, Broches specifically stated that:

the consent of the investor may be evidenced by an express statement to that effect made to the host State, or it may be given at the time when the investor institutes proceedings against the host State. *It must, however, be remembered that each party's consent becomes*

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126. *Id.* at 1010.

127. *Id.*

128. Lowenfeld, *supra* note 48, at 123.

129. Int'l Ctr. for Settlement of Inv. Disputes, *supra* note 125, at 1010.



*irrevocable only after both parties have given it. Therefore, in the examples last mentioned [one of them refers to a BIT case], the host State could withdraw its consent as long as the investor had not equally consented.*<sup>130</sup> (emphasis added).

It is also important to remark that most of these discussions have been widely interpreted by the detractors of this theory in their writings. So even when the words of Mr. Broches seem to be self-explanatory, some authors (as seen below) try to find an explanation that would not invalidate the opposing theory. The strength of this offer-to-consent theory resides precisely in its historical roots, which links it to the very foundation of the Centre. Recently, a French author stated that:

[t]his viewpoint appears less than convincing as all the history of the Convention, combined with the writings of the most qualified authors, and customary international law point in the same direction: an offer to arbitrate is a proposal to do a thing. . . usually accompanied by an expected acceptance, counter-offer, return promise or act.<sup>131</sup>

In sum, if Bolivia's only source of non-contractual consent to ICSID jurisdiction were contained in its Investment Protections Law, the proponents of the offer-to-consent theory would not have much of a problem. Once the law has been abrogated, the consent would have disappeared for of everybody. The problem arises when the parties of the dispute in question try to assert jurisdiction on a BIT. Here, the proponents of this view hold that even when the BIT in question is still in effect (because it has not been denounced or it is still in effect under the term established by the survival clause) after the expiration of the six months established in §72 the country, in this case Bolivia, may no longer be hailed into ICSID.

##### 5. [just] Consent

This theory comprises different readings to the aforementioned interplay between §25(1), §71, and §72 of the Washington Convention. First, Professor Gaillard argues that great weight should be given to the actual language of the BITs. According to this author, wherever there is consent and not an offer to consent in the BIT, ICSID would still have jurisdiction even after denunciation.<sup>132</sup> Second, another study proposes the use of dynamic interpretation. The authors of this study state that:

130. Broches, *supra* note 48, at 353.

131. Julian Foutet, *Denunciation of the Washington Convention and Non-Contractual Investment Arbitration: "Manufacturing Consent" to ICSID Arbitration?*, 25 J. INT'L ARB. 80, 80 (2008). In fact, Foutet adopts a drastic position by considering that this discussion is a fake one, invented by the creativity of practitioners in the field. *Id.* at 81. To him "[. . .] it seems easy to determine the correct interpretation: consent is an exchange and not a unilateral act;" to support his findings he quotes the findings of an ICSID tribunal in the case *Salini v. Kingdom of Morocco*, ICSID ARB/00/4 (July 23, 2001) (Decision on Jurisdiction). *Id.* at 87.

132. Emmanuel Gaillard, *The Denunciation of the ICSID Convention*, 237 N.Y. L. J. 3 (2007).

[i]t seems to be more than appropriate to apply the principle of dynamic treaty interpretation also to the ICSID Convention and thereby provide an understanding of the regulatory interplay of its articles 25 and 72 in conformity with present-day conditions of consenting to ICSID arbitration that does not run contrary to the original and current object and purpose of the Convention.<sup>133</sup>

Finally, two practitioners from a prestigious law firm have published an article supporting this theory through an approach linked to the international obligation to State consent.<sup>134</sup> This approach is based primarily on the dissenting vote of Arbitrator Francisco Orrego Vicuña in the case *Waguïh Elie Georg Siag & Clorinda Vecchi v. Egypt*,<sup>135</sup> and general principles of international law, specifically those related to good faith and unilateral declarations.

a. Professor Gaillard's Point of View:

E. Gaillard explains that "consent to ICSID jurisdiction does not result from a State's status as Contracting Party to the Convention but, in accordance to §25(1), requires both parties' written consent to the Centre's jurisdiction."<sup>136</sup> Then the explanation on consent begins by commenting on the discussion transcribed above between Aron Broches and other country representatives.<sup>137</sup> His posture in this particular area is simple, but very interesting:

[h]ad the drafters of the ICSID Convention intended to refer to a State's 'agreement to consent' rather than to its 'consent,' they would have so provided. As a result, a denouncing State's consent to the jurisdiction of the Centre based on an investment protection treaty depends on the terminology used in the arbitration clause contained in that treaty.<sup>138</sup>

To clarify his position Professor Gaillard divides the types of consent contained in the different BITs as "unqualified consent," and "agreements to consent."<sup>139</sup> An example of the former is found in the language of §11 of the Bolivia-Germany BIT (use of the word 'shall'),<sup>140</sup> and an

133. CHRISTIAN TIETJE ET AL., *supra* note 116, at 23.

134. See generally Michael Nolan & F.G. Sourgens, *The Interplay Between State Consent to ICSID Arbitration and Denunciation of the ICSID Convention: The (Possible) Venezuela Case Study*, *TRANSNAT'L DISPUTE MGMT.*, Sept. 2007, available at [http://www.milbank.com/NR/rdonlyres/A49BAAD9-E6C3-40C8-ABC1-7DFA99B4E3FB/0/TDM\\_Nolan\\_Sourgens\\_Milbank.pdf](http://www.milbank.com/NR/rdonlyres/A49BAAD9-E6C3-40C8-ABC1-7DFA99B4E3FB/0/TDM_Nolan_Sourgens_Milbank.pdf).

135. *Siag v. Egypt*, ICSID ARB05/15 (Apr. 15, 2007) (Decision on Jurisdiction).

136. Emmanuel Gaillard, *Anti-Arbitration Trends in Latin America*, 237 *N.Y. L. J.* 2 (2008).

137. Gaillard, *supra* note 132.

138. *Id.*

139. *Id.*

140. Treaty Concerning the Promotion and Mutual Protection of Investments, Bol.-F.R.G., art. 11, ¶ 3, Mar. 23, 1987, 1706 U.N.T.S. 29497 (section 11(3) of the Bolivia-Germany BIT establishes that: "If both Contracting Parties are parties to the Convention of 18 March 1965 on the settlement of investment disputes between States and nationals of other States, any disputes between either Contracting Party and an investor, as referred to in the article, shall be submitted, in accordance with

example of the latter may be found in §8 of the Bolivia-United Kingdom BIT (use of the word ‘may’).<sup>141</sup> In his opinion, “where an unqualified consent exists, as opposed to an agreement to consent, the rights and obligations attached to this consent should not be affected by the denunciation of the ICSID Convention.”<sup>142</sup>

b. Tietje, Nowrot & Wackernagel Study:

These German Professors advocate for the dynamic treaty interpretation established in the *Tyrer v. United Kingdom* case, before the European Court of Human Rights. In this case, an International Treaty was considered “a living instrument which . . . must be interpreted in the light of present-day conditions.”<sup>143</sup> Accordingly, these Professors propose the application of this same methodology (*i.e.*, the so-called “dynamic interpretation” of treaties) to the discussion of the founding fathers of the Washington Convention, in particular, to Mr. Broches’ remarks. They believe that their suggestion finds strong support in §31(3)(c) of the Vienna Convention of the Law of Treaties, which establishes the general rule of treaty interpretation and proscribes that “there shall be taken into account, together with the context: (c) any relevant rule of International law applicable in the relations between the parties.”<sup>144</sup>

The application of the dynamic treaty interpretation methodology to ICSID cases would drive these Professors to look at the “extraordinary number of international investment agreements that have entered into force since the adoption of the ICSID Convention, in particular more than 2,500 BITs, but also the more than 240 other international agreements that deal with economic activities and also contain investment provisions.”<sup>145</sup>

Aside from the socio-economic and legal developments, another element to consider in this innovative methodology is the cause of such developments. Accordingly, these authors found that “all of these agreements are at least primarily also aimed at the promotion of foreign

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the rules of the laid Convention, to mediation and arbitration by the International Centre for Settlement of Investment Disputes.”) (emphasis added).

141. Agreement Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Bolivia for the Promotion and Protection of Investments, U.K.-Bol., art. 8, ¶ 2, May 24, 1988, 1640 U.N.T.S. 1990 (section 8(2) of the Bolivia-United Kingdom establishes that: “Where the dispute is referred to international arbitration, the investor and the Contracting Party concerned in the dispute *may agree to refer the dispute* either to: (a) the International Center for the Settlement of Investment Disputes[. . .]”) (emphasis added).

142. Gaillard, *supra* note 132.

143. *Tyrer v. United Kingdom*, 26 Eur. Ct. H.R. 31 (1978).

144. Vienna Convention on the Law of Treaties, art. 31, ¶ 3(c), May 23, 1969, 1155 U.N.T.S. 331 (even though when The Vienna Convention on the Law of Treaties would be applicable as a primary source of law only to Contracting States, its content is nowadays widely considered part of the customary provisions of International law and applicable as established in § 38(b) of the Statute of the International Court of Justice).

145. CHRISTIAN TIETJE ET AL., *supra* note 116, at 23.

investment and, in order to reach that goal, at providing private investors with additional legal safeguards.”<sup>146</sup> Thus, the principle of dynamic treaty interpretation would provide a “balanced interpretative approach of upholding the original and still current objects and purposes of the ICSID Convention by taking into account subsequent developments in the realm of international law.”<sup>147</sup> Finally, by applying this principle to the issue of consent, these authors find that “if the respective BIT provides for consent this may only be revoked by bringing to a final end the legal effects of the BIT.”<sup>148</sup> In other words, Professors Tietje, Nowrot, and Wackernagel believe that Bolivia might be taken before ICSID after November 2, 2007, as long as its BITs referring to the jurisdiction of the Centre are still in effect, which includes the duration of the survival clauses.

c. Nolan & Sourgens Approach:

As briefly mentioned above this approach takes into consideration the dissenting vote Arbitrator Francisco Orrego Vicuña in the case *Waguïh Elie Heorg Siag & Clorinda Vecchi v. Egypt*, and general principles of International law, specifically those related to good faith, and unilateral declarations. According to Orrego’s partial dissent:

[. . .]the common situation became one where the State expresses its consent in the treaty and later the investor expresses its own consent in either a separate instrument or by simply applying to the Centre for the registration of its claim. *At that point the expression of consent became decoupled and separated by a lapse of time, many times long. It has been often understood that the consent of the State was an offer, which upon acceptance by the investor became the consent to arbitration.*

This is the situation later reflected in Rule 2 of the ICSID Institution Rules which takes the “[d]ate of consent” to mean, when both parties did not act simultaneously, the date in which the second party acted, which is usually the case of the investor.

*Yet, the date in which the State expresses its consent in the treaty is not just an offer. It is much more than that and it has special legal effects, including obligations of the host State under the treaty and the prohibition to exercise diplomatic protection by the other Contracting Party. The date of expression of consent for the State is that of the entry into force of the treaty or some other instrument which embodies consent. When this consent is later matched by the consent of the foreign investor, the required conditions for submitting the dispute to arbitration are met, but the respective expressions of consent do not appear to change their dates.”*<sup>149</sup> (emphasis added).

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146. *Id.*

147. *Id.* at 28.

148. *Id.* at 27.

149. Siag, *supra* note 135.

According to these authors, the core of Professor Orrego's remarks has a dichotomous foundation: even though the Washington Convention was drafted following a contractual type of consent in mind, this would not "affect the nature of international obligations incurred by the States in their ICSID consent."<sup>150</sup> Hence, in their view, the consent given by a state in their BITs would amount to international obligations of such nation. The nature of these unilateral declarations was established in the case *New Zealand v. France* (a.k.a., the Nuclear Test Case), in which the International Court of Justice highlighted the differences between a private unilateral promise and a public unilateral promise, holding that the latter constitutes an International obligation binding upon such country.<sup>151</sup> In words of Nolan and Sourgens: "promises made by sovereigns are qualitatively different from those made by private individuals, as axiomatically all promises of the sovereign on the international stage are binding as a matter of international law."<sup>152</sup>

Finally, these authors conclude their interesting theory by stating that if the consent contained in BITs is deemed as a valid International obligation of a country, this finding would be contrary to the offer-to-consent theory. Therefore, the consent of BITs would be sufficient to assert ICSID's jurisdiction, even after a country denounces the Washington Convention. In their own words:

[i]f undertakings to arbitrate investment disputes with private investors in bilateral investment treaties and national investment laws *are understood as independent international obligations*, that a state's consent to ICSID arbitration operates as more than an offer to arbitrate. *An implication is that denunciation by a state should not necessarily be viewed as immediately putting an end to the investor's ability to invoke ICSID jurisdiction for an arbitration against that state.*<sup>153</sup> (emphasis added).

Accordingly, under this theory, Bolivia could still be sue in ICSID by investors nationals of countries with which Bolivia maintains BITs with ICSID arbitration clauses in force.<sup>154</sup>

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150. Nolan, *supra* note 134, at 25-26.

151. *Nuclear Tests (N.Z. v. Fr.)*, 1974 I.C.J. 457, 472 (Dec. 20).

152. Nolan, *supra* note 134, at 28.

153. *Id.* at 31.

154. Other notable practitioners from all over the world have advocated for a similar result. For instance, Timothy G. Nelson, from Skadden, Arps, Slate, Meagher & Flom in New York, says that: "any implication that withdrawing from ICSID closes the door on expropriation cases is simply incorrect." *Bolivia Withdraws from ICSID*, *LATIN LAWYER*, May 2007, [http://www.americasnet.net/news/Bolivia\\_ICSID.pdf](http://www.americasnet.net/news/Bolivia_ICSID.pdf). Similarly, Jose Rafael Bermudez, from Bermudez, Nevett, Mezquita & Lopez in Caracas, holds that "any BITs containing consent to ICSID would stand, and that the Venezuelan government would have to also denounce those treaties to fully withdraw." *Id.* Of course, after denouncing the BITs, the survival period would have to lapsed, in order to fulfill a complete exit from ICSID.

6. *A Look Into the Future, and the Availability of Potential Avenues for Investors Harmed by Bolivia*

Currently, it is impossible to predict with certainty what position is going to be adopted by ICSID Secretariat or by an ICSID Tribunal. The explanation about consent seems to be too abstract, but with significant potential consequences. On the one hand, it seems like the natural path would be to follow the offer-to-consent theory as this was advocated by the drafters of the Convention. But the other theory is supported by at least three persuasive explanations that seek to tailor any solution on a case-by-case basis, either by looking at the actual language of the BITs, or by undertaking a comprehensive dynamic interpretation.

For this reason, the safest grounds would probably be to expect that the theory of offer-to-consent is going to be applied, and hence, that Bolivia may no longer be hailed into ICSID. Despite the fact that Bolivia's move to withdraw from ICSID may potentially bring disastrous consequences to future inflows of FDI, our attention now must focus on the already existing FDI in Bolivia. Here, the logical issue that arises is whether existing foreign investors in Bolivia will be left totally unprotected in the eventual case that the government, for instance, decides to expropriate them without paying just compensation.

The answer is probably no. The vast majority of Bolivia's BITs, for example, contemplate the possibility of resorting to UNCITRAL ad hoc arbitration, an option that may be particularly appealing at this stage, especially given that Bolivia is a signatory of the New York on the Recognition and Enforcement of Foreign Arbitral Awards. Notwithstanding this, there are some BITs concerning Bolivia, like the Bolivia-Belgium BIT, which refers to ICSID,<sup>155</sup> and other avenues (such as the International Chamber of Commerce (ICC) in Paris, and the Arbitration Institute of the Stockholm Chamber of Commerce) but does not refer to UNCITRAL ad hoc arbitration.

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155. Bilateral Investment Treaty (BIT), Belg.-Bol., art. 11, ¶ 3, Apr. 25, 1990 (section 11(3) of Bolivia-Belgium BIT establishes that: En cas de recours à l'arbitrage international, le différend est soumis à l'un des organismes d'arbitrage désignés ci-après, au choix de l'investisseur : le Centre international pour le Règlement des Différends relatifs aux investissements (CIRDI), créé par "la Convention pour le règlement des différends relatifs aux investissements entre Etats et ressortissants d'autres Etats", ouverte à la signature à Washington, le 18 mars 1965, lorsque chaque Etat partie au présent Accord sera membre de celle-ci. Aussi longtemps que cette condition n'est pas remplie, chacune des Parties contractants consent à ce que le différend soit soumis à l'arbitrage conformément au règlement du Mécanisme supplémentaire du CIRDI; le Tribunal d'Arbitrage de la Chambre de Commerce Internationale, à Paris; l'Institut d'Arbitrage de la Chambre de Commerce de Stockholm. Si la procédure d'arbitrage est introduite à l'initiative d'une Partie contractante, celle-ci invitera par écrit l'investisseur concerné à exprimer son choix quant à l'organisme d'arbitrage qui devra être saisi du différend. Accord entre l'Union économique belgo-luxembourgeoise et le Gouvernement de la République de Bolivie concernant l'encouragement et la protection réciproques des investissements)."

The question that has been asked here is whether the famous “Most-Favored-Nation” clause (“MFNC”), which is included very often in BITs, can be used to extend the UNCITRAL ad hoc arbitration option to other cases. For instance, as seen above, investors from Belgium do not have the option to initiate an UNCITRAL ad hoc arbitration against Bolivia; however, at the same time their BIT contains the MFNC in §12, which establishes that: “for all the issues related to the treatment of investments, the investors from either Contracting party enjoy, on the territory of the other party, the most-favored-nation treatment.”<sup>156</sup>

The case-law of the different arbitral tribunals in this particular issue seems to be inconsistent. In the cases *Mafezzini*,<sup>157</sup> *Siemens*,<sup>158</sup> *Gas Natural*,<sup>159</sup> and *Suez*,<sup>160</sup> different tribunals interpreted “silence or ambiguity as indicative that the MFNC included, with certain limits, procedural provisions.”<sup>161</sup> On the other hand, in the cases of *Plama*,<sup>162</sup> *Salini*,<sup>163</sup> and *Telenor*<sup>164</sup> different tribunals found it impossible to use the MFNC to “by-pass a limitation in the very same BIT when the parties have not chosen language in the MFN clause showing an intention to do this, as has been done in some BITs.”<sup>165</sup> Therefore, it remains unclear whether the MFNC could be used for extending jurisdiction to an ad hoc arbitral tribunal, governed by the UNCITRAL rules. But, in the rare cases where UNCITRAL arbitration is not an option, an ICC arbitration could then be an ideal venue for the investors.

156. *Id.* art. 12. (section 12 provides “Pour toutes les questions relatives au traitement des investissements, les investisseurs de chacune des Parties contractantes bénéficient, sur le territoire de l’autre Partie, du traitement de la nation la plus favorisée”).

157. *Mafezzini v. Spain*, ICSID ARB/97/7 (2000) (Decision on Jurisdiction) (the tribunal held that “if a third-party treaty contained provisions for the settlement of disputes that are more favorable to the protection of the investor’s rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most-favored-nation clause as they are fully compatible with the *ejusdem generis* principle).

158. *Siemens A.G. v. Argentina*, ICSID ARB/02/8 (2004) (Decision on Jurisdiction).

159. *Gas Natural SDG, S.A. v. Argentina*, ICSID ARB/03/10 (2005) (Decision of the Tribunal on Preliminary Questions on Jurisdiction) (The tribunal held that “[u]nless it appears clearly that the State parties to a BIT or the parties to a particular investment agreement settled on a different method for resolution of disputes that may arise most-favored-nation provisions in BITs should be understood to be applicable to dispute settlement”).

160. *Suez v. Argentina*, ICSID ARB/03/17 (May 16, 2006) (Decision on Jurisdiction).

161. Alejandro Faya Rodriguez, *The Most-Favored-Nation Clause in International Investment Agreements*, 25 J. INT’L ARB. 95, 104 (2008).

162. *Plama Consortium Ltd v. Bulgaria*, ICSID ARB/03/04 (2005) (Decision on Jurisdiction) (the tribunal held that “an MFN provision in a basic treaty does not incorporate by reference dispute settlement provisions in whole or in part set forth in another treaty, unless the MFN provision in the basic treaty leaves no doubt that the Contracting Parties intended to incorporate them.”).

163. *Salini Costruttori S.p.A. v. Jordan*, ICSID ARB/02/13 (2004) (Decision on Jurisdiction).

164. *Telenor Mobile Commc’n A.S. v. Hungary*, ICSID ARB/04/15 (2006) (Award).

165. *Id.* at ¶ 92

B. ECUADOR'S OIL AND GAS EXCLUSION AND  
SUBSEQUENT WITHDRAWAL

*1. Background*

The adoption of free-market policies began in Ecuador in the presidency of Sixto Durán Ballén in the early 1990s.<sup>166</sup> President Durán implemented a series of free market policies in order to open the country to foreign capital.<sup>167</sup> For these means, Ecuador became part of the World Trade Organization (“WTO”) in 1996,<sup>168</sup> and signed approximately twenty-five percent of its BITs during the last year of Durán’s presidency.<sup>169</sup> Notwithstanding the efforts to liberalize FDI, the political instability of Ecuador grew after Durán; in fact from 1996 to 2000 Ecuador had four presidents. But, from 1992 to 1994 the levels of FDI tripled “and subsequently doubled from 1996 to 1998.”<sup>170</sup> Even though unprecedented levels of inflation (more than 100 percent) accelerated the crisis in 1998, the inflows of FDI remained stable. In part, this increase happened because the “lion’s share” of the FDI in the 1990s went to the oil and gas sector (more than 80 percent),<sup>171</sup> and those type of investments, once completed, tend to be less volatile and last for longer periods of time.

President Mahuad aggravated the social and political turmoil in Ecuador in 1998 when he announced the decision to *dollarize* the economy by making its currency, the *Sucre*, obsolete.<sup>172</sup> Two years later Mahuad was ousted and his Vice-President Gustavo Noboa assumed office.<sup>173</sup> Noboa restored some of the lost stability during his presidency when the dollarization, announced by Mahuad, was implemented and when he undertook important infrastructure projects, such as the construction of a major pipeline.<sup>174</sup> Noboa’s successor, Colonel Lucio Gutierrez assumed control of the government on January 15, 2003, but was later impeached for charges of corruption and ousted from power.<sup>175</sup> Alfredo Palacio, Gutierrez’ Vice-President, assumed office for the remaining twenty

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166. *Ecuador*, ENCYCLOPEDIA BRITANNICA, available at <http://www.britannica.com/EBchecked/topic/178721/Ecuador>.

167. *Ecuador*, CIA WORLD FACTBOOK, 1996, <http://www.umsl.edu/services/govdocs/wofact96/79.htm>.

168. UNITED NATIONS CONFERENCE ON TRADE AND DEV, INVESTMENT POLICY REVIEW: ECUADOR 88 (2001), available at [http://www.unctad.org/en/docs/iteipcmisc2\\_en.pdf](http://www.unctad.org/en/docs/iteipcmisc2_en.pdf).

169. *Id.* at 59.

170. *Id.* at 1.

171. *Id.* at 10.

172. See Hale E. Sheppard, *Dollarization Of Ecuador: Sound Policy Dictates U.S. Assistance To This Economic Guinea Pig Of Latin America*, 11 IND. INT’L & COMP. L. REV. 79, 86 (2000).

173. *Id.* at 88-89.

174. *Id.* at 88-93.

175. Roberto Ortiz de Zárate, *Lucio Gutiérrez Borbúa*, CONFEDERATION OF INDIGENOUS PEOPLE OF BOLIVIA, Nov. 11, 2009, [http://www.cidob.org/es/documentacion/biografias\\_lideres\\_politicos/america\\_del\\_sur/ecuador/lucio\\_gutierrez\\_borbua](http://www.cidob.org/es/documentacion/biografias_lideres_politicos/america_del_sur/ecuador/lucio_gutierrez_borbua).



months.<sup>176</sup> In the following elections in 2006, Noboa won the first round, but lost the second round to Rafael Correa, who was running on an anti-establishment platform that won him the presidency.<sup>177</sup>

Correa's victory came in a particularly stressful year for Ecuador's FDI. In fact, by 2006 "Ecuador was in the final stages of negotiating a free trade agreement (FTA) with the United States, but that progress stalled with an April 2006 hydrocarbons law mandating revisions in contract terms."<sup>178</sup> In May 2006, the Palacio Administration ordered the seizure of the assets of Occidental Petroleum, who was at the time Ecuador's largest investor.<sup>179</sup> This late measure of President Palacio resulted in one of the largest claims ever filed before ICSID.<sup>180</sup>

After assuming office, Correa announced his decision to halt the FTAs talks, and in October 2007 the Correa administration imposed a new tax on many foreign oil companies operating in Ecuador, ordering them to pay ninety-nine percent of their extraordinary income to the government.<sup>181</sup> Probably, to avoid a wave of new claims related to oil and gas the Ecuadorian government decided to exclude its consent to arbitrate this class of claims, and more recently, decided to denounce the Washington Convention and all its BITs.<sup>182</sup> Notwithstanding this, in the last years major oil companies have sued Ecuador before ICSID. Once any of these still pending cases reach a final decision, its eventual enforcement or non-enforcement and any potential consequences for Ecuador will ultimately test the effectiveness of the ICSID system as an ideal mechanism to protect FDI.<sup>183</sup>

176. Roberto Ortiz de Zárate, *Alfredo Palacio González*, CONFEDERATION OF INDIGENOUS PEOPLE OF BOLIVIA, Mar. 1, 2010, [http://www.cidob.org/es/documentacion/biografias\\_lideres\\_politicos/america\\_del\\_sur/ecuador/alfredo\\_palacio\\_gonzalez](http://www.cidob.org/es/documentacion/biografias_lideres_politicos/america_del_sur/ecuador/alfredo_palacio_gonzalez).

177. *See Ecuador Swears in New President*, BBC NEWS, Jan. 16, 2007, <http://news.bbc.co.uk/1/hi/world/americas/6262555.stm>.

178. *Background Note: Ecuador*, U.S. DEP'T OF STATE, May 24, 2010, <http://www.state.gov/r/pa/ei/bgn/35761.htm>.

179. *Ecuador Cancels an Oil Deal with Occidental Petroleum*, N.Y. TIMES, May 17, 2006, at C12.

180. *Occidental Petroleum Corp. v. Ecuador*, ARB/06/11 (2008) (Decision on Jurisdiction) (According to an Associated Press release, Occidental Petroleum is seeking more than \$1 billion in relief. *Ecuador Has 'No Confidence' in World Bank Review*, TAIPEI TIMES, May 12, 2008, at 10. Regarding the legal nature of the claim, according to the decision on jurisdiction by the arbitral tribunal in the case Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador: "On 15 May 2006, the Minister of Energy and Mines notified OEPC of his decision to terminate the Participation Contract by declaring its *caducidad*. The Claimants filed their Request for Arbitration two days later on 17 May 2006.")

181. *Ecuador Rejects U.S. Free Trade Pact*, TRADE OBSERVATORY, Dec. 10 2006, <http://www.iatp.org/tradeobservatory/headlines.cfm?refID=96647>; *Ecuador decides to keep 99 percent of oil windfall profits*, AFP, Oct. 4 2007, [http://afp.google.com/article/ALeqM5iU8Xf\\_ly2O3xFcBcDUrBEPVeMZXQ](http://afp.google.com/article/ALeqM5iU8Xf_ly2O3xFcBcDUrBEPVeMZXQ).

182. Memorandum from John L. Gardiner et al., Partners, Skadden, Arps, Slate, Meagher & Flom, *Ecuador Moves to Denounce and Leave* (June 17, 2009) available at [http://www.martindale.com/members/Article\\_Atachment.aspx?od=124454&id=730598&filename=asr-730600.Ecuador.pdf](http://www.martindale.com/members/Article_Atachment.aspx?od=124454&id=730598&filename=asr-730600.Ecuador.pdf).

183. Notwithstanding its withdrawal from ICSID, there are six claims against Ecuador still pending in ICSID. These are: *Corporación Quiport S.A. v. Ecuador*, ICSID

## 2. Legal Analysis of Ecuador's Exclusion

On December 4, 2007 the Republic of Ecuador formally notified to the ICSID Secretariat that it would not consent to Centre's jurisdiction in "disputes that arise in matters concerning the treatment of investment in economic activities related to the exploitation of natural resources, such as oil, gas, minerals, or others."<sup>184</sup> The basis of such notification is found in §25(4) of the Washington Convention:

Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, *notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre.* The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1).<sup>185</sup> (emphasis added).

In fact, these kinds of exclusions serve the purpose of limiting the scope of the Centre's jurisdiction, as was established in the case *Ceskoslovenska Obchodni Banka, a.s. v. The Slovak Republic*.<sup>186</sup> In this case the tribunal reasoned that if a Contracting State wishes to exclude a particular investment from the reach of the Convention, §25(4) provides a more suitable way to do so, rather than challenging the meaning of the term 'investment' under the Convention. The tribunal reasoned that the "acceptance of the Centre's jurisdiction with respect to the rights and obligations arising out of its agreement creates a strong presumption that it considered its transaction to be an investment within the meaning of the ICSID Convention."<sup>187</sup> Furthermore, the arbitral tribunal stated that:

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ARB/09/23 (construction of airport facilities); *Murphy Exploration & Prod. Co. Int'l v. Ecuador*, ICSID ARB/08/4 (regarding hydrocarbon concession; alleged breach of Ecuador-U.S. BIT); *Burlington Res., Inc. v. Ecuador*, ICSID ARB/08/5; *Perenco Ecuador Ltd v. Ecuador*, ICSID ARB/08/6 (regarding hydrocarbon concession; alleged breach of Ecuador-France BIT); *Repsol YPF Ecuador, S.A. v. Ecuador*, ICSID ARB/08/10 (regarding a contract of oil exploration); *Occidental Petroleum Corp. v. Ecuador*, ICSID ARB/06/11 (regarding hydrocarbon concession).

184. Communication No. 56354/GM from the Minister of Foreign Relations of Ecuador to ICSID's Secretary General, (Nov. 23, 2007) (providing La República de Ecuador no consentirá en someter a la jurisdicción del CIADI, las diferencias que surjan en materias relativas al tratamiento de una inversión, que se deriven de actividades económicas relativas al aprovechamiento de recursos naturales como petróleo, gas, minerales u otros. Todo instrumento contentivo de la voluntad previamente expresada por la República del Ecuador en someter esta clase de diferencias a la jurisdicción del Centro, que no se haya perfeccionado mediante el expreso y explícito consentimiento de la otra parte previa la fecha de presentación de esta notificación, es retirado por la República del Ecuador, con eficacia inmediata a partir de esta fecha).

185. Washington Convention, *supra* note 11, art. 25(4).

186. Gaillard, *supra* note 132 (citing *Ěeskoslovenska Obchodni Banka, A.S. v. Slovakia*, ICSID ARB/97/4 (1999) (Decision on Objections to Jurisdiction) (Professor E. Gaillard represented the Respondents in this case).

187. *Ěeskoslovenska Obchodni Banka, A.S. v. Slovakia*, Decision on Objections to Jurisdiction, ICSID ARB/97/4, at ¶¶ 66 (1999).

It is worth noting, in this connection, *that a Contracting State that wishes to limit the scope of the Centre's jurisdiction can do so by making the declaration provided for in Article 25(4) of the Convention.* The Slovak Republic has not made such a declaration and has, therefore, submitted itself broadly to the full scope of the subject matter jurisdiction governed by the Convention.<sup>188</sup> (emphasis added).

Applying the tribunal's reasoning to Ecuador, after the December 4, 2007 notification the country has limited the scope of the Centre's jurisdiction in disputes arising from natural resources investments, including oil & gas, mineral, and others. In other words, by limiting the scope of ICSID's jurisdiction, Ecuador may not be sued anymore in those types of cases. An interesting consideration at this point is that some of the detractors of the offer-to-consent theory in BITs do not see any problem in a country effectively excluding the Centre's jurisdiction for a particular class of claims. For instance, Professor Gaillard wrote that:

While §72 of the Convention sets forth the effect of a state's denunciation in relation to its rights and obligations under the Convention, there is no comparable provision addressing the effect of a notification pursuant to §25(4). *An investor's position is therefore more uncertain, even where the investment was made prior to the state's notification under §25(4).*<sup>189</sup> (emphasis added).

Professor Gaillard's explanation is based on the nature of the notification and not on the consent of the parties, which in turn is required by §25(1) in order to assert the jurisdiction of the Centre in a particular case. Such consent, once given may not be withdrawn.

According to Gaillard a §25(4) notification is neither an expression of consent nor a lack thereof.<sup>190</sup> But the issue that has been omitted from this reasoning is what would happen when the consent for a particular dispute arises from a BIT that is still in force and the host country has subsequently excluded that particular class of claims. If, under Professor Gaillard's approach, the country may successfully exclude a particular type of claims from the Centre's jurisdiction, but may not do it through the denunciation of the Washington Convention (in case of having BITs with unqualified consent language still in force), then it would be possible to arrive to the counter-intuitive conclusion that in many situations exclusion is a more radical move than denunciation.

A significant legal issue that may arise from the topic of exclusion is whether exclusion may be used retroactively. This was addressed in the third case ever filed in ICSID, a contractual arbitration case: *Alcoa Minerals Jamaica v. Jamaica*.<sup>191</sup>

In 1968, Alcoa entered into an investment contract with Jamaica for the construction of an Alumina refining plant in exchange for a series of tax

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188. *Id.* at ¶ 65.

189. Gaillard, *supra* note 132.

190. *Id.*

191. *Id.*

concessions, including a 'no-further-tax' clause and long-term leases for the mining of bauxite.<sup>192</sup> This agreement contained an ICSID arbitration clause.<sup>193</sup> In 1974 the Jamaican government indicated that the revenue from the mining of bauxite would be unilaterally increased, but since the parties could not reach an agreement on this issue, the government imposed a new tax on bauxite by enacting the Bauxite Act, which dramatically increased the government's revenue from the mining of bauxite.<sup>194</sup> But prior to the enactment of the Bauxite Act the Jamaican government notified the Centre, in accordance with §25(4), of the exclusion of disputes arising out from investments related to natural resources.<sup>195</sup> For this reason, when Alcoa decided to sue Jamaica before ICSID, Jamaica, relying on §25(4), did not appear before the ICSID Tribunal.<sup>196</sup> Nonetheless, the Tribunal found jurisdiction by deciding the issue of whether Jamaica's notification had the effect of withdrawing natural resources investment disputes from the scope of Jamaica's prior consent to arbitrate.<sup>197</sup>

The Tribunal's ruling in *Alcoa* on the consent to arbitrate is of crucial importance today. The tribunal found that the sole agreement of the parties to stipulate an ICSID arbitration clause constituted the consent required by §25(1), which may not be unilaterally withdrawn thereafter. Section 25(4)'s notification, according to the Tribunal, only operates for the future. A decision finding otherwise, "would very largely, if not wholly, deprive the Convention of any practical value."<sup>198</sup> To celebrate this decision an author wrote that "the Alcoa Minerals result demonstrates the success of the ICSID Convention in dealing with the problem of State obligation to arbitrate, and the decision is a reassurance to the many investors presently relying upon ICSID arbitration clause."<sup>199</sup>

Even though the Alcoa case involved a form of contractual consent (a *clause compromissoire*), it does reveal that a country may not step back on the issue of consent once it has acquired an irrevocable international obligation, such as the obligation that Jamaica had to appear before ICSID in cases related to its 1968 Alumina/Bauxite contract with Alcoa. The case with Ecuador is potentially structurally different. After the formal notification of the exclusion it is clear that the country may not be hailed into ICSID in cases concerning new investments. But the afore-

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192. W. Michael Tupman, *Case Studies in the Jurisdiction of the International Centre for Settlement of Investment Disputes*, 35 INT'L & COMP. L. Q. 813, 821 (1996).

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.* at 822.

197. *Id.*

198. *Id.*

199. See John T. Schmidt, *Arbitration Under the Auspices of the International Centre for the Settlement of Investment Disputes (ICSID): Implications of the Decision on Jurisdiction in Alcoa Minerals Jamaica, Inc. v. Government of Jamaica*, 17 HARV. INT'L. L. J. 90, 93 (1976).

mentioned issue of foreign investments done in light of BITs in effect, prior to the formal notification, remains unanswered.

In order to answer this question one should undertake an analysis of the issue of consent similar to the one performed with Bolivia's denunciation of the Washington Convention. For instance, under the theory of offer-to-consent Ecuador will no longer be bound to appear before ICSID in cases that have not been filed prior to the notification of the formal exclusion, even if the investments were made before the exclusion and under the coverage of a BIT that is still in force. Conversely, under the theory of [just] consent Ecuador could still be subject to the Centre's jurisdiction in cases related to natural resources, notwithstanding the formal notification, if the investments were made prior to such notification under the coverage of a BIT that is still in force. Notwithstanding this, some supporters of the latter agree with the former result.<sup>200</sup>

The jurisdictional outcome of these five cases, *Murphy*, *Burlington*, *Quirport*, *Perenco*, and *Repsol*, will be extremely important for the Ecuadorian economy, and also for the future of the ICSID in the region. If the ICSID tribunals decide to assert jurisdiction in these cases, Ecuador may be on the eve of facing potentially disastrous financial distress. On the one hand, such events could accelerate and give momentum to a move in the Latin American region against ICSID. On the other hand, these eventual decisions, as happened with the *Alcoa* case in the 1970s, may "better secure the good faith performance of investment agreements . . . [by showing] that foreign investment need not be subject to national whim."<sup>201</sup> Arguably, such a scenario could positively impact the fate of ICSID in the long run.

### C. VENEZUELA'S INVESTMENT PROTECTION APPROACH

#### 1. Background

The father of Venezuelan opening for FDI in the early 1990s was President Carlos Andrés Pérez, whose second term in office lasted four years.<sup>202</sup> After an impeachment on corruption charges, the Supreme Court ousted him from power in 1992.<sup>203</sup> Pérez's presidency undertook a major reform in the country that has been called "neo-liberal." Among the most relevant aspects of such reform were: (i) a major privatization of the country's public companies, including a national airline, the national phone company, and different electricity companies; (ii) a liberalization of the interest rates, which, up until then were fixed by the Ministry of Finance; and (iii) a rise of the price of gas.

These reforms proved to be very unpopular. In fact, Pérez experienced great political turmoil during his second term in office. The first major

200. See Gaillard, *supra* note 132, at 2.

201. Schmidt, *supra* note 199, at 108.

202. H. MICHAEL TARVER, *THE RISE AND FALL OF VENEZUELAN PRESIDENT CARLOS ANDRÉS PÉREZ VOLUME 2: THE LATER YEARS 1973-2004* (2005).

203. *Id.*

hardship of Pérez's presidency took place only twenty-five days after he took the presidential oath, on February 27, 1989.<sup>204</sup> An unprecedented social revolt (known as the *Caracazo*) marked the unpopularity of the free-market reforms proposed by Pérez in his presidential campaign. Years after the *Caracazo*, Pérez suffered two failed *coup-d'Etats* in February and November of 1992 respectively.<sup>205</sup> A highlight of the February 4, 1992 *coup-d'Etat* was the appearance on television of Lieutenant Hugo Chávez, who was one of the heads of the defeated rebels. In a brief speech addressed to his colleagues, Chávez called for a cease-fire, personally assumed responsibility, and recognized the failure of the coup "for now."<sup>206</sup>

After Pérez's impeachment, the head of the Venezuelan Congress, Ramón J. Velásquez, served for the remainder of the presidential term.<sup>207</sup> In 1993 elections, former President Rafael Caldera was elected for a second term in office.<sup>208</sup> During Caldera's second presidency, Venezuela experienced a rapid downward economic spiral. The government's response included the continuation of several of the unpopular economic measures adopted by Pérez. Among the measures implemented in the framework of a program called *Agenda Venezuela*, were: the liberalization of the interest rates, the raise of the price of fuel, the devaluation of the currency rate, the imposition of a foreign currency exchange control regime, and the further opening of the oil sector to FDI, through the continuation of a program called the *Apertura Petrolera*.<sup>209</sup>

But the social, economical, and legal scenario would radically change in Venezuela after the December 1998 elections, when Chávez gained power. The arrival of a former insurrectionist to power, four years after being condemned by the incumbent President Caldera, would drastically halt the free-market measures implemented by the past governments. In fact, when President Chávez took office in February 1998, he promised a major reform of the National Constitution, and the saturation of a new

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204. George Ciccariello-Maher-Counterpunch, *The Fourth World War Started in Venezuela*, VENEZUELA ANALYSIS.COM, Mar. 5, 2007, <http://venezuelanalysis.com/analysis/2253>.

205. *Id.*

206. *See id.*

207. Human Rights Foundation, International Council, <http://www.humanrightsfoundation.org/internationalcouncil.html>.

208. *Rafael Caldera: President of Venezuela 1969-74 and 1994-1999*, TIMES, Dec. 29, 2009, <http://www.timesonline.co.uk/tol/comment/obituaries/article6969744.ece>.

209. The *Apertura Petrolera* program was based on a lax interpretation given to section 5 of the Organic Law that Reserves to the State the Industry and Trade of Hydrocarbons of 1975 (a.k.a., the Nationalization law). This article provided for the joint participation of private capital along with the State, in: (i) operating agreements; (ii) strategic associations (e.g., Cerro Negro, Petrozuata, Sincor, and Hamaca upgrading projects); and (iii) association agreements. By the same token, the State had to retained control over these projects, in accordance with the same section 5 of the Nationalization Law. The program was gradually implemented in three stages or 'rounds.' The first and second rounds took place during Pérez, and Velásquez, and the last one was carried out by Caldera. *See* Decree 1404 of 1/20/76, available at <http://www.glin.gov/view.action?glinID=1501>.

economic system.<sup>210</sup> In 1999, a new Constitution was passed by a National Constituent Assembly, and following the passage of the new Constitution the Chávez Administration gradually implemented a major legal reform, including the enactment of a new Hydrocarbons Law in 2001.<sup>211</sup> Such reforms gave momentum to major strikes and public manifestations of discontent, which resulted in the ousting of Chávez in April of 2002 for two days. Shortly after his return to power, Chávez became more drastic in the implementation of his programs. Finally in February 2005, President Chávez said for the first time that his programs and policies were all directed towards the “Socialism of the 21st Century.”<sup>212</sup>

Meanwhile, the Chávez Administration announced the strict application of the Hydrocarbons Law of 2001 through the implementation of the programs *Plena Soberanía Petrolera*<sup>213</sup> and *Siembra Petrolera*.<sup>214</sup> These programs involved a process of renegotiation of oil contracts with private investors and a consequent dramatic increase of the country’s share in the profits. The *Apertura Petrolera* had died. Yet some of the investors resisted until the end, to the mandated process of migration from a private to a mixed corporate form, involving a majority stake in the hands of the State. These investors, ExxonMobil and ConocoPhillips, preferred to sue Venezuela before ICSID during the last trimester of 2007.<sup>215</sup>

Whilst announcing the arrival of Socialism to Venezuela, Chávez commenced a series of expropriations and nationalizations that changed the panorama for foreign investors and FDI. The first expropriations were targeted at agricultural farms and two of the highest-profile cases were *Hato La Marqueseña*, and *Hato El Charcote*.<sup>216</sup> The latter belonged to the Vestey Group, from the United Kingdom, who decided to sue Venezuela before ICSID in 2006.<sup>217</sup> Recently, some other strategic areas that have been targeted by the government include: telecommunications, by

210. *Background Note: Venezuela*, U.S. DEP’T OF STATE, Feb. 25, 2010, <http://www.state.gov/r/pa/ei/bgn/35766.htm>.

211. *Id.*

212. See Mary Pili Hernández, *¿Qué es el Socialismo del Siglo XXI?*, APPOREA, Dec. 13, 2006, <http://www.aporrea.org/ideologia/a22833.html>; see also *Venezuela: The Chávez Effect*, REVISTA: HARV. REV. LATIN AM., Fall 2008.

213. FINANCIAL AND OPERATIONAL INFORMATION, PETRÓLEOS DE VENEZUELA S.A. AND SUBSIDIARIES 30 (2007), available at <http://www.pdvsa.com/interface.sp/database/fichero/free/3271/245.pdf>.

214. See generally Rafael Ramírez, President of Petroleos de Venezuela, Presentation of PDVSA’s Strategic Plans, and Plan Siembra Petrolera at Caracas Hilton Hotel (Aug. 19, 2005) available at <http://www.pdvsa.com>.

215. See *Mobil Corp. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/07/27 (2007); *ConocoPhillips Co. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/07/30 (2007).

216. *Reports on Venezuela: UNPD and ECLA Indicators, Democracia y Desarrollo Democracy and Development*, VENEZUELA TODAY, Sept. 14, 2005, [http://www.venezuelatoday.org/05-09-14\\_in.htm](http://www.venezuelatoday.org/05-09-14_in.htm).

217. See *Vestey Group Ltd v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/06/4 (2006) (some press releases have reported that the parties settled the case a month after the filing of the claim in ICSID on March 14, 2006); see *UK Farm Group Settles BIT Claim Over Venezuelan Land Seizures and Invasions*, INV. TREATY NEWS, April 11, 2006, [http://www.iisd.org/pdf/2006/itn\\_april11\\_2006.pdf](http://www.iisd.org/pdf/2006/itn_april11_2006.pdf).

the announcement of the de-privatization of the national phone company (CANTV); electricity, by the announcement of the de-privatization of the Caracas' power company (*Electricidad de Caracas*); and cement, by the announcement of the acquisition of the four largest cement companies (Andino, Caribe-Holcim, LaVega-Lafarge, and Vencemos-Cemex). These cases have also resulted in two ICSID claims against Venezuela.<sup>218</sup>

Notwithstanding that Venezuela has settled four of the six cases already before ICSID,<sup>219</sup> the only two cases that have reached to an arbitral award did not involve large amounts.<sup>220</sup> Venezuela has taken some anti-arbitration measures directly targeted to potential claims that may arise out of the recent expropriations and nationalizations. Aside from the hostile political discourse against ICSID, the two most important anti-arbitration steps taken by the country are the denunciation of the Venezuela-Netherlands BIT<sup>221</sup> and the Supreme Tribunal's Decision number 1541 of October 17, 2008.<sup>222</sup> Yet the effects of these anti-arbitration measures remains to be seen in the other four cases against Venezuela currently outstanding before ICSID,<sup>223</sup> and in any other potential claim that may be filed in the near future.

## 2. *Investment Protection Law and Decision 1541*

This decision was delivered by the Constitutional Chamber of the Venezuelan Supreme Tribunal, which is the highest court in the country, and also the only court whose decisions set binding judicial precedent (*erga omnes* effects). An interesting aspect about this decision is that it was rendered after a petition for the interpretation of §258 of the Venezuelan Constitution, filed by representatives of Venezuela's Attorney General

218. See *Brandes Inv. Partners, LP v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/08/3 (2008) (the Brandes Fund owned a minority stake in CANTV); *CEMEX Caracas Invs. B.V. and CEMEX Caracas II Invs. B.V. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/08/15 (2008).

219. Cases settled: (i) *GRAD Assocs., P.A. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/00/3 (2000); (ii) *I&I Beheer B.V. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/05/4 (2005); (iii) *Eni Dación B.V. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB/07/4 (2007); and (iv) *Vestey Group*, Case No. ARB/06/4 (2006).

220. The Venezuelan cases that have been decided on the merits by an ICSID Tribunal are: *Autopista Concesionaria de Venez.*, ICSID Case No. ARB/00/5 (2001) (Decision on Jurisdiction) (in which the tribunal awarded the investors \$12 million of the over \$150 million requested); and, *Fedax NV v. Neth.*, ICSID Case No. ARB/96/3 (1998) (Award) (in which the tribunal awarded the investors with approximately \$810,000, when \$600,000 were recognized by Venezuela).

221. Gaillard, *supra* note 132, at 3 (Venezuela notified the Netherlands of the termination of the Venezuela-Netherlands BIT, to become effective on December 31, 2008; nonetheless, the BIT's survival clause would keep the instrument in force for an extra 15 year period of time).

222. See Decision 1541 of the Constitutional Chamber of the Venezuelan Supreme Tribunal, published on Oct. 17, 2008, available at <http://www.tsj.gob.ve>.

223. The Venezuelan cases still outstanding in ICSID are: (i) *Vannessa Ventures Ltd. v. Bolivarian Republic of Venez.*, ICSID Case No. ARB(AF)/04/6 (2004); (ii) *Mobil Corp.*; (iii), *ConocoPhillips Co.*; (iv) *Brandes Inv. Partners*; and, (v) *CEMEX Caracas Invs. I & II*.



Office.<sup>224</sup> Such constitutional mandate provides that “the law shall encourage arbitration, conciliation, mediation and any other alternative means for resolving conflicts.”<sup>225</sup> The object of the Attorney General’s petition of interpretation was to limit the constitutional reach of §22 of the Law Concerning the Promotion and Protection of Investment (LPPI), thereby excluding any consent of the Republic to arbitration on the basis of a unilateral consent contained in this provision. Section 22 of the LPPI establishes that:

Any dispute arising between an international investor whose country of origin has in effect an agreement for promotion and protection of investments with Venezuela, or any disputes to which the provisions of the Articles of Association of the Multilateral Investment Guarantee Agency (MIGA) or the Convention for the Settlement of Investment Disputes between States and Nationals of other States (ICSID) *shall be submitted to international arbitration* under the terms provided for in the respective treaty or agreement, should it so provide, without prejudice to the possibility of using the systems of litigation provided for in the Venezuelan laws in force, when applicable.<sup>226</sup> (emphasis added).

The motivation of the Attorney General’s petition was narrowed to concerns caused recently by disputes arising from the renegotiation of the major oil & gas projects, in other words, as a response to ExxonMobil and ConocoPhillips ICSID claims. Furthermore, the Tribunal in the ‘whereas’ section of the decision referred to the petitioners arguments and established that:

[the possibility of] hailing Venezuela into arbitral tribunals is present, *as a reaction of some companies that have felt affected by nationalists measures taken by the Government*, such as: those related to the affirmation of the absolute sovereignty over the oil (*plena soberanía petrolera*) *through the elimination of the Strategic Associations operating in the Orinoco’s Oil Belt and its conversion into mixed corporations*, in the form established by the Hydrocarbons Law.<sup>227</sup> (emphasis added).

The approach adopted by the Supreme Tribunal was based on a purposive interpretation of the language of the law. The Supreme Tribunal analyzed the Investment Protections Laws of fourteen countries to conclude that the “international tendency is to establish clear dispositions [in the law] in regards to the unilateral consent of the State to the jurisdiction of an arbitral tribunal.”<sup>228</sup> Likewise, the Supreme Tribunal relied upon the

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224. Moreover, the representatives of the Attorney General who filed the petition of interpretation are closely related to the current management of PDVSA, Venezuela’s state-owned oil company.

225. Constitution of the Bolivarian Republic of Venez. art. 258.

226. Inv. Promotion and Protection Law, Code Civil [356] art 22 (Venez.).

227. El Tribunal Supremo de Justicia [Supreme Tribunal], Decision 08-0763 (Venez.) available at <http://www.tsj.gov.ve/decisiones/scon/Octubre/1541-171008-08-0763.htm>.

228. *Id.*

opinion of Professor Schreuer, who said that,

[T]he host State may offer consent to arbitration in general terms to foreign investors or to certain categories of foreign investors in its legislation. However, *not every reference to investment arbitration in national legislation amounts to consent to jurisdiction*. Therefore, the respective provisions in national laws must be studied carefully.<sup>229</sup> (emphasis added).

Thus, the Supreme Tribunal held that the meaning of the phrase “shall be submitted to international arbitration *under the terms provided for in the respective treaty or agreement*” contained in §22 of the LPPI, “denotes . . . that the intent of the legislator relates expressly and unequivocally to the internal content of the respective treaties,”<sup>230</sup> and not to a unilateral consent of the Republic to submit any investment dispute to arbitration. According to the Tribunal, a converse interpretation would cause the absurd result that a sole mention of the Washington Convention by the Municipal Law of a country would automatically translate into the assertion of the country’s consent, as required by §25(1) of the Convention, to submit a particular dispute to arbitration.<sup>231</sup>

Moreover, in a scholarly article by Ms. Hildegard Rondon de Sanso, who is a prominent former Justice of the Venezuelan Supreme Court and a very influential figure linked to the Venezuelan Oil industry, she expressed her rejection for an interpretation of §22 LPPI as establishing unilateral consent.<sup>232</sup> Ms. Rondon de Sanso heavily criticized former legislator Dr. Allan Brewer Carías, who said that the words “shall be submitted to international arbitration” in §22 LPPI implies the express consent of the country to submit the controversies to international arbitration.<sup>233</sup> Interesting enough, Ms. Rondon de Sanso tries to make an exegetical distinction in the norm, which also contains the phrase “as established thereunder” (“*si así éste lo establece*”).<sup>234</sup> Ms. Rondon de Sanso found further fundamental grounds to the decision 1541 in the current legal framework of Venezuela. But Ms. Rondon de Sanso’s own opinions expressed in the media reveal political or ideological biases in her legal analysis of this area.<sup>235</sup> For instance, another prominent and respected

229. Christoph Schreuer, *Consent to Arbitration*, Feb. 27, 2007, [http://www.univie.ac.at/intlaw/wordpress/pdf/88\\_con\\_arbitr\\_89.pdf](http://www.univie.ac.at/intlaw/wordpress/pdf/88_con_arbitr_89.pdf).

230. Decision 1541, *supra* note 222.

231. *Id.*

232. Hildegard Rondon de Sanso, *El Consentimiento del Estado para el Arbitraje en el CIADI y la Interpretación del Artículo 22 de la Ley de Inversiones de Venezuela*, ACADEMIA NACIONAL DE DERECHO Y CIENCIAS SOCIALES DE CORDOBA, Jan. 11, 2009, <http://www.acaderc.org.ar/doctrina/articulos/el-consentimiento-del-estado-para-el-arbitraje-en>.

233. *Id.*

234. *Id.*

235. See Hildegard Rondón de Sansón, *Ciadi, Arbitraje y Ley de Inversiones*, APORREA, FEB. 25, 2009, [www.aporrea.org/actualidad/a73220.html](http://www.aporrea.org/actualidad/a73220.html) (Ms. Rondon de Sanso stated that “[c]on el paso del tiempo, el Convenio del CIADI ha demostrado que no posee el régimen de solución de controversias que más nos favorezca, ya que nos obliga a someternos a un derecho que es la negación de los principios con-

practitioner in Venezuela opined that “[i]t is widely thought that the government’s request for interpretation of article 22 was an attempt to weaken the position of certain foreign investors currently pursuing ICSID cases against Venezuela.”<sup>236</sup>

By the same token, it is important to remark that the Supreme Tribunal found its decision to be consistent with the accepted principles of international law in this matter.<sup>237</sup> For this reason, the Tribunal referred to the criterion developed by an ICSID tribunal in the case *Southern Pacific Properties (Middle East) Ltd. v. Arab Republic of Egypt*,<sup>238</sup> according to which “even though the consent contained in a law may not be interpreted broadly or narrowly, it can only be interpreted objectively under the principle of good faith. . . .”<sup>239</sup> Therefore, the Supreme Tribunal distinguished the Venezuelan provision from similar provisions of other countries, such as the one discussed in *Southern Pacific*, finding this reading to be in accord with the international principle of good faith.

It is likely that the most important effect of Decision 1541 would be that if an ICSID tribunal asserts jurisdiction on the basis of the unilateral consent of the Republic as contained in §22 of the LPPI, a potential adverse award would not be enforceable within the boundaries of Venezuela. In fact, the Supreme Tribunal expressly stated that “in case that the decision of the respective organism violates the internal juridical system, such decision would be unenforceable in the Republic.”<sup>240</sup>

An interesting study of the issue of consent to ICSID arbitration as contained in §22 LPPI disagrees with the Supreme Tribunal’s finding.<sup>241</sup> The author of this study tries to reconcile a textual interpretation of the norm with the ultimate goals of the investor-State system of protection, by stating that: “[t]he fact that the law uses the term ‘shall’ and not ‘may’ could be of tremendous importance if a foreign investor were to rely on this provision to bring a case before ICSID, as it could make the allega-

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*tenidos en nuestro proceso hasta llegar, incluso al extremo de no priorizar la decisión de la cuestión de competencia, sino de permitir que la misma se debata conjuntamente con el fondo (que es como ponerse los zapatos antes que las medias). En síntesis, el arbitraje es para Venezuela, ir a litigar ante jueces extranjeros, con un idioma y un sistema procesal que nos son ajenos. Además, los tribunales que se ubican según los intereses de los árbitros, implican onerosísimos desplazamientos, no solo de los abogados y representantes, sino también de los expertos y los testigos. Lo anterior exige que se replantee si existe la necesidad, la conveniencia y la legitimidad de figuras como el arbitraje internacional, el CIADI y el actual régimen de protección de las inversiones extranjeras”*) (emphasis added).

236. *Venezuelan Court Rules on Article 22*, GLOBAL ARB. REV., Nov. 3, 2008, [http://eanzola.com/images/uploads/Venezuelan\\_court\\_article22.pdf](http://eanzola.com/images/uploads/Venezuelan_court_article22.pdf).

237. *Id.*

238. Decision 1541, *supra* note 222.

239. *Id.*

240. *See id.*

241. See Thomas Pate, *The Past, Present, and Future of the Foreign Arbitration Clause in Foreign Investment Legislation: In Pursuit of The Balance* at 76, available at <http://www.desolapate.com/publicaciones/The%20Past%20Present%20and%20Future%20of%20the%20Arbitral%20Caluse%20in%20Foreign%20Investment%20Legislation,%20In%20Pursuit%20of%20The%20Balance.pdf>.

tion that the state committed itself to arbitrate.”<sup>242</sup> Nonetheless, the appreciation of this author regarding the future of this topic (as expressed in a footnote) proved to be exactly correct:

In any event, in recent years Venezuela has been involved in several significant international arbitrations that have been distasteful for the government and as a result it may be expected that Venezuela will move to reduce its exposure to international arbitral jurisdiction as, indeed, it has done with respect to the new petroleum sector joint ventures signed in early 2006.<sup>243</sup>

Another, more recent study has also been prophetic about this particular issue and the potential effects of decision 1541:

Venezuela is nonetheless very likely to seek all possible injunctions in order to avoid international arbitration. . . . *Even if a plaintiff company is able to subject Venezuela to an international arbitration tribunal’s jurisdiction and subsequently win on the merits*, unless there has been a separate waiver of immunity from enforcement of any successful arbitration award, a state or state enterprise may still claim sovereign immunity from enforcement of the award.<sup>244</sup> (emphasis added).

A final aspect to highlight on the Decision 1541 is its reference to the country’s consent contained in BITs. In one part of the decision, the Supreme Tribunal stated that depending on the language of a particular BIT, by subscribing to it a country may be pledging its consent to further arbitrations.<sup>245</sup> But in the last part of the decision the Supreme Tribunal added an ambiguous paragraph, whose interpretation would define Venezuela’s future approach to ICSID:

Finally we reiterate that the sole subscription of the ICSID Convention, by one, several, or all the States linked in the subject of investments by BITs, or MITs, *does not constitute an automatic submission of the respective disputes to the procedures contained in such Convention; being essential, at all times, the existence of a written unequivocal consent to arbitrate.*<sup>246</sup> (emphasis added).

The polar question that remains open with Venezuela is whether it will further accept the Centre jurisdiction and potential adverse awards in cases where consent has arisen both from the LPPI, and a BIT in effect, or whether Venezuela will adopt more radical solutions, such as a withdrawal à la Bolivia, or an exclusion and withdrawal à la Ecuador, or an annulment request attitude towards enforcement of an ICSID award à la Argentina. In spite of explosive anti-ICSID declarations by representatives of the Venezuelan government, Venezuela has not yet adopted a

242. *Id.*

243. *Id.* at 77 n. 230.

244. Brandon Marsh, *Preventing the Inevitable: The Benefits of Contractual Risks Engineering in Light of Venezuela’s Recent Oil Field Nationalization*, 13 *STAN. J.L. BUS. & FIN.* 453, 474 (2008).

245. Decision 1541, *supra* note 222.

246. *Id.*

drastic anti-ICSID measure.<sup>247</sup>

In order to answer those questions an element to consider would be the interlocutory decision of the Political and Administrative Chamber of the Venezuelan Supreme Tribunal, in the case *Autopista Concesionada de Venezuela (Aucoven)*.<sup>248</sup> In this case the Supreme Tribunal dismissed a motion to dismiss for lack of subject matter jurisdiction, filed by the foreign investor, on the grounds that the Nation waived its right to sue in domestic courts by including an arbitral clause in the concession agreement with the foreign investor. Indeed, by the time this decision was rendered an ICSID arbitral tribunal had already asserted jurisdiction over the case. But in *Aucoven*, the Supreme Tribunal established that the Venezuelan tribunals had to have jurisdiction to hear the case, notwithstanding the existence of a concession agreement with an arbitration clause vesting the ICSID with exclusive jurisdiction over the subject matter.<sup>249</sup> This should provide indication of the willingness of Venezuelan courts to recognize the jurisdiction of an arbitral tribunal in every case.

Another element, perhaps more shocking, to consider is the political agreement on the campaign launched by the transnational corporation ExxonMobil against PDVSA, enacted by the National Assembly on February 13, 2008 and published in the Official Gazette number 38.869. Section V of such agreement of the legislature exhorted the President of the Republic to denounce the Washington Convention and withdraw from ICSID. A withdrawal from ICSID would likely cause a massive outflow of the FDI existing in Venezuela. Such measure in conjunction with the anti-capitalistic speech of the government and the recent trend of nationalizations, expropriations, and de-privatizations, may send a clear signal to the markets that the country is no longer interested in receiving or providing assurances to foreign capital.

#### D. CONCLUSIONS-ICSID AND LATIN AMERICA: A GRAY AND UNCERTAIN FUTURE

A few decades ago it was argued that the Washington Convention filled

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247. Venezuelan Court Rules on Article 22, *supra* note 236 (according to Alberto Ravell, attorney at King & Spalding in Houston, the Venezuelan government has strategically issued a favorable judicial interpretation of §22, but without resorting to drastic measures).

248. See Decision 1753 of the Political and Administrative Chamber of the Venezuelan Supreme Tribunal, (Nov. 18, 2003) available at <http://www.tsj.gob.ve>.

249. This case never reached a decision on the merits because on February 10, 2004 the Republic desisted on the claim by stating that: “after the ICSID award rendered on November 23, 2003, [. . .] it would be meaningless to maintain this claim when there is no object to decide” (free translation from the Spanish text). See Press Release, Venezuelan Supreme Tribunal, Aclaratoria de la Sala Político Administrativa en caso de la autopista Caracas-La Guaira (Feb. 2, 2006), available at <http://www.tsj.gob.ve>. Presumably, if the ICSID award would not have favored the Nation (by awarding \$12 million out of the \$311 million requested), the Republic would not have desisted on its counter-claim before Venezuelan courts.

the lacunae left by the famous *Barcelona Traction* case.<sup>250</sup> In that case, the ICJ held that a State could make a claim when investments by its nationals abroad were prejudicially affected in violation of the right of the State itself to have nationals enjoy certain standards of treatment previously agreed in a treaty or special agreement.<sup>251</sup> Yet, the common situation when no such treaty or special agreement existed, thereby covering the particular conflict, was that investors would be left unprotected. Here, the Washington Convention and today's system of protection, as configured by the simultaneous existence of BITs and MITs, fits perfectly to cover this hole in the laws.

But such assertion would only make sense if the countries in question are interested in seeking the ultimate goal of the investor-State system of protection: that of facilitating the flows of capital. In fact, thirty years ago, Paul Szasz pointed out that one of the reasons why Latin American Nations initially rejected the Convention was that not every country was keen to attract foreign capital.<sup>252</sup> At the time, it seemed reasonable to suspect that an anti-capitalistic government would avoid FDI.

But today we live in a different world. Even when the resurgence of the left in the governments of Latin America have given momentum to a wide variety of anti-FDI measures, in today's world, the flow of capital between countries is a reality. Investors, whether from capitalistic, anti-capitalistic, or mixed economies, seek protection for their investments abroad. This reasoning may not apply, however, in cases where public and not private funds are at stake. By mentioning the new positioning of Venezuela as a capital-exporter country in Latin America,<sup>253</sup> we may find an explanation to some of the anti-FDI measures commented. Yet this explanation comes with a caveat: first, even when the traditional forms of FDI protections are being rejected, new forms of protections will likely appear; and second, the flow of capital will be impacted by the fluctuations of the price of oil.

The fate of ICSID and the Washington Convention is still uncertain in Latin America. It is probably too early to predict what would be the ultimate consequences of Bolivia's withdrawal, Ecuador's exclusion, and Venezuela's growing reluctance to the Centre. In fact, in a Summit of UNASUR,<sup>254</sup> Venezuela fiercely promoted the creation of an alternative—maybe regional—center of investor-State dispute resolution, as an al-

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250. See *Barcelona Traction, Light & Power, Co. (Belg. v. Spain)*, 1970 I.C.J. 3 (Feb. 5); see also Charles Vuylsteke, *Foreign Investment Protection and ICSID Arbitration*, 4 GA. J. INT'L & COMP. L. 343, 345 (1974).

251. See *Summary of the Barcelona Traction, Light & Power, Co. Judgment (Second Phase)*, Int'l Court of Justice, available at <http://www.icj-cij.org/docket/files/50/5389.pdf>.

252. See Szasz, *supra* note 46.

253. See UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, TRADE AND DEVELOPMENT REPORT 29 (2008), available at [http://www.unctad.org/en/docs/tdr2008\\_en.pdf](http://www.unctad.org/en/docs/tdr2008_en.pdf).

254. The Union of South American Nations is a regional multilateral effort, which tries to integrate the Andean Community Pact, and MERCOSUR.

ternative to ICSID.<sup>255</sup> This proposal, if accepted and adopted by Latin American countries, could jeopardize the future of ICSID, especially if Brazil agrees to join it. At such an uncertain moment, one would expect the arising of a new wave of scholarly disagreement in the issue of the viability of an ICSID withdrawal in mass. If such a time actually comes, we will find ourselves discussing the issue of consent.

Meanwhile, the ICSID will continue to play a central role in the protection of FDI in the Latin American region. The extent of such role will be measure by the jurisdictional findings of the ICSID tribunals in the cases pending against Bolivia, Ecuador, and Venezuela. “Now more than ever,” as was once stated, the effectiveness of ICSID arbitration “depends upon the power of the Convention to render agreements to arbitrate mutually binding.”<sup>256</sup>

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255. See Juan Francisco Alonso, *For the TSJ, All Cases are Relevant, We do not Discriminate*, EL UNIVERSAL ONLINE, Oct. 16, 2008, [http://www.eluniversal.com/2008/10/16/en\\_pol\\_esp\\_for-the-tsj,-all-ca\\_16A2073343.shtml](http://www.eluniversal.com/2008/10/16/en_pol_esp_for-the-tsj,-all-ca_16A2073343.shtml) (last visited May 16, 2010).

256. See Schmidt, *supra* note 199.





# THE CONCEPT OF INCOME AS RELATED TO THE NON-CHARITABLE NONPROFIT SUBSECTOR IN CANADA

Lori McMillan\*

## I. INTRODUCTION AND CONTEXT

WHETHER or not something is “income” is a question that has frequently caused conflict since income taxation began. Usually, determining what constitutes income is important because it establishes liability for taxation. For purposes of this article, however, income classification is important for determining the existence of a public subsidy for certain nonprofit organizations currently exempt from federal income taxation in Canada. Although the nonprofit sector encompasses both charitable and non-charitable organizations, I will use the specific term “nonprofit” in this article to refer to non-charitable entities exempt from taxation by virtue of paragraph 149(1)(l) of the Income Tax Act<sup>1</sup> (ITA) (the “Provision”), explored later in this work.

This paper will examine the concept of “income” and will conclude that: (1) these entities can earn income and would therefore be properly subject to taxation but for the Provision; and (2) as a consequence, the exemption from taxation that nonprofits enjoy is a tax expenditure. Furthermore, the program supported by this spending should be evaluated to determine its effectiveness.

## II. NONPROFITS GENERALLY

There are three sectors to the economy: private, public, and nonprofit. The nonprofit sector has been given other names in an attempt to describe its role with absolute precision,<sup>2</sup> but that is not the focus of this work, thus I will use this term throughout. The nonprofit sector contains both charitable and non-charitable actors, and by virtue of the way the private and public sectors are defined it is a sector composed of residual actors, meaning if one is not a member of the governmental sector or the

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1. Income Tax Act, R.S.C., ch. 1, § 149(1)(l) (1985) (Can.).

2. Jacqueline Thayer Scott, *Session A: Defining the Nonprofit Sector, in The Emerging Sector: In Search of A Framework*, 48-50 (Ronald Hirschhorn ed.) (1997), available at [http://www.cprn.org/documents/25944\\_en.pdf](http://www.cprn.org/documents/25944_en.pdf). See also Richard Steinberg & Bradford H. Gray, *The Role of Nonprofit Enterprise in 1993: Hansmann Revisited*, 22 NONPROFIT & VOLUNTARY SECTOR Q. 4, 298 (1993).

private sector, then one is a member of the nonprofit sector.<sup>3</sup> Charities are the most visible actors in the sector, but are not the only ones.<sup>4</sup> Within the sector, the members typically have a non-distribution constraint, which prohibits profit-taking by owners, operators, or members of the individual entities.<sup>5</sup> Charities, at least ones that wish to be able to issue tax receipts for donations, must be registered with the Canada Revenue Agency,<sup>6</sup> but the *Promaster Memory Card* other members of the sector may be much more informally organized to the point of being ad hoc. I will further distinguish between charities and non-charities by referring to the latter as 'nonprofits', which is how they are referred to in the heading of the Provision. These nonprofits can be clubs, societies, or associations.<sup>7</sup> Associations have been judicially interpreted to include corporations,<sup>8</sup> which are the most organized type of entity contemplated in this Provision, while clubs and societies can be loose and unorganized. The use of these three qualifying entities ensures that the types of organizations which can avail themselves of the benefit of the Provision are virtually unlimited, with the exception of inter vivos trusts and partnerships.

### III. THE PROVISION

The Provision exempting the income of nonprofits from federal income taxation reads as follows:

No tax is payable under this Part on the taxable income of a person for a period when that person was

Nonprofit organizations

(l) a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof unless the proprietor, member or shareholder was a club, society or association the primary purpose and function of which was the promotion of amateur athletics in Canada.<sup>9</sup>

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3. Scott, *supra* note 2, at 48-50.

4. *Id.*

5. Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 *YALE L.J.* 54, 56 (1981).

6. Income Tax Act, R.S.C., ch. 1, § 118.1(1). This grants a charitable donation tax credit for gifts to registered charities and certain other entities. "Registered charity" is in turn defined in ITA § 248, which requires application to the Minister of National Revenue in prescribed form.

7. Income Tax Act, § 149(1)(l).

8. *Minister of Nat'l Revenue v. St. Catharines Flying & Training Sch. Ltd.*, [1955] S.C.R.738 (Can.).

9. Income Tax Act, § 149(1)(l).

Thus the Provision bestows exemption on any person who can bring itself within the wording of the paragraph, as no registration or recognition is required.<sup>10</sup> Any person who claims exemption by virtue of the Provision must file an information return for a taxation year in which the person received certain passive income in excess of \$10,000, had assets with a book value of \$200,000 at the close of the preceding fiscal year, or had been required to file the information return in a previous year.<sup>11</sup> Accordingly, there are likely a large number of entities claiming the benefit of the Provision which are not known to the Canada Revenue Agency. Estimates of the size of the nonprofit sector in 2003 range from 161,000<sup>12</sup> to 200,000 entities,<sup>13</sup> and further estimates place the percentage of charitable nonprofits to the nonprofit sector at just over half,<sup>14</sup> leaving just under half the entities as non-charitable nonprofits, likely numbering between 80,000 and 100,000 entities.<sup>15</sup> The number of information returns that were filed in 2003, however, was a mere 12,399,<sup>16</sup> leading to the conclusion that significant authoritative statistical information on the non-charitable subsector is presently unavailable.

The requirement that a nonprofit entity be a club, society or association is very broad, and excludes very few organizational forms, while the need for the nonprofit organization (NPO) to be organized and operated for a purpose other than profit is both strict and lax.<sup>17</sup> The mandatory technical requirements are strict and must be met, including that no dividends or other personal benefits can inure to shareholder/owners, the operations of the organization must accord with its purpose, and that the organization claims a purpose other than profit.<sup>18</sup> The purpose requirements, however, are lax; there is no broad mandate that entities must

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10. *Id.*

11. *Id.* § 149(12).

12. National Survey of Nonprofit and Voluntary Organizations (NSNVO), *Cornerstones of Community: Highlights of the National Survey of Nonprofit and Voluntary Organizations*, No. 61-533 XPE, at 8 (2005) available at <http://www.statcan.gc.ca/pub/61-533-x/61-533-x2004001-eng.htm> [hereinafter National Survey]

13. Scott, *supra* note 2, at 8.

14. Imagine Canada, *How Many Charities and Nonprofits are there in Canada and the Provinces*, NONPROFIT LIBRARY COMMONS, 2003, [http://nonprofitscan.imagine-canada.ca/tir\\_how\\_many\\_charities](http://nonprofitscan.imagine-canada.ca/tir_how_many_charities).

15. According to data supplied by Canada Revenue Agency (CRA), in 2005 approximately 82,200 registered charities existed in Canada. Using the information from the National Survey, and taking 161,000 to be the whole of the sector, it would seem that just under 80,000 non-charitable nonprofit entities exist in Canada. The study states elsewhere, however, that forty-four percent of all nonprofit organizations are non-charitable entities, which would result in 70,840 non-charitable nonprofits, still a significant number. The truth undoubtedly rests somewhere between the two figures, but ultimately the size of the entire sector is significant, as is the specific part of the sector being examined here. *Registered Charities Newsletter*, CANADA REVENUE AGENCY, No. 27, Fall 2006, at 2, [http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-27/charitiesnews-27-e.html#P151\\_3567](http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-27/charitiesnews-27-e.html#P151_3567).

16. Data from ATIA request A-041872 (on file with author) [hereinafter ATIA].

17. *GST for Not For Profit Organizations and Registered Charities*, BDO Dunwoody LLP, <http://www.bdo.ca/markets/notforprofit/documents/BDODunwoody-GSTfor-nonprofitorganizations.pdf>.

18. *Id.*

fulfill, and no quid pro quo that must be given.<sup>19</sup> As long as any object other than profit is stated in conjunction with the other requirements, the organization will be exempt under this provision.<sup>20</sup>

The jurisprudence on ITA paragraph 149(1)(l) and its successors has evolved over the years, largely causing the types of entities exerting a claim to the exemption to change significantly. The biggest evolution revolves around the type of activities that a NPO can engage in, and by extension the types of entities attempting to claim the exemption, through the interpretation given to the purpose test.<sup>21</sup> When the Provision was first enacted in 1917, small grass-roots type entities sought to claim its benefit, but by the end of the 20th century large commercial operations operating for the benefit of private groups were unabashedly litigating to seek its application.<sup>22</sup> Case law requires a few elements to be present before exemption is granted under this provision. The nonprofit purpose must actually be pursued by the entity claiming the exemption as merely funding another entity to carry out the nonprofit purpose is insufficient.<sup>23</sup> Commercial activity is acceptable in a nonprofit entity, and it does not matter whether it operates in an industry in competition with members of the private sector, as long as the 'organized and operated' elements are properly structured, and the true focus of the entity is its stated nonprofit objectives.<sup>24</sup> The purpose of an entity may be focused solely on the benefit of a private group, such as lawyers, which are not underprivileged and have no identified need for social support.<sup>25</sup>

#### IV. THE INCOME DEFINITION THEORY AND CANADIAN NONPROFITS

The scholar who proposed that nonprofits do not earn income as we understand the concept to be was American Boris Bittker; he focused on the definitional difficulties faced by organizations whose revenue is generated mostly from donations.<sup>26</sup> Bittker asserted that the concept of income is an uneasy fit because the underpinnings are for entities that exist to maximize profit, and these do not translate to nonprofit entities: "When the familiar methods of income measurement proscribed by the

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19. *Id.*

20. *Id.*

21. Income Tax Act, § 149(1)(l).

22. *E.g.*, Income War Tax Act, 1917, 7-8 George V., c. 28, assented to Sept. 20, 1917; Conner, Carter & Walters, *New Canada Not-For-Profit Corporations Act and Its Impact on Charitable and Non-profit Corporations*, CANADIAN ASS'N, Jan. 2005, [http://www.axi.ca/tca/jan2005/guestarticle\\_3.shtml](http://www.axi.ca/tca/jan2005/guestarticle_3.shtml).

23. *E.g.*, *Woodward's Pension Soc'y v. Minister of National Revenue*, [1962] CTC 11 (Can); Eliza Erskine, *Can a Canadian Non-Profit Earn a Profit? CRA's Views on The Subject*, GLOBAL PHILANTHROPY, Nov. 11, 2009, [http://www.globalphilanthropy.ca/index.php/blog/comments/can\\_a\\_canadian\\_non-profit\\_earn\\_a\\_profit\\_cras\\_views\\_on\\_the\\_subject/](http://www.globalphilanthropy.ca/index.php/blog/comments/can_a_canadian_non-profit_earn_a_profit_cras_views_on_the_subject/).

24. Erskine, *supra* note 23.

25. *Id.*

26. Boris Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J 3, 307-14 (1976).

Internal Revenue Code, the accounting profession, or administrative practice are applied to nonprofit organizations, these methods must be stretched to, or beyond, the breaking point.<sup>27</sup> The primary cause of this disjunct was the issue of how to classify donations for public service organizations, whether as income, gifts that would be exempt from taxation, or capital contributions.<sup>28</sup> On the other hand, he also stated that the expenditures incurred in carrying out the nonprofit mandate of an organization would not be allowable deductions under existing taxation concepts, as they were not incurred for the purpose of making a profit,<sup>29</sup> the basic standard for allowing deductions from income. In Bittker's opinion, these problems mean that income cannot be accurately determined for entities which rely on donations as a primary source of revenue.<sup>30</sup> But the article in which Bittker made this assertion is very clear that only donative nonprofits experience this problem, not mutual benefit organizations,<sup>31</sup> which is Bittker's classification, and where many of the non-charitable nonprofit entities at the focus of this article would fit. In Bittker's terms, donative nonprofits are a type of public service organization which receives the bulk of its revenue from donations and gifts. Another broad category, mutual benefit organizations, exist to provide goods or services to their members, and are controlled by these members.<sup>32</sup> The non-charitable nonprofit entities at the center of this examination do not earn a significant proportion of their revenues from donations or gifts, but rather from active and passive income.<sup>33</sup> Although some Canadian academics have discussed the taxation of the nonprofit sector as a whole and seem to understand and apply this income definition theory to the whole sector rather than just donative entities, this is simply not what the theory was meant to do. Bittker's income definition theory focuses exclusively on donative entities, which are entities that receive the bulk of their revenue from donations; he specifically states in this article that mutual nonprofits should be treated as flow-through entities for tax purposes, with individual members having an entity's income imputed to them.<sup>34</sup>

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27. *Id.* at 307-8.

28. *Id.* at 308-9.

29. *Id.* at 310-12.

30. *Id.* at 314.

31. Bittker's classification of entities are subject to the same non-distribution constraint as donative entities, but which exist for the benefit of their members rather than for public service. *Id.* at 305-6.

32. Bittker, *supra* note 26, at 305-6. *See also* Hansmann, *supra* note 5, at 60 n.25.

33. For example, data provided by Canada Revenue Agency pursuant to Access to Information Request A-041872 demonstrates that, for the 2006 tax year, gifts to entities claiming exemption under ITA para. 149(1)(l) totalled just 0.34% of the total revenue of these entities who filed the information return Form 1044. Active income made up 49.68% of revenues, and passive income made up 5.94%. This demonstrates the relative insignificance of gifts to these entities, and the fact that they do not rely on donations for much of their revenue. While some categories of entities within this class had higher percentages of gifts than others, at no time did gifts form a significant part of the income of any category of entity type, and certainly did not rival active income as a revenue source. ATIA, *supra* note 16.

34. Bittker, *supra* note 26, at 306-07.

His theory recognizes that income can be earned by such organizations, but the tax circumstances surrounding them would be the same as partnerships, which have some legal personality but are not taxed as a separate legal person.<sup>35</sup>

Bittker's income definition theory has an alternative position which centers on the concept of 'ability to pay' as something that must be determined before an entity can be subjected to taxation.<sup>36</sup> His primary concern is that the true incidence or burden of taxation would be felt by the beneficiaries of the public service works performed by the nonprofit entity, and it would be impossible to determine with any accuracy their ability to pay, let alone who these beneficiaries are.<sup>37</sup> Since their ability to pay is not able to be accurately determined, as his theory states, it is not appropriate to tax these organizations since they can properly be viewed as mere conduits for the persons they service.<sup>38</sup> While ability to pay is a key tax policy concept, it is not one that has been often used in evaluating entity-level taxation, but rather personal taxation; entity level taxation does not generally take into account the ability to pay of the entity's underlying shareholders and is not considered particularly progressive.<sup>39</sup> As such, there is no precedent to view incorporated nonprofits as the mere aggregate of their beneficiaries for tax purposes, which would require taking their ability to pay into account when determining the income of the overarching entity. If the activities of the nonprofit are carried on through an unincorporated association, ability to pay is taken into account by attributing income to each of the participating members or partners, to be included in their regular income and taxed at their ordinary progressive rates.<sup>40</sup>

Finally, it also must be stressed that this alternate assertion also focuses on public service nonprofits, which are not typically the entities that enjoy exemption under paragraph 149(1)(l) of the Income Tax Act.<sup>41</sup> The entities which are exempted under paragraph 149(1)(l) run the gamut from community-oriented entities with open beneficiaries (community improvement, social welfare organizations) to mutual entities with restricted beneficiaries (social and recreation clubs, and organizations with any purpose other than profit), which demonstrates at least for the restricted membership mutual entities that the underlying beneficiaries can in fact be determined with absolute accuracy.<sup>42</sup> To the extent that some organizations exist to benefit their members only, and these members can be determined, this alternate theory does not fit the exemption given to the non-charitable nonprofit subsector of the nonprofit sector through

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35. *Id.*

36. *Id.* at 315.

37. *Id.*

38. *Id.*

39. Hansmann, *supra* note 5, at 64-65.

40. *Id.*

41. Income Tax Act, § 149(1)(l).

42. *Id.*

the Provision. This demonstrates a need to rationalize the exemption accorded to these entities, as there is no focus or goal which can be seen to be encouraged through the existence of the exemption.

As demonstrated in Hansmann's article, the income definition theory does not apply to nonprofit entities which are exempted by operation of paragraph 149(1)(l), as it was only meant to apply to entities which receive the bulk of their revenue from donations.<sup>43</sup> In addition, Hansmann has authoritatively contradicted this theory,<sup>44</sup> and no other academic has published a defense of its core assertions to date. Therefore, using this theory to assert that income is not something that can be earned by the nonprofit sector in Canada does not work.

## V. INCOME: BACKGROUND THEORY

Even if Bittker's version of the income definition theory does not apply to Canadian nonprofits, is it still possible that these entities do not earn income as conceived in the Canadian system? To answer this question, a theoretical and practical exploration of the underpinnings of 'income' in the Canadian system, put into the context of the nonprofit sector, is required.

### A. THEORETICAL CONTEXT: THE BEGINNING OF A DEFINITION OF INCOME

In order to levy a tax on income or to exempt a certain type of income, one must first define the word. This definitional exercise is one of the most basic stumbling blocks to achieving consensus in the tax policy area. A layperson might think that "income" can easily be defined, encompassing mostly the wages she brings home and any interest or dividends she might collect. But, academics view these types of receipts as the mere beginning of what constitutes income, and one must look at what the definition will be used for, if at all. For legal academics, income is a concept which must properly form the basis for a tax system, and therefore has a practical purpose that requires black and white application.<sup>45</sup> One must also take into consideration other practical and theoretical concepts, such as equity, simplicity, and political considerations. Various policy goals will cause the actual income tax to depart from the academic "ideal concept" of income, but the ideal must still be understood in order to know what it is that one is 'missing'; in many ways, it is trying to understand the "theory of the second-best" in action.<sup>46</sup>

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43. Hansmann, *supra* note 5, at 59-63.

44. *Id.*

45. See, e.g., Bittker, *supra* note 26, at 305-14.

46. This is an economic theory that focuses on "what happens when the optimal conditions are not satisfied in an economic model." This model was established by Kelvin Lancaster and Richard Lipsey in 1956. Generally, this theory would apply "whenever all of the equilibrium conditions satisfying economic nirvana cannot occur simultaneously," such as in the case of market imperfections or distortions. The best outcome obtained would be less efficient than in the ideal, thus the moni-

Income is a social construct, created by legislation and defined by each nation to reflect priorities and values inherent to their respective societies, and accordingly, will differ from country to country.<sup>47</sup> Under the statute used to impose and collect taxes in Canada, the Income Tax Act, non-charitable nonprofit entities earn income that would otherwise be subject to taxation, but that income is exempted from taxation under ITA paragraph 149(1)(l) as long as the recipient is organized and operated for a purpose other than profit.<sup>48</sup> This will be examined in greater detail later in this article.

## B. RELEVANCE

The definition of “income” is likely to be most relevant in the real world in order to calculate liability under an income tax. Income differs from the concept of “wealth,” which, at its basic level, assesses the depths of one’s overall financial picture.<sup>49</sup> Income deals with a calculation for a specific period of time, a snapshot that usually encompasses a year, and may or may not include every penny that touches a taxpayer’s hands during that time, as well as certain amounts that do not.<sup>50</sup> Income is usually defined by legislation, and certain receipts are included in a taxpayer’s income, while others are left out entirely.<sup>51</sup> Value judgments are made in the development of this legislation; for example, is a dollar found on the sidewalk considered “income” and therefore properly subject to taxation? Would the answer change if the finder of that dollar gave it to a homeless person on the next corner? Or if she bought a coffee with it at the corner store? Or if she directed the homeless person to pick it up himself? In each of these scenarios, the individual made a specific consumption choice and determined where the dollar would be consumed, or by whom, so why should the treatment differ, if at all? Should a child’s birthday money from his mother be counted as income to the child? Should it matter if that child is eight or twenty-eight? Or, is it true that “a buck is a buck is a buck,”<sup>52</sup> such that it is appropriate to classify any and all receipts as income to a recipient? The reasons behind why the tax

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ker of “theory of the second-best.” Steven M. Suranovic, *The Theory of the Second Best*, *INT’L TRADE THEORY AND POL’Y*, Feb. 16, 2007, <http://internationalecon.com/Trade/Tch100/T100-2.php>.

47. For example, Canada does not define ‘income’ to include lottery winnings, while the United States does. Netherlands imputes income to taxpayers from owner-occupied housing, which neither Canada nor the United States include in their definitions of ‘income’. See M. Peter van der Hoek, *Taxing Owner-Occupied Housing: Comparing the Netherlands to Other European Union Countries*, *PUB. FIN. AND MGMT.* 4, 7 (2007): 393-421, MPRA Paper No. 5876, available at <http://mpra.ub.uni-muenchen.de/5876/>.

48. The Provision refers to these entities as non-profit organizations. Income Tax Act, § 149(1)(l).

49. *BLACK’S LAW DICTIONARY* 1624 (8th ed. 2004).

50. *Id.* at 778.

51. Such as windfalls, like lottery winnings, under the Canadian tax regime.

52. A phrase popularly attributed to the findings of the Carter Commission. Kenneth Carter, *Royal Comm’n on Taxation*, Report of the Royal Comm’n on Taxation, Queen’s Printer, Ottawa (1966).



system contains the elements it does or does not contain certain other elements are as much tax policy as politics. These questions need to be explored when looking at a provision in order to understand what that provision is supposed to accomplish, in order to assess and determine whether or not it accomplishes its purpose and should remain, or if it needs to be amended or abolished. Thus, it is necessary to enunciate the tax policy behind the exemption for nonprofit organizations in order to evaluate the provision, which although necessary is beyond the scope of this paper.

### C. THEORETICAL STARTING POINT: HAIG-SIMONS FORMULATION

The most widely accepted theoretical formulation of income is the one put forth by Henry Simons in 1938, based on the earlier works of Robert Haig and George von Shantz.<sup>53</sup> Commonly referred to as the Haig-Simons definition of income, or the comprehensive definition of income, this states that income for a given period is the sum of a taxpayer's change in real wealth and her consumption during this period. This can be expressed as the following algebraic sum:

$$AI = C + DW$$

where AI is the taxpayer's annual income, C is the value of her annual consumption, and W is the real value of her wealth.<sup>54</sup> Controversy arises, however, in defining the terms used in the formula, specifically what constitutes "consumption"<sup>55</sup> and what constitutes "wealth".

Determining 'income' is important for many reasons; for our purposes, two reasons stand out. First, for discussion purposes, it is important to have a framework for understanding the discussion behind the definition of income; for as discussed above Bittker disputes the notion that nonprofit organizations can even have 'income' because the concept is unique to profit-oriented ventures.<sup>56</sup> Second, when examining the cost of the tax preference for nonprofit organizations, a benchmark norm must exist to be able to quantify the deviation from the norm. An absolute figure for this 'deviation,' or 'preference' as a tax person is more likely to call it, is impossible to authoritatively quantify, since the real-world economy is heavily influenced by the presence of big government, through taxes, regulatory requirements, and other overlapping laws, and one must have a great imagination to hypothesize what the normative tax would be in the absence of influence.

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53. See Victor Thuronyi, *The Concept of Income*, 46 TAX. L. REV. 45, 46 (1990).

54. *Id.*

55. For example, there is controversy about whether interest should be considered part of a person's consumption. Some state that interest constitutes a reduction in net wealth and is not consumption. Others argue that 'consumption' must include expenditures which produce a current personal benefit, and therefore personal interest should be non-deductible. See Stanley Koppelman, *Personal Deductions Under an Ideal Income Tax*, 43 TAX. L. REV. 679, 716 (1988).

56. Bittker, *supra* note 26, at 302.

In attempting to define ‘income,’ Simons stated that “income must be conceived as something quantitative and objective. It must be measurable; indeed, definition must indicate or clearly imply an actual procedure of measuring. Moreover, the arbitrary distinctions implicit in one’s definition must be reduced to a minimum.”<sup>57</sup> Some commentators expect that the Haig-Simons definition would confuse, as it is a concept borrowed from the discipline of economics for use in the discipline of law, and without the narrow meanings applied to the underlying concepts used in economic theory, the “meaning collapses when it is applied in the real world.”<sup>58</sup> The quest for the perfect definition of income is a chimera, however, as the existential question of “what is perfect” will come back to haunt one every time. In dealing with the ideal formulation of “income” one must examine the goals of the tax system as a whole, as well as taking into account numerous tax policy concerns, such as administrative ease, fairness, efficiency, equity, and political constraints, to name a few. It has been recognized that the tax system is more than just a simple revenue raising tool for the various levels of government that employ it;<sup>59</sup> it is also a social tool used to re-engineer the burdens of society, encourage various types of behaviors, and discourage others.<sup>60</sup> The search for the perfect definition of ‘income’ would have to be done in a vacuum, which is not possible in the real world. There is no absolute criterion for income and what may be a constituent element of it; it is a social construct, and therefore always open to debate. Simons recognized this, stating that “one must face the fact that income is an actual tax base and that income taxes must finally be appraised in terms of general rules of procedure which best define their nature. Hence arises the need for rigorous, objective definition.”<sup>61</sup> The comprehensive definition is a starting point for establishing income, taking a global approach, which is then modified to suit the needs and norms of each taxing jurisdiction. Under this broad theoretical definition of income, any accession to wealth experienced by non-charitable nonprofit organizations would clearly be income, but since each country is free to define income as it pleases, the practical application of income in Canada could theoretically result in a definition that does not result in income recognition for nonprofit organizations.

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57. HENRY C. SIMONS, *PERSONAL INCOME TAXATION: THE DEFINITION OF INCOME AS A PROBLEM OF FISCAL POLICY*, 42-43 (1938).

58. Thuronyi, *supra* note 53, at 46.

59. “[T]axation serves many purposes in addition to the old and traditional object of raising the cost of government from a somewhat unenthusiastic public.” *R. v. Golden*, [1986] 1 S.C.R. 209, 1986 CarswellNat 236 ¶ 10 (Can.).

60. See David G. Duff, *Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform*, 42 Osgoode Hall L.J. 47, 52 (2001), available at <http://papers.ssrn.com/abstract=293706> (the key purpose of an income tax is “. . . to impose a social claim on a share of each taxpayer’s annual gains from participation in the market economy.”).

61. Simons, *supra* note 57, at 139.

## VI. THE CANADIAN DEFINITION OF INCOME

To determine what “income” is, whether or not in the context of non-profits, the ITA is the starting point. But, since nowhere in the ITA is “income” actually defined, jurisprudence must also be examined to expand on our understanding of the concept.

## A. THE STATUTE-ITA SS.3(A)

The Canadian approach to income reflects its historical ties to the United Kingdom, eschewing the comprehensive approach adopted by the United States in favor of a schedular approach. As a starting point to defining income in the United States, the Internal Revenue Code states in section 61 that all income shall be included in gross income, regardless of source, except as otherwise provided.<sup>62</sup> Thus the default position in the United States is that everything is included in the definition of income.<sup>63</sup> The Canadian approach comes from the opposite direction; the ITA expresses in section 3(a) that income of a taxpayer arises from an office, employment, business or property,<sup>64</sup> and despite global language in the provision, it has been relatively narrowly interpreted so that if a receipt is not on this list, it is not included in a taxpayer’s income and as such is not taxable to her.<sup>65</sup> There seems to be a presumption that something is not income unless it is of the type listed in section 3(a). As the Federal Court of Appeal wrote, “Parliament has chosen to define income by reference to a restrictive doctrine while recasting it in such a manner as to achieve broader ends.”<sup>66</sup> Thus the Canadian approach uses the ‘source’ concept of income, meaning that a receipt by a taxpayer must be “analyzed and allocated to a source which is either expressly enumerated in the Act or recognized by case law” in order for it to be considered as ‘income’.<sup>67</sup> This different approach is one reason why Bittker’s assertion that nonprofits do not earn income cannot be imported into Canada without analytical thought, i.e. his assertion was meant to apply in the American context, which views income concepts far differently than do Canadians. This is not to say that his theory fits any better in the American context, but rather that the two different concepts of income must be taken into account when sending theory across national boundaries.

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62. 26 U.S.C. § 61(a) (2006).

63. *Comm’r v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955). The Court developed a three-part test to determine if something was income: undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion.

64. Income Tax Act, § 3(a).

65. For example, lottery winnings and strike pay are not income. *Fries v. Canada*, [1990] 2 C.T.C. 439 (Can. Tax Ct.). Also, damages stemming from the cancellation of an employment contract prior to the commencement of employment is not income. *Schwartz v. Canada*, [1996] 1 C.T.C. 303 (Can. Tax Ct.).

66. *Bellingham v. Canada*, [1995], 1 F.C. 613, at ¶ 28 (Can. Fed. Ct.).

67. TIM EDGAR & DANIEL SANDLER, MATERIALS ON CANADIAN INCOME TAX 79, (Thompson Carswell, 13th ed. 2005).

### 1. *Liability to Tax-Persons*

Who is liable to taxation is also important, and this is determined with reference to the ITA. Tax legislation used to be subject to a rule of strict interpretation,<sup>68</sup> but today is more properly interpreted using the ordinary rules of statutory interpretation, using a teleological approach,<sup>69</sup> meaning “a legislative provision should be given a strict or liberal interpretation depending on the purpose underlying it, and that purpose must be identified in light of the context of the statute, its objective and the legislative intent.”<sup>70</sup> With this in mind, like any other statute, the wording of the Provision must be carefully examined and all parts must be given meaning including words like ‘person’ and ‘taxable income.’

Subsection 2(1) states that “an income tax shall be paid, as required by this Act, on the taxable income for each taxation year of every person resident in Canada at any time in the year.”<sup>71</sup> Thus the object of taxation is a resident ‘person.’<sup>72</sup> ‘Person’ is defined in section 248 to “‘include any corporation, and any entity exempt, because of subsection 149(1), from tax under Part 1 on all or part of the entity’s taxable income.’”<sup>73</sup> ‘Taxpayer’ is defined in a slightly different manner, to “‘include any person whether or not liable to pay tax.’”<sup>74</sup> The terms ‘taxpayer’ and ‘person’ are generally used interchangeably,<sup>75</sup> and include individuals, which are persons other than corporations.<sup>76</sup> General charging provisions in the ITA attach to persons, not taxpayers, which mean if someone or something falls within the definition of ‘person’ in the ITA, then they are liable to pay tax pursuant to subsection 2(1) on their worldwide income, as set out in s. 3(a).<sup>77</sup> This is how liability attaches in the ITA; it does not depend on what kind of person (*i.e.* private, charitable, etc.) earns the income, but whether or not it is a ‘person.’ Since the definition of ‘person’ is extremely broad, and the definition explicitly states that any

68. *See, e.g.,* *British Columbia Railway v. The Queen*, [1979] C.T.C. 56 (Can. Tax Ct.). That traditional view went unchallenged until the decision of the *Supreme Court of Canada in Stubar Investments Ltd. v. The Queen*, [1984] 1 S.C.R. 536, at ¶ 61. In that case the Supreme Court displaced the rule of strict construction with the contextual approach to statutory interpretation advocated by E. A. Driedger in his classic work, *CONSTRUCTION OF STATUTES* 87, (Toronto: Butterworths 2d ed. 1983). *Québec (Communauté urbaine) v. Corp. Notre-Dame de Bon-Secours*, [1994] 3 S.C.R. 3. “The tenets of the ‘teleological’ approach are, now, firmly entrenched in our jurisprudence.” *Bellingham v. Canada*, *supra* note 44, at ¶ 30.

69. *See* EDGAR & SANDLER, *supra* note 67, at 763. Usually statutory interpretation concepts in income tax law are used when determining whether a transaction is within the reach of the ITA. The focus here is much more basic.

70. *Id.*

71. Income Tax Act, § 2(1).

72. I will assume for purposes of this paper that all persons are residents.

73. Income Tax Act, § 248(1).

74. *Id.*

75. This is usually the case. *But see, Oceanspan Carriers Ltd. v. R.* [1987] 1 C.T.C. 210, 1987 CarswellNat 340 (Can. Fed. Ct.) (where the Federal Court of Appeal ruled that ‘taxpayer’ does not include a non-resident corporation with no Canadian source of income).

76. *See* Income Tax Act, § 248(1) (defining individual).

77. *Id.* § 2(1).

entity claiming exemption under subsection 149(1) is a person, there can be no doubt that nonprofit organizations are persons under the ITA, and would therefore be subject to taxation on their worldwide income if no exemption provision existed. This might seem like circular reasoning, as the Provision both gives the exemption and results in personhood, but the definition of person merely states the obvious, that these entities are persons just like entities which exist for a profit purpose, and the definition of person was amended to include this statement in order to require entities seeking exemption under the Provision to file information returns.<sup>78</sup> The focus of their activities does not have anything to do with whether one group is a person and an identical group with a different focus is not.

### 2. *The Provision*

Further, an examination of the wording of 149(1)(l) itself is instructive, and necessary under the canons of statutory interpretation. The object of the Provision is a person, as the opening of subsection 149(1) states that the subsection applies to persons, for taxable periods during which that person was one of the enumerated entity types which are set out in the paragraphs following, (l) being nonprofit organizations.<sup>79</sup> Thus, if there were no person, there would be no availing oneself of the benefits of the exemption granted by paragraph 149(1)(l), which would obviate the very existence of the Provision. In addition, the exemption applies to the taxable income of the person, which means that the Provision itself anticipates that these entities will earn income. There is a presumption that the words are in a provision for a reason, and this means that the only ones who may benefit from the Provision are persons who earn income. Put in another way, if it was not possible for anyone to get the benefit of the Provision (*i.e.* the person cannot earn income), the presumption is that the Provision would not have been created in the first place. Generally, statutory provisions are made to be used.

### 3. *Source*

As stated earlier, in order for an amount to be income for Canadian income tax purposes, it must be from an office, employment, business, or property source.<sup>80</sup> If the amount has no source and is not a taxable capital gain, it is not subject to taxation.<sup>81</sup> It is the character of the source that determines income status, not the character of the earner. In the ITA, a 'person' is defined to specifically include any club, society, or association which claims the benefit of the paragraph 149(1)(l) exemption.<sup>82</sup>

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78. This filing requirement was added in § 149(12) by 1992 Technical Bill, effective for fiscal periods ending in 1993 or later. Such an organization must file Form T1044.

79. See Income Tax Act, § 149(1)(l).

80. Income Tax Act, § 3(a).

81. Taxable capital gains are not 'income' but are still subject to taxation.

82. Income Tax Act, § 248(1). "person", or any word or expression descriptive of a person, includes any corporation, and any entity exempt, because of subsection 149(1), from tax under Part I on all or part of the entity's taxable income and the

The two most likely sources of income for a nonprofit to earn are business and property income because a non-corporeal person, such as a nonprofit, would be unable to serve as an employee or hold office.<sup>83</sup>

In determining whether something is from a source, the Supreme Court of Canada stated, “whether the taxpayer intends to carry on the activity for profit, and whether there is evidence to support that intention” is an appropriate consideration.<sup>84</sup> That statement would seemingly prevent any amount earned by a nonprofit from being classified as income, because the focus is on the intent to generate profit, and a nonprofit must have as its purpose any purpose other than profit. This seeming conundrum can be clarified by understanding that the definition of profit as used in the case law relating to the source concept of income is from a merely mathematical perspective,<sup>85</sup> meaning simply that in respect of a revenue stream it generally refers to any amount that remains after allowable expenses (*i.e.* net income) as profit. There are two different focuses for the concept of ‘profit’ in the context of this exemption, and this is the reason for the confusion. Profit, in the context of determining if an entity has made a profit on a particular endeavor, is calculated pursuant to ordinary commercial practices,<sup>86</sup> which may reflect generally accepted accounting principles as well as specific legislative provisions. In the other context, determining that the purpose of the nonprofit organization is for a purpose other than the generation of profit, such as community improvement, has no impact on whether or not it actually has revenue in excess of expenses with regard to a particular endeavor. The dichotomy of having pure mathematics on one side, and focus and purpose on the other is essential for resolving this; one concept refers to a particular endeavor that the entity enters into, and if the entity intends to make money on the endeavor, while the other refers to the existentialist issues surrounding the creation and *raison d’être* for the organization. The confusion is reflected in the literature in this area. Specifically, in the first Canadian article that addressed NPO taxation, the author, Ronald Knechtel, stated that “since an organization, to qualify for exemption under para.149(1)(l) cannot carry on any activity for the purpose of profit, it appears that it cannot carry on a business within the ordinary meaning of that word. Thus, all of its activities must be non-business activities.”<sup>87</sup> Case law decidedly contradicts this assertion, since entities

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heirs, executors, liquidators of a succession, administrators or other legal representatives of such a person according to the law of that part of Canada to which the context extends.

83. Profit includes income from business and investments. Ronald C. Knechtel, “Tax Treatment of Non-Profit Organizations” in *Report of Proceedings of the Forty-First Tax Conference*, 35:1, at 35:5 (1991) [hereinafter Knechtel]. See also IT-459—Adventure or Concern in the Nature of Trade, Canada Revenue Agency, Sept. 8, 1980, available at <http://www.cra-arc.gc.ca/E/pub/tp/it459/README.html>.

84. *Stewart v. R.*, [2002] 2 S.C.R. 645, 2002 SCC 46, at ¶ 61 (Can.).

85. Knechtel, *supra* note 83, at 35:5.

86. See, e.g., *The Royal Trust Co. v. Minister of Nat’l Revenue*, [1957] Ex. C.R. 70, 9 D.L.R. (2d) 28 (Can. Fed. Ct.).

87. Knechtel, *supra* note 83, at 35:5-35:6.

which carry on active businesses have qualified for nonprofit status;<sup>88</sup> the distinction is in the drafting and ordering of their objectives and operations, so that the entity's purpose is anything other than profit, even if certain for-profit activities are pursued.<sup>89</sup> In making his assertion, Knechtel confused the entity's objectives and purposes with the specific activities it undertakes, and continued this confusion throughout his article, so that the idea of "profit" is confusing and indefinite.<sup>90</sup> This leads to ludicrous results, presuming that everything these types of entities do is destined to lose money. A Trappist monastery in Virginia may intend to sell cheese from its dairy for more than the costs incurred in its production and marketing so that the monastery can take the profit to use for its stated nonprofit purposes.<sup>91</sup> It defies common sense to state that a nonprofit entity cannot earn a profit on an endeavor, which would just be the excess of its receipts over its costs. Nonprofit entities would not engage in the sale of any goods or services if this were the result, which is not the case in reality, as active income forms a significant proportion of the income earned by these types of entities in Canada.<sup>92</sup>

Jurisprudence on the "source of income" concept states that an income source may recur on a periodic basis, involves a marketplace exchange, generates legally enforceable claims to payment, and arises from a pursuit of profit in a business or property source context.<sup>93</sup> This "pursuit of profit" element merely recognizes that the nonprofit tried to earn revenue in excess of its expenses in the related endeavor.<sup>94</sup> From a statutory and jurisprudential perspective, nonprofit entities are capable of earning income.

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88. See, e.g., *Gull Bay Dev. Corp. v. R.*, [1984] C.T.C. 159 (Can.); *Can. Bar Ins. Ass'n v. R.*, [1999] 2 C.T.C. 2833 (Can.).

89. See *Otineka Dev. Corp. v. Canada*, [1994] 1 C.T.C. 2424 (Can.).

90. See Knechtel, *supra* note 83, at 35:8.

91. Jean Denton, *Our Lady of the Angels Monastery: Prayer, Work, & Community*, CATHOLIC VIRGINIAN, Apr. 7, 2008, <http://www.catholicvirginian.org/archive/2008/2008vol83iss12/pages/parishprofile.html>. For other food businesses run by monastic orders, see Mary A. Jacobs, *Gourmet Goodies Gives Monasteries, Convents a Boost*, DALLAS MORNING NEWS, Oct. 28, 2006, [http://www.dallasnews.com/shared/content/dws/dn/religion/stories/DN-holychow\\_28rel.ART0.State.Edition1.3e68790.html](http://www.dallasnews.com/shared/content/dws/dn/religion/stories/DN-holychow_28rel.ART0.State.Edition1.3e68790.html).

92. ATIA request, *supra* note 16.

93. See e.g., Peter W. Hogg & Joanne E. Magee, *Principles of Canadian Income Tax Law* 76-77 (2005); Knechtel, *supra* note 83, at 35:5.

94. "[A]n adventure or concern in the nature of trade" is included in the definition of "business" under ITA § 248(1). Income Tax Act, § 248(1). IT-459 states that if a transaction was handled in the same way as a normal business transaction, in terms of quantities or a commodity purchased, method of promotion and sale, etc., there may be evidence of an adventure in the nature of trade leading to the finding of a business. Adventure or Concern in the Nature of Trade: Income Tax Interpretation Bulletin, Canada Revenue Agency, Sept. 8, 1980, available at <http://www.cra-arc.gc.ca/E/pub/tp/it459/it459-e.html>. The Interpretation Bulletin also states, in para. 1, that as a general principle, "when a person habitually does a thing that is capable of producing a profit [i.e. revenue in excess of expenses], then he is carrying on a trade or business." *Id.* at ¶ 1.

## B. JURISPRUDENCE ON INCOME, GENERALLY

Since the ITA does not actually define income, one must turn to judicial interpretation. While no single case exhaustively states what is and what is not income, there are certain factors considered when weighing the status of a receipt. Courts will look to see if the taxpayer had an enforceable claim to the payment in question, and whether there was an organized effort to receive the payment.<sup>95</sup> They will also consider whether the taxpayer sought after or solicited the payment, and whether the taxpayer specifically or customarily expected it.<sup>96</sup> Other indicia include whether there is a foreseeable possibility of recurring payments, whether the payor was a customary source of income to the taxpayer, and whether the payment was “in consideration for or in recognition of property, services, or anything else provided or to be provided by the taxpayer.”<sup>97</sup> In short, if the taxpayer does not earn the revenue item as a result of any activity or pursuit of gain on its part, even if for only one transaction, then the item is more likely a windfall than income from a source, and therefore is not taxable. These characteristics depend on the activities of each nonprofit, not on characteristics inherent to the organizational form of the entities claiming exemption. There is no distinction to be made here between for-profit and nonprofit organizations generally, just between individual entities and their activities to generate revenue.

## C. JURISPRUDENCE ON ITA 149(1)(L) AND INCOME

The Provision anticipates that exempt entities do in fact earn income: it begins with the very specific words, “No tax is payable under this Part on the *taxable income* of a person for the period.”<sup>98</sup> The 1917 act creating the original version of the exemption also made reference to the income of nonprofits being exempt from taxation, clearly recognizing that not only will these entities earn income for purposes of the Income Tax Act, they will also earn *taxable* income. The Exchequer Court in the *St. Catharine’s* case further illuminates this point, clarifying that the object of taxation is the person and not the income itself.<sup>99</sup> The identity of the person who earns the revenue stream does not change the nature of that revenue from being income to not being income; all that changes is whether or not that income is subject to taxation. The court specifically stated that the statutory provision assumes that non-charitable nonprofit organizations will earn income as defined under the ITA, and this income could be taxable except for the exemption provision.<sup>100</sup>

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95. *Bellingham*, 1 C.T.C. 187 at ¶ 37.

96. *Id.*

97. *Id.*

98. Income Tax Act, § 149(1)(l) (emphasis added).

99. *St. Catharine’s*, C.T.C. 362.

100. *Id.* at ¶ 15.



An examination of the entire body of case law on the Provision and its predecessors over the years shows that in all cases, the question is whether the nonprofit's income is exempt from taxation, not whether the receipts constitute income as defined under the income tax statute.<sup>101</sup> The two cases decided on the basis of the definition of income dealt with the question of who had ultimate control of the money, rather than of whether the funds might be taxable in the abstract.<sup>102</sup> It is always possible that money received by any organization, nonprofit or for-profit, does not actually belong to the entity, under the same principles that determine whether income belongs to any person. Specifically, if the person does not have the right to control the funds, and they must be paid over to another person, then these funds simply do not belong to the organization initially receiving them.

No other case law exists considering whether a putative nonprofit's receipt is income in its hands. It is clear from the tone of existing jurisprudence that income characterization is not the focus of the dispute; rather, the focus is the taxability of the income based on the entity's status. This also means that the exemption is extrinsic to the income tax, rather than intrinsic; but for this provision, the income of NPOs would be subject to taxation under the Income Tax Act just as it is for any other non-exempt person. The fact that the body of case law supports income characterization for the receipts of nonprofits helps to build our understanding of the law in this area. Borrowing heavily from and paraphrasing a statement by Justice Rand in a Supreme Court of Canada decision in the related field of municipal taxation,

to characterize. . .[certain bodies] as. . .[nonprofit organizations] merely because of the. . .destination of the net revenues, would be to distort the meaning of familiar language; and to make that ultimate application the sole test of their. . .[nonprofit] quality would introduce into the law conceptions that might have disruptive implications upon basic principles not only of taxation but of economic and constitutional relations generally.<sup>103</sup>

#### D. ADDITIONAL CONSIDERATIONS: TAX POLICY AND POLITICS

The debate behind the constituent elements of income is framed in terms of definitions, as the definition of words like "wealth" and "consumption" will drive the discussion of what is "income." Many factors can influence what one considers each of these elements to be, or what they should be, and equity may be a consideration in determining these definitions. Equity, at its basic construct, is a codification of what society

101. See e.g., *Can. Bar. Ins.*, 2 C.T.C. 2833; *Gull Bay*, C.T.C. 159; *Woodward's Pension Soc'y v. Minister of Nat'l Revenue*, [1962] C.T.C. 11 (Can.); *Milk Producers Coop. Agric. Ass'n v. Minister of Nat'l Revenue*, [1958] C.T.C. 1 (Can.).

102. *St. Catharine's*, C.T.C. 362; *Minister of Nat'l Revenue v. Begin*, [1963] C.T.C. 148 (Can.). Woodward's also discussed an income definition argument as an alternative argument, which was dismissed by the court. *Woodward's*, C.T.C. 11.

103. *Pasteur v. R.*, [1952] 2 S.C.R. 76, ¶ 40 (Can.).

considers “fair” in particular circumstances.<sup>104</sup> This can be interpreted to be yet another subjective minefield, but there are areas of equity which can be authoritatively stated. For example, it would almost certainly be perceived to be unfair if the government levied a tax of 100% on a person’s income, or if redheads are taxed at seventy-five percent on all their receipts, while brunettes are only taxed at ten percent. The extremes are easy, but problems will arise in establishing equitable treatment for the rest of the spectrum.

Horizontal and vertical equity considerations are both important as they relate to nonprofit organizations. Horizontal equity means that taxpayers with similar abilities to pay should bear similar tax burdens,<sup>105</sup> while vertical equity holds that taxpayers with greater ability to pay should bear a greater tax burden.<sup>106</sup> Since nonprofit organizations are exempt from taxation, both concepts of equity are violated. A regular taxpayer having an ability to pay similar to that of a nonprofit will have to pay tax on her income, while the latter will not. Nonprofits with high revenues will not pay any taxes, despite having a greater ability to do so than taxpayers that earn less but must actually pay taxes. The existence of a nonprofit tax exemption appears to violate both elements of equity. Some scholars, however, have interpreted the Simons definition as having intended equity to weigh in when determining the definition of ‘income.’ Thuronyi, for example, stated in his interpretation of Simons that “income is to be defined in such a manner as to lead to an equitable distribution of tax burdens.”<sup>107</sup> Thus, equity could be satisfied by carefully crafting the definition of income, and not just in the application of a tax on income. From an analytical perspective, however, that approach is more awkward, as it does not allow for a true assessment of horizontal equity, or for true evaluations of policy trade-offs between exempt and non-exempt entities. Be that as it may, a government balances the competing elements that must be weighed in establishing a tax system, and the revenue raised by personal and corporate income taxes fuels the workings of governments around the world. In any case, the tax system is not only used as a method of collecting money, but also as a method of spending money.

## VII. TAX EXPENDITURES IN GENERAL

[W]e must review special tax preference. In a fully employed economy, special tax benefits to stimulate some activities or investments mean that we will have less of other activities. Benefits that the Gov-

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104. See Richard A. Musgrave, *Horizontal Equity Once More*, 43 NAT’L TAX J. 113, 113-14 (1990).

105. Joseph J. Cordes, *Horizontal Equity*, in *The Encyclopedia of Taxation and Tax Policy* (1999), available at <http://www.taxpolicycenter.org/publications/url.cfm?ID=1000533>.

106. *Vertical Equity*, *ECONOMIST*, <http://www.economist.com/research/economics/alphabetic.cfm?letter=V> (last visited June 14, 2010).

107. Thuronyi, *supra* note 53, at 50.

ernment extends through direct expenditures are periodically reviewed and often altered in the budget-appropriation powers, but too little attention is given to reviewing particular tax benefits. These benefits, like all other activities of Government, must stand up to the tests of efficiency and fairness.<sup>108</sup>

Tax legislation has an obvious purpose: to raise money through the imposition of tax on a defined tax base. Less obvious is the purpose tax legislation has in *spending* public money through the granting of various preferences and exclusions. Tax expenditures are a concept developed by U.S. academics Stanley Surrey and Paul McDaniel, which conceptually equates foregone tax revenue with direct governmental subsidy, allowing a dollar amount to be placed on many tax preferences.<sup>109</sup> The Organization for Economic Co-operation and Development (OECD), defines a tax expenditure to be a “transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by direct expenditure.”<sup>110</sup> To illustrate, if the government exempts from taxation the income of a corporation that would otherwise have had to pay \$100 in tax, then the corporation has received a subsidy of \$100, and the government has ‘spent’ \$100 subsidizing that corporation. Conceptually, any tax incentive, subsidy, or other deviation from the normal tax structure which favors a particular group of taxpayers, such as industry, activity, class, or persons, is a tax expenditure. In form, a tax expenditure can be a deduction, credit, deferral, rate reduction, or exclusion from income;<sup>111</sup> basically any deviation from the normal tax system, in any shape or form, is a tax expenditure and as such is government spending delivered through the tax system. Tax expenditures are primarily used to effect social policy goals and to promote economic development.<sup>112</sup> Since tax expenditures are the economic equivalent of direct governmental spending, they should be evaluated by much the same criteria that is used to examine direct governmental spending, which are driven by the concepts of efficiency, effectiveness, and accountability. The U.S. government has been using tax expenditure reports to evaluate tax provisions since 1968, while the Canadian government has been using them since

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108. 113 Cong. Rec. H. 16890 (1967) (statement of Rep. Wilbur D. Mills, Chairman, Comm. on Ways & Means of the House of Reps.).

109. See generally STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* (1985).

110. *Best Practices Guidelines – Off Budget & Tax Expenditures*, ORG. FOR ECONOMIC CO-OPERATION & DEV., June 9-10, 2004, at 10, [http://www.oelis.oecd.org/olis/2004/doc.nsf/LinkTo/NT000041AA/\\$FILE/JT00164525.PDF](http://www.oelis.oecd.org/olis/2004/doc.nsf/LinkTo/NT000041AA/$FILE/JT00164525.PDF) [hereinafter OECD Report].

111. These can take almost any form. For example, a sales tax exemption is a tax expenditure, as is a tax holiday; the benefit need not be permanent, as timing differences can give rise to tax expenditures.

112. See, e.g., Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison With Direct Government Expenditures*, 83 HARV. L. REV. 705 (1970); see also D. Larry Crumley, *Behavioral Implications of Taxation*, 48 ACCT. REV. 759-63 (1973).

1979.<sup>113</sup>

The entire concept of tax expenditures hinges on a normative tax system as a benchmark to measure deviation. The Haig-Simons definition of income<sup>114</sup> is one benchmark that has been proposed, but is by no means accepted by all. Differences in opinion exist as to what the benchmark should be, so it should be no surprise that differences in opinion exist as to what deviations from the benchmark should be. The concept of the benchmark is essential; without a starting point, no deviation can be measured and the exercise is useless. According to the OECD, a benchmark need not necessarily be the normative tax base, but “should be comprehensive and unique.”<sup>115</sup> A benchmark tax includes considerations such as “rate structure, accounting conventions, the deductibility of [varying] compulsory payments,” and administrative provisions, to name but a few.<sup>116</sup> There is a lack of consensus among countries about what should constitute the benchmark for evaluating tax expenditures, and for the most part this disagreement is rooted in differences of opinion about the normative tax base.<sup>117</sup> Defined, “the normative tax base is the monetary sum in the hands of private households to which the tax ought to be applied, for instance income, value added, profit, [or] sales.”<sup>118</sup>

As discussed earlier, while the Haig-Simons/accretion definition may be well-regarded, there are definitional problems with its conceptual underpinnings, which make it unworkable as a benchmark. The accretion concept takes the sum of the taxpayer’s change in net worth and consumption to be income, so both consumption and savings constitute income. Problems arise in defining both consumption and savings, and since the return on savings is subject to further tax while the return, intangible as it may be, on consumption is not, this leads to what some perceive to be a bias toward consumption.<sup>119</sup> Certain subtractions, such as business expenses, are properly allowed as deductions in reaching this base, but do not constitute savings or a change in net worth, and therefore are not “income.” After these “appropriate” deductions, any additional reductions would be categorized as tax expenditures. Arbitrary judgments about whether and to what extent such “appropriate” deductions should be excluded in determining “income” seem to be employed. Should interest be considered consumption, for example? If not, then it should be deductible. How is the valuation of assets to be made on an

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113. Albert J. Robinson, *Tax Expenditures and the MacEachen Budget*, 8 CANADIAN PUB. POL’Y / ANALYSE DE POLITIQUES 2, 249 (Spring, 1982); 1986 REP. OF THE AUDITOR GEN. OF CANADA ¶ 4.141, available at [http://www.oag-bvg.gc.ca/internet/English/parl\\_oag\\_198611\\_04\\_e\\_4195.html](http://www.oag-bvg.gc.ca/internet/English/parl_oag_198611_04_e_4195.html).

114. Bruce Bartlett, *Why the Capital Gains Tax Rate Should Be Zero*, NCPA Policy Report No. 245 (2001), available at [www.ncpa.org/studies/s245/s245.html](http://www.ncpa.org/studies/s245/s245.html).

115. OECD Report, *supra* note 110.

116. *Id.*

117. *Id.*

118. *Id.*

119. See Vice Chairman Jim Saxton, 111th CONG., TAX EXPENDITURES: A REVIEW & ANALYSIS 4 (Aug. 1999).

annual basis; mark-to-market assessment of all taxpayer assets, even above a *de minimus* threshold, would be inconceivably complicated to administer, and it would be unwise to impose a tax that cannot be policed, as evasion would become much more attractive, and faith in the tax system would suffer.

The purpose behind the tax expenditures concept is to hold up to public scrutiny the government's allocation of resources, both through direct concessions and through indirect effects like the distortion occasioned by such allocation.<sup>120</sup> To the extent that a spotlight is focused on allocation decisions, tax expenditure analysis may be a useful tool in balancing spending priorities against revenue needs. Nonetheless, there are weaknesses inherent in the tax expenditure concept that set limits on its usefulness. First of all, tax expenditures are dependent upon the existence of a defined benchmark norm, and the constitution of this norm is controversial, since inclusion or exclusion from this benchmark tax base is fraught with value judgments unique to each society.<sup>121</sup> This is likely why no two countries define their benchmark the same.

Aside from the insight gained from its application, it is unclear what effect tax expenditure analysis has: it is not quantifiable what tax expenditures would have been in the absence of the scrutiny given them. In addition, while the analysis captures a quantified measure of tax liability reduction stemming from a particular provision, it does not purport to quantify the amount of tax that would be collected should the particular provision cease to exist, behavioral changes that arise as a response to legislative changes are not accounted for, nor are related or complementary provisions adequately determined. Even so, "periodically evaluating the size and effectiveness of tax expenditures is a necessary (although not sufficient) requirement for good government."<sup>122</sup> In carrying out this "necessary requirement," using the actual tax base as a benchmark is the best tool to identify and quantify tax preferences. The actual tax base as a benchmark shows the best approximation of what effect the Provision has in a real-world context, and the deviation that it causes, to the extent that the Provision is looked at in isolation.

### VIII. TAX EXPENDITURE: THE PROVISION

Since nonprofits can earn income as that concept is defined in Canada, this income would be properly subject to federal income taxation but for

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120. See e.g., Julie Roin, *Truth in Government: Beyond The Tax Expenditure Budget*, 54 HASTINGS L.J. 603 (2002-2003); Michael J. McIntyre, *A Solution to the Problem of Defining a Tax Expenditure*, 14 U.C. DAVIS L. REV. 79 (1980-81).

121. See Boris Bittker, *A "Comprehensive Tax Base" As a Goal of Tax Reform*, 80 HARV. L. REV. 925, 929 (1967) ("To determine the extent of erosion, we must first have some notion as to what the tax system ought to be. Since this is to a large extent a matter of equity, and since equity judgments are highly personal, no single standard will meet everybody's approval.").

122. Leonard E. Burman, *Is The Tax Expenditure Concept Still Relevant?*, 9/1/03 NAT'L TAX J. 613 (2003).

the existence of the Provision. As a result, the exemption found in the Provision is a deviation from the benchmark norm of income as the Canadian system has, in practice, defined it. It is a tax preference given to nonprofit organizations, and as such is the functional equivalent of direct spending.

#### A. INCOME TAX THEORY

Classical economic theory discourages high levels of taxation that it views as a disincentive to hard work and entrepreneurship, and thus would encourage supply-side policies.<sup>123</sup> Supply-side policies deal with improving the workings of the markets and the economy's capacity to produce, and are aimed at enabling the economy to expand without inflation.<sup>124</sup> At the heart of classical economic theory is the belief in a free market economy as being the most important factor in fueling economic growth, so that any tax levied by a government should be kept to an absolute minimum. In addition, classical theory has no role for income redistribution.<sup>125</sup> In the 20th century, taxes have been used as a tool for redistributing income and wealth, because large disparities have arisen under the free market system.<sup>126</sup> Adam Smith asserted as the rationale behind such redistributive policies that men are essentially equal but for circumstances,<sup>127</sup> although Smith would likely be turning in his grave if he was aware of the levels that governmental intervention have achieved. In recent years, redistribution has become somewhat less of a concern for governments: the level of distortion and economic inefficiency resulting from redistributive policies is less attractive to government and harder for the electorate to swallow.<sup>128</sup> Taxes are also used as a tool by governments to manage the economy, encourage economic stability, international competitiveness, economic growth, and development in general.<sup>129</sup>

Tax expenditure analysis focuses on every departure from a normative base as either a tax expenditure or a subsidy. Aside from Bittker, most scholars accept without question that the tax exemption accorded to the nonprofit sector is a subsidy. William D. Andrews posed the question of "whether the provision can intelligently be seen as reflecting a refinement

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123. See, e.g., Edmund S. Phelps, *Taxation of Wage Income for Economic Justice*, 87 Q. J. of Econ. 331-354 (1973); A COMPANION TO THE HISTORY OF ECONOMIC THOUGHT 122-126 (Warren J. Samuels et al. eds., 2003).

124. See Robert E. Lucas, Jr., *Supply-Side Economics: An Analytical Review*, Oxford Econ. Papers, New Series, Vol. 42, No. 2, Apr. 1990, at 293-316.

125. See A.B. Atkinson, *Bringing Income Distribution in from the Cold*, ECON. J., Mar. 1997, at 297-321.

126. William R. Johnson, *Income Redistribution in a Federal System*, 73 AM. ECON. REV. 570-573 (1988).

127. John W. Danford, *Adam Smith, Equality, and the Wealth of Sympathy*, AM. J. OF POL. SCI. Vol. 24, No. 4, Nov. 1980, at 674-695.

128. See, e.g., Erich Weede, *Income Inequality, Democracy and Growth Reconsidered*, EUR. J. OF POL. ECON., Vol. 13, Issue 4, Dec. 1997, at 751-764.

129. Eric M. Engen & Jonathan S. Skinner, *Taxation and Economic Growth* (Nat'l Bureau of Econ. Research, Working Paper No. W5826, 1996), available at <http://ssrn.com/abstract=225613>.

in our notion of an ideal. . . income tax, rather than a departure from it.”<sup>130</sup> If not, then and only then can a provision be considered and evaluated as a tax expenditure, according to Andrews.<sup>131</sup> This approach requires examining the object and purpose of the income tax itself, as well as of the provision. The express stated object of the non-charitable non-profit exemption is unknown. It is likely that the Provision is aimed at encouraging socially desirable behavior, rather than merely encouraging a certain legal form of entity to exist.<sup>132</sup> The purpose of the income tax must also be explored. Many state the primary purpose of the income tax to be a revenue-raising device for the federal government, with secondary purposes being the encouragement of economic development and social redistribution. Some theorists do not see the income tax in quite this light: they view it not as a tax on income per se, but rather as one on,

aggregate personal consumption and accumulation of real goods and services and claims thereto—the uses to which income is typically put rather than the sources from which it is derived. . . [I]t is consistent with the primary, intended, real effect of the tax, which is to reduce private consumption and accumulation in order to free resources for public use. The practical operating base on which the tax is computed consists of income transactions, but the ultimate object of the tax is to lay a uniform graduated burden on aggregate consumption and accumulation.<sup>133</sup>

Since the income tax exists to effect social policy goals through tax expenditures, amongst other methods, income tax theory could state many reasons why a provision which gives a special preference should exist in a taxing statute. But in this case, the design and delivery of the Provision has become disconnected with any underlying purpose. The design of the Provision has the effect of encouraging a particular form of organization with a non-distribution constraint and operational compliance with stated

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130. William D. Andrews, *Personal Deductions in An Ideal Income Tax*, 86 HARV. L. REV. 309, 312 (1972).

131. *See id.*; Bittker, *supra* note 121, at 928 (“Implicit in the reference is the idea that the income tax has an essential integrity; that there is a fundamental standard for determining the tax base and the applicable rates; that maintenance of the standard (restoration where it has been eroded) is important to society, high on its scale of values; that the proponent of a measure which deviates—which creates a preference—has a burden of proof which goes as much to the use of the tax system as the means of accomplishment as to the measure’s specific social or economic objective.”).

132. *See e.g.*, Ontario Law Reform Commission, Report on the Law of Charities (1996), [http://www.mtroial.ca/wcm/groups/public/documents/pdf/npr03\\_lawcharities.pdf](http://www.mtroial.ca/wcm/groups/public/documents/pdf/npr03_lawcharities.pdf); Duff, *supra* note 60, at 64 (“Since the subsidy is designed to support only activities having a public benefit, however, it is reasonable to require eligible recipients to devote all of their resources to these activities, or related activities for the purpose of activities having a public benefit, and to deny or revoke eligibility to organizations engaging in other activities that are either detrimental to the public good or carried on primarily for private advantage. In order to ensure public accountability for these tax expenditures, it seems reasonable to enforce these requirements by regular audits and to require public reporting of revenues and disbursements by eligible recipients.”).

133. Andrews, *supra* note 130, at 313.

goals.<sup>134</sup> There is no requirement that these goals advance a social good, or any other social policy. It does not advance a coherent, directed goal. Rather, it overshoots its likely target of encouraging socially desirable behaviors, with the result that it cannot be said to advance a social policy that society would want to support. It would be reasonable to connect the benefit that society wishes to derive from the Provision to the qualifying requirements for receiving the benefit of the Provision, but that connection does not exist. As a result, the effect of the Provision cannot be said to be a redistribution of wealth to benefit society as whole, but rather to create a potential inefficiency which must be re-evaluated.

#### IX. CONCLUSION

Non-charitable nonprofit entities may earn income as the concept is understood under Canadian tax law, as liability to taxation arises from being a 'person' under the Income Tax Act who earns profit from an office, employment, business, or property source. Non-charitable nonprofit organizations are "persons" under the law, and therefore their earnings, as long as they fit within the listed sources, will be considered "income"; there is no distinction made in determining the character of income based on the character of the earner. As a result, the exemption from taxation that these entities enjoy by virtue of the Provision is a special preference, a tax expenditure. Tax expenditures are used to advance social policy, as the privilege of being excused from common burdens comes with a price. The Provision, as a tax expenditure, must be evaluated to determine if it does effect the likely goals it was meant to achieve, and whether the indirect spending done through this tax subsidy is effective.

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134. The requirements of ITA § 149(1)(l) are technical and relate only to form (club, society, or association) giving no personal benefit to owner/members and broad purpose (any purpose other than profit). By having no other requirement for qualification, it cannot be said to encourage anything but what it requires. See also Robert B. Hayhoe, *An Updated Introduction to the Taxation of Nonprofit Organizations*, *PHILANTHROPIST*, Vol. 18, No. 2 (2004).



# I

## GRADING A REVOLUTION: 100 YEARS OF MEXICAN LAND REFORM

*William D. Signet\**

### ABSTRACT

*As Mexico celebrates the centennial of its Revolution and the bi-centennial of its Independence, its chief historical objective—the distribution and use of land for economic betterment and social justice—is assessed in this article. Mexico offers a paradox: Almost half of its territory is held by a communal form of agrarian organization called the ejido, and foreigners are expressly limited in the ways they may own land. Yet, for most of the last 100 years the country has been considered an economically attractive and legally secure haven for private investment in real property. Furthermore, although the ejido has been a dismal failure in terms of economic production and the betterment of its individual members, the reforms that created it are considered by some to have been successful, and will be cause for celebration this year. This article represents one of the few attempts to present the last 100 years of Mexican land reform from a legal point of view, that is, by a careful and coherent analysis of the legislation that preceded, occurred during, and was enacted after the Mexican Revolution. The author's conclusion is that Mexican land reform can be seen as successful only from a political point of view, in that through artful drafting and the exercise of great political acumen, the leaders who emerged from Mexico's Revolution were able to absorb and redirect the energies of its more radical factions, and attain decades of political stability and relative social harmony, albeit it at the cost of institutionalizing rural poverty.*

In 2010, Mexico will celebrate the centennial of the two most significant events in its history. Two hundred years ago,<sup>1</sup> beneath the night skies of the central plateau, Miguel Hidalgo stepped before his parish church and made a short but effective speech, in which he conveyed his heartfelt sentiment that the *gachupin* should die along with his 300 years

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1. September 16, 1810, is officially celebrated as Mexico's Day of Independence.

of colonial rule.<sup>2</sup> One hundred years ago,<sup>3</sup> Francisco Madero, representing his compatriots' impatience with the perennial presidential administrations of an octogenarian Porfirio Diaz,<sup>4</sup> initiated a Revolution into which his own presidency would quickly be swallowed.

This article assesses the motivation and legacy of the Mexican Revolution in terms of its most important issue, which was the place of land in the everyday life of the average citizen. If results can be measured by raw statistics, the Mexican Revolution led to a fundamental change in the nation's ownership of real property, and even in the legal regime by which property is owned and used. The Revolution ushered in a century which finally saw ownership over half the nation's surface area held by roughly 28,000 communal *ejidos* (eh-HEE-dos), in whose precincts the typical attributes of the free marketplace—the ability to buy, sell, lease, and mortgage land—were banned. Private ownership over strategic resources, like oil and other hydrocarbons, was constitutionally prohibited. No private person could own more land than closely prescribed limits allowed. Until recently, corporations could own no farmland at all. No one can argue that the Mexican Revolution was not revolutionary.

Against these results, on the other hand, can be juxtaposed a strange and often contradictory reality. Mexican elites today seem just fine with their homes in the cities and their hobby farms in the countryside. For foreign real estate investors, in particular, Mexico seems to be run on the same basis as most other capitalist countries.<sup>5</sup> Investors buy, sell, mortgage, and lease land in the free market for offices, factories, hotels, and shopping centers with a legal security that must be satisfactory—if the results now available are any indication. In the sixteen years in which private investors have been able to bring claims for discriminatory or unfair behavior against the three signatories of the North American Free Trade Agreement (NAFTA), not a single claim against Mexico based upon unfair deprivation of land ownership has even been arbitrated, much less won.<sup>6</sup> The two most important restraints on foreign ownership

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2. Although ethnically Spanish himself, Hidalgo used the disrespectful reference of *gachupin* to native-born Spaniards in the famous *grito* commemorated each year:

“My children: A new dispensation comes to us today. Will you receive it? Will you free yourselves? Will you recover the lands stolen three hundred years ago from your forefathers by the hated Spaniards? We must act at once. . . Will you not defend your religion and your rights as true patriots? Long live our Lady of Guadalupe! Death to bad government! Death to the *gachupines*.”[translation by author].

3. November 20, 1910, officially marks the outbreak of the Mexican Revolution.

4. Porfirio Diaz was elected president of Mexico from 1876 to 1880, and, beginning in 1884, was reelected in successive terms of office (the last one, 1910, is disputed) until his abdication and exile in 1911 (*see* discussion *infra*).

5. “Mexico stands out as a paragon of political stability within contemporary Latin America.” Peter H. Smith, *Mexico Since 1946: Dynamics of An Authoritarian Regime*, MEXICO SINCE INDEPENDENCE 321 (1991).

6. An authoritative compilation of claims brought against Mexico, that also contains the text of all pleadings, is found in the website of the Mexican Secretaria de la Economia [Secretariat of the Economy]; *see* Investor-State Dispute Settlement, Secretaria de la Economia, in [http://www.economia.gob.mx/swb/en/economia/p\\_](http://www.economia.gob.mx/swb/en/economia/p_)

of real property—the requirement that the foreigner agree to the “Calvo Clause” and the prohibition against direct ownership of land in the “Restricted Zone” (see discussion below)—are largely symbolic.

Similarly, the radical changes ushered in by the Revolution have not created a picture of prosperity in the countryside. Since 1940, a year that can be seen as the high watermark in the development of Mexico’s “social sector,” agricultural production on the *ejido*, as a share of the nation’s total, has consistently fallen.<sup>7</sup> From 1960 on, growth fell dangerously behind that of the population.<sup>8</sup> By 1980, the culture that had first perfected the cultivation of corn was not producing enough corn to feed itself.<sup>9</sup> The *ejido* began to depopulate. By the end of the Twentieth Century, the mean age of the total rural Mexican population was below the age of twenty; the mean age of the *ejido* population, on the other hand, was fifty-two.<sup>10</sup>

There are reasons for these discrepancies, these “disconnections,” between the nominal and the real changes brought about by one hundred years of land reform, and chief among them is that the reforms stare back far beyond the year 1910 both in terms of inspiration and political purpose. It is not just that the “land question” dominated the political history of both Mexican centuries. Land reform in the second century of Mexico’s existence was consciously perceived as a second chance to establish and implement the failed policies of the first, to “hit the reset button,” so to speak, on all the pertinent legislation of the pre-Revolutionary period. In so doing, the legislation that would shape land tenure and use in the Twentieth Century would owe more to the quaint notions of a by-gone era than the realities of the modern world. With all the complexities and challenges of 20th century life—the shift of economic activity to industrial and technological processes, the migration to the cities, the ascent of the financial industry, the inter-connectedness of the world economy—the Revolutionaries’ vision of the future could still be reduced to the phrase—to borrow from the American vernacular—“forty acres and a mule”<sup>11</sup>—only the Mexican *peon* received far less than forty acres, and was never given a mule. As a result, a policy designed to provide millions

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solucion\_controversias\_inversionista (last visited July 14, 2010). According to the author’s analysis, only four claims have involved the ownership of real property: Billy Joe Adams et al. (2000), Lomas de Santa Fe (2001), Calmark Commercial Development, Inc. (2002), and Robert J. Frank (2002), none of which have proceeded to arbitration.

7. By 1960, fifty percent of agricultural farmland accounted for four percent of total agricultural output, see *Auge y Crisis Agropecuario*, Secretariat of Agrarian Reform, <http://207.249.24.51/sraweb/conoce-la-sra/historia/auge-y-crisis-agropecuaria/> (last visited July 11, 2010).

8. *Id.*

9. *Id.*

10. Klaus Deininger & Fabrizio Bresciani, *Mexico’s Ejido Reforms: Their Impact on The Functioning of Factor Markets and Land Access* 3 (2001) available at <http://ageconsearch.umn.edu/handle/20519>.

11. A popular phrase originating from the temporary military orders issued by General William T. Sherman in which 400,000 acres of expropriated land in South Carolina, Georgia, and Florida would be redistributed among freed slaves.

of Mexicans with the articles of bare subsistence did not accomplish even that dubious end. Today, the great majority of the 28,000 *ejidos* that wind across Mexico's central plateau or its empty coastlines are archipelagos of poverty sustained by electronic remittances from men in other places.<sup>12</sup>

This assessment of land reform in the second century of Mexico's existence quite properly begins in its first century.

## I. 200 YEARS AGO

### A. FALSE START

The first decades of Mexico's nationhood were undeniably rocky for several reasons. Mexico's unfortunate presence in the path of its northern neighbor's westward expansion must be considered one of them, but not all of its initial problems can be blamed on external circumstances. Mexico's difficulties resided in the very nature and meaning of its independence, in the fact that many Mexicans who succeeded the Spaniards in power in 1821 did not really envision a break from the cultural and economic conditions of its colonial past. It is also possible they had no vision at all. The picture we may have of New World sons rising against the father country, eager to shake off the outworn strictures of an old and discredited order, is an attractive one. In this image, the colonial rebel is at least an unruly and assertive teenager, if not altogether considered a patricide. America's War of Independence would fit this form. It would be called a Revolutionary War (something other wars of independence, including Mexico's, would never be called) precisely because of the conscious decision to turn from old forms of government to new.

In the Spanish colonies of the early Nineteenth Century, by contrast, the "new" was not happening in Mexico City but in Madrid. It was the old Spanish parents who were becoming peculiar and getting crazy with the family car, threatening to make the kids not patricides but orphans. It was not only French troops and a French (Corsican really) king that had slipped into Madrid by 1810. Also sloshing across the Pyrenees (and perhaps of greater concern to the flame-keepers of Spanish orthodoxy) were the Enlightenment ideas of the previous century, most notably, a certain willingness to question the absolute nature of monarchical authority, and even the temporal if not spiritual authority of the Roman Catholic Church.

In a series of political and military maneuvers beginning in 1808, Napoleon forced the abdication of Spain's Bourbon king, Carlos IV, and the confinement of his heir, Ferdinand, in favor of his brother, Joseph Bonaparte. With Napoleon's fortunes descending steadily thereafter, Ferdinand's restoration (as Ferdinand VII) was universally accepted by 1813,

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12. *Money remitted by undocumented Mexican workers in the United States to Mexico in 2008 was reported to have exceeded 25 billion U.S. dollars.* Caen 11.88% Los Envíos de Remesas a México, *EL ECONOMISTA*, Feb. 27, 2009, available at <http://eleconomista.com.mx/notas-online/finanzas/2009/02/27/caen-49-envios-remesas-mexico>.

and he ruled Spain from 1814 until his death in 1833. Nevertheless, a certain Enlightenment seed, this one political, had taken root in Spanish soil.<sup>13</sup> The decade of the 1810's in Spain would be marked by an uneasy relationship between Liberals espousing restraints on absolute rule, and a monarch inclined to resist them. While, back in Mexico, the *criollos*<sup>14</sup> found some of the French ideas interesting, their exact political reaction at the crucial times (at the beginning of the insurrection and the end) was reactionary and conservative. In 1810, the year of Hidalgo's *grito*, the *criollos* (and obviously churchmen) responded to a Bonaparte-led Spain as a usurpation and broached the heady possibility of power descending to the "people" (meaning them) pending the restoration of the legitimate monarch.<sup>15</sup> In 1821, the year of Agustín Iturbide's triumphal march into the capital of a newly-independent Mexico, *criollos* would again rally to the cause of the same Spanish monarch, this time in support of his resistance to the reinstatement of the 1812 Constitution.<sup>16</sup>

In terms of several misguided policies and personal demeanor, Ferdinand might have filled the role of George III of England in relation to Mexico's independence, but with a huge exception: In the case of Mexico, he was supported, not rejected, as the symbol of *ancien regime* orthodoxy, spiritually and temporally. If legitimate monarchs were no longer welcome in Europe, they would be welcomed in Mexico.<sup>17</sup> Upon their final victory over Spanish troops in 1821, the *criollos* offered the "Empire of Mexico" to Ferdinand VII and three others of his royal line. When they declined, Agustín Iturbide, the *criollo* officer who had spent most of the preceding decade decimating the insurrectionists, but who was now their

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13. An example would be those legislators meeting in the city of Cadiz in 1812 who would adopt a form of constitutional monarchy *a la española*; see *The Political Constitution of the Spanish Monarchy*, Biblioteca Valenciana Digital, [http://www.cervantesvirtual.com/servlet/SirveObras/c1812/12159396448091522976624/p0000001.htm#I\\_2](http://www.cervantesvirtual.com/servlet/SirveObras/c1812/12159396448091522976624/p0000001.htm#I_2).
  14. *Criollo* (akin to *creole*) as used in Mexican history refers to the Mexican-born progeny of Spanish colonists, who maintained a relatively privileged position in Mexican society, both economically and socially. The word *peninsular* refers to a colonist born in Spain (*i.e.* the Iberian Peninsula).
  15. MICHAEL C. MEYER ET AL., *THE COURSE OF MEXICAN HISTORY* 265 (7th ed. 1998).
  16. The 1812 Liberal Constitution of Cadiz (*see supra* note 13) was abolished by Ferdinand upon his restoration, and it was the attempt to restore it in 1820 that provoked both Ferdinand and his loyal colonists. This "paradox" of Mexican Independence is noted in ENRIQUE KRAUZE, *MEXICO: BIOGRAPHY OF POWER, A HISTORY OF MODERN MEXICO, 1810-1996* 121 (1997).
  17. The "Treaty of Cordoba" between Agustín Iturbide, leader of the *criollos*, and Juan O'Donoju, the Spanish captain-general, in August of 1821, provided for Spain's recognition of the "Empire of Mexico" and for its imperial throne to be offered first to four specific candidates of the Spanish royal dynasty; only in the event of their refusal would the future emperor be selected by the Mexican congress. See LESLIE BETHELL, *MEXICO SINCE INDEPENDENCE* 2 (1991). The appetite for a constitutional monarchy survived Spain's later rejection of the treaty (Spain would not recognize Mexico's independence for fifteen more years) and Iturbide was crowned emperor on July 21, 1822.

leader, took the title upon himself.<sup>18</sup> In its first half-century as a nation, Mexicans would waste precious time trying to figure out who they wanted to be. In rough terms, their choices were either to continue the Old World model with some improvised link to the remaining Catholic dynasties of Europe, from which a suitable Bourbon or Hapsburg might become available, or to adopt, or better put, adapt to the New World model of presidents, legislatures, and judiciaries, similar to the American model whose success was beginning to attract the world's interest.

The catastrophe inflicted upon Mexico during that time was exacerbated by the failure to choose either. It is telling that the national chief executives at either end of this period were not called presidents but emperors: Iturbide (1822-1823), and Maximilian I (1864-1867). Though the leaders between these two imperial bookends might be called "presidents," the tenuous nature of their leadership, as well as their lack of wholeheartedness in embracing a republican form of government, is illustrated by their sheer number. Between 1824 and 1855, forty-seven presidential administrations held office, each lasting an average of about eight months.<sup>19</sup> Rebellions erupted in Texas and, soon thereafter, in Yucatan,<sup>20</sup> Guadalajara, Oaxaca, San Luis Potosi, Sonora, New Mexico, and Tampico.<sup>21</sup> It is hardly surprising that the Mexico of that day, whose territory extended all the way to the northern border of today's State of California, would tempt the territorial ambitions of other powers. In 1839, France invaded,<sup>22</sup> but was unsuccessful. In 1846, the United States invaded, more successfully. Only six Mexican states—Jalisco, Michoacan, Guanajuato, Queretaro, San Luis, Aguascalientes—and the Federal District, itself, came to Mexico's defense with men and revenues.<sup>23</sup>

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18. *Id.* at 4-5. Hidalgo's *grito* in 1810 had unleashed a popular campaign of murder and vengeance against the peninsular Spaniards then living in Mexico, sufficiently horrifying his fellow *criollos*, that the initial movement was brought to a quick end. Hidalgo was captured in Chihuahua in 1811, tried by his fellow clerics as a heretic, and executed. The Insurrection continued sporadically for the following ten years, led primarily by Vicente Guerrero, who was able to use the natural protection of the southern mountains to his advantage (the same protection that would be used by Emiliano Zapata 100 years later). Agustin Iturbide, a *criollo* assigned to lead loyalist troops, had successfully repressed the insurrection (with the notable exception of Guerrero), but towards the end (1820), saw that his better opportunity lay in forging an alliance with Guerrero and kicking the Spaniards out, based on a program—the "Plan of Iguala"—of loyalty to the Roman Catholic Church, independence from Spain, and legal equality between peninsular Spaniards and Mexicans. Upon victory, there were factions (epitomized by Masonic associations in Mexico City) that desired a republican form of government, but they were outweighed by those still favoring the monarch as the head of state.

19. See MARIANO CUEVAS, *HISTORIA DE LA IGLESIA EN MEXICO* 243-46 (6th ed. 1992).

20. Christon I. Archer, *Fashioning a New Nation*, in *OXFORD HISTORY OF MEXICO* 333 (2000).

21. CUEVAS, *supra* note 19, at 246.

22. *Id.*

23. *Id.* at 248.

## B. THE ARMIES OF REFORM (1855-1867)

The catastrophe that had been inflicted upon Mexico was due in part to the stubbornness of a political and economic establishment unwilling to acknowledge or accept the new forces at work in the Western world. It also smoothed the way for members of the next generation of Mexicans to take power in the 1850s. This generation was known as the *reformistas*, or Reformers. Its most honored hero, Benito Juarez, occupies a place in the Mexican political pantheon similar to Lincoln's: Both came from humble backgrounds and were contemporaries.

The Reformers represented the arrival in Mexico of Nineteenth Century liberal and bourgeois economic and political ideas.<sup>24</sup> In the political sphere, it meant the adoption of democratic and republican systems of government, especially as formulated in the United States. In the economic sphere, it meant freer markets, freedom to contract, and *laissez-faire*. In the social sphere, it largely meant the eradication of the privileges and entrenched power and influence of the old elites, in particular, the Roman Catholic Church.<sup>25</sup>

The Church seemed to embody everything the Reformers did not like about the old antiquated order, and its perceived abuses constituted a short list of what they wanted to change. First, the Reformers still identified land ownership as the main engine of economic prosperity; if the Church was still the dominant landowner in Mexico, scrutiny of its role and performance was unavoidable, and in this regard it came up short in the Reformers' eyes.<sup>26</sup> The instrument for the perpetuation of ecclesiastical landholding had been, for centuries, and in various countries, the "company sole," that is, the one-man corporation, a non-personal legal entity owned by one shareholder (*e.g.*, bishop) who held shares in a representative capacity, thus allowing ownership to survive death. To those who still equated agriculture with economic progress, and economic progress with individual initiative fueled by capital in search of profit, Church ownership seemed particularly retrograde.

Since medieval times, the Church's propensity to hold land interminably had become to be viewed as a "dead hand" holding back progress, hence the name *mortmain*.<sup>27</sup> It was this lack of mobility (what a modern real estate broker might call lack of "turnover" or "frozen market") that the Reformers cited as the official reason for some of their most important legislation, discussed below.<sup>28</sup>

24. Paul Vanderwood, *Betterment for Whom? The Reform Period: 1855-1875*, in OXFORD HISTORY OF MEXICO 371 (2000).

25. Friedrich Katz, *The Liberal Republic and the Porfiriato*, in MEXICO SINCE INDEPENDENCE 50 (1991); *see also* Vanderwood, *supra* note 24, at 371.

26. Katz, *supra* note 25, at 50. The Roman Church may have also been viewed unfavorably by the Reformers because of its supposed friction or disfavor with the mainly Protestant beliefs of the immigrant farmers it was trying to attract. *Id.*

27. "Mortmain," CATHOLIC ENCYCLOPEDIA (1913), available at <http://www.newadvent.org/cathen/10579a.htm>.

28. The preamble to the "Lerdo Law" cited "the lack of movement or free circulation of a great part of real property, the fundamental basis of public wealth," as "one of

But it was not just for its perceived inefficiencies as an agribusiness that the Catholic Church became the favored political target of the Enlightenment Liberals in Mexico. To the Reformers, it did not seem possible to dispose of the secular leaders of the *ancien regime* without also taking aim at the organization that seemed woven into its warp and woof. Their Jeffersonian vision, in which power and resources were distributed among the free and industrious citizens of a striving and growing country, seemed at odds with the reality before them in which millions of faithful peasants kneeled in humble obeisance before the local priest. It would not be enough to strip the Church of its lands. It would be necessary to strip its hold upon the Mexican mind. Or so they reasoned.

In their first year in power, the Reformers attacked the Church at the point of its greatest temporal strength, its ownership of land.<sup>29</sup> Named after the Reformer's first president, the "Lerdo Law,"<sup>30</sup> as it came to be called, required "civil" and "ecclesiastical" companies to divest all non-essential lands immediately and without exception. The law's putative aim was to place divested lands in the hands of their working tenants, for a price equal to paid rents capitalized at the rate of six percent per annum.<sup>31</sup> Anticipating that existing tenants, emotionally tied to the Church or to the communal interests of their community, would not immediately appreciate what was deemed good for them, the tenants' right of first refusal would expire in three months, whereupon civil authorities could intervene directly to sell the property, in the following order of preference: to any sub-tenant, then to any whistleblower who alerted the authorities to the violation, and then to the highest bidder at auction.<sup>32</sup> Lands that had no tenants would be sold immediately to the highest bidder, and as in the case of rented land, if the owner dragged his feet in selling, civil authorities would intervene to sell the land at auction, with eight percent of the proceeds going to the whistleblower.<sup>33</sup> The only properties exempt from forced sale were properties used exclusively for spiritual or educational purposes, like churches, convents, and schools.<sup>34</sup>

Another provision allowed purchasers of larger tracts to immediately subdivide them into lots they could immediately resell, provided the lots would remain encumbered by a master lien until the master note was repaid in full.<sup>35</sup> This provision greatly facilitated financing by land specu-

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the greatest obstacles to the prosperity and development of the Nation." [author's translation].

29. Katz, *supra* note 25, at 49.

30. Decree of June 25, 1856, "On the divestment of rural and urban tracts administered as owners by civil and ecclesiastical companies of the Republic." *LEY DE DESAMORTIZACIÓN DE BIENES DE CORPORACIONES CIVILES Y ECLESIASTICAS [LEY LERDO]*, 28 de junio de 1856, available at [http://www.biblioteca.tv/artman2/publish/1856\\_149/Ley\\_Lerdo\\_Ley\\_de\\_desamortizaci\\_n\\_de\\_bienes\\_de\\_la\\_i\\_247.shtml](http://www.biblioteca.tv/artman2/publish/1856_149/Ley_Lerdo_Ley_de_desamortizaci_n_de_bienes_de_la_i_247.shtml).

31. *Id.* art. 1.

32. *Id.* art. 10.

33. *Id.* arts. 5, 11.

34. *Id.* art. 8.

35. *Id.* art. 22.



lators and developers. The text of the Lerdo Law targeted not just “ecclesiastical corporations” (*corporaciones eclesiasticas*) but “civil corporations” (*corporaciones civiles*) as well. There was some confusion, even at the time, as to what a civil corporation was intended to include, but, in political terms, the phrase targeted the communal organizations in which indigenous communities still held and farmed property, despite three centuries of steady encroachments by the *peninsulares* and their progeny.

In the early Sixteenth Century, Hernan Cortes came upon one of the largest populations in the world,<sup>36</sup> much of it organized around local and familiar units sometimes called *calpulis*.<sup>37</sup> The various forms of the indigenous’ own social and economic organization were legally recognized in terms of a “Republic<sup>38</sup> of Indians” (as opposed to a “Republic of Spaniards”).<sup>39</sup> To these *calpulis*<sup>40</sup> and “indigenous communities” the Spaniards would add additional layers of social and economic arrangements, displaying varying degrees of communal, cooperative, or corporate organization that reflected their evolving interests and needs. From their own country they would emulate and transplant the ejido,<sup>41</sup> a Latin-

36. Placed by some estimates as high as twenty-five million. See MICHAEL R. HAINES & RICHARD HALL STECKEL, *POPULATION HISTORY OF NORTH AMERICA* 257 (1987).

37. Margarita Carbo, *De la Republica de Indios a la Corporacion Civil*, *REVISTA ELECTRONICA DE GEOGRAFIA Y CIENCIAS SOCIALES, UNIVERSIDAD DE BARCELONA*, Vol. X, num. 218 (73), Aug. 1, 2006, available at [http://www.ub.es/geocrit/sn/sn-218-73.htm#\\_edn4](http://www.ub.es/geocrit/sn/sn-218-73.htm#_edn4).

38. A better translation of *republica de los indios* might be a “legal regime applicable to the Indians (or indigenous peoples).”

39. The Spanish theoretical tolerance of existing social organizations was not all altruistic; they recognized the benefit of leaving in place a successful food-producing community already accustomed to tribute. See Carbo, *supra* note 37.

40. The term is Aztec (*nahuatl*) and refers to the village unit within the administrative and tributary system, which the arriving Spaniards sometimes referred to as *barrio*. The landholding regime of the *calpuli* would be repeated in later manifestations in that some land (*calpulalli*) was allotted to families but only in usufruct which could be transferred only by inheritance, and with the condition that it be worked continuously; other lands (*altepetalli*) were assigned for the communal benefit and working of the community. See *El Antecedente Lejano del Ejido*, Secretariat of Agrarian Reform, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/el-antecedente-lejano-del-ejido/> (last visited July 10, 2010). This division between individual parcels with limited rights, and common-area lands, would be extended into the landholding system of the Colonial administration—the so-called Republica de los Indios—the individual usufructs taking the name of “*tierras de comun repartimiento*” and the common lands taking the name *proprios* or *fundo legal*. The numerous title documents assigned to these various categories by the Colonial administration became the legal basis for agrarian claims in succeeding centuries. See *Creacion de las Republicas de Indios*, Secretariat of Agrarian Reform, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/creacion-de-las-republicas-de-indios/> (last visited July 10, 2010). The same basic division between parcels enjoyed by individual members in usufruct, with limited rights of transfer, and the common areas used to support the community, was carried through into modern ejido legislation.

41. A word probably originating from the Latin that described the open lands for common use located just outside (hence *exitum*) of the towns of medieval Europe. “Ejido” Dictionary.com <http://dictionary.reference.com/browse/ejido> (last visited July 20, 2010).

derived name referring to common lands normally adjunct to the city and often used for common pasturage. Later, in the course of reorganizing colonial administration, and assimilating indigenous society to the rest of civil society, the indigenous communities would be rolled into the new municipal governments, or *ayuntamientos*, into which the country was intended to be organized.<sup>42</sup>

By the Reform Era, the term “civil corporation” had become a reference to these indigenous communities, but the extent was not clear.<sup>43</sup> At any rate, by virtue of the Lerdo Law, indigenous communal land was not expropriated to the same degree as church land. In the first six months in which the Lerdo Law took effect, \$3 million of communal land was sold, in comparison with \$20 million of church land.<sup>44</sup> After centuries of encroachment by Spanish hacienda owners, attrition caused by the Spaniards’ various manpower programs,<sup>45</sup> and disease, indigenous communities were spared by their own typical remoteness, and the low economic desirability of their holdings. Thirty years later, indigenous communities would be severely disrupted by the land programs of the Diaz administration, discussed below, but the legal pretext would shift from the appropriation of lands held by “civil corporations,” to the presumed privatization of lands presumably belonging to no one (*terrenos baldios*).<sup>46</sup>

Largely congregated in the middle sections of the country, the *ejido*<sup>47</sup> represented a form of land ownership and economic organization at odds with the new liberal economic model, a model that depended on companies, and individuals, acting in their own best interests and, therefore, requiring sufficient personal freedom to do so. In the tens of thousands of small communities that stretched from Zacatecas to Veracruz, the Reformers saw what we might today call “individual initiative” buried in an old-world culture that the Reformers, themselves, considered worth burying.<sup>48</sup> Like the neo-liberal reformers of our own age who saw privatiza-

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42. Carbo, *supra* note 37 (referring to the Constitution of Cadiz of 1812).

43. Jennie Purnell, *Popular Resistance to the Privatization of Communal Lands in 19th Century Michoacan*, Paper presented to the 19th International Congress of the Latin American Studies Association, Washington, D.C., Sept. 28-30, 1995, available at <http://lanic.utexas.edu/project/lasa95/purnell.html>.

44. MEYER ET AL., *supra* note 15, at 360.

45. The *encomienda*, followed by the *repartimiento*, were the two best-known programs implemented primarily to provide low-cost labor to arriving colonists. See generally MEYER ET AL., *supra* note 15, at 159-161.

46. Purnell, *supra* note 43.

47. While *ejido* is only one of several names given to the indigenous’ social and economic organizations during the Colonial Period, and is a Spanish word, in the remainder of this article it will be used generally to refer to indigenous (and later *mestizo* or mixed) local populations who farmed either communally or in family parcels in which the family was entitled to retain and in many case inherit the usufruct. In these communities, the concept of fee simple ownership was not fully developed. Individual parcels remained within the community. By the 1920’s, the word *ejido* began to be used more specifically as a result of agrarian legislation (see discussion *infra*).

48. *Colonizar y Desamortizar*, Secretariat of Agrarian Reform, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/colonizar-y-desamortizar/> (last visited July 10, 2010).

tion of government-run companies as the key to economic betterment, the liberal reformers of the mid-19th century saw the breakup of ecclesiastical and communal land tenure as the necessary precursor of modern Mexican society.<sup>49</sup>

Finally, to ensure that the Church and the “civil corporations” representing communal landowners did not reemerge as an economic force, article 25 of the Lerdo Law, and article 27 of the new Mexican Constitution of 1857,<sup>50</sup> stripped them of even their legal capacity to own or administer real property, other than (in the case of church corporations) the properties used directly for religious purposes. Without legal capacity, the *ejidos* were greatly handicapped in their ability to seek legal redress for alleged illegal expropriations of their property, a large impediment that would be noted in the major legislation of the Mexican Revolution, discussed below.

In hindsight, the Reformers’ direct challenge to ecclesiastical and civil landholding failed on several levels. First, it did not adequately provide for the realization of its ostensible objective, which was to put land in the hands of tenants and workers who could not afford to buy it.<sup>51</sup> The Reform-era legislation did not provide impoverished land tenants or *ejido* members with any means of financing. This omission stands in stark contrast with the ample financing that would be extended to foreign colonists in the following century. Even when tenants were able to purchase their lots, they were often preyed upon by alliances of local government and large estate owners, who complicated their lives through devices like denial of water rights, and extremely high tax assessments.<sup>52</sup> Whether tenants existed or not, most land passed into auction where money determined ownership. Many upper and middle class Mexicans boycotted the land auctions on religious grounds. The remaining bidders, who ultimately acquired most of the former lands of the Church and the *ejidos*, were land speculators and large landholding companies, hardly an emerging class of Jeffersonian farmers.<sup>53</sup>

The Reformers’ direct assault on Church ownership of land was also a political miscalculation of the first order. Many Mexicans viewed the legislation (probably correctly) as an attack on the Church’s role in Mexican culture, not on its possible shortcomings as an efficient farming organization. In addition, the forced divestiture of millions of hectares of real property did not seem compatible with what liberal political beliefs or

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49. Katz, *supra* note 25, at 50.

50. CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA MEXICANA DE 1857, 12 DE FEBRERO DE 1857 art. 27 (Mex.) (“No civil or ecclesiastical corporation, whatever its character, denomination or purpose, shall have legal capacity to acquire real property in ownership or its own administration, with the sole exception of buildings used directly and immediately in the service or for the purposes of the institution.”).

51. Katz, *supra* note 25, at 51.

52. STEPHEN H. HABER ET AL., THE POLITICS OF PROPERTY RIGHTS: POLITICAL INSTABILITY, CREDIBLE COMMITMENTS, AND ECONOMIC GROWTH IN MEXICO 295-96 (2003).

53. Katz, *supra* note 25, at 50-51.

laissez-faire capitalism supposedly stood for. Despite having passed a new Constitution that textually was a model of Nineteenth Century Liberalism, the Reformers, developed a reputation for being heavy-handed in the administration of civil liberties.

Almost immediately upon the adoption of Mexico's second constitution (1857), the country plunged into new internecine strife.<sup>54</sup> New life was breathed into the hopes of Mexican conservatives still pining for the old school monarchy. Ironically, their pleas were finally heard not by the Spanish, but by the French, and not by a Bourbon but a Bonaparte. With the help of French Emperor Napoleon III, a suitable Hapsburg was located (though one supposes that the term "royal headhunter" would not have been used to describe the firm that found him), and "Maximilian I," as he was now called, was installed in Mexico City with the help of French troops, a development that put the Reformers on the run, and plunged the country into further years of civil war. The situation soon became absurd. It had not dawned on the most reactionary and conservative members of Mexican society that Europe had moved on and was no longer living in the Eighteenth Century, and to the conservatives' growing horror, Maximilian appeared to have some rather progressive ideas of his own.<sup>55</sup> Maximilian's brief reign ended—and with it, any further European pretensions in Mexico—before a firing squad in 1867, bringing years of civil conflict to an end. In those years, however, the Reformists would age, and their political perceptions would harden even further.

Finally, the Reform Laws of the 1850's were probably wrong in their own underlying assumptions. The Reformers were at least fifty years behind the times in their understanding of the new economic forces then at

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54. The conflict can be more properly divided into:

"War of the Reforms," 1857-1861: Essentially a civil war between the Reformers and the Conservatives provoked by the former's strong anticlerical legislation, the liberal character of the 1857 Constitution (the second of Mexico's three distinct constitutions), and perceptions of the heavy-handed manner in which the Reformist government, ironically, was suppressing civil liberties. Benito Juarez would assume the presidency in 1858, and served until 1871, although his effective hold on power was interrupted by the French intervention.

"War of the French Intervention," 1861-1867. Ostensibly, an intervention by France, England, and Germany to force Juarez to retract his disavowal of foreign debts. It might also be seen as a new attempt by the defeated Conservatives to remove the Reformers, by supporting Napoleon III's appointment of Maximilian, a Hapsburg, to rule Mexico. Maximilian's reign would be short-lived. The Conservatives' support of Maximilian ebbed as signs of his own liberal tendencies became clear. After the U.S. Civil War, the U.S. clearly began throwing its weight behind Juarez, consistent with the Monroe Doctrine. Abandoned by the European powers, Maximilian was captured near Queretaro and executed on orders of Juarez, who wished to make the point that European powers, especially the French, should stay out of Mexico. The French would do so from that point forward. Nevertheless, the well meaning but naïve Hapsburg, with his charming wife, Carlota, won a permanent place in the romantic mythology of Mexico.

55. MEYER ET AL., *supra* note 15, at 374-377.

work in the world. Like Jefferson, they imagined land as the fundamental store of economic value and its cultivation as the fundamental engine of economic growth.<sup>56</sup> But this concept was already disintegrating even when Jefferson was thinking about it. By the 1850's, the growing irrelevance of land tenure in a world being transformed by the Industrial Revolution should have been noticed by the Reformers. Instead, by investing all their political capital in stripping ownership from the most powerful political forces in Mexico, the Reformers may have squandered a prime opportunity to bring Mexico into the 19th century, while preserving domestic tranquility. This observation would not be lost on Porfirio Diaz.

### C. THE "ONE INDISPENSABLE LEADER" (1876-1910)

Jose de la Cruz Porfirio Diaz was a young Reformer general whose political ambitions were fulfilled when he became president in 1876. Re-elected again in 1884, he occupied perennial terms of office until his abdication and exile in 1911. His era in Mexico is named "the Porfiriato."<sup>57</sup> To his country he provided an entrée into the Industrial Revolution and new international respect. By offering his countrymen a clear, practical choice between the "carrot or the stick," he gave them three decades of peace and order, and finally, through malice or benign neglect, he engineered the conditions that would lead to the Revolution. Public revenues and the national currency stabilized. It was an era for the building of rails and telegraph, the erection of *belle époque* monuments along the *Paseo de la Reforma*, and the development of a nascent oil industry.<sup>58</sup> Relations with the Catholic Church, though not widely advertised, began to improve.<sup>59</sup> Foreign investment was lured by generous tax exemptions and subsidies.<sup>60</sup> In 1884, a radical change in the centuries-old rule allotting sub-surface minerals to the sovereign spurred foreign investment in the extractive industries.<sup>61</sup> At the outbreak of revolution in 1910, foreign investment stood at about \$2 billion, half of which came from the United States, and was concentrated in railroads, mining, and oil.<sup>62</sup>

Diaz was a man of his times; he could spin the intellectual attitudes of Liberalism, and the social theories opportunistically appropriated from Darwin's recently published theories, in ways that allowed the strong to prosper and the weak to serve. In this, he collaborated closely with a like-minded group styling itself the *cientificos*, or scientists, who could be counted upon to drape any policy, no matter how depredatory, in the velveteen of fashionable intellectual theory. The chief luminary of the

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56. Katz, *supra* note 25, at 49-51.

57. See generally BENJAMIN KEEN & KEITH HAYNES, *A HISTORY OF LATIN AMERICA* 248-252 (2008).

58. *Id.* at 250.

59. *Id.* at 248.

60. *Id.* at 250.

61. *Id.*

62. ROBERT RYAL MILLER, *MEXICO: A HISTORY* 267 (1985).

*cientificos*, Jose I. Limantour, who became Diaz' Finance Minister, permitted himself to say things like "liberty constituted a privilege of the select; the weak would have to yield to superior men."<sup>63</sup> Diaz found it politically possible to tell a foreign reporter that "the indigenous, who are more than half of our population, care little for politics . . . They are accustomed to look to those in authority for leadership instead of thinking for themselves."<sup>64</sup> Such attitudes towards the weakest segments of the population may have been shared by their counterparts in Washington, D.C., London, Paris, or Berlin. The problem with Mexican leaders thinking this way was that the classes against whom this attitude was directed constituted a majority of the populace. The attitude could not last long in a nominal democracy, and it did not.

As stated above, with the help of the Lerdo Law, millions of hectares of productive farmland, much of it in the more fertile southern and central parts of the country, had fallen into the hands of speculators and large individual and corporate landowners.<sup>65</sup> The *porfiristas*, coming a bit later in the century, could turn their attention to privatizing the vast tracts of lands that were still public, especially those in the large and relatively empty states of the north, such as Sonora, Chihuahua, Tamaulipas and Coahuila.<sup>66</sup> For the ostensible purpose of colonizing the frontier through smallholding, much of it coming through immigration and colonization, a new version of the Vacant Lands Law<sup>67</sup> was enacted, followed by the Law of Occupation and Disposal of Vacant Lands.<sup>68</sup>

The rather military and sinister sound of the words "occupation and disposal" was appropriate. The less populated parts of Mexico were not, of course, completely unpopulated; they had been occupied for centuries by local people, or the remnants of those who had been dispersed during the Conquest. And it was not that such occupation took place with no legal basis whatsoever, but ownership often lacked the kind of documentary support that stood out in a courtroom. While the ostensible purpose of the laws was to privatize vacant public lands,<sup>69</sup> the machinery devised to implement the laws was strongly tilted in favor of resolving almost any legal irregularity in that direction. A surveying company (often foreign-owned) would survey a given region and determine which lands were "va-

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63. *Id.* at 266.

64. James Creelman, *President Diaz, Hero of the Americas*, in *THE MEXICO READER: HISTORY, CULTURE, POLITICS* 285, 289 (2003).

65. Marcelo Bitar, *La Vida Economica en Mexico de 1824 a 1867*, Escuela Nacional de la Economia de UNAM 149 (Mex., 1964).

66. *Deslinde y Acaparamiento: El Reino de la Hacienda*, SECRETARIA DE LA REFORMA AGRARIA, Mar. 23, 2009, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/deslinde-y-acaparamiento-el-reino-de-la-hacienda-2/>.

67. Ley de Terrenos Baldios [Vacant Lands Law], Diario Oficial de la Federacion [D.O.], 22 de Julio de 1863 (Mex.).

68. Ley de Ocupacion y Enajenacion de Terrenos Baldios [Law of Occupation and Disposal of Vacant Lands], Diario Oficial de la Federacion [D.O.] 26 de marzo de 1894 (Mex.).

69. *Terrenos baldios*, referring to a category of publicly-owned lands still recognized today that have not been marked or staked.

cant,” hence federally owned.<sup>70</sup> The surveying company would receive, in compensation, one-third of the land thus demarcated, giving rise to a monumental conflict of interest aggravated by the fact that few indigenous or small farmers could adequately prove their titles in modern legal terms.<sup>71</sup> The remaining two-thirds of the surveyed lands would be sold cheaply to wealthy and politically favored individuals and companies, most of who continued as absentee owners.<sup>72</sup> The former tenants would be incorporated into the new *latifundia* through debt peonage, or sometimes, like Yaqui and Mayo Indians living in the northwestern state of Sonora, they were shipped to the Yucatan peninsula and “contracted out” as laborers on henequen plantations.<sup>73</sup>

According to the Mexican government’s own statistics, between 1883 and 1910, fifty surveying companies staked out fifty-nine million hectares of lands purportedly in the public domain (about thirty percent of the entire national territory).<sup>74</sup> In compensation, they received twenty-one million hectares, or about ten percent of the entire national territory.<sup>75</sup> The remaining forty-two million acres (twenty percent of the national territory) were conveyed by the nation mainly to *hacendados*, mining companies, and rail companies.<sup>76</sup>

The disparity in landholding among *hacendados* and companies, on the one hand, and the millions of rural *peones*, on the other, became uninged. One-fifth of one percent of the total number of private landowners owned eighty-seven percent of the private land.<sup>77</sup> Of the forty-two million hectares of “vacant land” delivered to the nation through staking, ninety percent was ceded to twelve individuals.<sup>78</sup> Of a total Mexican population of 15.3 million in 1910, 11,000 persons and fifty surveying companies controlled fifty-four percent of the national territory.<sup>79</sup>

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70. KEEN & HAYNES, *supra* note 57, at 249.

71. *Id.*

72. *Id.*

73. Miller, *supra* note 62, at 267.

74. *Deslinde y Acaparamiento*, *supra* note 66. The roughly 59 million hectares cited by this governmental source resulted from the “surveying” activities conducted in the largely unpopulated northern states and along the Pacific Coast. In addition, 13.4 million hectares were confiscated from agrarian communities predominantly in the central part of the country as the result of private formal complaints (*denuncias*) in which the agrarian communities were unable to adequately document their titles, and their long-held lands were formally adjudicated (*adjudicados*) as “vacant,” creating a groundswell of peasant anger that would erupt in the Revolution, and become represented to a large degree by the zapatistas. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

79. Modesto Aguilar Alvarado, *La Política Agraria de los Gobiernos Nacionales y de Sinaloa de 1920 a 1940*, 6 CILLO 22, 61 (1998).

## II. 100 YEARS AGO

## A. REVOLUTION (1910-1917)

In the aftermath of the era of reform and the Porfiriato, there would emerge an array of political sensibilities towards the land that would eventually ripen into the public policies of the Revolution and beyond. By 1910, much of the populace had become alarmed if not disgusted by the extreme concentration of landholding and the retrograde social conditions it fostered. But different opinions were held as to the possible solutions.

Those who still believed in the ability of the indigenous and *mestizo* poor (most of Mexico's population) to operate within the market system wanted to reprise the original smallholder strategy of the 1850's Reformers (that is, the Jeffersonian vision in which land is widely held by individual and independent farmers in fee simple). But, to avoid the obvious mistakes made by the Reformers, land would be given directly to poor communities only after some preparation. It would be their land, but collectively only for a suitable time period. Eventually, it would convert to parceling and private, individual smallholding. This position made its way into the legal texts of the Revolution, as we shall see below.

Other Mexicans considered smallholding a suitable goal only for the more progressive elements (middle and upper classes) of Mexican society as well as foreign colonists. In this view, the needs of the agrarian underclass were "special," a euphemism that means insoluble, and their economic interests should be permanently and specially protected. As we shall also see below, this position became the de facto policy underlying Mexican legislation for most of the 20th century, although perhaps not consciously phrased in the same manner.

Others saw the agrarian problem as the domain of the legal system, a matter of restoring legal ownership over properties that had been taken wrongfully through the preceding decades. For them, the answer lay in perfecting existing procedural processes in which individual rights could be individually vindicated by creation of special agrarian tribunals or restoring to *ejidos* the legal capacity to sue. This program, too, found its way into the texts of the Revolutionary era.

Still others saw the merit of simply giving subsistence land to the poor, not based on a conventional legal pretext, but for reasons of political expediency, or a more radical agrarian ideology, or simple human compassion.

Some of these sensibilities were commingled, probably incompatibly, in the same person. Emiliano Zapata, for example, lobbied passionately for the restitution of legal titles—a policy that depended on the improvement, not abandonment, of the prevailing legal system. In many cases, he and his followers oversaw the wholesale redistribution of land from the rich to the poor—a result that required a discrete lack of concern for the rule of



law.<sup>80</sup>

In 1908, a seventy-seven year old Porfirio Diaz told a foreign journalist that he would not run again in 1910.<sup>81</sup> The news was digested by the local populace, who greeted it warmly and with high expectations for political change. But, not only did Diaz decide to stay in the race, he became particularly heavy handed in the manner in which he suppressed the opposition. His younger rival, Francisco Madero, was forced to spend election-day in a San Luis Potosi jail. This time, the electorate did not accept more business as usual from the now octogenarian leader. Diaz survived the election but his legitimacy did not. Madero escaped to San Antonio, Texas, where he organized an armed protest that quickly gained traction. Within four months, Diaz and Madero negotiated the terms of transfer. Diaz left Mexico for good, and died in Paris.

Madero, for his part, was a conciliator in an age that called for firmer action. He allowed a Diaz ally to serve as interim president for five more months, perhaps out of kindness,<sup>82</sup> and, even upon assuming the presidency, he allowed most of Diaz's ministers and hand-picked members of the legislature to remain in office. Despite Madero's vindication, Mexico's democratic institutions had botched it. Unable to maintain his credibility with the more whole-hearted revolutionaries of the day<sup>83</sup> or control the *porfirista* leaders he had allowed to stay in power, Madero's brief tenure came to an end before a firing squad arranged for him by his trusted general, Victoriano Huerta.<sup>84</sup>

Huerta proved so odious to all remaining factions of the Revolution—and, indeed, finally, to the administration of Woodrow Wilson<sup>85</sup>—that they began to develop a framework for ending it. In the northern state of Chihuahua, Doroteo Aranda, a quick-witted and charismatic muleteer

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80. The political platform of the Zapatistas became known as the "Plan of Ayala."

81. Creelman, *supra* note 64, at 231, 242.

82. This leniency, in the face of apparent victory, provoked severe criticism at the time, particularly by Venustiano Carranza, who became Madero's eventual political heir. One indication that Madero might not have been the man to keep the country together was the fact that, amidst the tumult of 1911, he found the time to write and publish the *Spiritualist's Manual* in which he assumed the name of Bhima, the second of the Pandava brothers in the Sanskrit epic, the *Mahabharata*. KRAUZE, *supra* note 16, at 343. The biographical similarities between Bhima and Madero will be instantly obvious to all readers of this article, but, just in case, Bhima also suffered exile (Madero in San Antonio and New Orleans), but later came back to successfully challenge and kill King Jarashanda. *See id.* Unfortunately for Madero, other comparisons were not so apposite: While Bhima would survive a trap laid by the treacherous Hidimba, and live to achieve great exploits, Madero would not survive the similar treachery practiced by Victoriano Huerta. *See* Creelman, *supra* note 64.

83. John Womack, Jr., *The Mexican Revolution, in MEXICO SINCE INDEPENDENCE* 134 (1991). By November 1912, "disgusted with the government's academic attitude towards 'the agrarian question,' the Morelos peasant chiefs under Zapata formally denounced Madero, proclaiming in their Plan of Ayala a national campaign to return land from haciendas to villages." *Id.* at 136.

84. *See* Creelman, *supra* note 64.

85. Womack, *supra* note 83, at 144. (Womack suggests U.S.-British rivalry as the primary cause of the rupture with Huerta).

who adopted the name, “Pancho Villa,” exploited the modern benefits of rail transportation, U.S. arms, and German cavalry maneuvers to thrash Huerta’s forces along the central rail axis. In the south, his ally Emiliano Zapata secured and held the mountainous terrain of the states of Morelos and Guerrero.

But another significant faction of leadership also emerged, represented by less interesting but more practical Venustiano Carranza who, like Madero, came from a prosperous northern family.<sup>86</sup> Carranza became the “First Chief” of the loose and shifting factions who initially united against Huerta, and who had significant success (particularly Villa) doing so. As the end game came into view, a split emerged between the Cadres led by Villa and Zapata, who we might call the “Conventionists” (named for their convention in Aguascalientes in which their rival plan, and government, was announced), and the self-described “Constitutionalists” led by Carranza.

It is of continuing importance to us today to understand the nature of the two sides battling for the soul of the Mexican nation in the concluding years of the Mexican Revolution, less than 100 years ago. To a certain degree, the Constitutionalists and Conventionists mirrored the two approaches in the larger world to the fundamental issues of labor rights and the distribution of wealth in the first half of the 20th century. In one corner—epitomized by the Conventionists in the person of Emiliano Zapata—were those who no longer trusted the various models of economic liberalism or institutions of bourgeois political democracy.<sup>87</sup> They came to regard the instruments of such power, like federal *apparatchiks* living in a distant capital city, or a judicial system applying Westernized concepts of real estate law, as the protectors and perpetrators of a rigged system that would inevitably crush them. They favored a new model that would distribute land on broad based moral and social grounds rather than strictly legal ones and that would see political power flowing downhill and away from a centralized federal government in Mexico City.<sup>88</sup>

In the other corner were the Constitutionalists, whose leaders, like Carranza and his ally Alvaro Obregon, were drawn from the big northern states and the bourgeoisie that had prospered in the Porfiriato. There is no doubt that these men were repelled by the excesses of the Porfirian

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86. In fact, men of almost identical backgrounds dominated the federal government in the post-revolutionary era. They were almost all from the big northern states, and mostly from prosperous families whose interests included extensive cattle-ranching and farming: Francisco Madero, 1911-1913 (assassinated in office), from Coahuila; Venustiano Carranza, 1916-1920 (assassinated in office), from Coahuila; Adolfo de la Huerta, 1920 (interim president after Carranza’s assassination), from Sonora; Alvaro Obregon, 1920-1924, from Sonora; Plutarco Elias Calles, 1924-1928, from Sonora; Emilio Portes Gil (interim president after assassination of Obregon before taking office, and resigned from office), 1928-1930, from Tamaulipas; Pascual Ortiz Rubio, 1930-1932, from Michoacan; Abelardo Rodriguez, 1932-1934, from Sonora.

87. Womack, *supra* note 83, at 142.

88. The point should be reiterated, however, that Zapata continued to attach importance to the vindication of conventional legal rights to land.

age, and fought for a wholesale change in the economic and social conditions of the country. They did so, however, as the reformers, not destroyers, of an existing political model.

Intense fighting occurred between the Conventionist and Constitutionalist forces for the last half of 1914 and the first half of 1915.<sup>89</sup> With the country's raw mood and manpower favoring Zapata and Villa, the Constitutionalists' eventual victory could only have been gained by drawing upon another resource, one that was not necessarily present in other countries of that era that were undergoing the same political distortions and one that still characterizes the rather unique politics of the country to this day. That resource was the superb political acumen of its leadership class. To provide only one of several examples, Villa and Zapata represented what might be called the Agrarian Revolutionaries, but there was still a vital revolutionary component of unionized and highly radicalized workers in Mexico City and in some of the industrial areas lying to its east that had never joined the Villistas and Zapatistas' military or culture. The *Casa del Obrero Mundial* (World Worker's House), one of the most radical of the unions, claimed 100,000 members.<sup>90</sup> They were far more citified than their agrarian comrades, their leaders faced eastward, towards Europe, for political inspiration, and, as a result, they labeled themselves "anarchists" and decked their meeting halls with the red and black of that international movement.<sup>91</sup> Nevertheless, it was the Constitutionalists, whom the trade unionists could easily have mocked as hideously bourgeois, not Zapata or Villa, that enlisted their active support. In a display of ideological suppleness that has marked Mexico's ruling class ever since, Obregon not only talked the anarchists into his own camp, he inspired them to fight Villa under the direction of his own officers.<sup>92</sup> The so-called "Red Battalions" moved into the broad central plateau of the Bajío, and, with the help of American machine guns and German military advisors, turned back Villa's far more experienced troops at Celaya, Leon, and Aguascalientes. While Villa's and Zapata's influence was never erased—they would retain their political and symbolic influence in the revolutionary movement for years to come—it was the Constitutionalists who ran the machinery of government from that point forward.

The same political calculus that allowed the Constitutionalists to make strange bedfellows of the anarchical trade unionists, now compelled Carranza to adopt the radical agrarian planks of the Zapatistas' agrarian platform—at least temporarily, and to the extent his own instincts would allow him to do so.<sup>93</sup> Carranza was a practical man from the northern state of

89. CHARLES CURTIS CUMBERLAND, *MEXICAN REVOLUTION: THE CONSTITUTIONALIST YEARS 186-87* (1972).

90. Womack, *supra* note 83, at 156.

91. *Id.* (One of which was the House of Blue Tiles (now Sanborn's Restaurant), occupying the corner next to the Fine Arts Palace in Mexico City).

92. *Id.* at 161.

93. Carranza's lack of natural sympathies for the more radical agrarians are shown in the words of one of his most significant speeches: "Once the armed struggle . . . is completed, Mexico will have to embark upon the formidable and majestic task of

Coahuila, himself a substantial landowner. His natural sympathies inclined him more towards the Reformers of the 1850's and their liberal Constitution of 1857 (still operative until 1917).<sup>94</sup> In his view, the Reformers were not wrong to have broken up the civil corporations by which *ejidal* farming was carried out in communal fashion or to facilitate the colonization and private ownership of public lands. Their error, according to Carranza, was in their implementation, specifically the manner in which the divested land had bypassed the poor communities involved, and had gone directly to speculators, the wealthy, and foreigners. The Carranzista policy taking shape by the year 1915 would hold that the wrongs perpetrated in the name of economic and political liberalism in the preceding sixty years should be undone, and the dials reset to the year 1857. This time, however, the land would be directly placed into the hands of the intended beneficiaries, who happened to include many Zapatistas.

#### B. LAW OF JANUARY 6, 1915

Carranza's political turn to the Zapatistas was embodied in his Law of January 6, 1915.<sup>95</sup> The law was officially incorporated by name into the most important land articles of the 1917 Constitution. It is the quintessential piece of Carranza legislation as much for its political artfulness as for its artifice. It facilitated the Constitutionalists' survival and eventual triumph. In so doing, it established the pattern and technique of political governance during the Revolutionary and post-Revolutionary periods.

Its preamble began with a *mea culpa* for the misdirected legislation of the *Reformistas*: "[U]nder the pretext of complying with the [Lerdo Law], and other regulations ordering the division and conversion to private property," it began, "communal lands that were granted to the Agrarian population by the colonial government were seized," and, instead of such lands being sold to "the neighbors of the villages to which they belonged," they "came into the hands of so many speculators."<sup>96</sup> Lamented as well was the seizure of other lands that had, perhaps, never been legally owned by their inhabitants in the strictest sense, but that had "originated with a family or families in common possession of tracts . . . that continued undivided for generations."<sup>97</sup> Both types of seizures, it was claimed, had been made under the pretext of the "laws [of the Re-

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the social struggle—the class struggle, *whether we ourselves like it or not . . .*" Speech by Venustiano Carranza, quoted in KRAUZE, *supra* note 16, at 343 (emphasis added).

94. Carranza's father had loaned money to Juarez during some of the latter's darker hours, and Juarez occupied a place at the apex of the Carranza family political pantheon. *See id.* at 335.

95. Ley de Dotaciones y Restituciones de 6 de enero de 1915 [Law of Endowment and Restitution of Lands and Waters], reproduced in JULIO CUADROS CALDAS, *CATECISMO AGRARIO* 7 (1999).

96. Law of Endowment and Restitution of Lands and Waters in CALDAS, *supra* note 95, at 7-9.

97. *Id.*

form], . . . or by sales carried out by [the tax authorities], or under the pretext of boundary proceedings, to benefit those who reported excessive holdings, and the so-called surveying companies.”<sup>98</sup> The laws under the prevailing system had “made a mockery” of the ability of aggrieved parties to seek redress. In the case of disenfranchised civil companies, it was because the 1857 Constitution had officially outlawed their legal existence. In the case of the indigenous communities evicted in the wake of the surveying of public lands in the latter part of the 19th century, it was because the legal standing for protecting such communities was cynically entrusted to the very local authorities who were among the primary beneficiaries of the public land grab.

Those who had profited from these injustices had no grounds for protest, the preamble continued: Their initial acquisitions had been “in express violation of such laws, that had only ordered the distribution of communal assets to neighboring peoples, not strangers.” The current owners had no grounds for claiming ownership through adverse possession, because the laws under which they had acquired their properties did not “establish the prescriptive rights with respect to such properties.”

To remedy this situation, restitution through legal proceedings would not be enough because “sales . . . had been made in accordance with the law, or because titles had been lost, or were deficient, or because it was impossible to identify the parcels or fix their boundaries.”<sup>99</sup> In such cases, there would be no other solutions than for the “higher military authorities in each place, after carrying out the necessary expropriations, to give lands to those who needed them . . .”<sup>100</sup>

The final paragraph of the preamble is interesting, and not often remembered: The legislation never intended the *ejido* communal form of land ownership to again become a permanent fixture in the Mexican real estate system, but rather a provisional station on the way to direct fee ownership by members of the indigenous communities. The principle of small land ownership was very much on Carranza’s mind. In carrying out the expropriations and distributions, the Preamble stated, “it was not a matter of bringing back the old communities, nor of creating new, similar ones, but simply of giving such lands to the miserable rural populations who lack them today . . . [O]wnership of such lands shall not belong to the people in common (*a comun*), but rather. . . they shall be partitioned off in full ownership, although with the restrictions necessary to prevent greedy speculators, foreigners in particular, from taking over their ownership, as invariably happened upon the legal distribution of *ejidos*. . . in the aftermath of the [1850’s reforms].”<sup>101</sup>

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98. *Id.*

99. *Id.*

100. *Id.*

101. It appears that Carranza could not bring himself to convey full ownership to the rural poor immediately because he, too, shared the common view of his time that the poor were not prepared for such responsibility: “[A]ll we need to do is to enlighten the people, to teach them—with dedication, with concern and with

Thus, the revolutionary land policy would be based both on restitution (*restitucion*)—a classical legal remedy for the recovery and vindication of legal rights, on a case-by-case basis—and endowment (*dotacion*)—the simple distribution of land to a group of people who may not have the complete means of proving their claims in court but who have nevertheless been injured by past social wrongs, or are simply living in an injured condition. Endowment was intended to be summary, collective, and direct, however, once lands were received by the community in question, future legislation would direct the manner in which they were to be partitioned and conveyed to members of the community in fee simple.

After so sweeping a preamble, one might have expected the Mexican sun to have risen over a new *bolshevik* heaven of mass expropriations (and that was, in fact, its hoped-for impression on many of the Zapatis-tas), but such was not the case. The operative provisions of the law may be summarized as follows:<sup>102</sup>

- The genius of the legislation lay in certain wording that could have given the impression—to those who wanted to hear it this way—that all transfers of property made under the laws of the Reform era were automatically invalidated. A closer reading, however, would establish that the only transactions that might be invalidated were those that could be proven to have taken place “illegally”—and such illegality had to be established on a case-by-case basis within the framework of conventional restitution (*reivindicacion*) proceedings, with the burden of proof squarely on the shoulders of the disenfranchised communities. The new legislation did not establish any new elements on which “illegality” might be based; thus, aside from restoring the communities’ legal standing to bring such actions, the new

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love—how to make sensible legal use of their freedoms, and to guide them until they understand public problems.” See William H. Beezley, *Governor Carranza and the Revolution in Coahuila*, 33 *THE AMERICAS* 1 (1976). The similarity of this language to that of Porfirio Diaz quoted above, and the fact that both were reported in U.S. publications (in other words, where foreigners were the intended audience) is striking.

102. “Article 1. The following are declared null:

I. “All alienations of lands, waters and mountains belonging to the villages, ranches, congregations or communities, made by the political executives, state governors, or any other local authority, in violation of the provisions of the Law of June 25, 1856 and related rules;

II. “All concessions, compositions or sales of lands, waters or mountains made by . . . any . . . federal authority from the first day of December of 1876 until the present, pursuant to which *ejidos*, distributed lands or any other kind of land belonging to villages, ranches, congregations or communities were illegally invaded or occupied;

III. “All judicial boundary determinations [*diligencias de apeo y deslinde*] made during the period of time referenced in the preceding section, pursuant to which *ejidos*, distributed lands or any other kind of land belonging to villages, ranches, congregations or communities were illegally invaded or occupied.” *Constitucion Politica de los Estados Unidos Mexicanos* [Const.], *as amended*, *Diario Oficial de la Federacion* [D.O.], 5 de Febrero de 1917, art. 1 (Mex.).

legislation did not provide them with any particular remedies they did not have before. In essence, it is not exactly revolutionary to tell someone that, if he or she can establish the illegality of a certain transaction under existing law, then that transaction will be invalidated.

- The other category of disenfranchised communities described in the preamble—those who had long occupied their lands but whose legal titles may not have been good enough to vindicate in court—could petition for outright endowment (*dotacion*) of lands necessary for their maintenance. Neither the communities nor the lands are identified.<sup>103</sup> Importantly, the text does not literally require that the lands to be used for endowment be the same lands on which the communities had lived. As the discussion below attempts to explain, this was a significant detail that allowed the large estates to survive almost intact during the following two decades, while communities were endowed with generally inferior public lands.
- Cases for restitution and endowment would be submitted to local governors, with the help of local agrarian boards; the provisional awards made by governors would then be vetted by a new federal agrarian commission.
- On the other hand, private landholders who considered themselves aggrieved by any land decision had the right to bring an action before federal tribunals,<sup>104</sup> whether through ordinary civil proceedings, or by a convoluted federal procedure called *amparo* (see below).
- Future regulations would define the manner in which the new lands would be subdivided and transferred in individual ownership.<sup>105</sup>

By failing to provide any criteria by which illegality might be proved, in the case of restitution proceedings by which a particular community entitled to endowment might be identified, or even by which its entitlement might arise in the first place, and, above all, by placing the entire implementation of the program within the personal discretion of local Agrarian

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103. KRAUZE, *supra* note 16, at 352: “The beneficiaries of the new law were to be the ‘pueblos,’ but the law did not precisely define them. The social fabric of the Mexican countryside included figures that the law ignored: partners owning small ranches, tenant farmers, agricultural peons, laborers living in shanties on the haciendas. Carranza had hoped for the peaceful submission of reality to the law, but violent reality, in many areas, went beyond the law.” See also RAYMOND B. CRAIB, *CARTOGRAPHIC MEXICO: A HISTORY OF STATE FIXATIONS AND FUGITIVE LANDSCAPES* 223 (2004): “Underneath the progressive patina, Carranza’s proclamation elided practical issues of implementation to the degree that one CNA [National Agrarian Commission, part of a new bureaucracy established to hear claims] official recalled that he and his colleagues operated ‘blind.’ Lengthy delays and Byzantine discussions over questions of jurisdiction, the relationship between grants and restitutions, and even the definition of the word ‘ejido’ ensued, leaving CLA [Local Agrarian Commissions] and CNA staff with little to show after a year’s work.”

104. Ley de Dotaciones y Restituciones, art. 10.

105. *Id.* art. 11.

commissions and governors, implementation could not have been made more political and discretionary.<sup>106</sup> Additionally, the legislation was unable to accomplish its announced goals on any wide scale, except in those states already under the control of the agrarian radicals where most lands had already been distributed to the peasantry.<sup>107</sup> In the two years between the Law of January 6, 1915, and the enactment of the new Constitution of February 5, 1917, a "total of nine villages in the entire country were established through the reform."<sup>108</sup> A report later written by the manager of a British-owned oil company would observe of Carranza: "A tendency to conservatism is observable now that the government is . . . not so dependent on the radical military element. Undoubtedly Carranza is doing his utmost to free himself from the extremists . . . You probably know that they returned Don Jose Limantour's properties."<sup>109</sup>

### C. CONSTITUTION OF 1917

By 1917, the Constitutionalist had consolidated power sufficiently to institutionalize their platform in a new constitution, Mexico's third and current one. The essential provisions of land reform were contained in Article 27<sup>110</sup>:

- *Sub-surface minerals.* The first plank of the new land program was to return subsurface minerals, as well as other national resources, to the sovereign (in this case the Nation), a rule that had been in place since the country was owned by the King of Spain, and whose application had only been suspended in 1884<sup>111</sup> to encourage investment by private oil companies. In 1917, the removal of hydrocarbons from the private sector became one of the most successful symbols of national sovereignty and of independence in Mexican politics, then, and since. Nevertheless, little would happen during or in the immediate aftermath of the Revolution to disturb private ownership rights in subsurface minerals and oil deposits. Throughout the 1920s, the United States would successfully lobby the Mexican government to exempt American real estate interests (including below-ground real

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106. CRAIB, *supra* note 103, at 224.

107. According to one source, Zapata's acquiescence in a Carranza-led government was secured by promises that his forces could retain the lands previously seized in the "Zapatista Zone" (states of Morelos and Guerrero). See Jean Meyer, *Revolution and Reconstruction in the 1920s, in MEXICO SINCE INDEPENDENCE* 233 (1991). And, of course, Zapata's acquiescence was further secured by his assassination in 1919 carefully arranged by Carranza supporters. Womack, *supra* note 83, at 188.

108. Womack, *supra* note 83, at 125, 169.

109. *Id.* at 179.

110. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27.

111. A Mining Code (Codigo de Mineria) promulgated on November 22, 1884, implementing authorizing legislation granted in the previous year, gave ownership over minerals in the earth to those who discovered and filed claims upon them (article 3), for an unlimited time as long as the exploitation was continuous (article 4). Private owners could include foreigners (article 6), and private rights were freely transferable (article 7).



estate interests) from the provisions of the 1917 Constitution.<sup>112</sup> In the last years of the Obregon administration (1920-1924), and early years of Calles' (1924-1928), these efforts resulted in "understandings" named after the street in Mexico City where many of the talks were held (Bucareli).<sup>113</sup> Sub-surface mineral ownership would be "grandfathered," that is, rights in place at the time of the Revolution would be respected. Additionally, in 1925, Mexico enacted a Ley del Petroleo (Petroleum Law) that expressly permitted the granting of oil concessions to private companies, even those foreign-owned.<sup>114</sup>

- *Foreign investment in real estate.* Despite all the anti-foreign rhetoric that one may have heard during and after the Revolution, the actual legislation produced in the course of the 20th century that was designed to prohibit, restrict, or limit foreign investment in Mexican real property, per se, was almost non-existent, and largely symbolic. It would be almost entirely contained within the provisions of Article 27 of the 1917 Constitution, and those provisions remain mostly unaltered to the present day.<sup>115</sup> The foreign owner must accept the so-called Calvo Clause under which it agrees to be treated as a Mexican in terms of its investment, and not invoke the protection of his or her home government in the event of a dispute.<sup>116</sup> In practical terms, acceptance of the Calvo Clause has been considered meaningless. The only other restriction on foreign ownership of real estate concerned purchases made in the so-called Restricted Zone, defined as a strip of land 50 kilometers in width along the coastlines, and 100 kilometers in width along Mexico's boundaries with the United States, Guatemala, and Belize.<sup>117</sup> Unlike land in other parts of Mexico where the foreigner's name may appear in the property's title, foreigners' interests in Restricted Zone property used for residential purposes could only take the form of beneficial interests in Mexican trusts in which Mexican financial institutions acted as trustees. Since 1917, the Mexican government has been considered scrupulous in respecting the beneficial rights of foreigners in trusts established to hold residential property in the Restricted Zone, as the survey of NAFTA claims brought against Mexico, referred to earlier in this

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112. On these efforts, *see generally* Meyer, *supra* note 107.

113. *Id.* at 206.

114. Ley reglamentaria del articulo 27 constitucional en el ramo del petroleo [Petroleum Law], *as amended*, Diario Oficial de la Federacion [D.O.] arts. 4 & 5, 26 de Diciembre de 1925 (Mex.). The only condition imposed on foreigners was their consent to the Calvo Clause, and the prohibition of outright ownership of resources by a foreign government.

115. Implemented in the Ley de Inversion Extranjera (Law of Foreign Investment), and refined further by Mexico's undertakings under international treaties and agreements, such as the North American Free Trade Agreement. *See* Ley de Inversion Extranjera [Law of Foreign Investment], *as amended*, Diario Oficial de la Federacion [D.O.], 27 de Diciembre de 1993 (Mex.); North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

116. Constitucion Politica de los Estados Unidos Mexicanos, art. 27, Para. I.

117. *Id.*

commissions and governors, implementation could not have been made more political and discretionary.<sup>116</sup> Additionally, the legislation was un- to invest in the Restricted Zone for commercial purposes to do so as sole shareholders of Mexican corporations taking direct title.<sup>119</sup> Second, in the years immediately following the Revolution, the American government successfully lobbied its Mexican counterpart to pass a new Foreigner Law (*Ley de Extranjeria*)<sup>120</sup> to grandfather the interests of Americans who owned land in the Restricted Zone. Their direct ownership would be respected during their natural lives.

- *Catholic Church.* It seems that the divestiture of Church property in the 19th century did not fully sate the appetite of certain segments of the Mexican population who wanted more. It will be remembered that the 1856 Lerdo Law stripped the Church of lands not deemed essential to its ecclesiastical function. That measure had contributed in large part to ten years of civil war. Arguably, the measure was too radical or could have been implemented more diplomatically, but at least it represented a semi-rational policy at the time. In 1917, by contrast, the goal was to strip the Church even of its churches, nunneries, and schools.<sup>121</sup> Other provisions of the new constitution severely curtailed the political activities of the clergy.<sup>122</sup> All property used for ecclesiastical purposes, including the homes of priests, bishops, nunneries, seminaries, were declared state property, to be used

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118. The author is not aware of a single instance in which beneficial rights in a Mexican trust holding land in the Restricted Zone have been expropriated or threatened based on the holder's nationality.

119. Subject to minimum shareholder requirements imposed on all Mexican corporations; the minimum number of shareholders of a Mexican business corporation (*sociedad anonima*) is two.

120. *Ley de Extranjeria*, Fraccion I del articulo 27 constitucional [Organic Law Article 27 Section 1], *as amended*, Diario Oficial de la Federaci3n [D.O.], 31 de Diciembre de 1925 (Mex.), in CALDAS, *supra* note 95, at 52.

121. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. II (original text, author's translation): "Religious associations called churches [*iglesias*], whatever be their creed, shall in no case have capacity to acquire, possess, or administer real property. . .that which they may have now, directly or through an intermediary, shall become the property of the Nation. . .The bishops' residences, rectories, seminaries, retreats or colleges of religious associations, convents, or any other edifice that may have been built for or for the use of the administration, dissemination of information, or teaching of a religious sect, shall pass henceforth, and in full ownership. To the direct dominion of Nation to be used in public service by the Federation or its respective States."

122. The original article 130 begins with the statement that "the historical principle of the separation of the State and the churches is the basis for the rules set forth in this provision"—a statement curious because the principle had never been particularly well recognized in Mexico. The article really deals with another historical principle, that of free speech and association, or the suppression thereof. The clergy was prohibited from: holding public office; supporting or opposing a political candidate or party; or "opposing the laws of the country." No political association could use a word in its name referring to a religious association (perhaps accounting for why the party currently holding the presidency of Mexico is not called the "Christian Democrats"); and no meeting held for a political purpose could take place in a church.

as governmental offices.<sup>123</sup> This time, the policy served no real social purpose, except, perhaps, the ventilation of personal or political animus.

It would take Mexican legislators almost ten years to implement the anti-clerical provisions of Article 27, and the predictable result would be renewed civil conflict. The Cristero Wars of the 1920s would take tens of thousands of lives, and destroy or dislocate hundreds of thousands more. The Roman Catholic Church would temporarily leave Mexico officially, and deny sacraments. Eventually, the Church would come back. Eventually, Mexican political leaders would once again proclaim their Christianity and belief in God, and the state and Church would achieve a type of co-existence which endures to this day. But political observers would still be left wondering exactly what benefits this innately Catholic nation would derive from the conflict.

- *Ejido creation.* The fourth major thrust of Article 27 was to address the primary issues of agrarian landholding that were part of the major political objectives of the Revolution, discussed above: (i) the need to restore lost lands to the *ejidos*, or to provide them with new ones, and (ii) the breakup of the *latifundia*.

Several paragraphs of the original Article 27<sup>124</sup> appeared to go even further than the Law of January 6, 1915, in making broad, bold proposals for restitution. All transfers of land made pursuant to Reform legislation (specifically, the Lerdo Law) that had deprived communities of their lands, woods, and waters were nullified. But, on closer inspection, the change was not so radical. Lands would be restored “pursuant to the provisions of the Law of January 6, 1915, which will remain in effect as a

123. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. II.

124. The original text of Article 27, subsection VII, paragraph 3, of the 1917 Constitution, reads:

“All proceedings, rulings, resolutions and transactions relative to surveys, concessions, compositions, judgments, transactions, sales or auctions that have deprived, totally or partially, commonly-held lands, hamlets, villages, congregations, tribes, or other bodies of population, that may still exist, from the Law of June 25, 1856, are declared null. . . Accordingly, all the lands, woods and waters from which the foregoing . . . were deprived, shall be restored to them in accordance with the Decree of January 6, 1915, which shall continue in effect as a constitutional law. In the event that, in accordance with such Decree, the award of the lands requested by any of the foregoing bodies is not appropriate, by way of restitution, they shall be given in endowment . . . There shall be as an exception to the aforementioned nullification only those lands titled as the result of distributions made pursuant to the cited Decree of January 6, 1915, or those held in possession in their own name as owner for more than ten years, when the surface area does not exceed 50 hectares. The excess of such surface area shall be returned to the community, indemnifying the owner for its value. . . Only members of the community shall have the right to the distributed lands and the rights to such lands shall be inalienable as long as they remain undivided, as well as rights of ownership, after they have been divided.” *See* *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27.

constitutional law.”<sup>125</sup> The invalidation would not be self-effectuating. It would require that further proceedings be brought successfully by the affected entities.

Other provisions were similarly intended to soften the blow of Revolution upon the thousands of persons who had purchased land—presumably in good faith—under the Reform-era laws.<sup>126</sup> To do this, the Revolutionists blended two policies: (i) the doctrine of adverse possession, to which Mexico had long adhered as a part of the Civil Law tradition, and which could therefore be employed without straining traditional notions of Western justice, and (ii) the still politically viable concept of the smallholder. Those Reform-era landowners who had occupied their lands for more than ten years would be entitled to keep them, but only to the extent of fifty hectares.<sup>127</sup> This part of Article 27 is particularly interesting because it provides the best example of what the Revolutionists (at least the faction that prevailed) really wanted, which was to perfect, not abolish, the laws of the Reform era. Retroactively, through constitutional mandate, lands divested by the Reform-era laws—even if done so illegally—would remain in the hands of the “small farmers” who had presumably worked them. Absentee *latifundists* would be excluded.

Article 27 also carried forward the program, first laid out in the Law of January 6, 1915, of endowing (through *dotacion*) communities which might not be able to prove restitution in the strictest legal sense, “in the event that, pursuant to such Decree [of January 6, 1915], lands [were] not adjudicated as a result of restitution proceedings, they might be given” to the plaintiffs by way of endowment.<sup>128</sup> This language did not address the issues of where the land would come from, or how exactly such endowment would come about, or who would make such decision. Clues must be gleaned from other portions of Article 27, such as the stand-alone paragraph that refers to the land coming from “immediately proximate properties,” always respecting, however, the “rights of small landholding:”

The villages and communities that lack land and water, or who do not have them in quantities sufficient for their needs, shall have the right to be endowed with them, taking them from immediately proximate properties, always respecting the rights of the small landowner.<sup>129</sup>

Finally, it is worth mentioning that the key idea present in the Decree of January 6, 1915, that the communal form of land ownership was only a temporary station on the way to full fee ownership of individual parcels, appears again in Article 27: “Only members of the community shall have

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125. *See id.*

126. *See id.*

127. *See id.*

128. *See id.*

129. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. I (original text, author’s translation).

the right to the distributed lands, and the rights to such lands shall be inalienable as long as they remain undivided, as well as rights of ownership, after they have been divided.”<sup>130</sup> The Carranzista formula was preserved: The communal form of ownership would eventually give way to partition, and subsequent distribution, of parcels to the individual members of the community.

- *Breakup of latifundia.* Article 27 further directed federal and state congresses to enact the legislation by which the “subdivision of large properties would be carried out,” in accordance with the following:
  - Each state jurisdiction would fix the maximum amount of land that one person or legally created company could own within its respective jurisdiction.<sup>131</sup>
  - Most importantly, it would also be the local law that would determine the time period in which over-sized properties must be partitioned, as well as the terms and manner of sale.<sup>132</sup> In case of the landholders’ refusal, the land would be expropriated for a value equal to tax value. The owner would be obligated to accept the purchase price in no fewer than twenty annual installments, receiving five percent interest. If the owner refused to undertake the partition and sale voluntarily, the local government could expropriate them.<sup>133</sup>
- *Limitations on corporate ownership.* Finally, Article 27 limited ownership of rural properties by commercial corporations and banks. Commercial companies could own the lands necessary to carry out industrial and commercial purposes, but could not own land for purposes of agriculture.<sup>134</sup> Banks could make loans secured by property, but could not own more property than that strictly necessary to carry out banking functions.<sup>135</sup>

The Constitution of 1917 has been called a victory for the agrarians and those who wished to restrict the influence of corporations, banks, large landholders, and the Roman Catholic Church. Certainly, there is a textual basis for such statement, but it should not be forgotten that the document also served as a political framework for resolving the conflicts inherent in a broad-based revolution, and thereby adjusted its results to suit the various factions.

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130. *See id.*

131. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. VII(a) (“In each State or Territory there will be established the maximum surface area of land of which a single individual or legally constituted company may be the owner.”) (author’s translation).

132. *Id.* sub-para. (b).

133. *Id.* sub-paras. (c)-(e).

134. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. IV (original text).

135. “The Banks. . . may not own or administer more real property than that strictly necessary for their direct purpose.” *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. V (author’s translation).

For example, although the nullification of all land transfers made as a result of the legislation of the Reform era was ostensibly bold, its effect was considerably tempered by the incorporation of the implementing methodology of the Law of January 6, 1915. The process of restitution became an exceedingly difficult path to pursue, and resulted in very few awards of land during the entire 20th century. Similarly, by letting the restitution questions be decided by local agrarian commissions and the local governor, subject to final review by the Federal Agrarian Board whose makeup was controlled by the president, the pace of endowments would depend very much on the political climate in each state, as well as the political climate in the national capital.<sup>136</sup>

Another example is the paucity of guidance provided on how those *ejidos* who were not able to prove restitution might still be able to receive endowments. At least the 1915 Law had placed decision-making authority with local boards and governors still under revolution. Aside from some vague references to land being taken from “immediately proximate” properties, “always respecting the rights of the small landholder,”<sup>137</sup> the new Constitution provided very little to go on.

Finally, the key issue concerning the breakup of *latifundia* was essentially punted to the states. Each state would determine the maximum size of land that could be held by an individual person or corporation, and even then the owner would have an initial opportunity to partition and sell the excess. As we will see below, that right afforded landowners a crucial opportunity to circumvent the law or mitigate its impact by sales to various entities. The constitutional text did not require that land deemed excessive be used to endow nearby poor communities or *ejidos*; presumably, the excess could be sold to anyone, including family members, associates, or newly created colonies. This is exactly what happened in many cases. Finally, by allowing states to set maximum landholding allowances, most large estates remained intact, because they were located in those states least likely to pass meaningful restrictions.

#### D. AND A MOUSE ISSUES FORTH (1917-1934)

The fifteen years following the new Constitution was a time period that, not coincidentally, encompassed a string of presidential administrations dominated by landowning men from northern states, Sonora in particular.<sup>138</sup> Very little expropriation took place, and even less restitution.

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136. The governors most supportive of agrarian reform included Candido Aguilar in Veracruz, Pascual Ortiz Rubio in Michoacan, Alfonso Cabrera in Puebla, Domingo Arrieta in Durango, and Gustavo Espinosa in Coahuila. See *La Transformación Agraria, Origen, Evolucion, Retos*, Secretariat of Agrarian Reform, 1 SECTOR AGRARIO 41 (1997). On the other hand, the governor of Tamaulipas simply dissolved the local agrarian board. See CRAIB, *supra* note 103, at 224.

137. Constitución Política de los Estados Unidos Mexicanos, art. 27, Para. I.

138. Venustiano Carranza, 1916-1920 (assassinated in office), from Coahuila; Adolfo de la Huerta, 1920 (interim president after Carranza's assassination), from Sonora; Alvaro Obregon, 1920-1924, from Sonora; Plutarco Elias Calles, 1924-1928, from Sonora; Emilio Portes Gil (interim president after assassination of Obregon before

During the Revolutionary decade, only 381,926 hectares would be distributed in all the country, an amount smaller than some *haciendas*.<sup>139</sup> During the first seven presidential administrations following the Revolution, covering about seventeen years, the actual endowments granted by the federal government would look like this:<sup>140</sup>

President	Years served	Hectares
Venustiano Carranza	1915-1920 (assassinated)	381,000
Adolfo de la Huerta	1920	34,000
Alvaro Obregon	1920-1924	971,000
Plutarco Elias Calles	1924-1928	3,088,000
Emilio Portes Gil	1928-1930	1,173,000
Pascual Ortiz Rubio	1930-1932	1,469,000
Abelardo Rodriguez	1932-1934	799,000

Private property was seldom the source of land turned over to *ejidos*.<sup>141</sup> Millions of hectares of publicly owned lands were available and used for such purpose.<sup>142</sup> Included among them were (i) lands taken in foreclosure by the Agrarian Credit Bank of Mexico in the years preceding the Revolution; (ii) the “vacant lands” (*terrenos baldios*) in the original possession of the Nation that had not been marked or staked (such as those that were later surveyed during the Porfiriato); and (iii) national lands, a special legal category of public lands that had been staked (therefore, lands that have been taken out of the vacant category) and were therefore susceptible for conveyance to the public. It is not surprising that agrarian commissions found endowment from these sources the preferred path of least resistance, when compared to the process of seizing excessive landholdings from enraged landowners who were willing to litigate, and who, in some cases, hired their own thugs, called *guardias blancas*, to resist seizures. Landowners were particularly enamored of the Mexican judicial proceeding known as *amparo* that allowed its proponent to challenge the actions of any governmental authority, whether in the executive, judicial, or legislative branch, due to the alleged violation of a constitutional right. With more than 100 articles in the Constitution, it would not require a particularly astute attorney to find at least one constitutional right violated by the state’s action. What was particularly attractive about *amparo* was that the proceeding could be brought in federal court, thus countering the potential disadvantage of bringing the

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taking office, and resigned from office), 1928-1930, from Tamaulipas; Pascual Ortiz Rubio, 1930-1932, from Michoacan; Abelardo Rodriguez, 1932-1934, from Sonora.

139. *La Transformacion Agraria, Origen, Evolucion, Retos*, Secretariat of Agrarian Reform 41 (1997).

140. Octavio Ianni, *El Estado Capitalista en la Epoca de Cardenas*, Serie Popular Era no. 51 (1983).

141. See CRAIB, *supra* note 103, at 252-57.

142. See *id.*

action before the tribunal of a state government that was almost by definition in favor of the seizure, under the mechanisms established in Article 27 and discussed above.

Claims for restitution, as opposed to outright endowment, encountered even more obstacles. Restitution claims greatly complicated the work of the local agrarian commissions, who would much prefer to endow an *ejido* with a defined parcel of public or expropriated land (a process that could literally be concluded in a few months) rather than spend the years and considerable expense involved in patiently listening to the immemorial stories of the local communities, many of whom relied on an oral tradition.<sup>143</sup> To paraphrase Zapata, the boundaries of indigenous parcels seldom ran in straight lines, and it seemed that each zig and zag along a garden wall was based on its own set of legal proofs that each proponent seemingly wanted to vindicate.<sup>144</sup> The lands claimed by restitution often overlapped the lands seized from the haciendas, claimed by the new municipal authorities, or, claimed by neighboring communities.<sup>145</sup> As a result, restitution as the means of fulfilling the policies of the Revolution offered nothing other than psychological satisfaction for the communities themselves. The period up to 1934 produced only 124 successful cases of restitution, involving not even 1.5 million hectares, while in the same period there were over 5,500 distinct *ejidal* endowments of more than 8.5 million hectares.<sup>146</sup>

Thus, while the extreme concentration of private landholding is always mentioned as a leading cause of the Mexican Revolution, or at least as the most notorious example of the worst conditions of the Porfiriato, surprisingly little was actually done about it in the early 20th century. In 1930, estates with more than 1,000 hectares (almost 2,500 acres) still accounted for 83.5% of all rural farmland, and estates with more than 10,000 hectares still controlled more than fifty-five percent of cultivated land.<sup>147</sup> Two million peasants had no land at all.<sup>148</sup> Two-thirds of the great estates remained undisturbed. One eminent historian wrote, “[f]rom absolutely no point of view could it be said that, through the *ejido*, the governments of the era would have proposed to eliminate the

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143. For a thorough and exhaustive description of such tradition, and the ways in which it was brought to bear upon many proceedings to determine and delineate land tenure, see CRAIB, *supra* note 103, at 224.

144. “You engineers sometimes get stuck on straight lines, but the boundary is going to be the stone fence, even if you have to work six months measuring all the ins and outs. . . .” JOHN WOMACK, *ZAPATA AND THE MEXICAN REVOLUTION* 227 (1968) (quoting Zapata).

145. CRAIB, *supra* note 103, at 244-46.

146. Everardo Escarcega Lopez, *El Principio de la Reforma Agraria*, 5 *HISTORIA DE LA CUESTIÓN AGRARIA MEXICANA* 39, 69 (1990).

147. *Las Transformaciones del Cardenismo*, Secretariat of Agrarian Reform, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/las-transformaciones-del-cardenismo/>.

148. Thomas Benjamin, *Rebuilding the Nation*, in *OXFORD HISTORY OF MEXICO* 467, 490 (2000).



great estates.”<sup>149</sup>

Even worse—from the standpoint of the Revolution’s announced objectives—much of the public land distributed during this era, including some of the best, was not given to *ejidos*, but to private entities, primarily those formed to avail themselves of the generous benefits of several new colonization laws. The public lands distributed to *ejidos* were often poor.<sup>150</sup> By 1930, of the 7.6 million hectares that had been distributed, only twenty-three percent were under cultivation.<sup>151</sup> *Ejidors* were in possession of only thirteen percent of total irrigated land.<sup>152</sup> The northern states were also the home states of most of the Mexican presidents of this era, who viewed farmland in an agricultural rather than agrarian light, as the instruments of economic progress rather than social harmony. To increase productivity, it was necessary to achieve scale in farm operations, bring in expertise, and lend money. The first of these goals could be accomplished, at the state level, by generous definitions of small ownership. In addition, new programs promoted mass colonization of both public and private lands, even by foreigners.<sup>153</sup> The Colonization Act,<sup>154</sup> for example, authorized not only the partition and colonization of public lands, but allowed private landowners—perhaps wishing to avoid their excess lands being allotted to an *ejido*—to do so as well. The era also saw new legislation designed to provide agricultural infrastructure and credit. A large portion of these facilities helped larger-scale irrigation and distribution projects in the presidents’ home states.<sup>155</sup>

The *Ley de Bancos Refaccionarios*,<sup>156</sup> a law passed in the early 1920s whose purpose was to facilitate farm credit, did not even mention the words *ejido* or communal farming, and by requiring that bank loans made for the purpose of purchasing seed, machinery, labor, etc., be secured by a mortgage on the property, made it virtually impossible to extend its benefits to communal farmers. The Irrigation Act (*Ley de Irrigacion*), intended to promote infrastructural projects, applied by its own terms ex-

149. LORENZO MEYER, *HISTORIA DE LA REVOLUCION MEXICANA. EL CONFLICTO SOCIAL Y LOS GOBIERNOS DEL MAXIMATO*, VOL. 13 188 (2000).

150. ENRIQUE KRAUZE ET AL., *HISTORIA DE LA REVOLUCION MEXICANA, 1924-1928: LA RECONSTRUCCION ECONOMICA* 117 (1981). The “Ley de Tierra Libre,” or Open Lands Act, enacted August 2, 1923, and suspended in 1926, was a short-lived exception; it extended the right of *all* Mexicans needing land to homestead “empty” or “national” lands not reserved to the Nation.

151. Secretariat of Agrarian Reform, *supra* note 147.

152. *Id.*

153. Alvaro Obregon, president of Mexico from 1920-1924, and from the state of Sonora, would demonstrate a marked preference for endowing colonies (subject to small landholding limits, and owning in fee simple), composed of foreign colonists. From the very richest excess lands expropriated from the Zuluoga hacienda alone, he gave one-half million hectares to Mennonite immigrants, while endowing ejidos in the same state a total of 116,000 hectares in his entire administration. See Lopez, *supra* note 146, at 59.

154. Ley de Colonización [Colonization Act], *Diario Oficial de la Federación* [D.O.], 5 de Abril de 1926 (Mex.) [hereinafter Colonization Act].

155. BETHELL, *supra* note 17, at 238.

156. Ley de Bancos Refaccionarios [Crop Loans Act], *Diario Oficial de la Federación* [D.O.], 29 de Septiembre de 1924 (Mex.).

clusively to private owners.<sup>157</sup>

#### E. THE EJIDO EMERGES

The 1917 Constitution was vague in defining the process by which those *ejidos* that were unable to prove entitlement to land in restitution proceedings might otherwise qualify for endowment. As long as there was vacant or public land to give *ejidos* in the 1920s, precise rules were not necessary. But by the early 1930s, it became increasingly apparent that the aspirations of the populace could only be satisfied from the excess lands held by large estates and *haciendas*.

Despite not much having been done to implement the 1917 Constitutional principles in a concrete way, several key features of an agrarian program did take shape in this period, without which Lazaro Cardenas, who would be elected president in 1934, and who took *ejido* endowment seriously, as we shall see below, would not have been able to accomplish as much as he did. First among these was the Law of *Ejidal* Parcel Estates (*Ley del Patrimonio Parcelario Ejidal*).<sup>158</sup> This act, in particular, established the rules of *ejidal* governance and, even more importantly, the rules governing the State's ability to expropriate private lands to endow *ejidos*. While these rules would be amended from time to time, they served to establish the basic framework for the agrarian program for most the Twentieth Century. They are summarized here.

##### 1. Governance

The basic question of exactly who could collectively benefit from land endowment had been over-answered in the 1917 Constitution, to the point where it was not. The original text of the 1917 Constitution, referring to villages, hamlets, and communities ("*pueblos, rancherías, y comunidades*"), could conceivably encompass any rural life form other than a hermit's cave.<sup>159</sup> While some of these descriptors were excised in subsequent constitutional amendments, and other phrases (like the not very poetic "nucleuses of population") added,<sup>160</sup> the reality remained that qualification was largely a matter of imagination, and therefore discretion.<sup>161</sup>

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157. Ley de Irrigacion [Irrigation Act] Diario Oficial de la Federación [D.O.], 4 de Enero de 1926 (Mex.).

158. Ley del Patrimonio Parcelario Ejidal [Ejidal Parcel Estates Act], Diario Oficial de la Federación [D.O.], 25 de Agosto de 1927 (Mex.) (replacing an earlier law of the same name enacted in 1925 under the same Calles administration).

159. See Constitución Política de los Estados Unidos Mexicanos, art. 27 § VIII(a).

160. *Id.*

161. One of the rare pieces of legislation that excluded places from consideration as recipients of *ejidal* endowments was the Ley de Dotaciones y Restituciones de Tierras y Aguas of March 21, 1929 (Law of Endowment and Restitution of Lands and Waters), whose article 14 excluded (i) the federal or state capitals, (ii) population centers of more than 10,000 inhabitants among whom less than 200 were eligible to receive endowments pursuant to the "agrarian census," (iii) any population center with fewer than twenty such eligible inhabitants, (iv) ports carrying on high-seas traffic, and (v) population centers formed within accredited colonies.

If distinctions were not made in terms of place, some were made in terms of the people who would be considered as members of the *ejido*. Excluded, at least in the early going, were *peones acasillados*, literally house peons, those who worked on haciendas and were normally provided their residences, together with a small garden plot, for free.<sup>162</sup> Perhaps such exclusion was due to the feeling that such persons were not those most in need of material help. Perhaps it was due to the political pressure exerted by *hacendados* who needed their workers. Perhaps it was due to the reality that, prior to the mid-1930s, haciendas had remained intact, and were carrying on business as usual. This exclusion was eliminated in the Cardenas administration.<sup>163</sup>

The governance of *ejidos* was designed mainly to be internal, with the agencies of the federal government involved in a support role to monitor and, in announced cases, certify acts taken by the various internal organs of the *ejido* (e.g., decisions by assemblies).<sup>164</sup> *Ejidos* would be internally governed much like a business corporation: major or organic decisions would be in the hands of *ejido* members, meeting from time to time in assemblies, with the day-to-day affairs and representation of the *ejido* handled by a smaller commission (*comisariado*) elected by the assembly. An agrarian registry was established to permanently record such decisions, as well as significant actions.<sup>165</sup>

*Ejid*os could elect to hold, work, and enjoy all *ejidal* land as truly collective, but few chose this option.<sup>166</sup> Most opted for the mixed regime under which land in the *ejido* would be assigned to one of three general categories: (i) the land dedicated to services benefiting all *ejido* members, like schools, clinics, or meeting halls; (ii) communal agricultural land, usually pastoral; and (iii) agricultural land, usually cultivated, that could be divided into parcels assigned to individual *ejido* members.<sup>167</sup> The *parcelarios* (parcel holders) could hold their parcel for the remainder

162. See Ley de Dotaciones y Restituciones de Tierras y Aguas, art. 14 (IV). This article defined "house peons" as "those individuals who live without charge in a house constructed within the confines of the hacienda. . . and whose means of subsistence habitually depend on the day-wage or salary they may receive for labors related to cultivation." In addition, article 16 of the same legislation excluded certain types of people from receiving *ejidal* parcels: (i) those with existing land greater than the parcel to be given, (ii) those with more than 2,500 pesos in any kind of capital, (iii) federal or state employees, (iv) those earning more than seventy-five pesos per month in salary, or (v) members of the "professions."

163. LRRAN Backgrounder, *Mexico's Land Reform: The Modification of Article 27*, at 24, available at <http://www.landaction.org/gallery/MexicoBack.doc.pdf>.

164. See Constitucion Politica de los Estados Unidos Mexicanos, art. 27 § XI.

165. See JOHN PEYTON DENNIS, *Ejido Property*, in HOW TO BUY REAL ESTATE IN MEXICO 3 (2006), available at <http://www.lawmexico.com/articles/Ejido%20Property.pdf>.

166. The only era in which wholly communal *ejidos* were widely operated was in the 1930s, during the Cardenas administration, an era that corresponded to some of the highest gains in productivity. Commencing in the 1940s, *ejidos* became increasingly parcelized. See BETHELL, *supra* note 17, at 259, 261. This may suggest that agrarian productivity, at least in this case, depended less on individual ownership and more on the whole-hearted backing of the administration in office.

167. *Ejidal Estates Act*, art. 16.

of their lives and, in fact, pass on their rights to their heirs, but did not enjoy typical ownership rights in any other sense. They could not sell, rent, or mortgage their land.<sup>168</sup> If they failed to till their respective parcel for more than one year, their rights could be forfeited.<sup>169</sup> This restriction later became particularly detrimental because it could penalize temporary emigration to the United States.

Both the *ejidos*, collectively, and the *parcelario* with respect to his or her individual parcel, were also prohibited from entering into any contractual arrangement with an outside party, be it the renting of land, or joint cooperative agreements.<sup>170</sup>

The original objective of the January 6, 1915 Act and Article 27 of the Constitution of 1917, making communal ownership a temporary measure on the way to full, fee ownership of land for Mexico's poor farmers, got no further than in this ability to assign certain parcels to individual *ejido* members, and in that ability it was entombed. There would be nothing provisional about the social sector: land would come into it, and never leave.

Perhaps worst of all, the policy makers of the 1920s and 1930s, in determining the amount of land necessary for *ejido* endowment, began to relate the amount of land that should be given to each parcel owner to the amount of income it could generate.<sup>171</sup>

Initially, two days of wages seemed right. At a surface level, the ability to earn two days' of wages in one day had appeal. The problem was that the policy was based on a conception of wages that barely kept people alive, and, in establishing an income floor, it established an income ceiling. To illustrate, if a member was given, say, four hectares (corresponding to the amount of land necessary to produce twice the perceived daily wages), he or she was doomed never to do better, assuming no substantial changes in agricultural productivity—and it is difficult to imagine any increase in productivity in farming four hectares of land, without the benefit of normal financing to purchase machinery or fertilizer, or infrastructure. By 1942, this policy was incorporated into an official program (*unidad de dotacion individual*); the amount given to each member was increased from four to six hectares of irrigated land (1942 amendments to Agrarian Law), and to ten hectares in 1947.<sup>172</sup> Nevertheless, the average parcel was and remains today about five hectares, with about two-thirds of the total campesino population in possession of three

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168. See, e.g., Ejidal Estates Act, art. 20(II).

169. See Ejidal Estates Act, art. 20(V) (one year limit for non-cultivation).

170. *Id.* sub-sections (II) and (III) of art. 20.

171. One law from this period, the Ley de Dotaciones y Restituciones de las Tierras y Aguas, set the following limits on parcel size: 3 to 5 hectares, for irrigated land; 4 to 6 hectares, for land with abundant rainfall; 6 to 10 hectares, for land with scarcer rainfall; up to 24 hectares, in good pastureland for the raising of cattle; and up to 48 hectares for pasturage in arid lands.

172. *Una Nueva Estrategia*, Secretariat of Agrarian Reform, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/una-nueva-estrategia/> (last visited July 11, 2010).

hectares.<sup>173</sup>

Since neither the *ejido*, collectively, nor the *parcelario*, with respect to his or her individual parcel, could mortgage land, an interesting question arose as to how seed and machinery could be procured. Only at certain times would there be a realistic answer to this question. It is to be assumed that no private bank provided loans to *ejido* members or to *ejidos*. Various forms of government-run rural credit banks were established to provide limited credit to *ejidal* farmers, secured by a limited lien upon the crops to be produced.<sup>174</sup> Not surprisingly, the only period in which such schemes achieved even a modicum of success was during the Cardenas administration.

## 2. Expropriable Lands

By the 1930s, the rules were being worked out for determining which private land was susceptible to expropriation to endow *ejidos*. This susceptibility, *i.e.*, vulnerability to expropriation, became coded into the Mexican legal lexicon in the words *afectacion*, or *afectabilidad*, whose correspondence to the English cognates “affection” or “affected,” began to slip away decades ago. For this reason, “expropriability,” though not really English, is used here, with apology. From the 1930s on, private landowners would care mightily whether their parcels were or were not expropriable. The following provides a summary of those rules.

- First and foremost, the legislation of the late 1920s and early 1930s hewed to the original constitutional concept that endowments would come “from immediately proximate properties, always respecting the rights of the small landowner.”<sup>175</sup> The legislation attempted to define the meaning of “immediately proximate property,” and “the small landowner.”

Article 21 of the Ley de Dotaciones y Restituciones de Tierras y Aguas (Law of Endowments and Restitutions of Lands and Waters) defined “proximate estates” (*fincas proximas*) as “those which, whether or not bordering the subject population, has all or part of its lands located within a distance of seven kilometers starting from where the urban zone of the population terminates.”<sup>176</sup> Thus, large estates outside of the seven-kilometer radius were not necessarily expropriable, and their mere ownership (until 1992) was not per se illegal. Additionally, the seven-kilometer rule was interpreted in a manner very favorable to the *hacendados*: the rule did not apply to communities completely enclosed within the boundaries

173. *La Iniciativa*, Secretariat of Agrarian Reform, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/la-iniciativa/> (last visited July 11, 2010).

174. Under the Ley del Patrimonio Ejidal, while liens to secure indebtedness were prohibited upon the *ejido* parcel, itself, indebtedness incurred to provide food to the debtor and his family might be secured by a lien on up to eighty-five percent of the value of the harvested crops. Ejidal Estates Act, art. 21.

175. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. I.

176. *Ley de Dotaciones y Restituciones de Tierras y Aguas*, art. 21.

of an existing *hacienda*.<sup>177</sup>

Although the original Constitution had delegated to the states responsibility for setting small landholder limits, by the late 1920's and early 1930's safe-harbors began creeping into federal legislation, and by 1947 the limits became defined at the federal level by constitutional amendments. The *Ley de Dotaciones y Restituciones de Tierras y Aguas*, cited above, for example, excluded either: (i) some lands that had been distributed under the Lerdo Law, or (ii) up to 50 hectares held under conditions of adverse possession (more than 10 years).<sup>178</sup> That legislation also exempted defined smallholdings based upon the familiar tiered system: 150 hectares for irrigated land, 180 hectares for land with abundant rainfall, etc.<sup>179</sup> The maximum sizes were variable, depending on whether the land was irrigated or depended on rainfall, or on the type of crop grown, or on whether the land was used for crop cultivation or the raising of livestock. The "base rate" to this tiered system, that is, the cap placed on irrigated land used to grow a staple crop like cotton or corn, was set at 100 hectares by the constitutional amendment of 1947, and has not been raised since.<sup>180</sup>

Regardless of the protections afforded by such legislation, the fortunes of large landowners were often determined by the judicial mechanisms available to them to assert or defend rights. Article 10 of the Law of January 6, 1915, discussed above, had given private landowners the right to go to federal tribunals, and to use the *amparo* proceeding, both extremely valuable assets. By the late 1920s, such rights were severely curtailed. A 1932 law amending article 10 now stated that "lands affected by *ejido* endowments or restitutions. . . had no rights or legal recourse either through ordinary [proceedings] or through extraordinary *amparo* [proceedings]."<sup>181</sup> The landholder's sole remedy was to argue the amount of indemnity to be paid for the expropriation before the federal government.<sup>182</sup> Just to spare one from arguing that such a deprivation of due process was unconstitutional, the law was followed by a 1934 amendment to Article 27. The ban effectively stripped landowners of ability to contest expropriation.<sup>183</sup> A 1947 amendment to Article 27 restored *amparo*, but only to litigants whose lands had been certified as compliant, pursuant to a certificate of non-expropriability (*certificado de no afectacion*) issued by what was then called the Agrarian Department (Departamento

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177. Modesto Aguilar Alvarado, *supra* note 79, at 65.

178. *Ley de Dotaciones y Restituciones de Tierras y Aguas*, art. 25.

179. *Id.* art. 26.

180. *Id.* art. 27 § XV. Other examples of maximum limitations are: (i) cotton on irrigated land, 150 hectares; (ii) where the source of water is natural rainfall, the limits corresponding to irrigated lands is doubled; (iii) forestry, 800 hectares; (iv) cattle-raising, the amount of land needed to raise 500 head of cattle, as determined by the local department of the federal agricultural authority.

181. Decreto que reforma el artículo 10 de la Ley Agraria del 6 de enero de 1915 [Decree amending article 10 of the Agrarian Law of January 6, 1915] D.O. Jan. 15, 1932.

182. *Id.*

183. *Constitucion Politica de los Estados Unidos Mexicanos*, art. 27, Para. I.

Agrario).<sup>184</sup>

In addition, smallholding did not always afford a complete guarantee against expropriation. If it was found that the amount of expropriable land within the seven-kilometer radius was insufficient for the needs of the *ejido*, the non-expropriable size of the smallholding could be reduced by one-third.<sup>185</sup> Thus, the owner of, say, eighty acres of irrigated farmland (otherwise within the 100 hectare limit of smallholding) was not completely secure. To the extent a population was recognized within seven kilometers of his or her farm, upon a finding of insufficiency of available land to endow the *ejido*, perhaps only 66 2/3 hectares might remain non-expropriable. Since an *ejido* could theoretically be formed from any nucleus of population, smallholders had no real assurance against expropriation until certificates of non-expropriability became available for such purpose in 1947.

Changes of land use presented another problem because smallholder limits were set according to whether the land was irrigated, whether it grew sugar cane or barley, or whether it was used for pasture, and so on.<sup>186</sup> It soon became apparent that a farmer, who might otherwise wish to boost productivity by converting rain-fed land to irrigated land, might not do so because part of his lands might become subject to expropriation. Laws were eventually passed that retained the greater smallholding limit prior to the use conversion.

Finally, large-scale farming activities involving a high degree of processing or industrial activity, such as sugar cane, hennequin, banana, cocoa, and maguey plantations, had their limits set by National Agrarian Commission in accordance with the "technical capacity of the plant [industria]."<sup>187</sup>

### 3. Other Measures Used to Avoid Expropriation

Colonization as a means of accomplishing the Mexican ideal of yeoman smallholding continued to be popular, particularly in the less populated northern part of the country. The Colonization Act (*Ley de Colonización*)<sup>188</sup> made public lands, and lands that had been foreclosed upon by the Banco Nacional de Crédito Agrícola, available for colonization, but it also allowed any private owner to develop a colony without participation of any governmental entity.<sup>189</sup> Colonists could be, and often were, foreigners<sup>190</sup> who were eligible with no other requirement than agreement to the Calvo Clause<sup>191</sup> and payment of a \$1,000 per family deposit that

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184. See Constitución Política de los Estados Unidos Mexicanos, art. 27 § XIV.

185. Ley de Dotaciones y Restituciones de Tierras y Aguas, art. 27.

186. See Constitución Política de los Estados Unidos Mexicanos, art. 27 § XV.

187. Ley de Dotaciones y Restituciones de Tierras y Aguas, art. 36(II).

188. Colonization Act.

189. *Id.* arts. 2, 3.

190. *Id.* art. 9

191. *Id.*

could be used immediately to defray operating expenses.<sup>192</sup> Lot sizes could range from 5 to 150 hectares,<sup>193</sup> in the case of irrigated land, from 15 to 250 hectares in cultivated land with abundant rainfall,<sup>194</sup> and even larger tracts in other cases.<sup>195</sup> Lots could be purchased with a down payment of only five percent which could be deferred and paid from the proceeds of the first harvest, even later if those proceeds were insufficient.<sup>196</sup> Most importantly, the size of each colonized parcel was determined by the more generous small landholder limits described above, not the *ejidal* single parcel limit.<sup>197</sup> Neither benefit was available to the member of an *ejido*. Since new colonies could come from private lands, and be organized by private landowners, colonization became a way around the possible forced expropriation of excessive landholdings to endow *ejidos*. The federal government also did its part to promote and occasionally favor colonization. From 1917 to 1934, it gave 1.5 million hectares of national lands to private landholders rather than *ejidos*.<sup>198</sup> During the administrations of Miguel Aleman (1946-1952), Adolfo Ruiz Cortines (), and Rodolfo Lopez Mateos (the government's agrarian policy shifted notably in favor of endowing colonies rather than *ejidos*, particularly in what concerned land with access to irrigation in the northern states of Sonora and Baja California, to the extent that, by 1962, article 58 of the Agrarian Law ( was amended "to prevent owners of surface areas greater than that permitted by agrarian law [that is, applicable to *ejidos*] from evading agrarian distribution through colonization."<sup>199</sup>

Even with these allowances, large landholders resisted expropriation, often through the simple expedient of voluntarily selling excessive parcels to family members, friends, and various straw men. While such transfers are routinely voidable in more advanced legal systems, the Mexican legal system had not, until recently, developed meaningful legislation designed to invalidate sham, fraudulent, or otherwise voidable transactions.<sup>200</sup> While it was widely assumed that large landowners were using such device to avoid or preempt forced expropriations, the only legal counter-

192. *Id.* art. 11.

193. *Id.* art. 8 (this law was passed before the smallholding limit was federalized).

194. *Id.*

195. *Id.*

196. *Id.* art. 11.

197. And even when small landholding limits became set by federal legislation, such as the Ley de Dotaciones y Restituciones de Tierras y Aguas, *supra*, the small landowner limit applicable to parcels in colonies were set at whatever they may have been pursuant to the legislation that created them (*see* art. 26(VII)), even if the smallholding limits applicable generally were exceeded.

198. Eyer N. Simpson, *El Ejido: Unica Salida Para Mexico*, in *PROBLEMAS AGRICOLAS Y INDUSTRIALES DE MEXICO* [PROBLEMS IN MEXICAN AGRICULTURE AND INDUSTRY] vol. 44 (1952).

199. *Una Nueva Estrategia*, *supra* note 172.

200. *E.g.*, the recent Bankruptcy and Insolvency Law that voids fraudulent transfers, using many of the same concepts (payment of inadequate purchase price) common in U.S. law. The civil codes adopted in each Mexican state contain provisions regarding fraudulent transactions, but they are rather toothless and have seldom been used to invalidate a transfer of property.



measure used against it was the rule that invalidated any transfers made after a formal application for ejidal restitution or endowment had been submitted, and denied recognition to transfers made prior to submission of the application if not recorded in the public registry of property.<sup>201</sup>

#### F. COMES CARDENAS

By the mid-1930s, the legal and political conditions were in place for a marked increase in the amount of lands being transferred into what became known as the social sector. It was not just the political effects of the Great Depression that tended to make people question the promise of the market system. Mexico's poor farmers had been so miserable prior to the Great Depression that a change towards the worse might well have gone unnoticed. What was changing was the political landscape: Political parties and other quasi-governmental organizations were becoming "institutionalized."<sup>202</sup> The men on horseback who won battles in the 1910s, and became presidents in the 1920s, were dying out, replaced by men who not only ran the new organizations but made their livings doing so. It will be remembered that the 1917 Constitution allowed states to determine the pace of agrarian reform within their own jurisdictions. In the states where such reform was most advanced, permanent political organizations sprang up that eventually joined to form national apparatuses. By 1934, Plutarco Elias Calles, the former president (1924-1928) who was acknowledged as running a de facto presidency (called the "*maximato*") during the terms of his three successors, would become so frustrated by the attitudes of these new political professionals that he would leave Mexico in disgust. He once told a reporter, "I was exiled . . . because I opposed the attempts to implant a dictatorship of the proletariat."<sup>203</sup>

The pronounced change could also be attributed to a man. Lazaro Cardenas was not a rancher from Sonora, or Coahuila, but from the central, more traditional state of Michoacan, and, to judge him by the opinions of his contemporaries, held the ideals of the Revolution—particular those of Zapata—closer to his heart. In governing his home state, his reputation for probity earned him the name "Boy Scout" (a sobriquet not always meant as a compliment in Mexico).<sup>204</sup>

Elected as president in 1934, Cardenas's agrarian policies struck early and hard. Instead of giving away relatively infertile land in the northern reaches of the country, he ordered the mass expropriations of fertile lands like those in a region called the Laguna around the city of Torreon (150,000 hectares given to 35,000 peons), the henequen plantations in the Yucatan (366,000 hectares to 34,000 peons), a fertile area in the state of Sonora called the "Valle del Yaqui" (47,000 hectares to 2,160 peons), in Lombardia and Nueva Italia in the State of Michoacan (61,449 hectares

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201. Ley de Dotaciones y Restituciones de Tierras y Aguas, art. 29.

202. BETHELL, *supra* note 17, at 244.

203. Benjamin, *supra* note 148, at 478.

204. BETHELL, *supra* note 17, at 249.

to 2,066 peons), and irrigated sugar cane fields near Los Mochis, Sinaloa (55,000 hectares to 3,500 peons).<sup>205</sup> While an estimated 942,125 *campesinos* were endowed in all the years prior to Cardenas, in his single term of office 771,640 were endowed.<sup>206</sup> More importantly, *ejidos* were given better lands. The portion of cultivated lands (*tierra de labor*) held by *ejidos* rose from 13.3% to 46.5%.<sup>207</sup> By the end of his term, *ejidos* represented almost fifty percent of total agricultural production in Mexico, a figure never again duplicated.<sup>208</sup>

Nor was the Cardenas administration content to leave undisturbed the understandings laboriously achieved with foreign oil companies on Bucareli Street. The Nation's ownership of in-the-ground oil assets would have to be restored, but this time the Cardenas administration found a way around the politically difficult route of direct expropriation of sub-surface real property. By adroitly managing labor confrontations between the companies and their labor unions, followed by the companies' refusal to honor the decisions of the labor authorities, a pretext for confiscation was found, and followed.<sup>209</sup>

#### G. AFTERMATH

True to his word, Cardenas did not provoke another constitutional crisis by attempting to run for a second term. The year 1940 would mark the conclusion of what might be called the revolutionary or post-revolutionary phases of agrarian reform in Mexico. While additional lands would be distributed to the social sector, particularly in the 1960s and early 1970s, the whole idea of land as a means of achieving social betterment—basically, as a solution for the Mexican peasant and widespread poverty—would never have the same importance.

Perhaps one reason was the diminishing role of land as the touchstone of the economy. A law passed in 1934 could call agricultural land “the supreme cornerstone” of wealth, but fewer and fewer of Mexico's poor, emigrating to the cities in the 1940s and 1950s to work in the new factories, would believe this was true. World War II created an opportunity for Mexico to send products, crops, and farm workers to the United States to fill the holes and new requirements created in the U.S. war economy. In the 1940s, Mexico's industrial production grew eight percent per year; in the 1950s, the annual increase was seven percent.<sup>210</sup> Agrarian policy was replaced by industrial policy, a policy that turned increasingly coddling towards its national producers, including commer-

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205. Secretariat of Agrarian Reform, *supra* note 147.

206. *Id.*

207. *Id.*

208. David Yetman, *Ejidos, Land Sales, and Free Trade in Northwest Mexico: Will Globalization Affect the Commons?*, at 4, available at <https://journals.ku.edu/index.php/amerstud/article/viewFile/3109/3068>.

209. See Benjamin, *supra* note 148, at 478.

210. CLARK WINSTON REYNOLDS, *THE MEXICAN ECONOMY: TWENTIETH CENTURY STRUCTURE AND GROWTH* 166 (1970).

cial crop producers, and increasingly indifferent to peasants tilling corn with oxen, five hectares at a time.

From 1940 to the mid-1960s, agriculture in general grew at an average annual rate of four percent, well above the rate of population growth in that period, but the social sector received little public support.<sup>211</sup> By 1960, 50 percent of agricultural properties contributed to only four percent of production.<sup>212</sup> Much of the rate of growth occurred in the countryside, in a period (late 1960s) preceding the creation of new employment programs (e.g., the twin-plant, or *maquiladora* program primarily along the U.S. border), and mass emigrations to the United States. The first response of the Mexican government to these demographic pressures was to endow new *ejido* lands rather than try to correct its inherent problems or abolish the program altogether. The Diaz Ordaz administration, in particular (1968-1974), distributed more new land to the *ejido* sector than any previous administration since Cardenas.<sup>213</sup>

The results of simply expanding the scope of a failed policy in order to mitigate its defects were predictable. By the 1980s, Mexico began to import corn for the first time, an event that shook the country that had basically perfected its cultivation.<sup>214</sup> Mexico's 20th century land program also came to be viewed not just as a failure, but the very special kind of failure brought about by the very principles it embodied. By capping *ejidal* parcels at ten hectares per farmer, and precluding access to credit, or participation with the outside world, rural poverty was not alleviated, it was institutionalized.

### III. NOW

The issue of land redistribution had emerged from the Mexican Revolution as an enshrined, if under-achieved, ideal of Mexican politics, but towards the end of the 20th century several factors came together that would enable Mexican leaders to fashion an exit from what was clearly a failed policy. First, the worldwide tendency to privatize state-owned assets and businesses, to open markets, and to liberalize the economy—a broad movement described as neo-liberalism—took strong hold in Mexico, particularly during the administration of Carlos Salinas de Gortari (1988-1994). Mexico acceded to the General Agreement on Tariffs and Trade (1986).<sup>215</sup> It negotiated a North American Free Trade Agreement (NAFTA) with the United States and Canada that became

211. See *Auge y Crisis Agropecuario*, Secretaría de la Reforma Agraria [Secretariat of Agrarian Reform], <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/auge-y-crisis-agropecuarial> (last visited June 7, 2010).

212. *Id.*

213. See Merilee S. Grindle, *Reforming Land Tenure in Mexico: Peasants, the Market, and the State*, in *THE CHALLENGE OF INSTITUTIONAL REFORM IN MEXICO* 42 (Riordan Roett, ed., 1995).

214. Mexico: Grain Production, Encyclopedia of the Nations, <http://www.country-data.com/cgi-bin/query/t-8744.html> (last visited Aug. 17, 2010).

215. See generally General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.

effective in 1994.<sup>216</sup> Major industrial and commercial sectors opened to private and foreign participation (telecommunications, natural gas distribution, railroads, banks). NAFTA, in particular, imposed a new logic on the agricultural sector. In theory at least, Mexicans would import more of those products in which U.S. and Canadian farmers enjoyed a competitive advantage (e.g., grains), and export those products in which they enjoyed a competitive advantage (e.g., broccoli, seasonal lettuce and tomatoes, avocados, tropical fruit). This logic did not augur well for low-productivity *ejido* farming which focused on corn and bean production.

Second, it was politically possible to point out that the purely political objectives of the Revolution had been achieved. By 1990, the great *latifundia* had been reduced (although large ranches were not hard to find, if one looked), and *ejidos* owned about 100 million hectares of real estate, almost one-half of the entire country, and the Mexican government could report that “if in 1900 less than 2,000 families were owners of 87% of the surface area of the country, by the end of the 1980s there were more than five million members of *ejidos*, communes, and small landholders with direct control over 90% of the territory.”<sup>217</sup>

But, perhaps most importantly, the grandchildren and great-grandchildren of the *peones*, who had clamored for their bit of land 100 years ago, were no longer there but in Dallas working in construction, in Iowa disemboweling poultry, or in Ciudad Juarez assembling auto parts.<sup>218</sup> Conversely, Mexican cities had swelled during the population boom of the late 20th century, and were now rubbing up against *ejidos* at several suburban points. Foreign investment created a demand for industrial parks; foreign tourists and home buyers created a demand for more beachfront; and, in almost all cases, it was difficult to find large pieces of developable land that did not encompass an *ejido*. If given a choice, would the *ejido* member living and working in Chicago prefer to sell his five-hectare parcel to Canadian sun-seekers or enter into a production-sharing arrangement with Green Giant, or would he rather return to his family parcel to eke out a subsistence living?

The politically astute response, embodied in a completely new Agrarian Law enacted in 1992, with accompanying changes to Article 27 of the Constitution, approached the issue from several directions.<sup>219</sup> First, the decision to privatize a particular *ejido* remained completely voluntary among its members; this made it impossible for any *ejido* to claim it was being railroaded by an outside entity.<sup>220</sup> Second, even when the *ejido* had

216. See generally North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993).

217. *La Iniciativa*, Secretariat of Agrarian Reform, <http://www.sra.gob.mx/sraweb/conoce-la-sra/historia/la-iniciativa/>.

218. *Id.*

219. Ley Agraria [Agrarian Act], Diario Oficial de la Federación [D.O.], 26 de Febrero de 1992 (Mex.).

220. Procuraduría Agraria [Office of the Federal Agrarian Attorney General], “Procede” (monograph), <http://www.pa.gob.mx/publica/pa070113.htm>.

opted for the privatization route, the decision to privatize effectively remained at the level of the individual parcel holder, who could choose among several options: privatize and hold, privatize and sell, or not privatize at all.<sup>221</sup> Third, in the event such owner of a now privatized parcel decided to sell to an outside entity, the collective interests of fellow *ejido* members were safeguarded somewhat by a preferential right to purchase.<sup>222</sup> In any case, it was the individual seller, not the State, who would reap the economic benefits of the sale. Fourth, old rules that required an *ejido* parcel to be continuously worked by the parcel owner, at the risk of losing it,<sup>223</sup> were abolished, thus extending the benefits of the program to hundreds of thousands, if not millions, of *émigrés ejido* members, a detail that virtually guaranteed its political acceptance. Finally, *ejidos*, and *ejido* parcel owners who did not wish to go all the way with privatization, but who desired the expertise or capital of outside parties, were now free to enter into almost any kind of development agreement with such entities.<sup>224</sup>

#### A. LAYING OUT THE BOUNDARIES

As the new Agrarian Law was passed, it was recognized that its liberalizing tendencies could not be implemented without addressing serious deficiencies in the legal descriptions not only of the lands originally given to *ejidos*, but of the internal divisions of lands within the *ejidos*, themselves.

Establishing the external boundaries of the *ejido* would have been necessary whether the new Agrarian Law was passed or not. By the end of the 20th century, the edges of many cities had pushed up to the edges of many *ejidos*,<sup>225</sup> and rights had to be delineated with precision. In the fifty years after the Mexican Revolution, both public and private lands had been distributed to 28,000 *ejidos* with breath-taking disregard for the essential points of legal conveyances or land surveying. One example is an endowment in which an *ejido* was given all land within a certain radius of a certain point on the earth's surface.<sup>226</sup> It is hard to imagine how a perimeter described by a geometric circle would address existing realities, or serve future needs. This perfect circle did, indeed, encroach on several privately owned tracts that were never intended to be disturbed. For the same reason, it left huge gaps between the circle and existing parcels,

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221. Agrarian Act, *infra* notes 250-59.

222. Agrarian Act, art. 84.

223. See, e.g., Ejidal Estates Act, art. 20(V) that subjected *ejido* parcels left uncultivated more than one year to forfeiture.

224. See Agrarian Act, art. 45.

225. Gareth A. Jones & Peter M. Ward, *Privatizing the Commons: Reforming the Ejido and Urban Development in Mexico*, at 78, available at [http://www.uky.edu/~tmute2/mexico/Mex%20PDFs/jones-ward\\_private-commons.pdf](http://www.uky.edu/~tmute2/mexico/Mex%20PDFs/jones-ward_private-commons.pdf).

226. Based on the author's personal examination of the map attached to the 1964 presidential decree endowing the *Ejido* Colonel Esteban Cantu. By coincidence, the endowment was the same one that caused scores of Americans, who had presumably purchased land near Punta Banda, south of the city of Ensenada, Baja California, to be evicted *en masse*.

creating *lagunas*. The predictable result was decades of needless litigation and in the end, the intervention of the Mexican Supreme Court.<sup>227</sup>

By the same token the internal divisions made within *ejido* land needed better delineation because of the manner in which the new legislation would stage the process of privatizing the *ejido*. Certain plots within the *ejido* might never be privatized, others could be used but not owned by outsiders, others still could be completely privatized eventually.

The program that would be created to address these deficiencies was called “PROCEDE,” the initials for *Programa de Certificación de Derechos Ejidales y Titulación de Solares* (Program for the Certification of Ejidal Rights and Titling of Urban Plots).<sup>228</sup> Participation in the program was voluntary and at no cost to the *ejido*.<sup>229</sup> Although the initial participation by *ejidos* was much less than expected, by 2006 more than ninety percent of all *ejidos* and communes had become certified.<sup>230</sup>

The benefit of PROCEDE is that it provided a practical mechanism and the resources for resolving boundary disputes in a relatively expeditious manner. For example, the governmental agencies charged with the program would literally bring *ejido* members together with adjacent private landowners, walk the fences, agree on boundaries, and enter into a binding agreement that would then be reflected in boundary maps kept in a formal registry. While this process did not always end happily, it was far superior to any process that had come before it.

## B. CATEGORIES OF EJIDO LAND

*Ejido* land is divided into three categories:

- Land used for “human settlements” (*asentamientos humanos*) is the portion of the *ejido* set aside for houses, schools, and the other facilities of everyday life.<sup>231</sup>
- Another is common use (*uso comun*), the land used in common for the economic sustenance of all the *ejido*; it is usually land used for grazing.<sup>232</sup>
- The principle of individual use and benefit is reflected in parcels

227. *Supreme Court Orders Return of Ejido Land to Original Owners*, All Business (Dun & Bradstreet), Nov. 1, 2000, <http://www.allbusiness.com/north-america/mexico/659922-1.html>.

228. PROCEDE is generally described in: “Procede” *supra* note 220; Ana de Ita, *Land Concentration in Mexico after PROCEDE*, PROMISED LAND: COMPETING VISIONS OF AGRARIAN REFORM 148-164 (2006).

229. Office of the Presidency of the Republic, “PROCEDE,” [http://www.contigo.gob.mx/index.php?idseccion=12&programa\\_id=31](http://www.contigo.gob.mx/index.php?idseccion=12&programa_id=31).

230. Ruben Aguilar Valenzuela, Presidential Spokesperson, *El Secretario de la Reforma Agraria, durante el ejercicio de transparencia y rendición de cuentas del Gobierno Federal de cara al Sexto Informe de Gobierno del Presidente Fox* [The Secretary of Agrarian Reform during the exercise in transparency and accountability of the Federal Government towards the Sixth Report of the Government of President Fox] (Aug. 4, 2006) (Mex.), available at <http://fox.presidencia.gob.mx/actividades/?contenido=26326>.

231. Agrarian Act, arts. 63-72.

232. *Id.* arts. 73-75.

(*parcelas*) that are assigned to individual *ejido* members.<sup>233</sup> The *ejido* may not collectively exploit a parcel without the written consent of its titleholder.<sup>234</sup> Within certain guidelines, individual parcel owners are able to convey their parcels into the private sector. No individual *ejido* member may own parcels representing more than five percent of the total area of the *ejido*, nor more than the maximum limit applicable to all Mexicans under the small landholding limitations applicable to all persons and corporations, discussed below.<sup>235</sup>

It is also possible for the *ejido*, by the vote of its assembly, to choose to collectively use all *ejido* land.<sup>236</sup> The *ejido* is also free to opt out of this collective regime, once in it.<sup>237</sup>

### C. ASSOCIATIONS AND TRANSACTIONS WITH THIRD PARTIES

The *ejido* enjoys considerable freedom in entering into transactions with persons or entities outside of the *ejido* for the temporary use or exploitation of *ejido* lands. Such transactions can range from joint ventures, other types of contractual associations, or leases. For the purposes of the remaining discussion, all of these shall be referred to as “use agreements.” The following are some examples of allowable use agreements under the Agrarian Law:

- The *ejido*, acting through its assembly, may enter into use agreements with respect to the common use areas described above.<sup>238</sup>
- An individual *ejido* member who holds title to a parcel, as described above, is similarly free to enter into use agreements.<sup>239</sup> Such agreement does not require permission of the *ejido* or any authority.<sup>240</sup>
- The term of the use agreement may be for the lifetime of the project involved, not to exceed thirty years. However, the term is extendable.<sup>241</sup>

It is noteworthy that the Agrarian Law uses the term “any” to describe the use agreements that may be entered into. There appear to be no limitations.

### D. USE OF EJIDO PROPERTY AS COLLATERAL

Article 46 of the Agrarian Law permits the *ejido*, in the case of common use lands, or the individual holder of a parcel in the case of a parcel, to secure loans by granting the creditor the *usufruct* (the product or fruit)

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233. *Id.* arts. 76-86.

234. *Id.* art. 77.

235. *Id.* art. 47.

236. *Id.* art. 11.

237. *Id.*

238. *Id.* art. 45.

239. *Id.*

240. *Id.* art. 79.

241. *Id.* art. 45.

of such respective properties.<sup>242</sup> Such grant may only be made to a credit institution (*e.g.* bank) or the entity with which the *ejido* or parcel owner has entered into an association or use agreement.<sup>243</sup> In the event of default, the creditor is only entitled to the *usufruct* for a stipulated period of time, after which the *usufruct* goes back to the grantor.<sup>244</sup> This means that the creditor is not entitled to foreclose upon the land itself. To exercise its rights in the collateral, the creditor must petition an agrarian tribunal, and the agreement granting the right must be entered into before a public notary and be recorded in the Agrarian Registry.<sup>245</sup>

Due to the fact that the creditor is only entitled to a *usufruct* for a certain period of time, must plead before an agrarian tribunal, and may not resort to extra-judicial procedures in enforcing its rights in the collateral, it is hard to imagine this security device appealing to private sector banks providing regular credit. This limitation must be considered a major impediment to the modernization of the *ejido*.

#### E. SALE OR TRANSFER OF EJIDO LANDS TO THIRD PARTIES

(i) *Transfer to governmental entity.* Lands for human settlement may be transferred to municipal or similar governmental entities only, when needed to provide public services.<sup>246</sup>

(ii) *Transfer of "common use" property.* In cases of manifest public utility, an *ejido* may contribute "common use" lands to regular business corporations whose shareholders consist of *ejido* members, other *ejidos*, and even third parties.<sup>247</sup> The plan must be approved by the *ejido* assembly and the Agrarian Attorney General. The contribution will also be subject to the following:

- The value of the lands contributed in exchange for shares must be at least equal the value established by the government agency called *Comision de Avaluos de Bienes Nacionales* (Commission for the Appraisal of National Properties) or any credit institution (*e.g.*, bank).<sup>248</sup>
- In the event of corporate liquidation, the *ejido* and *ejido* members will have a preferential right over non-*ejidal* shareholders to receive the contributed lands as an in-kind distribution.<sup>249</sup>

(iii) *Privatization of parcels.*

By far the most normal way to transfer or privatize *ejidal* lands is by transfer of specific parcels by their individual holders. The rules are as follows:

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242. *Id.* art. 46.

243. *Id.*

244. *Id.*

245. *Id.*

246. *Id.* art. 65.

247. *Id.* art. 75.

248. *Id.* art. 75(IV).

249. *Id.* art. 75(V).



- Once a majority of the parcels designated by the *ejido* have been assigned to *ejido* members, the *ejido* assembly may vote to allow individual parcel owners to own their parcels in fee simple, that is, as full owners of such parcels and incorporating such parcels into the private sector.<sup>250</sup> After the assembly has given such approval, each individual parcel owner may convert the parcel to the private sector by petitioning the Agrarian National Registry to deregister the parcel.<sup>251</sup> The Agrarian National Registry will then issue to the owner a certificate of ownership, which the *ejido* owner may then register with the (normal) public registry of property.<sup>252</sup> From that point forward, the property is in the private sector with respect to that parcel owner.<sup>253</sup>
- But, should the parcel owner (now regular owner) of the property wish to convey the land to someone else, the *ejido* is not done. He or she must give a right of first refusal to purchase the land to the following, in this order:
  - Family members;
  - Those who have worked the land in question for more than one year;
  - Other members of the *ejido*;
  - Neighbors (*avecindados*) of the *ejido*;
  - The *ejido*, itself.<sup>254</sup>

Presentation of a notice of sale, prepared before a public notary or two witnesses, and delivered to the commissariat of the *ejido*, constitutes valid evidence of notice to all the persons or entity listed above.<sup>255</sup> Such persons or entity have thirty days in which to declare their intent to exercise their right of first refusal.<sup>256</sup> If the right is not exercised, the owner of the land is free to sell or transfer to any third party.<sup>257</sup> Once consummated, neither the *ejido* nor any of the above persons have any further rights in the property.<sup>258</sup>

The sale must be for a price at least equal to the appraised value set by the *Comision de Avaluos de Bienes Nacionales* (Commission for the Appraisal of National Properties) or any credit institution (*e.g.*, bank).<sup>259</sup>

#### IV. CONCLUSION

The struggle that would commence in 1910 has been called the “first

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250. *Id.* art. 81.

251. *Id.* art. 82.

252. *Id.*

253. *Id.*

254. *Id.* art. 84.

255. *Id.* art. 85.

256. *Id.* art. 84.

257. *Id.*

258. *Id.*

259. *Id.* art. 86.

successful revolution” of the 20th century.<sup>260</sup> Such success would serve to end the lives of millions, disrupt the ownership of property on a large scale, provoke the intervention of the U.S. military at least twice, expose the utter dependency of Mexico upon the flow (or shut-off) of foreign arms, and create a new type of romantic revolutionary hero, thanks in large part to another revolution, this one technological, in the form of the motion picture camera. It would, in the year 1917, give Mexico its third and current, constitution. One article of that new charter, Article 27, would encapsulate many of the ideas regarding land use and tenure for which the Revolution was waged.

And yet the label of “success” should not belong to a program that has institutionalized and preserved poverty for millions of Mexicans strewn across its great land mass. A drive across the dirt roads of almost any region will reveal village after village predominantly peopled by women and children, except perhaps for the months of December until February when the young men return as conquering heroes, their pockets filled with money from their stints as emigrant laborers.

The “success” of the last 100 years of Mexican land reform, if indeed such label is accurate, might be better viewed in the sepia tones not of material, but political accomplishment. In the Revolution and beyond, an astute political class was able to fashion a formula for the survival of a process that would give Mexico a century of peace (its conflicts with the Catholic Church apart) and relative prosperity despite its real accomplishments in the fields. In the last 100 years, the private ownership of Mexican real property in general, and foreign ownership of real property in particular, have been marked by a stability and legal security seldom enjoyed in other developing countries. The restrictions on foreign ownership of Mexican land have not deterred foreigners from purchasing Mexican property, nor have the size limitations placed on individual and corporate land ownership cramped reasonable investment programs in the agricultural sector.

In the end, the successes or failures of land reform in the last 100 years have mattered less because land itself has mattered less. In the current stretch of Mexican history, land has become detached from wealth, in particular from the expectation of self-betterment. It is only for these reasons that Mexican history does not swirl about its distribution and tenure as it did in the past. The great, great grandsons of the aggrieved peasants of a bygone era will sell their dunes of white sand to the Marriott hotel chain, or they will work as waiters in exclusive restaurants in Cabo San Lucas, for good tips. And life will go on.

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260. John Mason Hart, *The Mexican Revolution*, in *THE OXFORD HISTORY OF MEXICO* 435 (2000).

## **Comments and Casenote**



## IS THERE A REMEDY TO SEX DISCRIMINATION IN MAQUILADORAS?

Corey Tanner-Rosati\*

*“Every major international human rights instrument, beginning with the United Nations Charter, prohibits discrimination on the basis of sex.”<sup>1</sup>*

### I. INTRODUCTION

ANY women workers in maquiladoras, foreign owned factories operated in Mexico, experience sex discrimination on a daily basis. These women are often poor, uneducated, and have little recourse against perpetrators of sex discrimination in the work place. But domestic laws and international human rights instruments purport to provide protection against this kind of employment discrimination. Why is it that these laws are not being enforced? What can concerned citizens do to ensure that the rights of women are not ignored by the Mexican government and the international community?

Mexico is certainly not the only country in the world that discriminates against women in the work place, but this discussion will focus on Mexico exclusively. This article will discuss the traditional political and social roles of men and women in Mexican society and how those roles operate in the work environment in maquiladoras. Next, it will explore the problems faced by women who work in these factories, including sexual harassment and pregnancy discrimination. This comment will then discuss the relevant domestic law, regional treaties, and international treaties that obligate the Mexican government to take action against employment discrimination and show how Mexico has repeatedly failed to meet these obligations. Finally, this comment will suggest possible remedies to the sex discrimination policies in maquiladoras, including placing international pressure on the Mexican government to pass new laws to conform to their obligations, initiating litigation under relevant laws and treaties, promoting advocacy groups for women, and demanding corporate responsibility from companies who own factories.

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1. Rebecca Adams, *Violence Against Women and International Law: The Fundamental Right to State Protection from Domestic Violence*, 20 N.Y. INT'L L. REV. 57, 107-08 (2007).

But before one can consider the worth and reasonability of these solutions, it is important to understand the roles of women in Mexican political and social spheres, how maquiladoras came into existence, and what the maquiladoras' continued growth has meant for the women of Mexico.

## II. WOMEN'S POLITICAL ROLES IN MEXICO

Women in Mexico won the suffrage movement in 1953, and feminist social and political groups began to form in the 1970s and 1980s.<sup>2</sup> Women joined together to create momentum for popular movements in urban communities that demanded basic social services like electricity and education.<sup>3</sup> Lower-class women were the primary instigators of most of these movements.<sup>4</sup> Eventually, women from higher social classes took an interest in these issues and organized to form non-governmental organizations (NGOs) that could lobby for these and other rights.<sup>5</sup> With time, the NGOs took up other women's issues including domestic violence and sexual discrimination.<sup>6</sup>

Throughout the 1970s and 1980s these groups grew both in size and strength, but the Institutional Revolutionary Party (PRI), a political party which remained in power until 1980, did not provide for input from citizens, so the rights of women were largely ignored until PRI lost political power.<sup>7</sup> After the national elections in 1988, PRI lost its majority in the Mexican Congress.<sup>8</sup> Because the National Action Party (PAN) and the Party of the Democratic Revolution (PRD) had to compete for votes, women's groups were finally given an opportunity to gain political power.<sup>9</sup> With these developments, women were given a louder voice in the Mexican political system, but despite these great strides their role today remains marginal at best. Part of the problem for women in garnering political power has been that women's roles in Mexican social life has largely remained the same despite the passage of time.

## III. GENDER ROLES IN MEXICO

Traditionalized roles of men and women still largely exist in Mexico.<sup>10</sup> Most of these roles are based on concepts of *machismo* and *marianismo*.<sup>11</sup> *Machismo* dictates that men are superior to women, and *marian-*

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2. Mary C. Wagner, *Belem Do Para: Moving Toward Eradicating Domestic Violence in Mexico*, 22 PENN. ST. INT'L L. REV. 349, 354 (2003).

3. *Id.*

4. *Id.*

5. *Id.* at 354-55.

6. *Id.*

7. *Id.* at 354.

8. Wagner, *supra* note 2, at 354.

9. *Id.*

10. Elizabeth Goergen, *Women Workers in Mexico: Using the International Human Rights Framework to Achieve Labor Protection*, 39 GEO. J. INT'L L. 407, 409 (2008).

11. Wagner, *supra* note 2, at 351.

*ismo* draws parallels between the Virgin Mary and women's purity.<sup>12</sup> Based on these roles, men are expected to be dominant providers whereas women are seen as the submissive caretakers.<sup>13</sup> Men are expected to dominate the public sphere while women are relegated to the internal functions of the home and family.<sup>14</sup>

These ideas about women's roles have remained fairly stagnant despite the fact that more and more women are joining the workforce in Mexico.<sup>15</sup> Women are still expected to take care of home and family matters, even as the prevalence of globalization and free trade have encouraged, and to some extent forced, women to leave traditional jobs close to home.<sup>16</sup> In the past, women were mostly employed in agricultural work in their communities, but today women have largely moved into positions within manufacturing and services.<sup>17</sup> Part of the shift is attributable to imports of subsidized foods from the United States as a part of the North American Free Trade Agreement (NAFTA).<sup>18</sup> Imported food products resulted in a decreased need for local production, and thus fewer positions in the agricultural sector needed to be filled.<sup>19</sup> As a result of the decrease in demand for home grown food and the growing prevalence of factories in Mexico, many of the women formerly employed in the agricultural industry moved to jobs in maquiladoras.<sup>20</sup>

#### IV. WHAT ARE MAQUILADORAS?

Maquiladoras are factories owned by corporations in foreign countries.<sup>21</sup> Workers in these factories assemble products to be shipped back to the nation where the company is based.<sup>22</sup> The use of maquiladoras for assembling products allows these companies to take advantage of low wage labor and reduce production costs overall.<sup>23</sup>

Maquiladoras are set up to result in the highest possible level of output.<sup>24</sup> In the United States, factories typically adhere to the forty hour work week.<sup>25</sup> But maquiladoras usually extend this work week by five to

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12. Adrienne Speas, *Sexual Harassment in Mexico: Is NAFTA Enough?*, 12 L. & BUS. REV. AM. 83, 86 (2006).

13. Goergen, *supra* note 10.

14. Nicole L. Grimm, *The North American Agreement on Labor Cooperation and its Effects on Women Working in Mexican Maquiladoras*, 48 AM. U. L. REV. 179, 186 (1998).

15. Goergen, *supra* note 10, at 411.

16. *Id.* at 409-10.

17. *Id.*

18. *Id.* at 410.

19. *Id.*

20. *Id.*

21. Grimm, *supra* note 14, at 182.

22. *Id.*

23. *Id.*

24. Elvia Arriola, *Accountability for Murder in the Maquiladoras: Linking Corporate Indifference to Gender Violence at the U.S.-Mexico Border*, 5 SEATTLE J. FOR SOC. JUST. 603, 617 (2007).

25. *Id.*

ten additional hours per employee, without overtime compensation.<sup>26</sup> The expectation of high production has led to the creation of a corporate culture that tends to ignore the problems inherent in forcing workers to work six day weeks and endure ten or twelve hour shifts.<sup>27</sup>

Maquiladoras are not a phenomena created by NAFTA, although their construction and operation has increased greatly since the passage of the treaty.<sup>28</sup> Maquiladoras were first established when the United States and Mexico agreed on the Border Industrialization Program in 1964.<sup>29</sup> The Border Industrialization Program aimed to develop industry and promote employment along the U.S.-Mexico border.<sup>30</sup> It created trade conditions that were favorable to large U.S. corporations and was instrumental in encouraging the development of factories along the U.S.-Mexican border and throughout Mexico.<sup>31</sup>

Today as many as seventy percent of maquiladoras are located along the Texas border in the state of Chihuahua.<sup>32</sup> Since the North American Free Trade Agreement was signed the number of Mexican citizens working in maquiladoras has surged.<sup>33</sup> In just three years, between 1996 and 1999, foreign owned factories in Mexico increased by thirty-seven percent, and overall employment of Mexican workers grew by fifty percent.<sup>34</sup> Today maquiladoras make up an essential part of the overall Mexican economy, accounting for thirty-one billion dollars per year in exports.<sup>35</sup>

## V. GENDER ROLES IN MAQUILADORAS

The increase in maquiladora operations has given many women the opportunity to work outside the home, earn money, and support themselves financially.<sup>36</sup> Fulfilling an important role outside of the home has allowed women greater visibility in the outer realm of business and contributed to the empowerment of both individual women and larger women's groups.<sup>37</sup> But though maquiladoras offer women a degree of indepen-

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26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. Arriola, *supra* note 24.

31. *Id.*

32. United Nations Convention on the Elimination of All Forms of Discrimination Against Women, Comm. On the Elimination of Discrimination Against Women, *Report on Mexico Produced by the Committee on the Elimination of Discrimination Against Women under Article 8 of the Optional Protocol to the Convention, and Reply from the Government of Mexico*, U.N. Doc. CEDAW/C/OP.8/Mexico at 49 (January 27, 2005).

33. NAALC Secretariat of The Commission for Labor Cooperation, *North American Labor Markets: Main Changes Since NAFTA*, 69, 2003, available at [http://www.naalc.org/english/pdf/labor\\_markets\\_en\\_1.pdf](http://www.naalc.org/english/pdf/labor_markets_en_1.pdf).

34. *Id.* at 81.

35. Harry F. Chaveriat III, *Mexican Maquiladoras and Women: Mexico's Continued Willingness to Look the Other Way*, 8 *NEW ENG. INT'L & COMP. L. ANN.* 333, 338 (2002).

36. Grimm, *supra* note 14, at 204.

37. *Id.*



dence and the potential for increased self-confidence, maquiladoras usually reflect the overall stereotypes about men and women in Mexican society.<sup>38</sup>

Men generally hold most supervisory and management positions, while women are normally placed in jobs that earn lower pay and come with less respect and poorer working conditions.<sup>39</sup> Many factories attempt to justify these hiring decisions based on assumptions that women are secondary wage earners, merely supplementing the wages earned by their husbands.<sup>40</sup> But it is not a given that female workers are merely supplementing income since many are actually providing for themselves or their families without the aid of a working spouse.<sup>41</sup>

Many maquiladora owners and managers also hire based on stereotypes about skills or behaviors.<sup>42</sup> For example, managers might assume that women would be better at assembling products because of greater dexterity stemming from their smaller hands and because of their experience sewing in the home.<sup>43</sup> But men are just as efficient and effective as women in performing tasks that require careful handling and intricate assembly.<sup>44</sup>

Another gender stereotype that contributes to hiring decisions is the idea that women are more agreeable and docile than their male counterparts.<sup>45</sup> Although women are less likely to organize in unions or complain about working conditions, their complacency is not caused by their sex.<sup>46</sup> Rather, women are less likely to organize because after their shifts they are still expected to perform their duties at home and are too busy or too tired to participate in unions.<sup>47</sup> Additionally, Mexican women who do not have families or financial support from husbands are often less inclined to join unions or speak out about poor working conditions out of fear that their only source of income will be lost if they anger employers by petitioning for better treatment.<sup>48</sup>

The sum of these stereotypes creates the perfect maquiladora worker in the minds of maquiladora owners: docile, passive women who are submissive, easy to train, and highly unlikely to cause problems by organizing to protest unfair treatment.<sup>49</sup> These stereotypes are ever present in maquiladoras and their perpetuation unquestionably contributes to sex discrimination against women.

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38. *Id.*

39. *Id.*

40. *Id.* at 205.

41. *Id.*

42. Grimm, *supra* note 14, at 206.

43. *E.g., id.*; Arriola, *supra* note 24, at 610.

44. Grimm, *supra* note 14, at 207.

45. Arriola, *supra* note 24, at 610-11.

46. Grimm, *supra* note 14, at 208.

47. *Id.*

48. *Id.*

49. Arriola, *supra* note 24 at 610-611.

VI. SEX DISCRIMINATION AGAINST WOMEN WORKING  
IN MAQUILADORAS

Most of the workers in maquiladoras are women.<sup>50</sup> These women work long hours, earn very low wages, work in unsafe conditions, and have few advocates.<sup>51</sup> Many of them endure sexual harassment and pregnancy discrimination on a regular basis.<sup>52</sup>

A. SEXUAL HARASSMENT

Sexual harassment is rampant within many of Mexico's maquiladoras.<sup>53</sup> It humiliates women and often forces them to quit jobs they desperately need to support their families.<sup>54</sup> Sexual harassment is generally viewed as either a kind of discrimination or a form of violence against women.<sup>55</sup> A Mexican government organization, the National Institute of Women, has identified three distinct components of sexual harassment:

- (1) Non-reciprocal sexual advances, which are repetitive unwelcome and premeditated actions that “‘pursue a sexual interchange.’”<sup>56</sup>
- (2) Sexual coercion which “‘refers to the intention to cause some form of prejudice or give a benefit to someone who rejects or accepts the proposed sexual actions;’” such behavior is asymmetrical.<sup>57</sup>
- (3) Displeasure inducing “‘humiliation, personal dissatisfaction, annoyance or depression’” that results from non-reciprocal sexual advances.<sup>58</sup>

The International Labor Organization estimates that four of ten women who quit their jobs in maquiladoras do so because of experiences with sexual harassment and, additionally, that sexual harassment is also a motive behind one in four firings.<sup>59</sup> In fact, in a study of 160 female maquiladora workers, forty-seven percent had either experienced sexual harassment themselves or seen someone else be victimized by it.<sup>60</sup> It is likely that the prevalence of sexual harassment is even greater, and that many instances remain unreported because of feelings of shame and a lack of knowledge regarding women's rights.<sup>61</sup>

Sexual harassment is often used as a tool to control women and pre-

50. Grimm, *supra* note 14 at 183.

51. *Id.*

52. *Id.*

53. Goergen, *supra* note 10, at 413.

54. *Id.*

55. Speas, *supra* note 12, at 85.

56. Instituto Nacional de las Mujeres, *Las Mexicanas y el Trabajo III* 14, Sept. 2004, available at [http://cedoc.inmujeres.gob.mx/documentos\\_download/100514.pdf](http://cedoc.inmujeres.gob.mx/documentos_download/100514.pdf).

57. *Id.* at 6.

58. *Id.*

59. *Id.* at 3.

60. Speas, *supra* note 12, at 85.

61. Goergen, *supra* note 10, at 413. (“Many respondents were surprised to learn that some behaviors they had always encountered in their places of work were considered sexual harassment, and that they could take action against it.”).

vent them from forming labor unions.<sup>62</sup> Maquiladora supervisors use techniques to manipulate young female workers by flirting and encouraging competition among the women for managerial affection.<sup>63</sup> Supervisors try to generate feelings of loyalty in these women and encourage them to report any organizational activity immediately so that management can stop it before any union can garner much support.<sup>64</sup> Maquiladora companies also host parties, dinners, dances, and beauty pageants.<sup>65</sup> Women who attend are encouraged to give in to sexual advances from supervisors and are rewarded with job benefits like additional pay and vacation days.<sup>66</sup>

Sexual harassment can have various adverse effects on female employees in maquiladoras. Those who are sexually harassed experience “stress, lack of self confidence, frustration, [and] lack of motivation.”<sup>67</sup> Victims also find it hard to concentrate and are more likely to be the cause of accidents or injuries.<sup>68</sup> They also tend to miss work as a result of the trauma they suffer.<sup>69</sup>

Sexual harassment may allow maquiladora managers to exert a degree of control over these women, but the continued practice of sexual harassment in the workplace can also have negative consequences for the maquiladoras themselves. Women who are continually sexually harassed may eventually quit, costing the factory time and money to train new employees. If workers experience lack of motivation or have trouble concentrating as a result of sexual harassment, there can be an overall decrease in productivity and higher incidents of worker injuries and product defects.<sup>70</sup> There is also the possibility that the company will garner negative publicity as a result of sexual harassment, thus risking a loss of profits and public support.<sup>71</sup>

#### B. PREGNANCY TESTING AND DISCRIMINATION AGAINST PREGNANT WOMEN

In addition to engaging in sexual harassment, many maquiladoras practice pregnancy discrimination as well. These factories force prospective female employees to take pregnancy tests and demand that women answer personal questions regarding their “menstrual cycles, sexual activity,

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62. Speas, *supra* note 12, at 86.

63. *Id.* at 87. (“One technique involves supervisors flirting with the women in a way that encourages them to compete for the affection of the supervisors. If the women later complain about job conditions, they are told that arguing is unladylike and unattractive.”).

64. *Id.*

65. *Id.* at 86.

66. *Id.* at 87.

67. Goergen, *supra* note 10, at 413.

68. *Id.*

69. *Id.*

70. *E.g.*, *id.*; Speas, *supra* note 12, at 88.

71. *E.g.*, Goergen, *supra* note 10, at 413; Speas, *supra* note 4, at 88.

and use of birth control.”<sup>72</sup>

If a maquiladora worker is found to be pregnant after she is hired, she is frequently subjected to abuse and discrimination.<sup>73</sup> Employers are obligated by law to provide benefits for pregnant women, so there is a clear incentive for them to encourage pregnant women to quit their jobs voluntarily.<sup>74</sup> Employers resort to giving pregnant women work that forces them to stand throughout a full shift or lift heavy objects all day long.<sup>75</sup> Major American companies such as General Motors and Zenith Electronics have admitted to the use of such techniques in their factories.<sup>76</sup>

Women in maquiladoras frequently handle chemicals without any safety training or protective gear, thus those who are pregnant risk compromising the health and safety of their developing babies.<sup>77</sup> Women who keep their jobs often have miscarriages or deliver babies with birth defects as a result of their working conditions.<sup>78</sup> When these women are injured, anecdotal evidence suggests that employers deny work-related injuries in order to avoid qualifying their employees for government disability programs.<sup>79</sup> In fact, many maquiladoras use in-house doctors who minimize the seriousness of health conditions or suggest questionable methods of treatment in order to prevent the parent companies from incurring liability or being penalized under occupational hazard laws.<sup>80</sup>

Pregnancy discrimination was not seriously scrutinized until 1996 when Human Rights Watch investigated allegations of the practice.<sup>81</sup> The next year, a U.S. government organization received a petition that alleged pregnancy discrimination and violation of international treaties in maqui-

72. Human Rights Watch, *Submission Concerning Pregnancy Based Sex Discrimination in Mexico's Maquiladora Sector to the United States National Administrative Office*, US NAO Publication Submission No. 9701 (May 15, 1997); Grimm, *supra* note 14, at 201-02.

73. Goergen, *supra* note 10, at 414.

74. *Id.* at 415.

75. Human Rights Watch, *supra* note 72.

76. Goergen, *supra* note 10, at 415. (“One particularly egregious case of pregnancy discrimination was reported by Human Rights Watch. In that case, a pregnant woman was responsible for packing hangers in to seventy-five to ninety boxes per shift, and putting the boxes on a conveyor belt. She requested to be reassigned to seated work, but was denied. One day, she started bleeding soon after she began her shift. The shift supervisor refused to let her leave to go to the hospital. By the time her shift ended and she was able to seek medical attention, she had hemorrhaged so much that she suffered a miscarriage.”).

77. Grimm, *supra* note 14, at 209.

78. *Id.*

79. Arriola, *supra* note 24, at 615.

80. *Id.* (“On one occasion, an in house medic denied that it was the chemicals in a particular pant fabric that had caused [female employee] an upper body rash. On another occasion, she cut her finger on a machine, a frequent problem for workers because it was on a ‘speed up’—a setting used by managers to increase a machine’s output to pressure workers to maintain a specific, hurried pace. That time. . . [a medic] suggested the easy remedy of amputating her finger when she complained the wound was not healing properly.”).

81. Natara Williams, *Pre-Hire Pregnancy Screening in Mexico's Maquiladoras: Is it Discrimination?*, 12 *DUKE J. GENDER L. & POL'Y* 131, 132 (2005).

ladoras throughout Mexico.<sup>82</sup> The organization's 1998 official report concluded that pre-hiring pregnancy screening was commonplace in Mexico but that such screening did not explicitly violate Mexican law.<sup>83</sup> The international attention put pressure on the Mexican government to prevent discrimination, and the government did pass a law in 2003 that seems to prohibit pregnancy discrimination in pre-hiring settings, but pregnancy discrimination continues to remain a common practice in maquiladoras.<sup>84</sup>

While there is some question as to whether pregnancy discrimination is prohibited by Mexican laws,<sup>85</sup> all forms of sex discrimination are unquestionably prohibited by several treaties Mexico has signed including the International Covenant on Civil and Political Rights (ICCPR), The Convention to Eliminate All Forms of Discrimination Against Women (CEDAW), the American Convention on Human Rights (ACHR), and the International Labor Organization's Convention 111.<sup>86</sup>

## VII. CURRENT LAWS AND TREATIES THAT PROTECT WOMEN WORKERS IN MAQUILADORAS

### A. MEXICAN LEGISLATION

The Mexican government has acknowledged that sexual harassment constitutes a violation of human and civil rights.<sup>87</sup> It has also recognized that sex discrimination goes against the values set forth in the Mexican Constitution.<sup>88</sup> Article One of the Mexican Constitution states that “‘All discrimination motivated by . . . gender. . . that may attempt to go against human dignity and have as its objective to restrict or diminish the rights and liberties of persons is prohibited.’”<sup>89</sup>

In 2001 the Mexican government amended the Constitution in an attempt to safeguard women's rights.<sup>90</sup> Article Five of the Constitution now recognizes a right to work, and if this article is read together with the

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82. *Id.* at 133.

83. Emily Miyamoto Faber, *Pregnancy Discrimination in Latin America: The Exclusion of “Employment Discrimination” From the Definition of “Labor Laws” in the Central American Free Trade Agreement*, 16 COLUM. J. GENDER & L. 297, 307 (2007). (“In its official report, released on January 12, 1998, the U.S. NAO concluded that pre-hire pregnancy screening occurred in the Mexican maquiladora industry. In response the Mexican NAO conceded that Mexican law prohibits post-hire pregnancy discrimination, but distinguished this from discrimination during the pre-hire period, stating that there is not explicit prohibition in Mexican law against pre-employment discrimination. Mexican law reaches discrimination only where there is an existing employment relationship.”).

84. *Id.* (“Mexico has perhaps addressed the illegality of pre-hire pregnancy discrimination through a new federal anti-discrimination law that came in to effect on June 12, 2003. Article IV of the antidiscrimination law arguably makes pre-hire pregnancy discrimination illegal, as it excludes women based on pregnant status.”).

85. See generally Williams, *supra* note 81.

86. Grimm, *supra* note 14, at 202.

87. Goergen, *supra* note 10, at 412.

88. *Id.*

89. *Constitucion Politica de los Estados Unidos Meixcanos [Const.], as amended*, Diario Oficial de la Federacion [D.O.], art. 1, 13 de Noviembre de 2007 (Mex).

90. Goergen, *supra* note 10, at 415.

prohibition against discrimination in article one, the Constitution seemingly grants women the right to work.<sup>91</sup>

The Mexican Federal Labor Law also grants women the right to work and suggests that women are to be protected from gender discrimination.<sup>92</sup> The law says that “No individual may be prevented from engaging in the professional, industrial, or commercial pursuit or occupation of her choice, so long as it is lawful,” and that “citizens have the right to be free from distinctions between workers based on sex.”<sup>93</sup>

The Mexican government also passed the Federal Law to Prevent and Eliminate Discrimination in 2003.<sup>94</sup> While the name of the law suggests a sweeping prohibition of sex discrimination, it is actually quite narrow in scope. The Federal Law to Prevent and Eliminate Discrimination does not provide for civil liability against discriminators or the companies that employ them.<sup>95</sup> Instead this law charges the Mexican government to eradicate discrimination within its own government agencies,<sup>96</sup> but the Mexican government has been sluggish even to monitor discrimination within itself, so hope for eradicating discrimination within the private sector seems even less likely to occur.

Other Federal sexual harassment laws are not addressed in civil labor codes but rather in the Mexican penal law.<sup>97</sup> But the penal code defines sexual harassment narrowly and there is no recourse in civil courts and thus no way for a victim to recover monetary damages.<sup>98</sup> Instead, sexual harassment can result in a fine equivalent to forty days worth of wages, but that fine goes to the Mexican government, not to victims.<sup>99</sup> Finally, there is no requirement for training or education within companies who have engaged in sexual harassment.<sup>100</sup>

In terms of protection for pregnant workers, Mexico has passed laws that require extensive pregnancy benefits and accommodations for female workers. Pregnancy is not a justified cause for dismissal and it is impermissible for an employer to try to coerce a woman in to leaving voluntarily.<sup>101</sup> If a woman is fired because she is pregnant, she has a cause of action under the Federal Labor Law.<sup>102</sup> But pre-hire pregnancy

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91. *Id.* at 424; *Constitucion Politico de los Estados Unidos Mexicanos, as amended*, Diario Oficial de la Federacion [D.O.], art. 5, 13 Noviembre de 2007 (Mex.).

92. *Id.* at 422.

93. *Ley Federal de Trabajo, as amended*, art 3-4, Diario Oficial de la Federacion [D.O.], 27 de Noviembre de 2007 (Mex.).

94. Goergen, *supra* note 10 at 422.

95. *Id.*

96. *Id.*

97. Speas, *supra* note 12, at 89.

98. *Id.*

99. *Id.*

100. *Id.*

101. Goergen, *supra* note 10, at 431; ROGER BLANPAIN ET. AL., *THE GLOBAL WORKPLACE: INTERNATIONAL AND COMPARATIVE EMPLOYMENT LAW—CASES AND MATERIALS*, at 210 (Cambridge University Press 2007).

102. Goergen, *supra* note 10, at 431-32.

screening is not prohibited under Mexican law.<sup>103</sup>

While Mexico has provided some legal protection for female workers, the laws are not strict and are not properly enforced.<sup>104</sup> Despite the passage of these laws, Mexico remains in breach of its obligations under human rights laws as well as international and regional systems.<sup>105</sup>

#### B. REGIONAL HUMAN RIGHTS SYSTEMS

Mexico is a member of the Organization of American States (OAS), which is a regional human rights system with inter-American treaties that prohibit discrimination and provide methods for protecting female workers.<sup>106</sup> Under the Organization of American States, Mexico has signed the American Declaration on the Rights and Duties of Man, the American Convention on Human Rights, and the Inter-American Convention on the Prevention, Punishment, and Eradication of Violence Against Women.<sup>107</sup>

The Inter-American Convention on the Prevention, Punishment, and Eradication of Violence Against Women is especially applicable to sex discrimination. The Convention includes a number of articles that cover sexual harassment and discrimination against women in the workforce.<sup>108</sup> The Convention declares that every woman has the right to be free from violence, which includes discrimination and sexual harassment.<sup>109</sup> Parties to the convention must report to the Inter-American Commission of Women, giving them information regarding the measures states have adopted to prevent and prohibit violence against women in their own countries.<sup>110</sup>

Though Mexico is a dualist country that requires implementing legislation in order to bring international and regional agreements within the sphere of domestic law, it is presumed that treaties are intended be effective immediately under the good faith principle of the Vienna Convention on the Law of Treaties.<sup>111</sup> Based on Mexico's inaction in preventing sex discrimination, the Inter-American Convention may have grounds to find it has not taken good faith measures to ensure the effectiveness of signed agreements.<sup>112</sup>

The Inter-American Convention has specific means to monitor and

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103. Faber, *supra* note 83, at 307.

104. Amnesty Int'l, *Mexico: Briefing to the Committee on the Elimination of Discrimination against Women*, AI Index AMR 41/031/2006, June 1, 2006.

105. Goergen, *supra* note 10, at 416.

106. *Id.* at 417.

107. *Id.*

108. Brian D. Tittenmore, *Ending Impunity in the Americas: The Role of the Inter-American Human Rights System in Advancing Accountability for Serious Crimes Under International Law*, 12 SW. J. L. & TRADE AM. 429, 434 (2006).

109. Wagner, *supra* note 2, at 357.

110. *Id.* at 358.

111. Vienna Convention on the Law of Treaties, Article 31(1), May 23, 1969, 1155 U.N.T.S. 340.

112. Goergen *supra* note 10, at 418.

correct human rights violations within member countries.<sup>113</sup> The Convention can investigate individual instances of human rights violations, conduct investigations, advise member states, order hearings on both individual and general human rights issues, and even bring litigation before the Inter-American Court of Human Rights.<sup>114</sup> The Convention has conducted several investigations regarding labor rights concerns, but as of yet there have been no instances where issues of Mexican sex discrimination have come up before the committee. Mexico is not required to report to the committee itself, rather the Convention must take initiative to conduct investigations either on its own or on the advice of concerned groups or citizens.<sup>115</sup>

### C. INTERNATIONAL HUMAN RIGHTS SYSTEMS

Mexico is a signatory to several international treaties that recognize the right of a woman to be free from discrimination based on sex.<sup>116</sup> As such, Mexico is under an obligation to protect women, provide them with meaningful remedies, investigate alleged discrimination, and punish the persons who engage in discrimination.<sup>117</sup>

#### 1. *The North American Free Trade Agreement and the North American Agreement on Labor Cooperation*

One major international treaty that Mexico is a part of is the well-known North American Free Trade Agreement (NAFTA). NAFTA was considered to be a breakthrough trade pact when it became operative in 1994 not only because it dispensed with barriers to free trade but also because it included side agreements that addressed environmental concerns and fair labor standards issues.<sup>118</sup> When NAFTA was passed, workers in the United States were afraid that businesses would take all their jobs to Mexico, where it would be cheaper to run a factory and where lower wages could be paid.<sup>119</sup> In response to these concerns the North American Agreement on Labor Cooperation (NAALC) was enacted along with NAFTA.<sup>120</sup> The NAALC agreement was the first international trade agreement in which the United States had included labor

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113. *Id.* at 417.

114. Tittenmore, *supra* note 108 at 435.

115. *Id.* at 433.

116. Goergen *supra* note 10, at 416. These treaties include but are not limited to the North American Free Trade Agreement (NAFTA), the North American Agreement on Labor Cooperation (NAALC), the Convention on the Elimination of All Forms of Discrimination Against Women (CEDAW), and the International Covenant on Civil and Political Rights (ICCPR).

117. Human Rights Watch, *supra* note 72; Goergen, *supra* note 10, at 416.

118. Grimm, *supra* note 14, at 180.

119. Goergen, *supra* note 10, at 410.

120. North American Agreement on Labor Cooperation (NAALC), U.S.-Can.-Mex., Sept. 13, 1993, 32 I.L.M. 1449 (1993) (hereinafter NAALC); Grimm, *supra* note 14, at 180.



agreements.<sup>121</sup> It was intended to fight employment discrimination.<sup>122</sup> But NAALC places obligations only on signatory nations, not on the private parties that operate within those nations.<sup>123</sup>

NAALC includes eleven labor rights provisions that are meant to ensure minimum labor standards.<sup>124</sup> The eleven rights are divided into three groups, with the first group receiving the most protection, the second group receiving less, and the third group receiving the minimum level of protection.<sup>125</sup> Elimination of employment discrimination and equal pay provisions are in the second tier; only violations of the three rights in the first tier warrant sanctions against a violating member country.<sup>126</sup> Violation of any of the other eight rights, which include discrimination in employment, can only be remedied by international negotiation.<sup>127</sup>

Furthermore, NAALC does not provide for uniform standards across all three member states.<sup>128</sup> The parties to NAFTA did not want to concede sovereignty as a part of the treaty, thus instead of imposing uniform laws on all three countries, the agreement only requires member states to enforce domestic labor laws.<sup>129</sup> The protections included in NAALC are essentially worthless without strong implementing legislation that establishes labor laws in line with the eleven guarantees set forth in the agreement.<sup>130</sup> A violation of NAALC only occurs when the domestic labor laws of a member state are violated.<sup>131</sup> Since Mexico does not have strong implementing labor laws, sex discrimination is unlikely to be seen as a violation of the NAALC agreement. Additionally, NAALC places obligations only on signatory nations, not on the private parties that operate within those nations.<sup>132</sup>

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121. *E.g.*, Goergen, *supra* note 10, at 411; Grimm, *supra* note 14, at 180.

122. *E.g.*, Phillip DeHart, *The NAALC and Mexico's Ley Federal Para Prevenir y Eliminar La Discriminacion: Further Failure Under a Flawed Treaty or the Beginning of a Meaningful Protection from Employment Discrimination Throughout North America?*, 34 GA. J. INT'L & COMP. L. 657,662 (2006); Faber, *supra* note 89, at 303.

123. *Id.*

124. NAALC, *supra* note 120; Goergen, *supra* note 10, at 411. ("Member states were concerned that the NAALC would erode their sovereignty to set labor standards, so they refused to adopt universal labor standards. Therefore, the agreement does not set a minimum standard for those rights, but instead requires member states to enforce their own domestic labor laws.").

125. NAALC, *supra* note 120.

126. Hannah L. Meils, *A Lesson from NAFTA: Can the FTAA Function as a Tool for Improvement in the Lives of Working Women?*, 78 IND. L. J. 877, 893 (2003).

127. *Id.*

128. *Id.* at 892.

129. NAALC, *supra* note 120; Goergen, *supra* note 10, at 411; Arriola, *supra* note 30, at 624.

130. Miels, *supra* note 126.

131. DeHart, *supra* note 122, at 663.

132. *Id.*

2. *Convention on the Elimination of all Forms of Discrimination Against Women*

The Convention on the Elimination of all Forms of Discrimination Against Women (CEDAW) is another agreement that Mexico has signed in order to protect female workers. This treaty has designated a specific body to monitor and review compliance with gender-based discrimination prohibitions.<sup>133</sup> These are well respected panels within the international community, and could thus be a possible powerful tool to compel Mexico to ensure women's rights.<sup>134</sup>

The text of the CEDAW does not explicitly prohibit sexual harassment, but there has been a recommendation from the committee that oversees treaty implementation stating that all parties to the convention must protect the right of all people to be free from "cruel, inhuman, or degrading punishment or treatment."<sup>135</sup> The same recommendation defines gender based violence as a form of discrimination and includes violence toward women based on gender, or violence that "affects women disproportionately."<sup>136</sup> The recommendation also provides guidance regarding the proper treatment of women in the workplace and calls on the signatory states to ensure that laws are passed to protect women and provide for their dignity and respect.<sup>137</sup> The recommendation advises that states provide education and engage in public information programs to help overcome traditional ideas about women's inferiority.<sup>138</sup>

3. *International Covenant on Civil and Political Rights*

Mexico is also a signatory to the International Covenant on Civil and Political Rights (ICCPR). The ICCPR also has a monitoring body for gender discrimination compliance.<sup>139</sup> The ICCPR does not specifically address employment issues for women, but prohibits discrimination and guarantees equal and effective protection on any ground, including sex.<sup>140</sup>

Mexico's domestic laws and practices do not keep the nation in compliance with its commitments to human rights in regional or international treaties.<sup>141</sup> In order to meet compliance standards, Mexico needs to take a more proactive role in providing protections for the basic rights of

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133. Goergen, *supra* note 10, at 417.

134. *Id.*

135. American Declaration on the Rights and Duties of Man, adopted by the Ninth International Conference of American States, art 5, Bogota, Colombia March 30-May 2, 1948.

136. Comm. On the Elimination of Discrimination Against Women, Gen. Recommendation No. 19, *Violence Against Women*, U.N. Doc A/47/38 (11th Sess., 1992) at ¶ 1.

137. *Id.*

138. *Id.* at ¶ 24(f).

139. Goergen, *supra* note 10, at 417.

140. Williams, *supra* note 81, at 142.

141. *Id.* at 425.

women.<sup>142</sup>

### VIII. WHAT SHOULD BE DONE?

There are several options available to create and enforce laws in Mexico that would protect women workers in maquiladoras, but most are complex and include numerous obstacles.

#### A. USE INTERNATIONAL HUMAN RIGHTS TREATIES

International Human Rights treaties can be useful tools in bringing women's rights to the forefront of the global community. Most international human rights agreements include provisions for fair treatment of women, and the high visibility of these international entities means a better chance at proper enforcement and greater publicity. At the same time, international enforcement can be highly time consuming and complex, and as a result it is not always entirely effective. Two of the international human rights treaties are particularly relevant: The CEDAW and the ICCPR.

##### 1. *File a Complaint with the CEDAW Committee*

As a signatory to the Convention on the Elimination of all Forms of Discrimination Against Women, Mexico has recognized the competence of the Committee on the Elimination of Discrimination Against Women, the body that monitors compliance with the Convention and hears complaints from individuals or groups within the member states.<sup>143</sup> A case should be brought to this committee that alleges the failure of the Mexican government to comply with the terms of the agreement.<sup>144</sup> There is ample evidence of non-compliance; there have been well documented studies done by the Mexican government and International Governmental Organizations.<sup>145</sup> An individual could bring a case herself, or major international human rights groups could choose to bring a case. It would likely be more effective if an international human rights group brought the case because of the extraordinary amount of time and capital it takes to effectively litigate a discrimination case on the international level.

The Committee has actually already issued recommendations to Mexico regarding the treatment of women in the workplace.<sup>146</sup> Such recommendations have included revisions to the Mexican Labor Law, prohibition of pregnancy testing, and ensuring equal remuneration for men and women in the workplace.<sup>147</sup> While Mexico has repeatedly claimed that the legislature is considering such measures, it has yet to

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142. *Id.* at 425.

143. *Id.* at 434.

144. *Id.*

145. *Id.* at 434.

146. Williams, *supra* note 81, at 434.

147. *Id.* at 435.

take any clear action to do so.<sup>148</sup>

## 2. *File a Complaint under the ICCPR*

As a member of the United Nations, Mexico ratified the Optional Protocol which allows the United Nations Human Rights Committee to “receive and consider communications from individual subject to its jurisdiction who claim to be victims of a violation by a State Party of any of the rights set forth in the ICCPR.”<sup>149</sup> The United States could complain that Mexico is not properly protecting the rights of women, or a Mexican woman could bring her own compelling case to the committee.<sup>150</sup> This strategy could be highly effective to establish a precedent for women to use international human rights treaties to garner basic protections. If one woman is able to make a case, she could set an example for others and help establish a framework for women around the globe to have their problems heard. As a practical matter, one successful case could provide precedent and would allow other women to format their claims in a manner that is most likely to result in success.

### B. USE REGIONAL HUMAN RIGHTS TREATIES

Regional Human Rights Treaties offer an incentive because the localized nature of the enforcement means a greater chance at a speedy resolution. But since these regional agreements are not as high profile as some of their international counterparts, there is often not as much political pressure for compliance and adherence.

#### 1. *File a Complaint with the Inter-American Commission on the Prevention, Punishment, and Eradication of Violence Against Women through the Organization of American States*

The Inter-American Commission can investigate human rights violations through a petition system.<sup>151</sup> Members of the Organization of American States (OAS), OAS political organs, and individuals themselves can make the petition to initiate an investigation, or the Commission can begin an investigation on its own initiative.<sup>152</sup> The Commission is better suited to investigate than the Mexican government, because there are no political or economic consequences for the Commission if their investigation reveals information that casts the Mexican government in an unfavorable light.<sup>153</sup> Further, an investigation by the Commission might increase international pressure on Mexico to amend and enforce laws to protect women’s rights. Finally, greater publicity from a regional

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148. *Id.*

149. *Id.*

150. *Id.*

151. Tittenmore, *supra* note 108, at 435.

152. Goergen, *supra* note 10, at 436.

153. *Id.*

body may alert women to some of their rights and better educate them on possible remedies.<sup>154</sup>

After the Commission considers a case of discrimination, it can refer the case to the Inter-American Court of Human Rights.<sup>155</sup> This court has a good track record of gaining respect and compliance from Member States involved and provides a particular benefit because it recognizes both pecuniary and non-pecuniary damages.<sup>156</sup> Damages would compensate victims and provide a deterrent method for corporations engaged in sexual harassment and other maltreatment of female employees.<sup>157</sup>

A claim before the court should allege violations of the American Convention on Human Rights and the Protocol of San Salvador. Mexico has violated the Convention by allowing sexual harassment in factories and thus denies women of the full exercise of their recognized right to humane treatment.<sup>158</sup> Mexico has not taken the required positive action to prevent violations of the rights and freedoms recognized under the convention.<sup>159</sup> The Mexican government has also failed to investigate claims of discrimination in violation of the San Salvador Protocol.<sup>160</sup>

## 2. *File a Complaint under NAALC with the United States or Canada*

Parties can file a complaint under NAALC if a member country has disregarded or failed to enforce its domestic laws in violation of the NAALC agreement. If NAALC heard a complaint about the treatment of women in Mexican maquiladoras, there would be valuable information gathering concerning sex discrimination in Mexico and the government's response.<sup>161</sup> NAALC's enforcement agencies operate through the National Administrative Offices (NAOs).<sup>162</sup> As a part of NAALC, each nation must develop its own NAO that investigates violations on its own initiative or in response to complaints.<sup>163</sup> In the event of a formal complaint, the National Administrative Offices would consult with the parties involved in the complaint and seek to find a solution that would address the concerns of each party.<sup>164</sup>

If the NAO consultation did not result in satisfactory compliance, the Evaluation Committee of Experts might be called to write a report reviewing Mexican discrimination laws.<sup>165</sup> In the formulation of this report, the Committee could consider input from a wide range of sources; it could consider documentation of sexual harassment, impacts of sexual

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154. *Id.*

155. Tittenmore, *supra* note 108, at 437.

156. Goergen, *supra* note 10, at 437.

157. *Id.*

158. *Id.*

159. *Id.* at 438.

160. *Id.*

161. *Id.* at 440.

162. *Id.*

163. Grimm, *supra* note 14, at 195.

164. Goergen, *supra* note 10, at 440.

165. *Id.*

harassment, and evidence that there has not been a proper governmental response.<sup>166</sup> Upon consideration of all these factors, the committee could draft a report with a recommendation and the parties to the complaint would be required to submit a response.<sup>167</sup>

There have been some successful cases before the U.S. NAO regarding maquiladora worker treatment.<sup>168</sup> One such case involved the dismissal of maquiladora workers who attempted to organize and join unions in a General Motors/Honeywell plant.<sup>169</sup> The workers accepted severance pay, which prevented the NAO from finding that Mexico failed to enforce labor laws in violation of the NAALC.<sup>170</sup> The NAO did find that Mexican authorities used questionable labor practices, but refrained from making a formal finding or requiring further action.<sup>171</sup> If other women who suffered maltreatment in maquiladoras brought a similar case but did not accept severance pay, they would be likely to get a favorable ruling from the NAO.

Another case in a Sony affiliate plant dealt with the same sorts of issues: workers were intimidated when they tried to form a union and Mexican police were involved in a violent effort to suppress employees and stop a demonstration.<sup>172</sup> In this case, the U.S. NAO found that the problems were serious enough to require a Ministerial Consultation, a process that forces member countries to divulge further information and suggests changes to remedy a member state's failure under the treaty.<sup>173</sup>

Another case under NAALC dealt specifically with discrimination against female workers.<sup>174</sup> A women's advocacy group filed a complaint that alleged maquiladora managers required women to take pregnancy tests, physical exams, and answer personal questions about sexual activity.<sup>175</sup> The managers refused to hire pregnant women and tried to coerce women who became pregnant after being hired to quit by giving them intense physical labor assignments and requiring mandatory unpaid overtime.<sup>176</sup> The U.S. NAO found that this treatment violated Mexican labor laws and that the Mexican government provided inadequate reporting procedures for women who had suffered discrimination.<sup>177</sup> This particu-

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166. *Id.*

167. *Id.*

168. Betty Southard Murphy, *NAFTA's North American Agreement on Labor Cooperation: The Present and the Future*, Conn. J. Int'l L. 403, 415 (1995); Grimm, *supra* note 14, at 211.

169. Grimm, *supra* note 14, at 212.

170. *Id.* at 212-13.

171. U.S. National Administrative Office, Public Report or Review, NAO Submission #94001 and NAO Submission #94002, at 29 (Bureau of International Labor Affairs, U.S. Dept. of Labor, Oct. 12, 1994).

172. See U.S. National Administrative Office, Report on Ministerial Consultations on Submission #94003 Under the North American Agreement on Labor Cooperation, at 1 (Bureau of Internal Labor Affairs, U.S. Dept. of Labor, June 4, 1996).

173. *Id.*

174. Grimm, *supra* note 14, at 219.

175. *Id.*

176. *Id.*

177. *Id.* at 220.

lar decision is significant because it shows that the U.S. NAO is responsive to women's issues. Since this proceeding, however, Mexico has failed to take adequate corrective action, and similar issues continue to arise.

The continued instigation of this process is important because it will produce data and statistics regarding the status of sexual harassment in Mexican workplaces and garner international attention to the issue.<sup>178</sup> Publicity about the problem of discrimination against female workers would likely provide additional support to the equality movement and pressure the Mexican government to make appropriate changes.

Despite the potential posed by the NAALC, it has inherent limits that may impede progress in gaining protection of women's rights. The lack of enforcement options suggests that the signatory nations to NAALC did not consider the prevention of sex discrimination to be a top priority.<sup>179</sup> Additionally, NAALC does not impose universal standards or harmonizing measures in the agreement, nor is there a supranational tribunal to hear employment disputes.<sup>180</sup> Another weakness of NAALC is that it cannot issue binding resolutions or require that damages be paid.<sup>181</sup> The only available remedies are either a Ministerial Consultation or referral to an Evaluation Committee of Expert Enforcement.<sup>182</sup> Both of these options require further communication between the signatory and the NAO, but no binding result is ever ordered.

Finally, under the NAALC there may be no cause of action at all for women who suffered sex discrimination because the agreement provides for hearings based on violations of state labor laws.<sup>183</sup> Mexico's prohibitions against discrimination are found in its penal code, not in its labor laws.<sup>184</sup> So if NAALC bodies decide to interpret the agreement strictly, they may find that they are unable to hear a claim based out of the Mexican penal code.

### C. OTHER STRATEGIES

#### 1. Education and Advocacy

Article three of the Mexican Constitution provides that "every individual has the right to an education."<sup>185</sup> Thus, Mexican women are entitled to an education that will inform them about their rights under applicable labor laws.<sup>186</sup> Today, most women in Mexico are not aware of their rights, and employers treat them unfairly without consequences.<sup>187</sup> In a survey of 160 women employees, twenty-eight percent were unfamiliar

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178. Goergen, *supra* note 10, at 440.

179. Grimm, *supra* note 14, at 198.

180. *E.g., id.*; Goergen, *supra* note 10, at 439.

181. Goergen, *supra* note 10, at 439.

182. Grimm, *supra* note 14, at 198.

183. Goergen, *supra* note 10, at 439-40.

184. *Id.*

185. *Id.* at 441.

186. *Id.*

187. *Id.* at 441-42.

with the concept of sexual harassment, and fifty-three percent were unaware of any laws protecting them from discrimination.<sup>188</sup> Educating women will encourage them to file complaints when they experience discrimination, like pregnancy testing or discrimination once they become pregnant.<sup>189</sup> Education will also encourage women to speak out when they see others being treated badly because of their sex.<sup>190</sup> Advocacy groups, which are discussed below, can have an instrumental role in helping to provide and promote educational opportunities.

## 2. *Institute Corporate Codes of Conduct*

In addition to education, Mexican women could benefit with the institution of effective corporate codes of conduct. Since 1991 there have been standards of conduct in place at many Mexican maquiladoras.<sup>191</sup> These standards of conduct include twenty-nine concepts ranging from environmental concerns to employment health and safety issues.<sup>192</sup> One of the standards explicitly states that U.S. corporations will take "positive steps to prevent sexual harassment."<sup>193</sup> But the current standards have not provided enough protection for workers in maquiladoras, nor has there been appropriate enforcement.<sup>194</sup>

Corporate codes of conduct are problematic in some ways because companies are reluctant to disclose their compliance with the codes. So on top of developing stricter codes, there should be advocacy for records of implementation and enforcement to be kept, monitored, and reported.<sup>195</sup> Corporations should institute training for managers to inform them about sexual harassment and discrimination. Such training should include strategies on how to detect sexual discrimination, procedures for informing higher-ups, and suggested methods for dealing with employees who violate the codes of conduct.<sup>196</sup> Codes could also require the company to keep track of sex discrimination and possibly even report it to an independent monitoring agency.<sup>197</sup>

## 3. *File Claims in the United States under the Alien Tort Statute*

A new and developing possibility has also been presented: filing a claim under the Alien Tort Statute in the United States.<sup>198</sup> Victims of sexual harassment and pregnancy discrimination in Mexico may be able to sue U.S. owned corporations for such offenses under claims of battery and assault, breach of covenant of good faith and fair dealing, and false

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188. *Id.* at 442.

189. Goergen, *supra* note 10, at 442.

190. *Id.*

191. *Id.*

192. *Id.*

193. Speas, *supra* note 12, at 84.

194. Goergen, *supra* note 10, at 442.

195. *Id.* at 443.

196. *Id.*

197. *Id.*

198. *Id.*



imprisonment just to name a few.<sup>199</sup> While jurisdictional choice of law issues may present problems, a number of successful cases indicate that these kinds of suits could be a viable solution for women who have suffered discrimination.<sup>200</sup>

The Alien Tort Statute provides “original jurisdiction of a civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States.”<sup>201</sup>

A 1980 case, *Filartiga v. Pena-Irala* laid an important foundation for future alien tort claims under the Alien Tort Statute.<sup>202</sup> The second circuit ruled in that case that an alien citizen can obtain jurisdiction in a U.S. federal court to seek damages for torts by others in the non-citizen’s country.<sup>203</sup> The court said such a claim is viable where “deliberate torture perpetuated under the color of official authority violates universally accepted norms of the international law of human rights, regardless of the nationality of the parties.”<sup>204</sup>

But in order for an allegation to be recognized under the statute, the allegation must meet the *jus cogens* test.<sup>205</sup> In other words, the offense must violate a norm that is both prohibited and recognized by all nations.<sup>206</sup> Examples of such offenses include, “genocide, slave trade, murder or causing the disappearance of individuals, torture, . . . prolonged arbitrary detention, systematic racial discrimination, or a consistent pattern of gross violations of internationally recognized human rights.”<sup>207</sup>

As of yet, it is unclear whether a maquiladora worker can qualify to sue under these requirements, but extreme cases of discrimination have resulted in severe consequences for women in these factories, so there may be a cause of action depending on the circumstances.

#### 4. *Involve Advocacy Organizations in the Empowerment of Women and Enforcement of Labor Laws*

Advocacy organizations and Non-Governmental Organizations can have a broad impact on women’s rights in maquiladoras. Labor rights advocates can provide hope for women suffering from discrimination.<sup>208</sup> Advocates can use many avenues to disseminate their messages.

Advocates can increase publication of documents, flyers, and cards that provide short segments of information that can inform women of their

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199. *Id.*

200. Goergen, *supra* note 10, at 443.

201. The Alien Tort Statute, 28 U.S.C. § 1350 (2010).

202. *Filartiga v. Pena-Irala*, 630 F.2d 876, 878 (2d Cir. 1980).

203. *Id.*

204. *Id.*

205. Arrieola, *supra* note 24, at 629.

206. *Id.*

207. *Id.*

208. Michelle Smith, *Potential Solutions to the Problem of Pregnancy Discrimination in Maquiladoras Operated by U.S. Employers in Mexico*, 13 BERKLEY WOMEN’S L. J. 195, 196 (1998).

rights in a way that is easy to understand.<sup>209</sup> Women who are too busy to attend meetings between balancing work and home responsibilities can read this information and learn about their rights and possible avenues for redress.

Advocates can also take a more personal role in educating employees and employers.<sup>210</sup> NGOs can forge alliances with major corporations that run maquiladoras and offer their services in order to show managers what sexual harassment is and how to stop the practice of it in the work environment.<sup>211</sup> If employers are not receptive to advocates' efforts, advocacy groups can set up meetings for employees off site to teach them how to identify discrimination and work toward a solution that will keep workers safe and preserve their jobs.<sup>212</sup>

Advocates can also use their power to pressure governments and corporations to improve working conditions in maquiladoras.<sup>213</sup> Non-Governmental Organizations can send letters, meet with officials, and use the media to bring public attention to the poor business practices being tolerated within the maquiladoras.

Those who advocate for women's rights in the workplace can also play a crucial role in the formation and passage of international treaties binding national governments to protect women from discrimination. Once these treaties are passed, NGOs can be instrumental in information gathering and reporting. If advocates observe repeated breaches of the obligations set forth in treaties, they can use the grievance process to draw attention to the matter and involve the international community in remedying the problems.

One advocacy organization, the *Comite Fronterizeo de Obreras* (CFO), The Border Workers Committee, has demanded accountability for the abuse of employees at the hands of multinational corporations and helped working women to understand their rights and achieve equality.<sup>214</sup> Recently, CFO members have won labor board arbitrations and received settlements that have allowed them to leave maquiladora work behind and start small businesses on their own.<sup>215</sup>

The success of CFO suggests that the involvement of advocacy organizations and NGOs can have real and substantial effects for women faced with discrimination in the work place. Once organizations are successful a handful of times, they will increase in strength and experience and have an even larger role to play in protecting the rights of women in maquiladoras.

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209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.*

214. Arriola, *supra* note 24, at 631.

215. *Id.* at 634.

### 5. *Hold Multi-National Corporations Accountable for Discrimination*

Multi-national corporations that benefit from free trade agreements like NAFTA should ensure that those benefits do not result in disproportionate harm to local workers.<sup>216</sup> Multi-national corporations have immense wealth and power, and many times they wield this power over foreign governments who need the economic opportunities these companies can provide. Leaders of these corporations should encourage governments to pass laws that protect workers and create a culture of accountability.<sup>217</sup> If corporations refuse to take responsibility for the events that happen in their factories, consumers can play a role in enforcing human rights by supporting only those companies who engage in fair and legal business practices.

### 6. *Amend Mexican Laws*

Other means to improve conditions for women in maquiladora include amending current domestic laws and ensuring better enforcement. This would be a massive political undertaking that would require a substantial commitment from all branches of the Mexican government. Perhaps the most important way to curtail discrimination in maquiladoras would be to provide civil causes of action for women who have suffered discrimination in employment. If multi-national corporations could be held financially liable for their failure to protect women, they would certainly have an incentive to provide sensitivity training to employees. The threat of punitive damages would be more likely to convince corporations to be more proactive in preventing sex discrimination.

As part of enforcement, the Mexican government should consider creating a task force that collects data and statistics about discrimination against women in maquiladoras. The task force should report back to the Mexican government with information about violations, and the government could prosecute maquiladoras under current criminal laws prohibiting discrimination. But because the penalties under these laws are relatively light, the Mexican legislature should consider amending these laws to provide more deterrence against violating these statutes.

The Mexican government may be reluctant to take these steps because of the economic impact the maquiladoras have on the country as a whole. Complex issues arise when attempting to balance what the Mexican government perceives as necessary economic stimulus with the health and safety of female workers. But from a human rights perspective, it is clear that the Mexican government should put its citizens' rights before its economic interests in attracting business from multinational corporations.

Although there would be many obstacles to achieving better legislation for women, the effective passage of better labor and discrimination laws,

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216. *Id.* at 636.

217. *Id.*

including causes of action for civil cases, would allow for greater protection for women in the workplace.

## IX. CONCLUSION

Mexico is unquestionably failing to protect women's basic human rights by allowing reprehensible conduct to continue in maquiladoras. Women's traditional political and social roles have prevented them from garnering any significant political or social influence that would enable them to make the necessary changes to protect their interests. Despite their emergence in the job market, the stigma remains that they belong in the home and should exhibit characteristics of docility and cooperation.

Without support from the Mexican government, women have been repeatedly exposed to maltreatment at the hands of their employers. Maquiladora workers endure sexual harassment and pregnancy discrimination, and are often too dependent on wages to risk advocating for better treatment or working conditions. As a result, women are consistently abused and forced to work in unsafe and unpleasant environments.

Mexico has not provided its women with a means to prosecute the individuals or the corporations that perpetuate sex discrimination in the workplace. The country's domestic laws do not provide an adequate remedy because they are not well drafted or meaningfully enforced. Additionally, the current lack of civil remedies means that women can never sue for monetary relief and that punitive damages cannot be used a deterrent for multinational corporations.

The maltreatment of women in maquiladoras clearly establishes that Mexico is in violation of the treaties to which it is a signatory. Both regional agreements, like the Organization of American States, and international agreements, like NAFTA, the Convention on the Elimination of all Forms of Discrimination Against Women, and the International Covenant on Civil and Political Rights, require that women's labor and human rights be respected. If legitimate complaints were lodged against the Mexican government, the reviewing committees established by these treaties would likely resolve the matter in favor of the victims of sex discrimination.

In addition to filing complaints under international and regional treaties, women in Mexico should also attempt to sue in the United States under the Alien Tort Statute and align themselves with nongovernmental organizations that will pressure the Mexican government to amend laws, lobby corporations to create and enforce codes of conduct, and encourage overall education and advocacy, about sex discrimination in maquiladoras.

Once sex discrimination is eradicated, the lives of Mexican women will improve. Corporations that own maquiladoras will improve their global image and likely benefit from better employee morale. Finally, Mexico will be able to come in to compliance with major treaties and gain legiti-

macy in the international community. Thus, ensuring equal rights for women in the workplace can truly benefit all parties involved.



# MORE THAN JUST WORDS?: THE RELATIONS BETWEEN VENEZUELA AND COLOMBIA AND UNASUR INTERVENTION IN LIGHT OF THE DEFENSE COOPERATION AGREEMENT BETWEEN THE UNITED STATES AND COLOMBIA

*Katherine M. Tullos\**

## I. INTRODUCTION

It is going to happen. . . . We are going to prepare for this, because the Colombian bourgeoisie hates us. And now, it just isn't possible to make up. No, it is impossible. The agreement of the seven bases is a declaration of war against the Bolivarian Revolution."<sup>1</sup> This statement by Venezuelan President Hugo Chavez is just one example of the highly verbal combat currently occurring between Venezuela and Colombia. In light of a defense cooperation agreement between the United States and Colombia for the occupation of seven military bases signed in October 2009, there has been a firestorm of aggressive statements made between Colombia and Venezuela, neighboring countries that already have a tenuous relationship.

The agreement, its origins, and the publicized and unpublicized justifications for the defense cooperation agreement will be analyzed to predict what the deal truly holds for Colombia, Venezuela, and the entire South American region. Further, the volatile history between Colombia and Venezuela will be examined to determine how those events affect the current relationship between the two countries. The recent events between Colombia and Venezuela, including the previous verbal clashes between Colombian President Alvaro Uribe and Venezuelan President Hugo Chavez, will be examined to determine if the belligerent rhetoric between the two popular leaders will actually escalate into a war. The current situation will be compared to past quarrels between the two countries to de-

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1. *Chavez: Ready to Cut Ties with Colombia*, CNN, Aug. 26, 2009, <http://edition.cnn.com/2009/WORLD/americas/08/26/venezuela.colombia/>.

termine how recent events are similar and yet different from events in the past.

In addition, Colombia's relationship with the Union of South American Nations (UNASUR) will be analyzed to determine the purpose and role of UNASUR in this conflict. Colombia's continued membership in the organization in comparison to Colombia's close relationship with the United States will also be analyzed to explore Colombia's current diplomatic isolation in the South American region. It should be noted that while this analysis unavoidably must examine the relationship between the United States and Colombia and Venezuela, the focus of this analysis will be on the relations between Colombia and Venezuela.

## II. THE BILATERAL DEFENSE COOPERATION AGREEMENT: COLOMBIA'S CONTROVERSIAL AGREEMENT WITH THE UNITED STATES

On July 12, 2009, Colombian President Uribe informally announced that an agreement was almost concluded "on the terms of a decade-long lease to allow U.S. military personnel to use Colombian military bases to conduct anti-drug trafficking and anti-terrorism operations."<sup>2</sup> The unfinished, and originally unreleased, agreement was quickly opposed by numerous countries within the South American region.<sup>3</sup> Numerous politicians within Colombia also criticized the agreement arguing that only the Senate, not President Uribe, had the authority to permit U.S. troops in Colombia.<sup>4</sup>

Despite initial concerns regarding this agreement, the United States and Colombia formally announced on August 14, 2009 that a provisional agreement had been reached between the United States and Colombia on a Defense Cooperation Agreement (DCA).<sup>5</sup> The announced agreement was again criticized by other South American countries, especially by Venezuelan President Hugo Chavez and Ecuadorian President Rafael Correa, both of whom saw the military bases as a security threat and were concerned that the U.S. military bases in Colombia would be used to target their respective countries.<sup>6</sup> Even Chile and Brazil, which are considered to be "moderate Colombian allies," were concerned about the use of the Colombian military bases and the possibility of U.S. forces extending beyond Colombia.<sup>7</sup>

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2. Roque Planas, *Colombia: U.S. Bases Stoke the Flames of Regional Conflict*, N. AM. CONGRESS ON LATIN AM. 2009, available at <https://nacla.org/node/6058>.

3. *E.g., id.*; Simon Romero, *Increased U.S. Military Presence in Colombia Could Pose Problems with Neighbors*, N.Y. TIMES, July 23, 2009, at A14, available at <http://www.nytimes.com/2009/07/23/world/americas/23colombia.html>.

4. Planas, *supra* note 2.

5. *U.S.-Colombia Defense Cooperation Agreement*, U.S. EMBASSY, Aug. 18, 2009, <http://montevideo.usembassy.gov/usaweb/2009/09-238EN.shtml>.

6. Diana Delgado, *Colombia, U.S. Near Deal on Military Bases*, WALL ST. J., Aug. 15, 2009, <http://online.wsj.com/article/SB125035015313134409.html>.

7. *Id.*



During remarks with Colombian Foreign Minister Jaime Bermudez on August 18, 2009, U.S. Secretary of State Hillary Rodham Clinton stated that Colombia was an important ally of the United States and noted three important points to offset concerns regarding the DCA.<sup>8</sup> First, Clinton stressed that the DCA did not create U.S. bases in Colombia, but rather created only access to seven bases,<sup>9</sup> which are reported to include five military and two naval bases.<sup>10</sup> Second, Clinton noted that there would not be a “significant permanent increase” of U.S. military in Colombia.<sup>11</sup> Perhaps in response to extreme concerns by Venezuela that “the United States is planning a war on South America,”<sup>12</sup> Clinton lastly stressed that the DCA “does not pertain to other countries” and only pertains to “the bilateral cooperation between the United States and Colombia regarding security matters within Colombia.”<sup>13</sup> In response to a question addressing concerns by both Venezuela and Brazil, Clinton reiterated this point stating that the DCA had “very clear recognition of territorial integrity and sovereignty.”<sup>14</sup> In what likely could be considered a response to the criticisms by Chavez, Clinton noted that people should first understand the agreement if they were speaking out against it, and that others countries within the region should help the United States in the fight against drugs which “threat[ens]. . .the whole region.”<sup>15</sup>

Even after the announcement, the United States was on the defensive regarding the agreement, sending the U.S. State Department’s Deputy Assistant Secretary for Western Hemisphere Affairs Christopher McMullen to meet with his counterparts in Argentina, Brazil, and Uruguay to counter any misunderstandings about the agreement.<sup>16</sup> A 100-page Pentagon document that was posted on the Internet entitled, “The Budget Estimate Justification Data for the Military Construction Program of the U.S. Air Force,” (The Air Force Document) has become very controversial as critics of the agreement claim that the document demonstrates the United States’ true intentions for the bases in Colombia.<sup>17</sup> The Air Force

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8. Hilary Rodham Clinton, U.S. Sec’y of State, Remarks with Colombian Foreign Minister Jaime Bermudez After Their Meeting, Aug. 18, 2009, available at <http://www.state.gov/secretary/rm/2009a/08/128023.htm>.

9. *Id.*

10. Delgado, *supra* note 6.

11. Clinton, *supra* note 8.

12. Juan Forero, *South American Leaders Assail U.S. Access to Colombian Military Bases*, WASH. POST, Aug. 29, 2009, available at <http://www.washingtonpost.com/wp-dyn/content/article/2009/08/28/AR2009082803768.html>.

13. Clinton, *supra* note 8.

14. *Id.*

15. *Id.*

16. Stephen Kaufman, *Agreement on Colombian Bases Does Not Increase U.S. Presence*, AMERICA.GOV, Sept. 30, 2009, <http://www.america.gov/st/americas-english/2009/September/20090929185928esnamfuak0.1292383.html>.

17. *E.g.*, Christina Equivel & Paulina Serna, *New Information Emerges on U.S. Leases of Colombian Military Bases*, CUTTING EDGE, Nov. 30, 2009, <http://www.thecuttingedgenews.com/index.php?article=11808>; *Colombia and the United States: Off Base*, ECONOMIST, Dec. 3, 2009, available at [http://www.economist.com/world/americas/displayStory.cfm?story\\_id=15019912](http://www.economist.com/world/americas/displayStory.cfm?story_id=15019912).

Document states the “possibility of using Colombia as a staging post” with the example of using the base to respond to a natural disaster.<sup>18</sup> While the example illustrates that the base will be used to respond to a natural disaster, critics of the base fear that the bases would be used as a staging post for other situations to counter against “anti-U.S. governments.”<sup>19</sup> For example, the document stated the possibility of using the bases to counter possible attacks from neighboring countries, which is suspected to refer to Venezuela.<sup>20</sup> Therefore, “the [Air Force] document appears to validate the persistent reservations expressed by Colombia’s neighbors, particularly Venezuela, in regards to the real motivation and potential scope of the DCA.”<sup>21</sup> The Air Force Document has been taken off the Internet since its initial publication.<sup>22</sup> Thus, this lack of transparency only further suggests to Venezuela and other critics of the DCA that the United States is covering up its true intentions regarding the DCA.

On October 30, 2009, the DCA, which was titled a Supplemental Agreement for Cooperation and Technical Assistance and Security (SACTA) and renamed the Defense Cooperation Agreement (DCA), was signed by the United States and Colombia and subsequently entered into force.<sup>23</sup> Although the United States has issued a fact sheet,<sup>24</sup> press releases, and numerous public statements<sup>25</sup> regarding the DCA, the text of the document was only released to the public on November 3, 2010, which was months after its initial announcement.<sup>26</sup> The thirteen page DCA is organized into twenty-five articles that touch on issues such as “Access, Use, and Ownership of Agreed Facilities and Locations,” “Payment of Fees,” “Respect for Domestic Law,” “Tax Treatment,” and “Facilitation of Aircraft Riders.”<sup>27</sup> The DCA states that it “shall remain in force for an initial period of ten (10) years” and will be renewable for additional periods of ten years through review and agreement by both

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18. *Colombia and the United States: Off Base*, *supra* note 17.

19. Equivel & Serna, *supra* note 17.

20. Obama’s Disappointing Year in Latin America: Interview with Julia E. Sweig, Nelson and David Rockefeller Senior Fellow for Latin American Studies and Director for Latin America Studies, Council on Foreign Relations, Jan. 12, 2010, available at [http://www.cfr.org/publication/21177/obamas\\_disappointing\\_year\\_in\\_latin\\_america.html?breadcrumb=%2Fpublication%2Fpublication\\_list%3Ftype%3Dinterview](http://www.cfr.org/publication/21177/obamas_disappointing_year_in_latin_america.html?breadcrumb=%2Fpublication%2Fpublication_list%3Ftype%3Dinterview) [hereinafter Interview with Julia E. Sweig].

21. Equivel & Serna, *supra* note 17.

22. *Colombia and the United States: Off Base*, *supra* note 17.

23. Fabio Valencia Cossio, the Minister of Interior and Justice, and Gabriel Silva Lujan, the Minister of National Defense, signed the document for Colombia. *Signing of the U.S.-Colombia Defense Cooperation Agreement*, U.S. EMBASSY, Oct. 30, 2009, <http://montevideo.usembassy.gov/usaweb/2009/09-298EN.shtml>; Supplemental Agreement for Cooperation and Technical Assistance in Defense and Security Between the Governments of the United States of America and The Republic of Colombia, U.S.-Colom., Oct. 30, 2009, available at <http://www.state.gov/documents/organization/131654.pdf> [hereinafter DCA].

24. *Signing of the U.S.-Colombia Defense Cooperation Agreement*, *supra* note 23.

25. Clinton, *supra* note 8.

26. Equivel & Serna, *supra* note 17.

27. DCA, *supra* note 23, at 1.

Colombia and the United States.<sup>28</sup> Overall, the text of the DCA is vague,<sup>29</sup> which was perhaps the intention of the United States so they would be able to broaden the scope of authority of the DCA if necessary, and may demonstrate why Venezuela may be reading more into the DCA.

### III. VENEZUELA'S LONG HISTORY OF CONFLICT WITH COLOMBIA

Colombia and Venezuela share not only a 1,375 mile border, but also a common, volatile history.<sup>30</sup> The history of the two neighboring countries is important because it demonstrates that the countries, while they experience a history of disputes, are interdependent. Thus, it is crucial for the two countries to cooperate. Further, it shows the trend of having "a strong centralist authority"<sup>31</sup> in the region, which can be seen today through Venezuelan President Chavez, whose rhetoric can be partially blamed for the escalating tension and conflict.

Both countries were first colonized by the Spanish in the sixteenth century.<sup>32</sup> In the 19th century, Simon Bolivar, a revolutionary from Venezuela, liberated the two countries from Spanish imperialism.<sup>33</sup> Bolivar organized a country that lasted ten years called Gran Colombia, which was made up of four liberated states: Venezuela, Colombia, Ecuador, and Panama.<sup>34</sup> In 1830, the country was split, resulting in the formation of the Republic of New Grenada (which is now Colombia) and the Republic of Venezuela.<sup>35</sup> Border disputes between the two countries existed beginning in 1833, which required international negotiation from the King of Spain in 1891 and the Swiss in 1916.<sup>36</sup> More recently, the two countries were close to going to war in 1987 regarding a "dispute over a maritime border in the Caribbean Gulf."<sup>37</sup>

Colombia has been involved in a decade long diplomatic dispute with Venezuela that has been dubbed the "'Cold War' of the Andes."<sup>38</sup> While the threatening nature of the relationship between Colombia and Venezuela should be taken seriously, the history of the dispute between the

28. *Id.* at art. xxv.

29. See e.g., *What Have You Done for Me Lately?*, Center for Int'l Pol'y's Colom. Program, Nov. 23, 2009, <http://www.cipcol.org/?p=1216>; DCA, *supra* note 23.

30. *FACTBOX: History of Tensions Between Venezuela, Colombia*, REUTERS, Nov. 4, 2009, <http://www.reuters.com/article/idUSTRE5A343F20091104> [hereinafter *FACTBOX*].

31. GEOFF SIMONS, *COLOMBIA: A BRUTAL HISTORY* 23 (2004).

32. E.g., *FACTBOX*, *supra* note 30; SIMONS, *supra* note 31, at 18-22.

33. E.g., *FACTBOX*, *supra* note 30; SIMONS, *supra* note 31, at 22.

34. Arthur M. Birken, *Gulf of Venezuela: Border Dispute*, 6 *LAW. OF THE AM.* 52, 53 (1974); SIMONS, *supra* note 31, at 23-24.

35. Birken, *supra* note 34.

36. *Id.* at 53-54.

37. Patrick Markey, *Tensions Escalate Between Colombia and Venezuela*, REUTERS, Dec. 20, 2009, <http://www.reuters.com/article/idUSTRE5BJ11Z20091220>.

38. Patrick Markey, *Analysis: Andean "Cold War" Raises Risks for Colombia, Venezuela*, REUTERS, Nov. 6, 2009, <http://www.reuters.com/article/idUSN06180988>.

two countries demonstrates that war is unlikely in this situation. In 2005, the “most serious diplomatic crisis between neighbors who are ideological opposites” occurred when Colombia arrested a Revolutionary Armed Forces of Colombia (FARC) guerilla army leader, Rodrigo Granda, who had been able to hide out in Venezuela for years despite being wanted by the Colombian government.<sup>39</sup> In response, Chavez “pulled his ambassador from Bogota, [Colombia], cancelled bilateral accords and demanded an unreserved apology” from Uribe.<sup>40</sup> Like in the current situation, the United States was at the center of the dispute because the Bush administration verbally supported Colombia and even stated that Venezuela was a “‘negative’ force” and “governs in an illiberal way.”<sup>41</sup> This event, which threatened to become a serious incident, was resolved within a month with a mere agreement and press release that didn’t explain how the resolution actually occurred.<sup>42</sup>

In November 2007, after “Colombia’s government abruptly halted Chavez’s mediation efforts to release hostages held by rebels in the Colombian jungle,” Chavez said that reconciliation was “impossible” with Uribe and that their relations were in the “most serious crisis.”<sup>43</sup> Chavez also stated that Uribe’s action in stopping the negotiations was a spit in Chavez’s face.<sup>44</sup> At the time, international news media stated that the dialogue was a “sharp break” for two leaders who had just one month earlier in October appeared together smiling, hugging each other, speaking of their “sister nations,” and opening a natural gas pipeline between the two countries.<sup>45</sup> Within one month, Chavez’s and Uribe’s relationship plummeted from “the most favorable moment for relations between the two countries since they separated in 1830” to the “most serious crisis.”<sup>46</sup>

In March 2008, Colombia bombed a suspected FARC guerilla camp and killed a top FARC leader in Ecuador,<sup>47</sup> which prompted Venezuela to move troops to the border.<sup>48</sup> Colombia threatened to go to the Inter-

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39. *E.g.*, Juan Forero, *Capture of Rebel Divides Latin American Neighbors*, N.Y. TIMES, Jan. 23, 2005, <http://www.nytimes.com/2005/01/23/international/americas/23colombia.html>; *FACTBOX*, *supra* note 30.

40. James T. Kimer, *Venezuela/Colombia: Relations Turn Carnal*, 38 NACLA REP. ON THE AM. 45 (2005), available at <http://www.encyclopedia.com/doc/1P3-803084811.html>.

41. Forero, *supra* note 39.

42. *Colombia, Venezuela Settle Row*, CNN, Jan. 29, 2005, <http://www.cnn.com/2005/WORLD/americas/01/29/colombia.venezuela/index.html>.

43. James Sturcke, *Colombia-Venezuela Relations Head Towards Deep Freeze*, GUARDIAN, Nov. 26, 2007, <http://www.guardian.co.uk/world/2007/nov/26/venezuela.colombia>.

44. *Id.*

45. *E.g.*, *id.*; Simon Romero, *Leaders of Venezuela and Colombia, Ideological Opposites, Are Tightening Ties*, N.Y. TIMES, Oct. 19, 2007, <http://www.nytimes.com/2007/10/19/world/americas/19latin.html>.

46. *E.g.*, Romero, *supra* note 45; Sturcke, *supra* note 43.

47. Saul Hudson, *Chavez Warns of “War” if Colombia Strikes Venezuela*, REUTERS, Mar. 1, 2008, available at <http://www.reuters.com/article/idUSN0126952620080302>.

48. Markey, *supra* note 37.

national Criminal Court (ICC) claiming that Venezuela was “abetting genocide” because of an allegation that Venezuela was assisting the FARC.<sup>49</sup> Again, what initially seemed to be a serious incident was quickly resolved within a week and with only a handshake.<sup>50</sup> Then, Uribe visited Venezuela to meet with Chavez in July 2008.<sup>51</sup> Subsequently, all three countries reopened their embassies, which had been previously closed during the dispute.<sup>52</sup> However, the relationship between Colombia and Ecuador is still considered tense even though the event is considered resolved.<sup>53</sup>

As the recent history between Colombia and Venezuela demonstrates, there is a constant ebb and flow of diplomatic relations with increasingly negative and then positive rhetoric used by the leaders themselves and the news media to describe the current situation.

#### IV. VENEZUELA’S RECENT CONFLICT WITH COLOMBIA OVER THE DCA

Immediately following the informal announcement of the DCA in July 2009, Chavez cancelled a summit with Uribe stating that he would need to “reassess” Venezuela’s relations with Colombia.<sup>54</sup> Chavez also stated that he considered the agreement as an “aggression” against Venezuela.<sup>55</sup> Colombia verbally combated Chavez’s allegations by arguing that Venezuela should not interfere with Colombia’s relationship with the United States considering Colombia has never interfered with trying to halt Venezuela’s relationship with foreign countries, especially Venezuela’s relationship with China and Russia.<sup>56</sup>

The prevailing dispute between the two countries involves an allegation by both the United States and Colombia that Chavez and Venezuela are supporting the FARC through both arms and logistical help.<sup>57</sup> Colombia has been involved in a “four-decade-old guerilla conflict” between the Colombian government and the FARC,<sup>58</sup> which was formed “in 1964 as a communist-inspired peasant army.”<sup>59</sup> The United States alleges that the

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49. Adam Isacson, *The Colombia-Venezuela-Ecuador Tangle*, OPEN DEMOCRACY, Mar. 17, 2008, [http://www.opendemocracy.net/article/democracy\\_power/the\\_colombia\\_venezuela\\_ecuador\\_tangle](http://www.opendemocracy.net/article/democracy_power/the_colombia_venezuela_ecuador_tangle).

50. Markey, *supra* note 38.

51. *Timeline: Venezuela*, BBC NEWS, <http://news.bbc.co.uk/2/hi/americas/1229348.stm> (last visited Jan. 30, 2010).

52. Isacson, *supra* note 49.

53. Planas, *supra* note 2.

54. Chris Kaul, *Colombia-Venezuela Relations Fall Further with Rocket Revelation*, L.A. TIMES, July 28, 2009, <http://articles.latimes.com/2009/jul/28/world/fg-colombia-rockets28>.

55. Romero, *supra* note 3.

56. *Id.*; see also *Venezuela and Colombia: Jaw-Jaw War*, ECONOMIST, Nov. 12, 2009, available at [http://www.economist.com/world/americas/displaystory.cfm?story\\_id=14848972](http://www.economist.com/world/americas/displaystory.cfm?story_id=14848972).

57. *FACTBOX*, *supra* note 30.

58. *Id.*

59. *FACTBOX: Key Facts on Colombia’s FARC Rebels*, REUTERS, Dec. 22, 2009, <http://in.reuters.com/article/worldNews/idINIndia-44923320091222>.

FARC is able to continue their operations in Colombia through safe havens in the jungle terrain along the borders with Ecuador, Panama, and Venezuela.<sup>60</sup> In response to these allegations of support, Chavez repeatedly denies helping the FARC.<sup>61</sup> As noted above, recent events in 2005 with the capture of Rodrigo Granda, and the halting of negotiations in 2007, are a part of this continuing conflict.

This dispute has only been furthered by the recent confirmation by Uribe on July 26, 2009 that the Colombian military had seized from the FARC AT4 antitank weapons, which had serial numbers from the manufacturer that were registered to the Venezuelan government.<sup>62</sup> Under a final-destination agreement between Venezuela and the manufacturer, these weapons were forbidden from being exported to another country without notification.<sup>63</sup> The Venezuelan government, through Interior Minister Tarek El Aissami, denied allegations that Venezuela had given the weapons, which had been sold to Venezuela, to the FARC.<sup>64</sup> Chavez denied the allegations stating that “anyone can take a rifle and put a Venezuelan seal and serial number on it.”<sup>65</sup> Some have noted that the serial numbers do not confirm that the Venezuelan government initially sold the weapons to the FARC considering corrupt Venezuelan military officers often resell arms.<sup>66</sup> Regardless of whether Venezuela did intentionally sell the weapons to the FARC, this event further complicated the fragile relationship between Colombia and Venezuela.

On July 28, 2009, Venezuela suspended all diplomatic relations with Colombia.<sup>67</sup> While this event is significant and represents the two countries’ unstable relationship, it must be looked at in the context that Chavez has recalled his diplomats from Colombia three times since 2005.<sup>68</sup>

Subsequently, Chavez froze all imports from Colombia into Venezuela.<sup>69</sup> Then in early November 2009, Chavez declared on television to the Venezuelan people: “let’s not waste a day on our main aim: to prepare for war and to help the people prepare for war.”<sup>70</sup> Chavez subsequently ordered over 15,000 national guard troops to Venezuela’s border, some to the border with Colombia.<sup>71</sup> Even though Chavez ordered the troop movement, Venezuela lacks the resources, such as trucks and air-

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60. Kaufman, *supra* note 16.

61. *FACTBOX*, *supra* note 30.

62. Kaul, *supra* note 54.

63. *Id.*

64. *Id.*

65. Planas, *supra* note 2.

66. Kaul, *supra* note 54.

67. *UNASUR Meeting Tackles Colombian-Venezuela Spat*, *AGE*, Nov. 28, 2009, <http://news.theage.com.au/breaking-news-world/unasur-meeting-tackles-colombianvenezuela-spat-20091128-jxvw.html>.

68. *FACTBOX*, *supra* note 30.

69. *Colombia and the United States: Off Base*, *supra* note 17.

70. *Timeline of the Colombia-Venezuela Conflict*, *JUST THE FACTS*, Dec. 4, 2009, <http://justf.org/blog/2009/12/04/timeline-colombia-venezuela-conflict>.

71. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

planes, to actually relocate the large number of troops.<sup>72</sup> Therefore, it is not clear how many troops actually arrived.<sup>73</sup>

In December 2009, Chavez alleged that a spy plane entered into Venezuelan territory when it flew near a military base in Zulia, which is on the Venezuela-Colombia border.<sup>74</sup> Chavez indirectly accused the United States as the origin of the spy plane, stating that the type of plane was a “technology of the empire” of the United States.<sup>75</sup> Therefore, Chavez ordered that the army shoot down any other plane if it entered Venezuela.<sup>76</sup> In response, the Colombian Defense Minister Gabriel Silva joked that “Venezuelan soldiers mistook Father Christmas’s sleigh for a spy plane” because the alleged invasion occurred in the week before the Christmas holiday.<sup>77</sup> More seriously, Silva dismissed Chavez’s claims stating that Colombia does not have the capability to fly the alleged espionage mission that Chavez alleges.<sup>78</sup> In response, Colombia formally protested the allegations made by Chavez.<sup>79</sup> The United States also denied Chavez’s allegations, noting that the last time the United States accidentally entered into Venezuelan controlled airspace occurred in 1988.<sup>80</sup>

In April 2010, Venezuela arrested eight Colombians on charges of “spying.”<sup>81</sup> Venezuela claims that the Colombians were taking photographs of restricted electricity areas as part of an effort to impair the country’s electricity grid.<sup>82</sup> Uribe has argued that Venezuela has violated these individual’s human rights, stating: “Colombia cannot permit violations of human rights against its citizens, whether they live in Colombia or elsewhere.”<sup>83</sup>

Thus, the recent events between Colombia and Venezuela have brought concerns that a violent war may erupt between the two countries. The international community, especially the countries in the Latin American region, has increasingly focused its attention on this escalating situation to determine what, if anything, can be done to alleviate some of the tension between Colombia and Venezuela.

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72. *Id.*

73. *Id.*

74. *Chavez Accuses Colombia of Spy Plan Incursion*, CNN, Dec. 21, 2009, <http://www.cnn.com/2009/WORLD/americas/12/21/venezuela.colombia/index.html>.

75. *Id.*

76. *Id.*

77. *Colombia to Chavez: Maybe ‘Spy Plane’ Was Santa*, ABC NEWS, Dec. 21, 2009, <http://abcnews.go.com/International/wireStory?id=9396310>.

78. *Id.*

79. *Colombia Protest Over Venezuela*, BBC NEWS, Jan. 28, 2010, <http://news.bbc.co.uk/2/hi/americas/8484848.stm>.

80. *US Denies Its Warplanes Violated Venezuelan Airspace*, AFP, Jan. 4, 2010, <http://www.google.com/hostednews/afp/article/ALeqM5gyfK6wyfWm-2fX0YpkExdQCAaQBw>.

81. Will Grant, *Venezuela Accuses Colombians of Spying and Sabotage*, BBC NEWS, Apr. 6, 2010, <http://news.bbc.co.uk/2/hi/8606359.stm>.

82. *Id.*

83. Luis Jaime Acosta, *Colombia Blasts Arrests of Spies by Venezuela*, REUTERS, Apr. 7, 2010, <http://www.reuters.com/article/idUSTRE63650020100407>.

V. INVOLVEMENT OF THE UNASUR IN THE CONFLICT  
BETWEEN COLOMBIA AND VENEZUELA

The Union of South American Nations (UNASUR), “a regional body aimed at boosting economic and political integration in the region” formed in 2008, has been very focused on the DCA and the resulting issues between its two member countries.<sup>84</sup> In addition to Colombia and Venezuela, the members of UNASUR are Argentina, Bolivia, Brazil, Chile, Ecuador, Guyana, Paraguay, Peru, Suriname, and Uruguay.<sup>85</sup> Some of the goals of UNASUR listed in the preamble to the UNASUR constitution are to “build a South American identity and citizenship,” “promote the sustainable development and wellbeing of our peoples,” and to strengthen “multilateralism and the rule of law in international relations.”<sup>86</sup> UNASUR was created during a time when Chavez and Uribe were bitterly disputing Colombia’s claims that Venezuela was assisting the FARC rebels in Colombia.<sup>87</sup> Therefore, the lofty goals of UNASUR were from the start considered unattainable because of the tensions between some of the UNASUR members.<sup>88</sup>

On September 15, 2009, a UNASUR meeting was held in Quito, Ecuador to review and question the details of the DCA.<sup>89</sup> Although Uribe had previously promised to show the actual contents of the DCA to the UNASUR Defense Council, Uribe later retracted this statement.<sup>90</sup> Further, Uribe stressed that the UNASUR could not revise the DCA.<sup>91</sup> Most importantly for the relations between the Colombia and UNASUR, Colombia reportedly threatened to leave UNASUR,<sup>92</sup> which has been supported by some in Colombia.<sup>93</sup> Supposedly, this UNASUR meeting and another previous meeting, held in August 2009, were aimed at pressuring Chavez and Uribe to diplomatically “negotiate and debate instead of the increasingly common practice [between the two countries] of uttering threats and moving troops to the border.”<sup>94</sup> As discussed later, UNASUR foresaw the downward spiral of diplomatic relations between the

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84. *South America Nations Found Union*, BBC NEWS, May 23, 2008, <http://news.bbc.co.uk/2/hi/americas/7417896.stm>.

85. *Id.*

86. South American Union of Nations Constitutive Treaty, May 23, 2008, available at <http://www.comunidadandina.org/ingles/csn/treaty.htm> [hereinafter UNASUR Treaty].

87. *South America Nations Found Union*, *supra* note 84.

88. *Id.*

89. Freddy Osorio-Ramirez, *Colombia-U.S. Military Cooperation Agreement Attracts UNASUR Attention*, FOCAL POINT, Sept. 2009, <http://www.focal.ca/publications/focalpoint/fp0909/?lang=e&article=article6>.

90. *Id.*

91. *Id.*

92. *Id.*

93. Gustavo Silva Cano, *UNASUR, the Worthless*, COLOM. REPORTS, Nov. 30, 2009, <http://colombiareports.com/opinion/131-gustavo-silva-cano/7101-unasur-the-worthless.html>.

94. Osorio-Ramirez, *supra* note 89.



two countries and these negotiations may have been able to somewhat halt the diminishing relations.

Colombia refused to send its senior officials to another UNASUR meeting on November 27, 2009.<sup>95</sup> Colombian Foreign Minister Jaime Bermudez defended his country's deliberate decision to only send a technical delegation of junior officers<sup>96</sup> because "the recent escalation in threats against the Colombian government' had made it 'impossible to hold respectful discussions during the meeting.'" <sup>97</sup> In response, Venezuela argued that Colombia's lack of attendance at the meeting was a "huge mistake and an act of contempt towards [UNASUR]."<sup>98</sup> Uribe's overall lack of communication with UNASUR seems to only be further hindering Colombia's relations with the region and is "providing arguments for Venezuela to accelerate its arms race."<sup>99</sup> Uribe's lack of communication has prompted Chavez to reason "what could we do if the Yanquis [referring to the United States] are establishing seven military bases?"<sup>100</sup> Clinton also sent a letter to UNASUR to calm the concerns of the UNASUR member countries stating that the DCA is being conducted "with total respect for the sovereignty and territorial integrity of the other countries."<sup>101</sup> While Venezuela and other countries in the region still seemed unconvinced about the scope of the DCA, at least Ecuador and Brazil seemed to be satisfied by Clinton's letter, which the Brazilian minister Celso Amorin described as "a text that plainly guarantee[d] no extraterritorial intervention."<sup>102</sup> Despite these statements from Clinton, Venezuela stated that it didn't want this guarantee to turn into a joke.<sup>103</sup> Therefore, the agreement between the United States and Colombia has large scale implications for the entire region, especially for the relations between UNASUR member states.

#### VI. ANALYSIS REGARDING THE DCA: THE NECESSITY OF THE DCA, THE LIKELIHOOD OF A "FULL-FLEDGED" WAR BETWEEN COLOMBIA AND VENEZUELA, POSSIBLE PERMANENT TRADE IMPLICATIONS SPILLING FROM THE DCA, AND THE ROLE OF UNASUR IN THIS CONFLICT

Considering the argument between Colombia and Venezuela that has occurred as the result of this DCA, it is important to analyze the potential consequences which may arise. The spectrum of these consequences can range from short-term conflict and trade implications, to mass conflict

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95. *Colombia and the United States: Off Base*, *supra* note 17.

96. *Id.*

97. *UNASUR Meeting Tackles Colombian-Venezuela Spat*, *supra* note 67.

98. *Id.*

99. Osorio-Ramirez, *supra* note 89.

100. Equivel & Serna, *supra* note 17.

101. *UNASUR Summit in Quito*, JUST THE FACTS, Dec. 3, 2009, <http://justf.org/category/blog-tags/unasur>.

102. *Id.*

103. *Id.*

with major implications for the United States and the entire Latin American region. Thus, the first consideration should be whether this alliance was even necessary for continued U.S.-Colombian relations. Second, there must be an analysis of whether a war is likely to erupt between Colombia and Venezuela from this conflict, or if this just another conflict in a series of threats and conflicts that are resolved quickly. Third, there must be an analysis of the potential for massive trade and economic consequences of the conflict. Fourth, there must be a determination of what actions, if any, Colombia should take to address this conflict with its neighbors in the Latin American region through UNASUR.

A. WAS THE UNITED STATES' ALLIANCE WITH COLOMBIA  
NECESSARY?: THE JUSTIFICATIONS FOR THE DCA BETWEEN THE  
UNITED STATES AND COLOMBIA

Instead of making the DCA with Colombia, the United States should have continued the relations with Colombia under Plan Colombia and the 1952 military assistance agreement with Colombia, without an additional bilateral agreement between the two countries.<sup>104</sup> Plan Colombia is a decade long relationship between the United States and Colombia “in which the United States has assisted the country in fighting drug trafficking, ending civil conflict, fostering economic growth[,] and strengthening the rule of law.”<sup>105</sup> Even the United States Defense Assistant Secretary McMullen has admitted that the agreement merely “formalizes access that we’ve had on an ad hoc basis the whole time of Plan Colombia.”<sup>106</sup> McMullen stated that the DCA was initiated because of the extensive time and effort required to negotiate the daily terms of the American use of the Colombian bases.<sup>107</sup> But, considering the even more extensive time and effort necessary to form, revise, publicize, and defend a formal bilateral agreement, this argument does not hold. The preamble of the DCA specifically notes former agreements and memorandum of understandings made from 1952 to 2007.<sup>108</sup> President Barack Obama even stated: “[w]e have had a security agreement with Colombia for many years now. We have updated that agreement.”<sup>109</sup> Therefore, it does not seem like a necessary agreement if the two countries were already cooperatively and successfully working to achieve the goals of the DCA.

Accordingly, American officials “ruefully agree that they should have thought about the regional response to an agreement they now say was not necessary.”<sup>110</sup> Rather than needing the bilateral agreement to continue having military bases in Colombia, it seemed like the Colombian

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104. See *Colombia and the United States: Off Base*, *supra* note 17.

105. Kaufman, *supra* note 16.

106. *Id.*

107. *Id.*

108. DCA, *supra* note 23.

109. John Otis, *U.S. Military Base Plan Puts Colombia in Hot Water*, TIME, Aug. 12, 2009, <http://www.time.com/time/world/article/0,8599,1915825,00.html>.

110. *Colombia and the United States: Off Base*, *supra* note 17.

government insisted on having a formal agreement in order to ensure their own safety in Latin America.<sup>111</sup> The agreement was likely advocated by the Colombian government in order to deter Chavez “from launching the war he has seemed rhetorically to threaten against Colombia” considering the agreement “was far cheaper [for Colombia] than trying to match Mr. Chavez’s arms build-up, which has included orders for 24 Sukhoi ground attack jets, 55 military helicopters, 92 tanks and air defense missiles.”<sup>112</sup> Further, Colombia lacked the capital to even hope to compete with the arms that have been amassed by its neighbors.<sup>113</sup> Thus, this agreement allowed Colombia to avoid worrying about how to accumulate more and more arms.<sup>114</sup> Therefore, this may demonstrate Colombia’s true intentions to initiating the DCA.

However, if America did not need the agreement to continue its military presence in Colombia, it seems unlikely that America would step out so far and expose itself to diplomatic liability by making a highly publicized bilateral agreement with an unstable country in a volatile region. Rather, America seems like it wanted to make the agreement with Colombia to legally guarantee its own military presence in the Latin American region after Ecuador decided not to renew its ten-year old agreement with the United States for access to an air base in Manta, Ecuador that was used for counter-narcotics surveillance.<sup>115</sup> Ecuadorian President Rafael Correa supposedly wanted to end the agreement because he did not like U.S. military presence within the country.<sup>116</sup> Correa’s close relationship with and influence from Chavez likely played a role in Correa ending the agreement with the United States.<sup>117</sup>

Even though American officials claim that the new base at Palanquero, Colombia is “not a direct replacement” for the base in Ecuador,<sup>118</sup> the actions in Latin America demonstrate otherwise. First, the base in Ecuador was closed only a month before the DCA with Colombia was formed.<sup>119</sup> Second, the planes that had previously been based in Manta, Ecuador are now at Colombian bases, along with other bases in Panama and El Salvador, for surveillance.<sup>120</sup> Third, Obama’s defense budget for 2010 allocated \$46 million to upgrade Palanquero,<sup>121</sup> begging the question of whether this large sum of money is needed to outfit the new base

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111. *Id.*

112. *Id.*

113. Equivel & Serna, *supra* note 17.

114. *Colombia and the United States: Off Base*, *supra* note 17.

115. Stephen Kaufman, *Loss of Ecuador Base Leaves Gap in Counternarcotics Surveillance*, AMERICA.GOV, Nov. 9, 2009, <http://www.america.gov/st/peacesec-english/2009/November/20091109103908esnamfuak0.8177912.html>.

116. *Id.*

117. Correa admits he is a “personal friend” of Chavez, but argues that Chavez is not in control of him. *Profile: Ecuador’s Rafael Correa*, BBC NEWS, Apr. 27, 2009, <http://news.bbc.co.uk/2/hi/americas/6187364.stm>.

118. *Colombia and the United States: Off Base*, *supra* note 17.

119. See Kaufman, *supra* note 115.

120. *Colombia and the United States: Off Base*, *supra* note 17.

121. Otis, *supra* note 109.

for these planes from Ecuador. Therefore, it seems like America directly made the agreement with Colombia because it needed another key military alliance in Latin America after it was ousted from Ecuador.<sup>122</sup> Rather than announcing this smart and justified decision to maintain presence in the region, the United States is couching this intention by arguing that the DCA only formalizes relationships between the two countries.

Regardless of the reasoning for the agreement, the United States likely should have avoided making this agreement if it was not absolutely necessary, in spite of Colombia's insistence, to avoid being the catalyst to a situation that could erupt into war.

B. MERELY WORDS OR WILL VIOLENCE AND ESCALATING PROBLEMS  
EMERGE?: THE LIKELIHOOD OF ACTUAL WAR EMERGING BETWEEN  
COLOMBIA AND VENEZUELA

While this event is serious and should be handled with diplomatic care, this event is unlikely to erupt into a major war and will likely be resolved like the other disputes without a violent war occurring. Like in the past, Chavez "may be ramping up the rhetoric over an external threat to distract [Venezuelan citizens] from domestic problems, such as high inflation and water and power shortages, and to project his international presence."<sup>123</sup> For example, recent events demonstrate Chavez's mounting problems:

Since November 2, [2009] water has been rationed in Venezuela; the same day on which the government introduced a plan to save electricity. In Caracas, [Venezuela] each of the city's neighborhoods is without running water for at least two days every week. Chávez has urged the public to take 'lightening showers' of just three minutes, and to become accustomed to bathing in the early hours of the morning, armed with a flashlight. Even before these recent austerity measures, in early October, Datanálisis found 66 percent of Venezuelans dissatisfied with the government's moves to resolve the electricity crisis. Moreover, the same survey found '70 percent critical of Chávez's policies to create employment' and that 87 percent thought the government had done little to ensure the personal security of its citizens.<sup>124</sup>

Further, Chavez seems to be attempting to place blame on the electricity crisis on Colombia by stating that the problem is partly due to sabotage by Colombia.<sup>125</sup> Therefore, Chavez seems to have a loud bark, but does not seem willing or able to back that up with any action. For exam-

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122. Interview with Julia E. Sweig, *supra* note 20.

123. Markey, *supra* note 38.

124. Guy Hursthouse, *Déjà vu in Venezuelan-Colombian Relations, as War of Words Reignites: What Next for Chavez?*, COUNCIL ON HEMISPHERIC AFFAIRS, NOV. 20, 2009, <http://www.coha.org/deja-vu-in-venezuelan-colombian-relations-as-war-of-words-reignites-what-next-for-chavez/>.

125. Grant, *supra* note 81.

ple, as described above, Chavez threatened war against Colombia in the past if forces struck inside Venezuela, called Uribe a pawn of the United States, and then just a week later resolved the dispute with a handshake.<sup>126</sup> But, it has been argued that this situation is “far more dangerous” than the situations in the past.<sup>127</sup>

Chavez likely would not follow up his threats because if an actual war were to break out, Colombia would likely win considering its experience in fighting the FARC and its aid from America, not to mention the presence of American military forces in the country.<sup>128</sup> Venezuela’s only advantage “would be a quick air strike, using recently acquired Russian Sukhoi jets.”<sup>129</sup> Considering that Venezuela does not even have the resources to get thousands of Venezuelan troops to the border areas, it is unlikely that Venezuela would have the resources to move troops and supplies to the border for a full out war.<sup>130</sup> Further, as discussed below, Venezuela, especially Chavez, does not have the political and popular support to successfully launch a coordinated attack against Colombia.<sup>131</sup>

Because Chavez realizes his slim chances in an actual war, Chavez is using hyped -up rhetoric to create a verbal war to garner public opinion.<sup>132</sup> But, Chavez is losing this “war” as a survey in Venezuela determined that eighty-percent of Venezuelans opposed a war with Colombia and most also opposed trade sanctions with Colombia.<sup>133</sup> Another problem is that the international community does not seem to take Chavez or his threats seriously. For example, U.S. President Barack Obama dismissed Chavez’s concerns stating that some within the region are merely “trying to play this up as part of a traditional anti-Yankee rhetoric.”<sup>134</sup> Therefore, the international community, including Venezuela, may not be readily preparing for the possibility of war especially considering that the “constant[ ] talk of war sometimes trigger[s] it, accidentally or on purpose.”<sup>135</sup> If Venezuela were to launch an attack, Colombia thus would be highly dependent on U.S. assistance in the terms of military supplies and resources, troops, and equipment such as tanks.

Even though war is unlikely there likely will be more violence along the Venezuelan-Colombian border.<sup>136</sup> Already since the DCA was initi-

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126. *E.g.*, *Chavez Warns of “War” if Colombia Strikes Venezuela*, REUTERS, Mar. 1, 2008, <http://www.reuters.com/article/idUSN0126952620080302>; Markey, *supra* note 38.

127. Hursthouse, *supra* note 124.

128. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

129. *Id.*

130. *Id.*

131. “If a war would be near-impossible for Venezuela to win given the inferiority of its armed forces against a combined Colombian-U.S. defense force, it would be even harder for the effort to succeed without popular support.” Hursthouse, *supra* note 124.

132. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

133. *Id.*

134. Otis, *supra* note 109.

135. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

136. Markey, *supra* note 38.

ated there has been “the kidnap and murder of 11 men, eight of them Colombian, the murder of two Venezuelan national guardsmen; deportations of undocumented migrants and the arrest on both sides of alleged spies.”<sup>137</sup> The two Venezuelan national guardsmen were shot in the back while doing routine tasks for their job during the day on November 4, 2009.<sup>138</sup> The economic tensions described below will continue to escalate the border region, where troops have already been called.

Venezuela may be attempting to escalate the tension with Colombia because of its overlapping tension with the United States. Chavez crudely stated that the reason for the DCA was because “with the election of Obama and the Democrats in Congress, Uribe began to fear he’d lose the support that he had from Bush, and he dropped his pants due to the fear of losing the backing of the United States.”<sup>139</sup> While Uribe was undoubtedly looking for security of support from the new U.S. administration, this statement demonstrates not only the shocking rhetoric of Chavez but also demonstrates the long-term tension between the United States and Chavez.

While Venezuela has been quick to blame the DCA and the United States for the “regional instability,” Congressman Eliot Engel, the Chairman of the House Foreign Affairs Subcommittee on the Western Hemisphere, has aptly noted that the regional instability has really been caused by Chavez’s “increasingly bellicose words” and “negative rhetoric against the U.S. and our allies in Latin America and around the world [which] continues almost unabated every day.”<sup>140</sup> Congressman Engel further argued that the “real challenge for regional stability lies in President Chavez’s increasingly cozy relationship with Iranian President Mahmoud Ahmadinejad,” who is aiming to use Venezuela “as a bridge to help Iran build relations with other Latin American countries.”<sup>141</sup> Chavez has supposedly wanted to ease Venezuela’s tension with the United States, yet at the same time criticized the United States’ efforts in the Haiti earthquake relief and accused the United States of spying.<sup>142</sup>

This situation between Colombia and Venezuela is just a “war of

137. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

138. Kariz Janicke, *Venezuela-Colombia Dispute Reaches WTO, Border Closed After 2 Venezuelan Troops Shot Dead*, *VENEZ. ANALYSIS*, Nov. 4, 2009, <http://www.venezuelanalysis.com/news/4912>.

139. *Chavez Seeks Improved Relations with U.S.*, *NEWSVINE*, Jan. 17, 2010, [http://www.newsvine.com/\\_news/2010/01/17/3770683-chavez-seeks-improved-relations-with-us](http://www.newsvine.com/_news/2010/01/17/3770683-chavez-seeks-improved-relations-with-us).

140. Rep. Eliot Engel, *Chavez Destabilizes Region; Don’t Blame U.S., Colombia*, *THE HILL*, Nov. 23, 2009, <http://thehill.com/opinion/letters/69209-chavez-destabilizes-region-dont-blame-us-colombia->.

141. *Id.*

142. *Chavez Seeks Improved Relations with US*, *supra* note 139; *see also* Christopher Toothaker, *Venezuela’s Chavez Expresses Hope for Diplomatic Breakthrough with Colombia*, *WASHINGTON EXAMINER*, Apr. 25, 2010, <http://www.washingtonexaminer.com/world/venezuelas-chavez-says-hes-hoping-for-diplomatic-breakthrough-with-colombia-92058269.html> (stating that Chavez hopes for better relations with Venezuela in the future).

words,”<sup>143</sup> rather than an actual violent war. Uribe and Chavez are political opposites because they come from two sides of the political spectrum with Uribe being a conservative lawyer<sup>144</sup> and Chavez being a “fiery leftist revolutionary.”<sup>145</sup> As noted above, Chavez has recalled his diplomats from Colombia three times since 2005,<sup>146</sup> which demonstrates that Chavez quickly rescinds his diplomats after a conflict occurs and diplomats are recalled. Chavez even expelled the United Ambassador to Venezuela giving him a mere seventy-two hours to leave Venezuela in September 2008<sup>147</sup> only to restore the ambassador in April 2009 after he shook hands with President Barack Obama.<sup>148</sup> Just as Chavez has called Colombia’s actions an “aggression” against Venezuela, he also accused the Netherlands in December 2009 of aggression for permitting the United States to have access to airports in the Dutch Antilles and Aruba.<sup>149</sup> Even further, Colombia claimed that it was freezing relations with Spain in 2007 after the Spanish King, Juan Carlos, supposedly told him to “shut up” during a meeting.<sup>150</sup>

Thus, Chavez seems to be making increasingly erratic behavior to garner international attention in the short-term without credibility to his claims or statements, which he singularly reverses. Considering war has not emerged from these verbal threats with the Netherlands and Spain, it demonstrates the unlikelihood of war in this situation. However, it should be noted that the relationship between Colombia and Venezuela is historically more tenuous and recent violence shifts this situation into more of a possibility than the situation with Spain or the Netherlands.<sup>151</sup>

In what could not be a better analogy, the Council on Hemispheric Affairs noted that “Chavez may have cried wolf one too many times” for anyone to believe that he is actually threatening war.<sup>152</sup> Remarkably, Uribe has been noticeably calm in response these continuous verbal threats by Chavez.<sup>153</sup> He and the rest of the Colombian government undoubtedly recognize the threats are unsupported and thus are unwilling to escalate the conflict even more with retaliatory responses. In the past,

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143. Hursthouse, *supra* note 124.

144. Markey, *supra* note 38.

145. *Bogota Files UN Complaint Against Chavez*, *TAIPEI TIMES*, Nov. 13, 2009, <http://www.taipeitimes.com/News/world/archives/2009/11/13/2003458343>.

146. *FACTBOX*, *supra* note 30.

147. *Alleging Plot, Chavez Expels U.S. Diplomat*, *N.Y. TIMES*, Sept. 12, 2008, <http://www.nytimes.com/2008/09/12/world/americas/12iht-12bolivia.16089979.html>.

148. Michael van der Gallen, *Obama’s Handshake Pays Off: Chavez Vows to Restore Ambassador to U.S.*, *POLIGAZETTE*, Apr. 19, 2009, <http://www.poligazette.com/2009/04/19/obamas-handshake-pays-off-chavez-vows-to-restore-ambassador-to-us/>.

149. Markey, *supra* note 37; *see also U.S. Denies Its Warplanes Violated Venezuelan Airspace*, *supra* note 80 (in response to allegations by Chavez that a plane entered into Venezuelan airspace in December 2009, “the Netherlands also rejected accusations that the United States was using the islands to mount military operations against Venezuela, calling the allegations ‘unfair, baseless[,] and fanatical’”).

150. Sturcke, *supra* note 43.

151. *See FACTBOX*, *supra* note 30.

152. Hursthouse, *supra* note 124.

153. *Id.*

Uribe has been less willing to stand back idly while Chavez makes bullying statements.<sup>154</sup> However, this time he may have remained quiet in order to gain “domestic political mileage out of the verbal sparring.”<sup>155</sup> Uribe’s supporters had been attempting to pass a constitutional amendment that would permit him to run for a third term when his second term ends in August 2010.<sup>156</sup>

Some of Chavez’s bullying threats during the past few months include: “if you hurt Venezuela you’ll regret it. We are not unarmed. We do not have our arms crossed;”<sup>157</sup> stating that the DCA is an “open aggression;” declaring that any “attack” would trigger “a 100-year war;”<sup>158</sup> and calling Uribe “a mafioso” and a “little Yankee.”<sup>159</sup> His statements have been increasingly threatening; so much so that *The Economist* stated: “Hugo Chavez’s belligerent rhetoric trades at a substantial discount.”<sup>160</sup>

Chavez’s threatening language is discounted not only because it is extreme, but also because it is unsupported by any concrete evidence. For example, Chavez cannot point to any specific language in the DCA to prove that the DCA is threatening his country because the DCA does not address attacking Venezuela.<sup>161</sup> Furthermore, one of Chavez’s biggest stated concerns is an increase in the number of American troops in Colombia and the Latin American region.<sup>162</sup> His concern, however, has been blown out of proportion considering the evidence and statements made by the United States:

The American military presence in Colombia has recently declined, partly because the Democrats in Congress have cut annual military aid by 70 [million], to around 320 [million]. The number of American troops is now around 250, down from a peak of 570 in early 2007.

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154. In 2007, Uribe told Chavez “If you are spreading an expansionist project on the continent, in Colombia this project will make no headway. . . You can’t bully the continent and set it on fire as you do, speaking against Spain one day, against the United States the next, being rude to Mexico another day, Peru the next[,] and Bolivia the following morning.” Humberto Marquez, *Colombia-Venezuela: Possibly the Bitterest Conflict in a Century*, IPS NEWS, Nov. 26, 2007, <http://ipsnews.net/news.asp?idnews=40220>.

155. *Colombia Complains to UN About Chavez Rhetoric*, TIMES LIVE, Nov. 12, 2009, <http://www.timeslive.co.za/news/world/article191167.ece>.

156. *Uribe’s Third Term*, WALL ST. J., Nov. 20, 2009, <http://online.wsj.com/article/SB10001424052748704204304574543904038401172.html>. However, Uribe is not running for a third term after all. It is unclear who will be elected to be the next President of Colombia when Uribe’s term ends in August and the effect this would have on the relations between the two countries. If the next President is former defense minister Manuel Santos, the relations between the two countries may only further deteriorate. Chavez has stated: “Santos could cause a war in this part of the world.” Toothaker, *supra* note 142; *see also* Grant, *supra* note 81 (noting that claims of spying and arrest continue, the prospect of having better relations between the two countries is unlikely even with a change in the Administration).

157. Markey, *supra* note 37.

158. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

159. *Colombia and the United States: Off Base*, *supra* note 17.

160. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

161. *See* DCA, *supra* note 23.

162. *Chavez Asks Obama Not to Raise Troops in Colombia*, REUTERS, Aug. 5, 2009, <http://www.reuters.com/article/idUSTRE5745WX20090805>.



[T]his number will continue to fall, in line with aid and as Colombia takes over the maintenance of American-supplied helicopters and pilot training.<sup>163</sup>

Therefore, Chavez's language seems vague and exaggerated in order to garner as much attention without having to make specific statements that would require him to substantiate his claims with concrete proof.

Although war may be unlikely without a subsequent catalytic event occurring, the perpetual tensions between Colombia and Venezuela, as demonstrated by the verbal sparring, are unlikely to be calmed in the long term considering the fact that the "two presidents rarely back down from a fight."<sup>164</sup>

### C. IMPLICATIONS OF THE TRADE RESTRICTIONS IMPOSED BY VENEZUELA ON THE FUTURE RELATIONS BETWEEN COLOMBIA AND VENEZUELA

The trade between the two countries may be something that may not be resolved quickly, even though a war will likely not erupt over this dispute. Unlike the disputes between the two countries in 2005 and 2008 that were quickly resolved, commentators have stated that Chavez is more "serious about curtailing trade" with Colombia.<sup>165</sup> Although "many experts believe the proximity of Colombia and the long history of trade and contacts mean two-way commerce will keep flowing,"<sup>166</sup> recent events demonstrate otherwise.

Colombia and Venezuela have a six to seven billion dollar annual bilateral trade.<sup>167</sup> Colombia exports food, leather, and textiles to Venezuela.<sup>168</sup> In return, Venezuela, an OPEC country,<sup>169</sup> exports fuel and agrochemical products to Colombia.<sup>170</sup> At the same time, Venezuela has been increasingly reliant on imports of natural gas from Colombia.<sup>171</sup> In July 2009, Chavez said that he would halt all imports from Colombia.<sup>172</sup> Then in October 2009, Chavez ordered a "freeze" on all imports from Colombia.<sup>173</sup> To offset this loss of goods, including milk and meat,<sup>174</sup> into

163. *Colombia and the United States: Off Base*, *supra* note 17.

164. Forero, *supra* note 39.

165. Markey, *supra* note 38.

166. *FACTBOX*, *supra* note 30.

167. Markey, *supra* note 38; *Colombia and the United States: Off Base*, *supra* note 17.

168. Marquez, *supra* note 154.

169. Alexandra Valencia & Santiago Silva, *Venezuela blasts Colombia as Region Takes Defense*, REUTERS, Nov. 27, 2009, <http://www.reuters.com/article/idUSTRE5AR09N20091128>.

170. Marquez, *supra* note 154.

171. Romero, *supra* note 3; *see also Update: Ecopetrol, Chevron Ship 300 Million Cf/D of Gas to Venezuela*, NASDAQ, 2009, <http://www.nasdaq.com/asp/company-news-story.aspx?storyid=200906172041dowjonesdjonline000898>.

172. Helen Murphy & Alexander Cuadros, *Uribe Urges Calm After Chavez Troops Blow Up Bridges*, BLOOMBERG, Nov. 20, 2009, <http://www.bloomberg.com/apps/news?pid=20601086&sid=AVPh.obsSfkQ>.

173. *Colombia and the United States: Off Base*, *supra* note 17.

174. Nadja Drost, *Where Chavez's Tirades Matter*, GLOBALPOST, June 19, 2010, <http://www.globalpost.com/dispatch/colombia/100617/election-venezuela-border>.

Venezuela, Chavez plans on increasing imports from Brazil and Argentina.<sup>175</sup> That same month, exports from Colombia to Venezuela fell seventy-one percent compared to the trade in October 2008, the same month the year before, as a result of the diplomatic dispute.<sup>176</sup>

Not only has Chavez ordered that trade be halted, he has ensured that trade will not occur by destroying two pedestrian bridges along the border on November 19, 2010, claiming that “drugs and paramilitaries entered Venezuela across the bridges, while smugglers carried food and fuel through the area.”<sup>177</sup> Chavez has also ordered the expropriation of six Exito stores in Venezuela, a French-Colombian owned retailer that was operating stores in Venezuela.<sup>178</sup> Chavez began the expropriation on January 6, 2010, claiming that the store illegally raised prices in response to Chavez’s currency devaluation.<sup>179</sup> Furthermore, he has rejected offers from Colombia to sell electricity, despite the fact that Venezuela is currently suffering a severe shortage of energy.<sup>180</sup> Therefore, Chavez’s recent actions will only deteriorate the tense relationship between Venezuela and Colombia.

Unlike other disputes, this one has gained the attention of the Colombian government and people, which may signify that it may have larger consequences than prior disputes, especially considering that the trade embargo has already lasted over six months. This may be especially true because the Colombian central bank estimates that the sanctions from Venezuelan may cost Colombia one-percent of its GDP.<sup>181</sup> Furthermore, the Colombian Finance Minister Oscar Ivan Zuluaga predicts that economic growth in 2010 will be hampered by the trade embargo with Venezuela, “which accounts for about fifteen percent of Colombia’s sales abroad.”<sup>182</sup> In reaction, Uribe has rightly contested the trade restrictions by filing a formal complaint with the World Trade Organization’s Committee on Sanitary and Phytosanitary Measures claiming that the embargo is a “‘flagrant violation’ of WTO norms.<sup>183</sup> Uribe has tried to solve this issue diplomatically, unlike Chavez, by planning on denouncing the acts before the Organization of American States (OAS) and the United Nations Security Council.<sup>184</sup>

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175. *Venezuela-Colombia Dispute Reaches WTO, Border Closed After 2 Venezuelan Troops Shot Dead*, *supra* note 138.

176. *Colombia and the United States: Off Base*, *supra* note 17. This downward slide has continued: “[t]rade between the two countries has dropped 70 percent in April [2010] as compared to the same period last year.” Drost, *supra* note 174.

177. Murphy & Cuadros, *supra* note 172.

178. *Venezuela Begins Expropriation of Six Exito Stores*, BLOOMBERG, Jan. 19, 2010, <http://www.bloomberg.com/apps/news?pid=20601086&sid=AH1aUhzBMT2A>.

179. *Id.*

180. *Venezuela Spurns Colombian Electricity Offer*, THE STAR, Feb. 16, 2010, <http://thestar.com.my/news/story.asp?file=/2010/2/16/apworld/20100216105953&sec=APworld>.

181. *Colombia and the United States: Off Base*, *supra* note 17.

182. *Venezuela Begins Expropriation of Six Exito Stores*, *supra* note 178.

183. *Venezuela-Colombia Dispute Reaches WTO, Border Closed After 2 Venezuelan Troops Shot Dead*, *supra* note 138.

184. Murphy & Cuadros, *supra* note 172.

Although Chavez will be able to maintain the trade embargo against Colombia, by doing so he will only hurt Venezuela's economy and further lose the respect of the international community, who sees his behavior as increasingly irrational. It is likely that these trade restrictions imposed by Chavez will also continue to significantly and negatively impact the Colombian economy, unless there is an international intervention. But, the WTO does not seem to be interfering with the trade embargo except for noting in its meeting that Venezuela asked for the complaint in writing and Venezuela also suggested bilateral discussions would be more useful.<sup>185</sup> Venezuela also devalued its currency in January 2010, which will further complicate its trade relationship with Colombia because doing so makes imports from Colombia more expensive.<sup>186</sup>

The WTO should intervene with this dispute sooner rather than later because trade restrictions can have lasting and irreversible consequences for the economic and diplomatic relations between Colombia and Venezuela. If trade between the two countries is disrupted long-term, and the countries begin trade agreements with other countries, there may not be an economic incentive to promote diplomatic peace along the border. As discussed above, a full out war is unlikely to erupt; however, more and more smaller, yet still violent, clashes have occurred, likely as a result of the growing economic tension due to the decreasing trade between the two countries.

In the past, the "robust bilateral trade. . . acted as a deterrent" for both organized violence between the two countries and smaller violent skirmishes along the border.<sup>187</sup> If there is no bilateral trade to encourage peaceful diplomatic relations, violence along the border may increase. So far, there have been "frequent protests by truckers, local merchants, shop workers, and people who depend on petty contraband for a living" along the border protesting Chavez's restriction of trade.<sup>188</sup> With increased tension and lack of economic stability, violence will escalate. Already, the trade embargo "has thrown many people out of work in Venezuela's border state of Táchira, aggravating a climate of lawlessness there."<sup>189</sup> Since many Colombians cross the Tachira River border by bridge either by foot, bicycle, or motorcycle to get to work in Venezuela,<sup>190</sup> there will likely be an increased number of unemployed people if people are unable to cross the border. Unemployed workers with no prospect for employ-

185. World Trade Organization, *Transparency Deal Emerging for Developing Nations' Treatment in Food Safety and Related Issues*, Oct. 28-29, 2009, [http://www.wto.org/english/news\\_e/news09\\_e/sps\\_28oct09\\_e.htm](http://www.wto.org/english/news_e/news09_e/sps_28oct09_e.htm).

186. *Update 2-Colombia Fears Pain from Venezuela Devaluation*, REUTERS, Jan. 10, 2010, <http://www.reuters.com/article/idUSN1012815520100110>.

187. Patrick Markey, *Scenarios: How Far Will Colombia-Venezuela Crisis Worsen?*, REUTERS, Nov. 20, 2009, <http://www.reuters.com/article/idUSTRE5AJ4E320091120>.

188. Humberto Marquez, *Colombia-Venezuela: Border Killings Heat Up Tension*, IPS NEWS, Nov. 4, 2009, <http://ipsnews.net/news.asp?idnews=49140>.

189. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

190. Constanza Viera, *Colombia-Venezuela: Diplomatic Crisis Worries Border Dwellers*, IPS NEWS, Nov. 29, 2009, <http://ipsnews.net/news.asp?idnews=40279>.

ment in the future and without necessary resources and food from across the border because of the trade embargo may be forced to resort to violence for survival. Already, “paramilitaries working in the border area whom, since greater restrictions were placed on the border crossing by Chavez. . . have stepped up their threats, in particular against the National Guard.”<sup>191</sup> As discussed above, there has also been the murder of eleven civilians and two murders of national guardsmen along the border.<sup>192</sup> Therefore, Venezuela’s trade restrictions have likely furthered violence along the region.

Instead of hastening a resolution between the two countries, the trade restrictions may actually entrench the two countries into a longer conflict. Therefore, the international community, such as UNASUR, should focus on the trade restrictions between Colombia and Venezuela as a pathway to addressing the larger dispute between the two countries.

#### D. POTENTIAL OF UNASUR INVOLVEMENT IN THE CONFLICT BETWEEN COLOMBIA AND VENEZUELA AND COLOMBIA’S FUTURE RELATIONS WITH UNASUR

Because of Colombia’s continued alliance with the United States, Colombia is becoming increasingly “isolated diplomatically as Mr. Chavez presses ahead with his efforts to expand Venezuela’s oil diplomacy while eroding American influence in the hemisphere.”<sup>193</sup> Venezuela, Ecuador, and Nicaragua are already part of a leftist political alliance headed by Chavez.<sup>194</sup> This alliance between the three countries, who are “wary of American influence in the region,” likely prompted Ecuador’s decision to end a ten year agreement between Ecuador and the United States which had previously allowed “E-3 AWACs and P-3 Orion surveillance plans to operate from the Manta Air Base on Ecuador’s Pacific Coast.”<sup>195</sup> Currently, Colombia has become increasingly diplomatically distanced from both Brazil and Chile because of the DCA and the lack of consultation or information to Colombia’s neighbors in South America before the agreement was announced.<sup>196</sup>

Because Colombia is already diplomatically isolated within the region, some within the country have argued that it should leave UNASUR.<sup>197</sup> Arguing that the UNSAUR is a “useless, biased bureaucracy,” one Colombian commentator noted that the region is a “hostile territory for Colombia’s alliance with the United States.”<sup>198</sup> But, this hostile relationship

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191. Hursthouse, *supra* note 124.

192. *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

193. Romero, *supra* note 3.

194. *Id.*

195. *Id.*

196. *Colombia and the United States: Off Base*, *supra* note 17.

197. E.g., Sebastian Castaneda, *Colombia Should Leave UNASUR*, COLOMBIA REPORTS, Dec. 2, 2009, <http://colombiareports.com/opinion/cantonese-arepas/7150-colombia-should-leave-unasur.html>; Cano, *supra* note 93.

198. Cano, *supra* note 93.

only furthers the argument that Colombia must remain in the UNASUR, if only to hope for better relations in the future. It would be reckless for Colombia to hastily leave UNASUR due to the DCA with the United States because of the negative implications it could have for the future of the region. Even though Colombia should not leave UNASUR, Colombia is justified in continuing to resist UNASUR attempts to control and oversee Colombian bilateral agreements.

Even though the United States has repeatedly stated what the DCA is intended to do during negotiations and through press releases,<sup>199</sup> the vagueness of public announcements and the lack of transparency regarding the DCA, especially in light of the Air Force Document that was taken off the internet after criticism, has justifiably concerned Venezuela and other UNASUR countries. As discussed above, the Air Force Document stated the possibility of using the newly formed bases in Colombia to defend against attacks from neighboring countries.<sup>200</sup> Instead of shrouding the Document in secrecy, the United States should have been more transparent about the agreement.<sup>201</sup>

Initially, the United States should have allowed all of the UNASUR countries the ability to view the agreement before it was signed. If the United States was hesitant about open communication, Colombia should have persuaded the United States to be more open to safeguarding Colombia's political security in the region. Thus, the initial concerns the UNASUR countries had would at least be based on the actual text of the DCA, rather than on mere speculations about what the DCA may or may not agree to. In addition, Colombia should have attempted to cooperate more with the United States and UNASUR, rather than turning their backs to UNASUR, by complying with the request from UNASUR countries for the text of the agreement after initial announcement of the report.<sup>202</sup> As fully discussed below, this was not required under the UNASUR constitution,<sup>203</sup> but disclosure to UNASUR members would have benefited Colombia. Instead, by continuing to refuse to communicate openly, Colombia is only isolating itself more in Latin America and then attempting to hide behind the military shield of the United States. But, at the same time, the United States has been criticized for also "abandoning" Colombia during this conflict:

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199. See Clinton, *supra* note 8.

200. Interview with Julia E. Sweig, *supra* note 20.

201. See *Clarity About the DCA Could Reduce Tensions*, THE CENTER FOR INT'L POL'Y'S COLOM. PROGRAM, NOV. 24, 2009, <http://www.cipcol.org/?p=1218> (arguing that "(1) [t]he United States must be clearer with Colombia's neighbors that its presence in Colombia will never support any operations beyond Colombian soil; (2) [t]he United States must be clearer about the commitment that this agreement implies for Colombia's national defense," and "(3) [t]he United States must be clearer about its desire to see the Colombia-Venezuela tensions resolved peacefully").

202. Sarah Stephens, *Why Latin America is Disappointed with Barack Obama*, HUFFINGTON POST, Jan. 7, 2010, [http://www.huffingtonpost.com/sarah-stephens/why-latin-america-is-disa\\_b\\_415341.html](http://www.huffingtonpost.com/sarah-stephens/why-latin-america-is-disa_b_415341.html).

203. See UNASUR Treaty, *supra* note 86.

If the mute behavior of a bloc [UNASUR] to which Colombia belongs is surprising in the face of President Chavez's wild insults, war-like threats and provocative acts, the attitude of our great ally to the north [referring to the United States] is nothing less than outrageous. Washington not only seeks to distance itself, but has sought to place both governments' conduct on a sort of equal footing.<sup>204</sup>

Colombia, consequently, would be ill advised to rely on their relationship with the United States to pull them out of this diplomatic mess. Therefore, even though Colombia "leaving UNASUR would be an act of political bravery,"<sup>205</sup> it would also be political suicide at a time that Colombia cannot afford to have declining diplomatic relations.

While the agreement formation process was not transparent, the United States may be stepping up to Colombia's defense when the United States agreed in January 2010 to discuss the DCA with UNASUR.<sup>206</sup> Clinton stated that there is an "interest in getting close to this organization" to the Ecuadorian President and UNSUAR pro tempore President Rafael Correa,<sup>207</sup> who had previously requested an urgent meeting with U.S. President Barack Obama in August 2009.<sup>208</sup> Thus, if UNASUR and the United States are able to communicate and effectively cooperate with each other, Colombia may be able to better their relations with UNASUR. If there is better communication between the United States, Colombia, and UNASUR about what the DCA actually does authorize, UNASUR, and its member countries, may be less apprehensive about the agreement.

Although the United States and Colombia are not innocent in this escalating tension, UNASUR should also be held accountable for its role in this conflict. Rather than trying to negotiate between the countries to reach a settlement, UNASUR is only intensifying the verbal conflict between Colombia, Venezuela, and the United States by requesting more and more information and attempting to put restrictions on countries' bilateral agreements.<sup>209</sup> Rather than the UNASUR urging open talks and negotiations to calm the two countries, only the Organization of American States (OAS) seems to be "urging talks," with Brazil and the Dominican Republic offering to serve as negotiators.<sup>210</sup> Even though the OAS seems willing to facilitate negotiations between Colombia and Venezuela, Venezuela has been arguing that it will only accept mediation through UNASUR because the DCA is threatening the regional integra-

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204. *What Have You Done for Me Lately?*, *supra* note 29.

205. Cano, *supra* note 93.

206. *U.S. Agrees to Hold Dialogue with UNASUR*, PEOPLE'S DAILY, Jan. 21, 2010, <http://english.people.com.cn/90001/90777/90852/6875378.html>.

207. *Id.*

208. *UNASUR: Correa Proposes Meeting with Obama*, MOMENTO 24, Aug. 28, 2009, <http://momento24.com/en/2009/08/28/unasur-correa-proposes-meeting-with-obama/>.

209. *See e.g., id.; US Agrees to Hold Dialogue with UNASUR*, *supra* note 206.

210. *E.g., Markey*, *supra* note 187; *Timeline of the Colombia-Venezuela Conflict*, *supra* note 70.

tion of South America specifically.<sup>211</sup> Considering the membership in OAS includes all thirty-five countries of North and South America, including the United States,<sup>212</sup> Venezuela may be unwilling to engage in negotiations with OAS because of possible involvement by the United States.

Even though Colombia disagrees with some of the current policies of the UNASUR, Colombia should continue being a member of UNASUR and must respect the organization because of the possibility of better relations in the future. It has been argued that Colombia's decision to ignore the concerns from UNASUR has "weakened faith in multilateralism."<sup>213</sup> Therefore, it is argued that the result of this conflict "is an overall reduction in the value of such efforts at integration that might have acted as safeguards against war."<sup>214</sup> Not only has Colombia ignored the concerns from UNASUR, it has decided to bypass UNASUR and file complaints with the Organization of American States (OAS) and the United Nations Security Council.<sup>215</sup> Even though the organization may not seem as effective as expected, Colombia must retain membership in UNASUR because UNASUR still has the potential to achieve its lofty goals. Therefore, Colombia should try to communicate through UNASUR rather than just bypassing the organization by filing complaints with OAS and the UN.

Even though Colombia's disregard of UNASUR could be considered to weaken the central authority of UNASUR, Colombia was and is under no obligation to comply with every demand of the organization. The preamble to the UNASUR constitution states clearly that there is an "unlimited respect for sovereignty and territorial integrity and inviolability of States."<sup>216</sup> Thus, the UNASUR must honor the "sovereignty and territorial integrity" of Colombia to make bilateral agreements with another country regardless of consultation or approval of the agreement, because it is a sovereign independent nation.<sup>217</sup> Consequently, Colombia's refusal

211. *Venezuela-Colombia Relations Keep Worsening*, EL UNIVERSAL, NOV. 27, 2009, [http://english.eluniversal.com/2009/11/27/en\\_ing\\_esp\\_venezuela-colombia-r\\_27A3125811.shtml](http://english.eluniversal.com/2009/11/27/en_ing_esp_venezuela-colombia-r_27A3125811.shtml).

212. The member countries of OAS are Antigua and Barbuda, Argentina, The Bahamas, Barbados, Belize, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago, the United States of America, Uruguay, and Venezuela. *Member States*, Organization of American States, [http://www.oas.org/en/states/member\\_states.asp](http://www.oas.org/en/states/member_states.asp) (last visited June 4, 2010).

213. Robbie Cavoors, *The U.S. in Colombia: Splitting South America*, AWOL, 2009, <http://www.awolau.org/2009/11/18/the-u-s-in-colombia-splitting-south-america/>.

214. *Id.*

215. *E.g.*, Murphy & Cuadros, *supra* note 172; Castaneda, *supra* note 197.

216. UNASUR Treaty, *supra* note 86.

217. Colombian commentators have made a persuasive argument: "But what is not clear to me is why the Colombian government is expected to give explanations to South American states about a deal it signed with a third state. Colombia, as a sovereign, free nation, is endowed with the right to sign agreements and deals with whatever states it chooses, so far as they do not contradict international law or

to agree at a UNASUR meeting in September that “military agreements with countries outside the UNASUR bloc should be approved by it” was legally justified.<sup>218</sup> An independent nation should have the ability to make contracts with other countries without the supervening nature of approval by an intergovernmental organization. There is nothing in the UNASUR Constitution that provides the member states are legally obligated to consult with UNASUR before making agreements.<sup>219</sup> Rather, UNASUR seems to offer “a space for consultation in order to reinforce South American integration and the participation of UNASUR in the international area” if a country wishes to take opportunity of it,<sup>220</sup> but the Constitution does not command consultation.

But, Colombia’s second refusal at the September UNASUR meeting to provide “real security guarantees for the region’s countries regarding the U.S.’s agreement with Colombia”<sup>221</sup> was less justified if Colombia was committed to transparency and fully cooperating with the UNASUR. Unlike UNASUR’s first request that all agreements should be approved by UNASUR, this request seems to some extent reasonable. An organization that is committed to the “strengthening of multilateralism and the rule of law in international relations in order to achieve a multipolar, balanced[,]and just world” through integration of the countries<sup>222</sup> would have a justified interest in maintaining security in the region. There is a heightened interest if this conflict, especially the American involvement in the conflict, truly “constitutes a grave danger for peace in Latin America” according to Ecuadorian President and UNSUAR pro tempore President Rafael Correa.<sup>223</sup> It seems like an admirable goal for the UNASUR to want to be consulted about international agreements, but without the expectation of being able to forbid the agreement from being made. Instead, there is a continued lack of transparency and a lack of communication with UNASUR. Thus, Venezuela continues to speculate that Colombia is refusing to provide information to UNASUR and its member countries because of the true reasons for the DCA.<sup>224</sup>

Considering that Colombia was not consulted as a member of UNASUR when Chavez initiated bilateral agreements with Russia or

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previous agreements signed by Colombia. Why must Colombia submit itself to scrutiny by other UNASUR nations on this matter? Why should the rest of South America have the privilege of questioning Colombia’s foreign and domestic policies?” Cano, *supra* note 93.

218. *UNASUR Fails to Reach Full Consensus on U.S. Bases in Colombia*, VENEZ. ANALYSIS, Sept. 17, 2009, <http://www.venezuelanalysis.com/news/4800>.

219. See UNASUR Treaty, *supra* note 86.

220. *Id.*

221. *UNASUR Fails to Reach Full Consensus on U.S. Bases in Colombia*, *supra* note 218.

222. UNASUR Treaty, *supra* note 86.

223. Cavooris, *supra* note 213.

224. *UNASUR Fails to Reach Full Consensus on U.S. Bases in Colombia*, *supra* note 218.



China,<sup>225</sup> it does not seem just for Chavez to now insist on disclosure or consultation for Colombia's agreements. Therefore, if Venezuela were arguing for consultation and approval in this situation, it would require Venezuela to go through the same diplomatic procedure for any bilateral agreements it would make in the future. If Venezuela was Colombia's situation, it would likely also be protesting the demands of other countries and UNASUR. Thus, UNASUR should not be permitted to argue authority over this agreement now when UNASUR failed to exercise this supposed authority in the past.

Although Colombia has the authority to contest UNASUR's restrictions about its sovereign authority to enter into bilateral agreement, Colombia must continue to communicate and cooperate with UNASUR to hope to maintain collaboration in the region. Although Colombia may think it can suffice with support from the United States, Colombia needs UNASUR involvement in the future for continued peace and stability in the region.

## VII. CONCLUSION

The DCA between the United States and Colombia has far-reaching consequences for the relations between the South American countries and the South American region and the United States. While a war is unlikely to occur as a consequence from the Venezuela-Colombia conflict and the DCA, this agreement will continue to tear apart the diplomatic relations between Colombia and Venezuela, the entire South American region, and United States relations with the South American region for at least a decade, which is the length of the DCA. The DCA may not be the catalyst that causes Colombia and Venezuela to erupt into a conventional war from a mere verbal war, but eventually there may be an event that does escalate the situation into more than just Chavez's ceaseless rhetoric. If and when that event does occur, Colombia will need to rely on its UNASUR membership to attempt to end any conflict diplomatically rather than militarily. Therefore, Colombia needs to maintain its membership in the organization while asserting its sovereignty at the same time. Furthermore, the international community must interfere with Venezuela's trade embargo in an attempt to continue to have a multi-billion dollar deterrent to an actual war. This situation should demonstrate to the United States that it should be more hesitant the next time it enters into a defense cooperation agreement with another country because it may be unnecessary for future relationships and could have long-lasting implications for U.S. relations. Overall, this conflict between Colombia and Venezuela demonstrates how one, perhaps unnecessary, agreement could spark a multitude of consequences: threatened war,

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225. Colombia's foreign minister stated: "[w]e never expressed our opinion in what our neighbors do. . . . Not even when the Russian presence became known in Venezuelan waters, or with relations with China." Romero, *supra* note 3; see also *Venezuela and Colombia: Jaw-Jaw War*, *supra* note 56.

verbal assaults between leaders of neighboring countries, declining diplomatic relations between two countries, a multi-billion dollar trade embargo, and international legal questions regarding membership in an intergovernmental organization.



# FINDERS, WEEPERS—LOSERS, KEEPERS? FLORIDA COURT SAYS U.S. COMPANY MUST RETURN RECOVERED TREASURE TO KINGDOM OF SPAIN

*Michael R. Nelson\**

## I. INTRODUCTION

ON June 3, 2009, Magistrate Mark Pizzo, sitting in U.S. Federal Court in Tampa, Florida, ruled that Odyssey Marine Exploration (the “Odyssey”), an American marine archaeology company, should return an estimated \$500 million worth of bullion to the Spanish government after it was removed from the site of a centuries-old shipwreck in the Atlantic Ocean.<sup>1</sup> Odyssey recovered seventeen tons of gold and silver coins from the site—located in international waters about 100 miles west of the Straits of Gibraltar—in 2007, and promptly hauled them back to its Florida base.<sup>2</sup> Odyssey’s decision to move the treasures infuriated the Spanish government, which filed legal claims demanding their return, insisting that the wreck was the *Nuestra Senora de las Mercedes* (“the *Mercedes*”), a Spanish warship that was sunk by the British Royal Navy in 1804.<sup>3</sup> Peru further complicated matters in 2008 when it filed a conditional claim stating that the treasure may be part of its country’s heritage, arguing that it is entitled to any property that originated in Peru or was produced by Peruvian people.<sup>4</sup>

Odyssey insists that there is not enough evidence to prove that what it found at the site, code named “Black Swan,” was indeed part of the *Mercedes* and alternatively, that if it *is* the wreckage of the *Mercedes*, then the “ship was on a commercial mission and its *cargo* could be legitimately

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1. Cahal Milmo, *Why Is There A Storm Brewing Over the Right to Plunder Shipwrecks?*, INDEPENDENT, June 9, 2009, <http://www.independent.co.uk/news/world/politics/why-is-there-a-storm-brewing-over-the-right-to-plunder-shipwrecks-1700207.html>.

2. Posting of Hans Verstraate to PEACE PALACE LIBRARY, <http://peacepalacelibrary-weekly.blogspot.com/2009/06/maritime-cultural-property-and-treasure.html> (June 16, 2006, 12:18 EST).

3. Milmo, *supra* note 1.

4. Verstraate, *supra* note 2.

recovered under salvage law and shared among salvors and claimants.”<sup>5</sup> Not surprisingly, Spain continues to demand the full return of the unearthened riches to Madrid,<sup>6</sup> while Peru contends that its right to the treasure is superior to Spain’s because the property “physically, culturally, and historically originat[ed] in Peru.”<sup>7</sup>

A. A UNIQUE INTERSECTION OF INTERNATIONAL LAW, TREATIES,  
AND AGREEMENTS

Odyssey’s purported ignorance as to the identity of the vessel at the discovery site and alternative claim that the ship was on a commercial mission are calculated attempts to circumvent an array of international policies. Proving either contention could create waves in what otherwise looks like smooth sailing for Spain.

The International Maritime Organization’s 1989 International Convention on Salvage declares that most wrecks found in international waters are there for the taking, *except* for around “3,000 sovereign immune vessels which litter the world’s seabeds.”<sup>8</sup> State-owned ships, “including *all* naval vessels, remain the inalienable property of their originating nation.”<sup>9</sup> Such language exists, among other places, in the Geneva Convention on the High Seas.<sup>10</sup> In fact, this notion is so prevalent that it is generally accepted in admiralty law that a sovereign government’s naval ships “belong in perpetuity to the countries that owned them” and cannot be abandoned.<sup>11</sup> Merchant vessels, on the other hand, may be fair game for treasure hunters.<sup>12</sup>

Recent action by the United Nations may also modify the status of admiralty law as it relates to sunken shipwreck discovery.<sup>13</sup> The 2001 UNESCO Convention on the Protection of Underwater Cultural Heritage, much to the chagrin of private sector marine explorers, allows for the government of whichever coastal nation is closest to the discovery site to claim title to a sunken vessel and its cargo, as long as it rests on the continental shelf or is less than 200 miles offshore.<sup>14</sup> Under the

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5. Milmo, *supra* note 1 (emphasis added).

6. Unopposed Mot. for Admis. to Appear Pro Hac Vice and Written Designation and Consent to Act (Docket No. 12) at ¶ 5, *Odyssey Marine Exploration, Inc. v. The Unidentified, Shipwrecked Vessel*, No. 8:07-cv-00614 (M.D. Fla. June 1, 2007).

7. Ex. A to Peru’s Sur-Reply in Opp’n to Spain’s Mot. to Dismiss (Docket No. 206) at ¶ 25, *Odyssey*, No. 8:07-cv-00614 (May 4, 2009); *see also* Report and Recommendation at 29, *Odyssey*, No. 8:07-cv-00614 (June 3, 2009).

8. Milmo, *supra* note 1.

9. *Id.*

10. Convention on the High Seas art. 8, Apr. 29, 1958, 13 U.S.T. 2312, T.I.A.S. No. 5200 (“Warships on the high seas have complete immunity from the jurisdiction of any State other than the flag State”).

11. *See, e.g.*, Mike Celizic, *Sunken Treasure Stirs International Booty Battle*, MSNBC—TODAY, Mar. 24, 2009, <http://today.msnbc.msn.com/id/29856469>.

12. *Id.*

13. Mark A. Wilder, *Application of Salvage Law and the Law of Finds to Sunken Shipwreck Discoveries*, 67 DEF. COUNS. J. 92, 104 (2000).

14. *Id.*

UNESCO Convention, there is a presumption of abandonment of title to a vessel and its cargo twenty-five years after sinking, and it declares absolute abandonment after fifty years.<sup>15</sup> Again, the only exception is that “sovereign” shipwrecks—naval vessels, aircraft and, naval auxiliaries—are deemed the property of the original government in perpetuity.<sup>16</sup> But, to date, only fifteen countries have formally signed this convention, and twenty signatories are required for it to come into force.<sup>17</sup>

Instead of relying on the collection of jurisdictional legislation and multilateral treaties that make up the bulk of admiralty law, the Spanish government has proceeded by asking the court to honor the U.S. Foreign Sovereign Immunities Act (“FSIA”).<sup>18</sup> Section 1609 of the FSIA provides that “property in the United States of a foreign state shall be immune from attachment, arrest and execution.”<sup>19</sup> Spain also cited the 1902 Treaty of Friendship and General Relations between the United States and Spain in their request to extend protection to their submerged warship and its cargo—even if the cargo was being transported commercially. Per the treaty’s provisions, “in cases of shipwreck . . . each party shall afford to the vessels of the other, whether belonging to the State or to individuals, the same assistance and protection and the same immunities which would have been granted to its own vessels in similar cases.”<sup>20</sup> Because the United States is a party to the aforementioned Geneva Convention on the High Seas and acknowledges that naval vessels are forever the property of their flag country, *Odyssey* looks like it is destined to be left high and dry.<sup>21</sup> To be precise, if the bullion that *Odyssey* discovered *did* come from a sovereign warship, whether it was on a naval mission or a commercial mission, then by law it is the property of Spain. It has never been abandoned, and it cannot be awarded to another party in a U.S. court. Enter *Odyssey*’s doubt about the identity of the supposed *Mercedes*.

#### B. LA NUESTRA SENORA DE LAS MERCEDES

Somewhat surprisingly, the history of the *Mercedes*, from its construction at the Spanish Navy Shipyard in Havana, Cuba, to its destruction in the Battle of Cape Saint Mary, is extremely well documented.<sup>22</sup> The *Mercedes* distinguished tenure in the Royal Spanish Navy began in 1789 and

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15. *Id.*

16. *See id.*; see also Peter Hess, *Legalized Plunder?*, UNESCO, May 14, 1998, <http://www.imacdigest.com/unesco.html>.

17. Milmo, *supra* note 1.

18. Mot. to Dismiss and for Other Relief of Claimant-Def. Kingdom of Spain (Docket No. 37) at 13, *Odyssey*, No. 8:07-cv-00614 (Sept. 19, 2007).

19. 28 U.S.C. § 1609 (2006).

20. Treaty of Friendship and General Relations, U.S.-Spain, art. X, July 3, 1902, 33 Stat. 2105.

21. *See* Report and Recommendation (Docket No. 209) at 25, *Odyssey*, No. 8:07-cv-00614.

22. *See* Claimant Kingdom of Spain’s Mot. to Dismiss or for Summ. J. (Docket No. 131) at 4-7, *Odyssey*, No. 8:07-cv-00614 (Sept. 22, 2008).

“included diverse missions that ranged from participation in combat operations to the secure transportation of troops, specie, and government officials.”<sup>23</sup> The *Mercedes*’ final voyage took place during a period marked by constant warring among Europe’s superpowers.<sup>24</sup> Spain’s King Carlos IV had allied Spain with Napoleonic France in their struggle against Great Britain by pledging his financial and military support in the Treaty of San Ildefonso in 1800.<sup>25</sup>

The Treaty of Amiens brought about a temporary peace between the warring nations in 1802; however, the Spanish government worried that Spain would be forced back into hostilities with Great Britain if, as anticipated, war between Great Britain and France resumed.<sup>26</sup> Fearing that continued involvement in Napoleon’s conflict with Great Britain would be disastrous to the future of his country, King Carlos secretly agreed to pay France a generous monetary subsidy in lieu of furnishing the military aid required by the Treaty of San Ildefonso.<sup>27</sup> The King thus directed the Minister of the Spanish Navy to dispatch warships to gather precious metals and other valuables from their Viceroyalties in South America.<sup>28</sup> Consequently, the *Mercedes* and her sister ship, the *Clara*, began their voyage across the Atlantic in 1803 “with the objective of bringing back the specie and effects of the Royal Treasury which [were] ready in America.”<sup>29</sup> As predicted, hostilities between France and Great Britain resumed shortly thereafter, delaying the return trips of both warships until August of 1804.<sup>30</sup>

Anticipating that the Spanish warships returning from the Americas would be feeding the coffers of its French archenemy, the “British government ordered its Navy to intercept any Spanish homeward-bound Ships of War with treasure on board.”<sup>31</sup> On the morning of October 5, 1804, the British fleet intercepted the Spanish squadron just south of Portugal, opened fire, and the Battle of Cape Saint Mary commenced.<sup>32</sup> Minutes later, “the *Mercedes* was rocked by a catastrophic explosion and sank,” killing over 250 military personnel and several civilians.<sup>33</sup>

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23. *Id.* at 4.

24. *Id.*

25. See Report and Recommendation (Docket No. 209) at 5, *Odyssey*, No. 8:07-cv-00614.

26. Kingdom of Spain’s Motion to Dismiss or for Summary Judgment, *supra* note 22, at 4.

27. Report and Recommendation (Docket No. 209) at 5-6, *Odyssey*, No. 8:07-cv-00614.

28. Kingdom of Spain’s Mot. to Dismiss or for Summ. J. (Docket No. 131) at 5, *Odyssey*, No. 8:07-cv-00614.

29. *Id.* (internal quotations omitted).

30. *Id.* at 6.

31. *Id.* (quoting Decl. of James P. Delgado, Ph.D., Ex. D to Claimant Kingdom of Spain’s Mot. to Dismiss or for Summ. J. at ¶ 15, *Odyssey*, No. 8:07-cv-00614 (Sept. 22, 2008)).

32. *Id.*

33. *Id.* at 7.

## II. APPLICATION

## A. CAN THE LAW OF FINDS OR THE LAW OF SALVAGE HELP ODYSSEY?

Finding a half a billion dollars on the ocean floor seems like it would be perfect fodder for an adventure novel or a Hollywood feature film, but history and reality have proven that the protagonist rarely, if ever, sails into the proverbial “sunset” in such cases.<sup>34</sup> Instead, expensive litigation over ownership rights and interests almost always ensues. The *Columbus-America Discovery Group* (“*Columbus-America*”) may well be the poster-child for this assertion, as they were forced into a protracted legal battle after discovering the *S.S. Central America*, a steam ship that went down in a hurricane off the coast of South Carolina in 1857.<sup>35</sup>

When the *Central America* sank, so did 425 passengers making the journey from California to New York after striking it rich in the gold rush, as well as close to \$2 million of bullion (valued in 1857 dollars).<sup>36</sup> In litigation to determine the ownership rights surrounding the bullion, the federal district court awarded *Columbus-America* title when it ruled that the ship had been abandoned; but on appeal, the Fourth Circuit reversed, refusing to conclude that full abandonment of the gold had taken place.<sup>37</sup> On remand, the district court took the Court of Appeals’ suggestion, but still awarded *Columbus-America* a ninety percent salvage award for the recovery of the gold.<sup>38</sup> The victory, however, was moral rather than substantive as the whole debacle resulted in harsh losses for *Columbia-America*. Their projected costs for exploration, recovery, and litigation at the date of the award were \$30 million, compared with the final salvage award of roughly \$19 million.<sup>39</sup>

Albeit frustrating, jockeying between claims of title and questions of abandonment is present in almost every case involving the discovery of sunken treasure. This confusion is wholly attributable to the need to apply either “the law of finds” or the “law of salvage” to such recovered goods.<sup>40</sup> While its application has become less and less common, “the law of finds necessarily assumes that the property involved was never owned or was abandoned, and therefore the ancient and honorable principle of ‘finders, keepers’ applies.”<sup>41</sup> The key element to the law of finds is that

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34. See Wilder, *supra* note 13, at 92.

35. See *id.* at 99-100; see also *Columbus-Am. Discovery Group v. Atl. Mut. Ins. Co.*, 974 F.2d 450 (4th Cir. 1992).

36. Wilder, *supra* note 13, at 99.

37. *Id.* at 100.

38. See *id.*; see also *Columbus-Am. Discovery Group v. Unidentified, Wrecked, & Abandoned Sailing Vessel*, its Engines, Tackle, Apparel, Appurtenances, Cargo, Etc., 1993 WL 580900, at \*32 (E.D. Va. Nov. 18, 1993); *Columbus-Am. Discovery Group v. Unidentified, Wrecked, & Abandoned Sailing Vessel*, 742 F. Supp. 1327 (E.D. Va. 1990).

39. Wilder, *supra* note 13, at 100.

40. See *id.* at 93-94.

41. *Id.* at 93 (quoting Craig N. McLean, *Law of Salvage Reclaimed: Columbus-Am. Discovery v. Atl. Mut.*, 13 BRIDGEPORT L. REV. 477, 499 (1993)).

of “abandonment,” which, considering the ramifications, courts are justifiably reluctant to find.<sup>42</sup> It is not often that owners expressly and publicly abandon their property, and although a court can infer abandonment from circumstantial evidence, like lapse of time and nonuse by the owner, its doing so requires support by “strong and convincing evidence.”<sup>43</sup> Instead, courts tend to err on the side of caution by applying the law of salvage.

The origins of the law of salvage reaches back almost 3000 years to the Rhodian era.<sup>44</sup> Salvage law does not address the title to recovered property as the law of finds does. Rather, it provides for “liberal compensation” for a successful salvor in return for “labor expended. . . in rendering salvage service[;]. . . the promptitude, skill, and energy displayed in rendering the service and saving the property[;]. . . the risk incurred by the salvors in securing the property from impending peril[;]. . . and the value of the property saved.”<sup>45</sup> A plaintiff is permitted to plead both salvage law and the law of finds, so that if the court denies finds, salvage law can serve as a backup, as Odyssey has done in this case. It should be noted that courts in admiralty favor the application of salvage law over the law of finds because salvage law “is more consonant” with the standards of marine activity, encourages less secretive forms of conduct, and aims to preserve property, “saving it from destruction, damage, or loss.”<sup>46</sup>

In light of his pleadings to the Court and unwavering assertions to the press, it appears that Odyssey’s CEO, Greg Stemm, is determined to hold on to the notion that the bullion did not come from the *Mercedes*.<sup>47</sup> Of course, if that ends up being the case, the entire discovery could then be awarded to Odyssey under the law of finds.<sup>48</sup> But, the location of the site, the type of coins they recovered there, as well as the presence of other artifacts (unique cannons and copper plating), cast a lot of doubt on his already self-serving assertion.<sup>49</sup> Likewise, despite Odyssey’s efforts, Judge Pizzo does not agree with its assertion that admiralty law requires a distinction between a vessel and its cargo.<sup>50</sup> According to Judge Pizzo, the idea that the actual ship-wreckage of the *Mercedes* is sovereign but the cargo she was carrying was not is unacceptable because “a vessel and

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42. See Wilder, *supra* note 13, at 93; see also *Columbus-Am. Discovery Group*, 974 F.2d at 460-61.

43. *Zych v. The Unidentified, Wrecked, and Abandoned Vessel, Believed to be the SB “Lady Elgin”*, 755 F. Supp. 213, 214 (N.D. Ill. 1990).

44. Wilder, *supra* note 13, at 92.

45. *The Blackwall*, 77 U.S. 1, 14 (1869); see also Wilder, *supra* note 13, at 92-93.

46. *Hener v. U.S.*, 525 F.Supp. 350, 356 (D.C.N.Y. 1981).

47. See Celizic, *supra* note 11 (“One difficulty in doing that is that the Mercedes was hit in its powder magazine during the battle and blew up, leaving little actual wreckage at the bottom of the ocean.”).

48. *See id.*

49. Report and Recommendation (Docket No. 209) at 7-11, *Odyssey*, No. 8:07-cv-00614.

50. *Id.* at 23.



its cargo are inextricably intertwined.”<sup>51</sup>

It seems then, that what the “liberal compensation” salvage law calls for may be the best bet for *Odyssey*, which has already expended a considerable amount of time and money exploring, excavating, and transporting the treasure—not to mention mounting litigation costs. Nevertheless, Spain and their counsel have navigated these turbulent legal waters with expert efficiency. By focusing on the identity of the sovereign warship and the aforementioned FSIA, Spain has all but capsized *Odyssey*’s claim. If Judge Pizzo’s Report and Recommendation, which concludes that the site and cargo are indeed the remnants of the *Mercedes* and thus the sovereign property of Spain, is not overturned, then it will be jurisdictionally impossible for any U.S. court to award *Odyssey* anything, let alone “liberal compensation.”<sup>52</sup>

B. WHY IS PERUVIAN METAL CLAIMED BY SPAIN AND FOUND NEAR  
PORTUGAL BEING LITIGATED IN THE MIDDLE  
DISTRICT OF FLORIDA?

At first glance, it might seem odd that a U.S. federal court in Florida would be charged with resolving salvage claims to the remnants of a colonial-era shipwreck discovered near the European continental shelf in international waters.<sup>53</sup> But, this is not the first time that such an issue has been presented within the jurisdiction of U.S. courts. In fact, “the exercise of admiralty subject matter jurisdiction has never been limited to maritime causes arising solely in the United States territorial waters.”<sup>54</sup> U.S. Courts ascribe their authority in these types of cases to two legal principles—(1) *jus gentium* and (2) constructive *in rem* jurisdiction,<sup>55</sup> as well as the language of the U.S. Constitution. Under Article III, section two, clause one of the U.S. Constitution, “the judicial power of federal courts extends to *all* cases of admiralty and maritime jurisdiction.”<sup>56</sup> Indeed, “since our nation’s founding, federal courts sitting in admiralty, and particularly when adjudicating salvage claims, have applied the *jus gentium*, or customary law of the sea. . .irrespective of the nationality of

51. *Id.* (quoting Sunken Military Craft Act, §§ 1401, 1408(1), (3), 10 U.S.C. § 113 note (2004) (The Act defines a “sunken military craft” to include “associated contents,” which means “(A) the equipment, cargo, and contents of a sunken military craft that are within its debris field; and (B) the remains and personal effects of the crew and passengers of a sunken military craft that are within its debris field.”)).

52. Report and Recommendation (Docket No. 209) at 12 n.10, *Odyssey*, No. 8:07-cv-00614 (“I find the evidence as to the res’s identity so one-sided that Spain would prevail as a matter of law, which is the standard for granting summary judgment under Rule 56.”).

53. *Id.*

54. *Wilder, supra* note 13, at 102-05; *R.M.S. Titanic Inc. v. Haver*, 171 F.3d 943, 961 (4th Cir. 1999).

55. Report and Recommendation (Docket No. 209) at 12, *Odyssey*, No. 8:07-cv-00614.

56. Stephen P. Coolbaugh, *Raiders of the Lost. . .Sub? The Potential for Private Claims of Ownership to Military Shipwrecks in International Waters: The Case of Japanese Submarine I-52*, 49 BUFF. L. REV. 929, 952 (2001) (citing U.S. CONST. art. III, § 2, cl. 1) (emphasis added).

ships, sailors, or seas involved.”<sup>57</sup>

Constructive *in rem* jurisdiction, which is applied even more frequently, requires that the property in question be deposited into the court’s possession.<sup>58</sup> Since doing so can be a monumental task in some situations, over time courts have allowed for one or two items of a discovery that may consist of hundreds of thousands of different pieces to serve as the “fictional equivalent” of the entire cache.<sup>59</sup> Once the property is *in custodia legis*—or in the court’s possession—they have dominion over the property and can adjudicate accordingly.<sup>60</sup> As Judge Pizzo pointed out though,

[A] court should wade carefully into international waters to adjudicate a salvage claim, particularly one that concerns a historical wreck with significant loss of life. . . . this admonition is even more appropriate when the salvor’s claim implicates a foreign sovereign’s patrimonial interests and that sovereign’s asserted independence from suit per the FSIA.<sup>61</sup>

This line of thought seems to have resonated with Judge Pizzo, who, after evaluating the proceedings of the case, decided that he was ready to return the treasure to Spain and let *Odyssey* fight for what would, at best, probably be limited to a salvage fee in Spanish courts.

### C. HISTORY? PATRIMONY? TREASURE? OR POLITICS?

The implications of the outcome of this case are not exactly far-reaching; still, it would be hasty to write off the proceedings as legally insignificant simply because they involve naval battles, ancient history, precious metals, and treasure hunters. In fact, several of the issues under examination are just as practical as they are quixotic. For example, it is important to remember that when Judge Pizzo accepted Spain’s belief that the wreck in question is that of the *Mercedes*, he also accepted that the wreck-site is the graveyard of over 250 Spanish citizens. Whether or not such an area should be treated with the reverence of a cemetery or whether is instead fair game for exploration is a culturally significant matter that touches a large number of people.

In addition, the relationship between the FSIA and the principle that a warship belongs to its flag country in perpetuity probably piques the interest of any sea-faring nation. Given the proclivity of treasure hunters to discover downed ships, any countries whose naval vessels are currently resting on the ocean floor are likely to agree with Spain’s Minister of Culture in believing that this is “a hugely important ruling and one that

57. Report and Recommendation (Docket No. 209) at 12, *Odyssey*, No. 8:07-cv-00614; see also *Treasure Salvors, Inc. v. Unidentified Wrecked & Abandoned Sailing Vessel*, 640 F.2d 560, 567 (5th Cir. 1981).

58. See *R.M.S. Titanic*, 171 F.3d at 967-968.

59. Report and Recommendation (Docket No. 209) at 12, *Odyssey*, No. 8:07-cv-00614; see also *Cal. v. Deep Research, Inc.*, 523 U.S. 491, 496 (1988).

60. See *U.S. v. Rizzo*, 297 U.S. 530, 535-36 (1936).

61. Report and Recommendation (Docket No. 209) at 14, *Odyssey*, No. 8:07-cv-00614.

will set a precedent for future claims.”<sup>62</sup> Interestingly enough, the United States, while not a party to this lawsuit, submitted a brief in support of Spain’s claim to all items recovered from the site.<sup>63</sup> Accordingly, the U.S. Department of Justice defended such a position by declaring that “the United States seeks to make sure that its own warships that are sunk. . . be treated as sovereign vessels and honored tombs not subject to exploration or exploitation without authorization.”<sup>64</sup>

It is tough to discount Spain’s concern for the gravesite of its soldiers and their desire to have any cultural artifacts returned. But at the same time, it is easy to speculate as to whether or not their attention to the matter would be so focused without the half a billion dollars worth of bullion that Odyssey recovered. Spanish officials have moved to quash such suspicions by openly declaring that they are not after the gold, but rather the “history. . . the memory, [and] the respect, essentially, for what is a marine graveyard of [its] people.”<sup>65</sup> Yet, past inquiries for cooperation, and numerous recent offers to arrange some sort of division<sup>66</sup> of the valuables recovered by Odyssey CEO Greg Stemm have been brushed aside by Spain, which repeats that everything on the ship is cultural heritage, and that the Kingdom of Spain “does not do commercial deals.”<sup>67</sup> Stemm may take offense to the characterization of his company’s work as simply “commercial,” though.<sup>68</sup> He has always maintained that Odyssey’s archaeological prowess is “unsurpassed,” and has pointed out that they have been “thoroughly documenting and recording the site,” noting its “immense historical significance.”<sup>69</sup> On the other hand, a different selection of commentators are much harsher than Spain even, alleging that Stemm’s salvage work on shipwrecks constituted “theft of public history and world history” and that Odyssey is only out to make money because “they’re a corporation with enormous expenses. . . they’re not there to preserve history.”<sup>70</sup>

Considering Peru’s position in this matter, it is ironic to see supporters

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62. Brendan Borrell, *Treasure Hunter Odyssey Ordered to Give Booty Back to Spain*, SCIENTIFIC AM. NEWS, June 8, 2009, <http://www.scientificamerican.com/blog/post.cfm?id=treasure-hunter-odyssey-ordered-to-2009-06-08>.

63. See Statement of Interest and Brief of the U.S. as Amicus Curiae in Supp. of the Kingdom of Spain (Docket No. 247), *Odyssey Marine Exploration, Inc., v. The Unidentified, Shipwrecked Vessel, & the Kingdom of Spain*, the Rep. of Peru, et al., No. 8:07-cv-00614-SCB-MAP (M.D. Fl. filed Sept. 29, 2009).

64. *OMEX Firm Asks Court to Reject U.S. Brief in Spain Treasure Fight*, TRADINGMARKETS.COM, Sept. 11, 2009, <http://www.tradingmarkets.com/.site/news/Stock%20News/2524546/>.

65. Al Goodman, *Spain’s Lost Treasure Battle in U.S. Court*, CNN, June 9, 2008, <http://edition.cnn.com/2008/WORLD/europe/06/08/spain.treasure/index.html>.

66. See Celizic, *supra* note 11.

67. *Id.*

68. Terry Aguayo, *A Bountiful Undersea Find, Sure to Invite Debate*, N.Y. TIMES, May 19, 2007, <http://travel.nytimes.com/2007/05/19/us/19treasure.html>.

69. *Id.*

70. *Id.*

of Spain's claim brand Odyssey as "thieves"<sup>71</sup> and "looters."<sup>72</sup> Although Peru was a Spanish Viceroyalty at the time, the coins that were aboard the *Mercedes* were minted in Lima in 1803 and crafted with Peruvian silver from the mines of Potosi.<sup>73</sup> Obviously then, with the *Mercedes* being destroyed before she reached her final destination, the coins that are being so hotly contested and claimed as sovereign property by Spain have never even been on Spanish soil. Moreover, even if they had gotten there, their stay would have been extremely brief. As admitted in their Motion to Dismiss or for Summary Judgment, as soon as the coins were to arrive in Spain they would have been transferred directly to France in lieu of furnishing soldiers and military equipment.<sup>74</sup> Such historical observations are not as legally significant in a court of law as the FSIA or the Geneva Convention are, but with Odyssey and Spain both straining to claim a moral high ground, it is easy to wonder if the most legitimate claim to the treasure belongs to Peru.

Peru's Foreign Minister, Jose Garcia Belaunde, does not think that the claims are as complicated as the intensity of the litigation would lead one to believe.<sup>75</sup> Everyone admits that the "500,000 gold coins on Spanish warship Nuestra Senora de las Mercedes were minted in Peru," thus giving Peru ownership "as this was and continues to be Peruvian territory."<sup>76</sup> He continued, asserting that the precious metals belong to Peru "through the principle of succession of states."<sup>77</sup> Odyssey CEO Stemm has gone on record advocating Peru's position, but one would be hard pressed to view his support as being completely genuine and not out of spite for the vehement opposition that the Kingdom of Spain has maintained throughout this controversy.<sup>78</sup> In either case, Stemm noted that "Peru's filing raises a significant and timely question relating to whether a former colonial power or the colonized indigenous peoples should receive the cultural and financial benefit of underwater cultural heritage derived from

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71. *Id.* ("[their] salvage work on shipwrecks constituted "theft of public history and world history").

72. Ben Sills, *Odyssey Treasure is from Spanish Warship, Spain Says*, BLOOMBERG, May 8, 2008, [http://www.bloomberg.com/apps/news?pid=20601103&sid=AMcAp\\_5mOIf4&refer=US](http://www.bloomberg.com/apps/news?pid=20601103&sid=AMcAp_5mOIf4&refer=US), ("looting the Mercedes was akin to raiding the wreck of the USS Arizona sunk by Japanese bombers at Pearl Harbor in 1941.").

73. *Odyssey Marine Exploration in More Choppy Water: Peru Pushes Legal Claim Over Rights to Sunken Treasure*, ANDEAN AIRMAIL & PERUVIAN TIMES, Jan. 31, 2009, <http://www.peruviantimes.com/odyssey-marine-exploration-in-more-choppy-water-peru-pushes-legal-claim-over-rights-to-sunken-treasure/311556> [hereinafter *Odyssey Marine Exploration in More Choppy Water*].

74. Kingdom of Spain's Mot. to Dismiss or for Summ. J. Claimant Kingdom of Spain's Mot. to Dismiss or for Summ. J. (Docket No. 131) at 4-5, *Odyssey*, No. 8:07-cv-00614.

75. Alex Emery, *Peru Demands Return of Odyssey Treasure, Garcia Belaunde Says*, BLOOMBERG, Sept. 8, 2008, <http://www.bloomberg.com/apps/news?pid=20601086&sid=A1JLoR2XHJ988>.

76. *Id.*

77. *Id.*

78. *Odyssey Marine Exploration, Peru Filing Claim in "Black Swan" Case*, COINLINK, Aug. 22, 2008, <http://www.coinlink.com/News/shipwrecks-treasure/peru-filing-claim-in-black-swan-case/>.

the previously colonized nations.”<sup>79</sup>

#### D. OVERBOARD AND MAROONED? OR HOPE FOR RECOVERY?

It is interesting to point out that if not for a few thousand feet of water covering the *Mercedes* wreck site, this issue would almost certainly not be litigated. Disputes of this nature are hardly seen on land, but the fact that the case at bar concerns an undersea discovery seems to alter the perspective of parties involved and casual observers alike. As one commentator points out, “If these guys went and planted a bunch of dynamite around the Sphinx, or tore up the floor of the Acropolis, they’d be in jail in a minute.”<sup>80</sup> One could surmise that the Kingdom of Spain would not hesitate to group the purported wreck site of the *Mercedes* with the Sphinx or the Acropolis, standing strongly by the fact that they do “not want their [sunken] warships interfered with. . . at all.”<sup>81</sup> But now that it is past that point and “what’s done is done,” what should happen to all of that gold?

As alluded to previously, Spain has refused to partner, more than once, with Odyssey for any sort of recovery mission, and there is no reason to suspect that their position will change.<sup>82</sup> Spain’s Minister of Culture has been unwavering about the country’s position by stating that Spain is “positively against Odyssey and people like Odyssey.”<sup>83</sup> Surely, Mr. Stemm does not take such a comment personally. But the fact that Spain probably has more treasure-laden ships at the bottom of the ocean than any other country must be frustrating for a man who has devoted his life to treasure hunting.<sup>84</sup> In spite of its colossal tensions with Spain, however, Odyssey is not on unfriendly terms with any other country.

As a matter of precaution, and to avoid these expensive legal battles, Odyssey tends to try to negotiate arrangements with nations that may have a claim to a wreck it is working to excavate.<sup>85</sup> Recently, Odyssey came to an agreement with the government of Great Britain to recover *HMS Sussex*, a British frigate that sank with as much as \$500 million worth of gold ingots aboard.<sup>86</sup> As per their arrangement, as “owner” of the wreck, the British government retains all “historically significant” artifacts that are found. Odyssey and Great Britain will then split the overall value of the cargo—eighty percent to Odyssey and twenty percent to the government for the first \$45 million, a 50-50 split of the value of the remaining artifacts up to \$500 million, and a 60-40 split, the bigger share

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79. *Id.*

80. Aguayo, *supra* note 68.

81. Jim Flannery, *Court Will Decide Who Gets \$500M Haul*, SOUNDINGS, Nov. 2009, <http://www.soundingsonline.com/features/in-depth/243142-court-will-decide-who-gets-500m-haul>.

82. *Id.*

83. *Id.*

84. Sills, *supra* note 72.

85. *Id.*

86. *See id.*; *see also HMS Sussex*, BRITISH ARCHAEOLOGICAL TRUST, <http://www.rescue-archaeology.freeserve.co.uk/news/hms-sussex.html>.

going to Odyssey, for anything after that.<sup>87</sup> Odyssey is seeking similar arrangements with the British to recover two other vessels—*HMS Victory* and the *Laconia*.<sup>88</sup>

### III. CONCLUSION

In spite of Judge Pizzo's findings, it is clear that not all of the parties to this lawsuit are convinced that the rights to the *Mercedes* and her precious cargo have been adequately resolved. Peruvian Chief Prosecutor Katty Aguize insists that Peru has "sufficient and reasonable indications, as well as rights to claim the treasure and have it returned to Peru."<sup>89</sup> But the fact that Peru was not a part of this case until late 2008 put their position at a significant disadvantage. Despite swiftly dispatching Peru's interests, Judge Pizzo himself admitted "that the Viceroyalty of Peru might have claims, but that there was no jurisdiction to handle those claims," having already concluded that the wreckage was a Spanish naval vessel, and thus, subject to sovereign immunity.<sup>90</sup> Nevertheless, Peru intends to appeal Judge Pizzo's recommendation that Odyssey return the rescued treasure to Spain.<sup>91</sup> Unlike Odyssey, the Peruvian government does not dispute that the vessel carrying the gold and silver was the *Mercedes* that belonged to Spain, but instead relies on the fact that all of the valuable objects whose ownership is being determined originated in Peru.<sup>92</sup> In short, Peru claims that it has the right to the trove of treasure "because it was looted in the first place."<sup>93</sup>

Odyssey will also appeal Judge Pizzo's recommendation, and has claimed that it is "surprised at the outcome" of the case thus far.<sup>94</sup> Odyssey CEO Stemm remains confident that his firm will prevail and that "ultimately the judge or the appellate court will see the legal and evidentiary flaws in Spain's claim, and [they'll] be back to argue the merits of the case."<sup>95</sup> With all the political and legal pressure mounting on Judge Pizzo and the Eastern District of Florida, though, it remains to be seen if either appeal will gain any traction or if Odyssey will be forced to mount its offensive in Spanish Courts. As it relates to future discoveries, Spain obviously has a different viewpoint of treasure-recovery than Great Britain, but as it concerns the *Mercedes*, it seems, what is done is done. So again, what is to be done with all of that gold?

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87. *Id.*

88. See Milmo, *supra* note 1.

89. *Peru Joins Odyssey/Spain Dispute Over Recovered Sunken Treasure*, MERCOPRESS, June 6, 2009, <http://en.mercopress.com/2009/06/06/peru-joins-odysseyspain-dispute-over-recovered-sunken-treasure> [hereinafter *Peru Joins Odyssey*].

90. David L. Ganz, *Odyssey Could Lose Treasure*, NUMISMATIC, June 11, 2009, <http://www.numismaster.com/ta/numis/Article.jsp?ad=Article&ArticleId=6782>.

91. *Peru Joins Odyssey*, *supra* note 89.

92. *Id.*

93. *Odyssey Marine Exploration in More Choppy Water*, *supra* note 73.

94. *Id.*

95. *Id.*

It is doubtful that Spain would elect to dump the silver and gold coins back into the sea, and there are hundreds of thousands of duplicates of whichever coins they could select to display in museums. Although the specific amount is unknown, Odyssey has incurred “millions and millions of dollars” in costs associated with the exploration and excavation of the Black Swan site.<sup>96</sup> If Spain is to keep everything brought up, should Odyssey not be compensated for its salvage work? Why is an arrangement like the one Odyssey reached with Great Britain so out of the question? Should the favored Law of Salvage fall by the wayside because cargo found on the ocean floor was aboard a naval vessel and not a merchant vessel? What about Peru’s claim? Perhaps light will be shed on these questions should litigation continue in Spain.

As mentioned previously, the concepts involved in this sort of litigation have existed for thousands upon thousands of years. Among other things, this particular case is demonstrative of the high costs involved in this sort of litigation and “highlights the need to resolve the issue of ownership for ancient wrecks found in international waters.”<sup>97</sup> It is a prime example of the conflicts that exist “among finders/salvors, owners, governments, preservationists, and cultural property advocates,” and invites questions as to whether or not “the current laws governing shipwrecks in international waters” are simply “inadequate.”<sup>98</sup> Dozens of sunken vessels are discovered every year, yet there has been little, if any, progress in arriving at a method of dealing with shipwrecks that would alleviate the need for such costly international litigation. That being said, predicting what sort of guidelines the international community could agree upon to help the current situation is difficult given the subject matter and wide range of opinions. Instructing private firms like Odyssey to stop looking for ship wreck locations may inhibit the discovery and preservation of any such wrecks at all.<sup>99</sup> In addition, unfounded guidelines for staying away from locations that could literally be bursting at the seams with valuable artifacts promises to “promote clandestine behavior on the part of salvors” and could move interesting specimens that are already out of human touch into the abyss of the black market.<sup>100</sup> Hopefully a compromise can be made that would protect the sanctity of such sites while providing an opportunity to ensure that any cultural artifacts are given an opportunity to be admired by the public and not selfishly poached or exploited.

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96. Celizic, *supra* note 11.

97. David Curfman, *Thar Be Treasure Here*, 86 WASH. U. L.R. 181, 187 (2008).

98. *Id.* at 207.

99. See Wilder, *supra* note 13, at 105.

100. *Id.*





# Updates



# CANADA UPDATE—HIGHLIGHTS OF MAJOR LEGAL NEWS AND SIGNIFICANT COURT CASES FROM JANUARY 2010 THROUGH APRIL 2010

*Andrew C. Brown\**

## I. SUMMARY OF LEGAL NEWS

### A. CANADIAN GOVERNMENT TO FAST-TRACK HAITIAN IMMIGRATION

In response to the devastating earthquake that hit Haiti on January 12, 2010, Citizenship and Immigration Canada (CIC) announced new measures relating to the immigration of Haitian nationals to the country. The new measures also addressed the status of Haitians already residing in Canada on a temporary basis.

Effective as of January 16, 2010, CIC will give priority to “new and existing sponsorship applications from Canadian citizens, permanent residents and protected persons who have close family members in Haiti.”<sup>1</sup> In order to benefit from this program, however, those applying for special priority must identify themselves as having been “directly and significantly affected” by the earthquake and its aftermath.<sup>2</sup> The procedures for priority immigration status will also extend to pending adoptions of Haitian children.<sup>3</sup> Interested persons filing new sponsorship applications should prominently and clearly write “Haiti” on the mailing envelope.<sup>4</sup>

In addition to the fast-tracking of new and existing immigration applications from Haiti, the CIC is allowing Haitian nationals who are in Canada on a temporary basis to extend their visas.<sup>5</sup> According to the CIC, extensions will be processed according to normal procedures, but the process for Haitian nationals will be expedited and any filing fees will be

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\* This will be Mr. Brown’s final update as the Canada Reporter for the Law and Business Review of the Americas. He will be graduating on May 15, 2010 from the SMU Dedman School of Law and hopes to pursue a career in international adoption. Mr. Brown would like to thank the staff of the International Law Review Association and wish the best of luck to the new Canada Reporter, Soji John.

1. Press Release, Citizenship and Immigration Canada (CIC), Government of Canada Introduces Special Immigration Measures in Response to the Earthquake in Haiti (Jan. 16, 2010), <http://www.cic.gc.ca/english/department/media/releases/2010/2010-01-16.asp>.

2. *Id.*

3. *Id.*

4. *Id.*

5. *Id.*

waived.<sup>6</sup>

While the announcement of the new expedited immigration procedures was welcomed by Haitian nationals in Canada, some expressed concern about the difficulty of processing the requests. A Haitian community organizer in Montreal, Chantal Barratteau, told the CBC news service that deciding which requests to honor and which to deny will likely prove to be a difficult task for immigration officials.<sup>7</sup>

#### B. MONTREAL FINANCIER SENTENCED FOR PONZI SCHEME

On February 15, 2010, Earl Jones, a Montreal financial advisor, was sentenced to eleven years in prison after pleading guilty in January to two counts of fraud related to a \$50 million Ponzi scheme he had orchestrated.<sup>8</sup> Jones' scheme spanned more than twenty years and victimized nearly 160 people, including many of his own friends and family.<sup>9</sup>

Since both Jones and the financial-services company that he operated have been declared bankrupt, many of his victims applied with the court for leave to file a lawsuit against the Royal Bank of Canada to recover the money Jones stole.<sup>10</sup> The Court granted the victims leave in early February and they subsequently filed a \$40 million class action lawsuit.<sup>11</sup> Jones operated his business through a personal account he had with the bank—an account that he misrepresented to his investors as “in-trust.”<sup>12</sup> Recent documents uncovered by the investigation revealed that RBC knew of suspicious activity related to Jones' account and had previously warned him that he could possibly get into trouble for misrepresenting the account as “in-trust.”<sup>13</sup> RBC, however, did nothing to stop Jones from continuing to use his account as usual.<sup>14</sup> Many of Jones' investors were duped because Jones had used RBC's letterhead and logo when corresponding with them, which gave an appearance of legitimacy to his scheme.<sup>15</sup> According to the class action lawsuit, if not for “the negligence and willful blindness of the Royal Bank of Canada,” Jones would not have been able to successfully carry out his scheme for so long.<sup>16</sup> As of the date of this update, the class-action lawsuit against RBC has not yet

6. *Id.*

7. *Canada May Fast-Track Haitian Immigration*, CBC NEWS, Jan. 16, 2010, <http://www.cbc.ca/canada/story/2010/01/15/haiti-canada-immigration.html>.

8. *Earl Jones Gets 11 Years for \$50M Fraud*, CBC NEWS, Feb. 15, 2009, <http://www.cbc.ca/canada/montreal/story/2010/02/15/earl-jones-sentenced-ponzi.html>.

9. *Id.*; see also *RBC Knew of Jones Account Oddity, Memo Shows*, CBC NEWS, Feb. 5, 2010, <http://www.cbc.ca/canada/story/2010/02/04/earl-jones-bank-memo769.html#ixzz0ehFypsWY>.

10. See *Earl Jones Gets 11 Years for \$50M Fraud*, *supra* note 4.

11. Paul Delean, *Earl Jones Victim Sues Royal Bank*, MONTREAL GAZETTE, Feb. 6, 2010, <http://www.montrealgazette.com/Earl+Jones+victim+sues+Royal+Bank/2530581/story.html>.

12. See *RBC Knew of Jones Account Oddity, Memo Shows*, *supra* note 9.

13. *Id.*

14. *Id.*

15. *Id.*

16. See Paul Delean, *supra* note 11.

been tried, however, some of Jones' victims have managed to recover their investments via other outside procedures.<sup>17</sup>

### C. PROPOSED LEGISLATION WOULD INCREASE NUMBER OF REFUGEES ACCEPTED BY CANADA

In March, the Canadian government proposed sweeping reforms to the country's refugee program that, if passed by Parliament, would increase the number of United Nations approved refugees that it accepts each year.<sup>18</sup> The proposal would expand the Government-Assisted Refugees Program by up to 500 places over time and the Private Sponsorship of Refugees Program by 2,000 places, for a total of 2,500 new refugees admitted annually.<sup>19</sup>

Under the Government-Assisted Refugees Program, the Canadian government (through CIC-supported non-governmental organizations) provides full support for refugees admitted into Canada for up to one year or until the refugee is able to support herself, whichever is sooner.<sup>20</sup> The support covers expenses related to relocation as well as necessities for everyday life, including food, shelter, and clothing.<sup>21</sup> The Private Sponsorship of Refugees Program is funded by Canadian citizens and permanent residents who wish to get help bring refugees to Canada.<sup>22</sup> As opposed to the Government-Assisted Refugees Program, all the funding for the refugees under Private Sponsorship comes from individuals or groups.<sup>23</sup> The sponsors commit to providing financial assistance that covers the same necessities as the Government-Assisted program covers, but coverage under Private Sponsorship may be extended for up to thirty-six months rather than the year allowed under the government program.<sup>24</sup> In order to qualify under both programs, refugees must qualify as refugees under the United Nations *1951 Convention Relating to the Status of Refugees* and meet the requirements for entry into Canada under *Canada's Immigration and Refugee Protection Act*.<sup>25</sup>

It is estimated that the program, once fully implemented, will help as

17. Anne Sutherland, *Earl Jones' Victims Start to Recover Funds*, MONTREAL GAZETTE, Apr. 20, 2010, <http://www.montrealgazette.com/business/Earl+Jones+vic-tims+start+recover+funds/2927795/story.html>.

18. Elizabeth Thompson, *Kenney Launches Refugee Reform*, TORONTO SUN, Mar. 30, 2010, <http://www.torontosun.com/news/canada/2010/03/29/13394081-qmi.html>.

19. Press Release, CIC, *Expanding Canada's Refugee Resettlement Programs* (Mar. 29, 2010), <http://www.cic.gc.ca/english/department/media/releases/2010/2010-03-29.asp>.

20. *Government-Assisted Refugee Program*, CIC, Sept. 1, 2005, <http://www.cic.gc.ca/english/refugees/outside/resettle-gov.asp>.

21. *Id.*

22. *Sponsoring Refugees: Private Sponsorship of Refugees Program*, CIC, Mar. 11, 2010, <http://www.cic.gc.ca/english/refugees/sponsor/private.asp>.

23. *See id.*

24. *Id.*

25. *See Government-Assisted Refugee Program*, *supra* note 20; *see also Sponsoring Refugees: Private Sponsorship of Refugees Program*, *supra* note 22.

many as 14,500 refugees resettle in Canada.<sup>26</sup> Additionally, the cost of the expansion over the next five years is will be approximately \$90 million with another \$21 million increase in ongoing funding.<sup>27</sup>

## II. RECENT SIGNIFICANT COURT DECISIONS

### A. *TECHRON CONTRACTORS LTD. V. BRITISH COLUMBIA*<sup>28</sup>—EXCLUSION CLAUSES

*Techron Contractors Ltd. V. British Columbia* concerned an exclusion clause included in a contract for the design and construction of a highway. The Province of British Columbia (B.C.) wanted to build a new highway and issued a “request for expression of interest” for its design and construction.<sup>29</sup> Six companies responded to the initial request. Following this response, B.C. decided that it wanted to handle the design portion of the project and contract out the construction. B.C. informed the six companies of this change and asked them each to submit a proposal for the construction. According to the terms of the contract, only the six original companies would be eligible to submit a proposal for construction. Also included in the contract was the following exclusion of liability clause:

Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for any compensation of any kind whatsoever, as a result of participating in this RFP [“Request for Proposals”], and by submitting a proposal each proponent shall be deemed to have agreed that it has no claim.<sup>30</sup>

Brentwood, one of the original six companies that expressed interest in the original design and construction plan, entered into a “pre-bidding agreement” with another company that was not a part of the six companies authorized to bid on the project. Under the terms of this agreement, Brentwood would be the primary contractor on the job and the new company would be subcontracted the drilling and blasting work. Ultimately, Brentwood won the project and the second-place company, Tercon, filed suit against B.C. for accepting the bid from Brentwood’s joint venture alleging that it violated the terms of the agreement by limiting bidding to the original six companies.

The Trial Court ruled in favor of Tercon, finding that B.C.’s breach was fundamental and not barred by the exclusion clause contained the contract. The Court of Appeal, however, reversed the Trial Court and found that the exclusion clause “was clear and unambiguous and barred compensation for all defaults.”<sup>31</sup>

The Supreme Court of Canada reversed the Trial Court’s decision by a 5-4 decision and held that B.C. had breached the contract by accepting

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26. See Elizabeth Thompson, *supra* note 18.

27. *Id.*

28. *Tercon Contractors Ltd. v. British Columbia*, [2010] SCC 4, at 3 (Can.).

29. *Id.*

30. *Id.*

31. *Id.* at 4.

bids from, and ultimately awarding the contract to, companies that were not eligible to bid on the project (the company that Brentwood contracted with).<sup>32</sup> Additionally, the SCC held that the existence of the exclusion clause in the contract did not bar Tercon's suit for damages against B.C.<sup>33</sup>

Although the Court was divided on the question of whether the exclusion clause applied, it was unanimous on the standard of interpretation that should be applied in analyzing such clauses. When a plaintiff wishes to challenge an exclusion clause or other contractual term that it had previously agreed to, the Court will follow a three-step framework for determining whether the plaintiff should be allowed to escape the challenged term. First, the Court will consider whether the exclusion clause even applies to "the circumstances established in evidence."<sup>34</sup> If the clause applies, the Court will then determine if the clause was unconscionable, which would render the entire contract invalid from the time of formation and end the inquiry. But if the clause both applies and is valid, the Court will consider whether it "should nevertheless refuse to enforce the exclusion clause because of an overriding public policy."<sup>35</sup> In all cases, the Court noted that the burden lies on the party challenging the clause to "demonstrate an abuse of the freedom of contract that outweighs the very strong public interest in their enforcement."<sup>36</sup>

In applying the framework to the exclusion clause at issue, the majority found that the specific breach alleged by Tercon, that B.C. had accepted bids from ineligible bidders and thus violated the contract, was not covered by the terms of the exclusion clause.<sup>37</sup> Specifically, the Court cites the language in the exclusion clause applying it to claims "arising as a result of participating in [the] RFP."<sup>38</sup> According to the express terms of the contract, the bidding process would be limited to the original six companies that responded to the initial request.<sup>39</sup> Thus, the Court held that the participation of "other ineligible parties" was a claim that, by its nature, lay outside of the coverage of the exclusion clause.<sup>40</sup>

The dissent noted that the primary conflict in this case was between "the public policy that favors a fair, open and transparent bidding process, and the freedom of contract of sophisticated parties and experienced parties in a commercial environment to craft their own contractual relations."<sup>41</sup> Although the dissent agreed that B.C. had breached the terms of the agreement by contracting with Brentwood while knowing that the work would actually be carried out by a joint venture of Brentwood and

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32. *Id.* at 5.

33. *Id.*

34. *Tercon*, [2010] SCC 4, at 5.

35. *Id.*

36. *Id.*

37. *Id.* at 37-38.

38. *Id.* at 38.

39. *Id.* at 43.

40. *Tercon*, [2010] SCC 4, at 38.

41. *Id.* at 49.

an ineligible bidder, it found that B.C.'s breach was not fundamental to the overall contract and that any conflict should be resolved in favor of freedom of contract since all the parties involved were sophisticated in the subject matter.<sup>42</sup> Ultimately, however, B.C. was found to have breached the agreement and Tercon was awarded damages.<sup>43</sup>

#### B. *R. v. NASOGALUAK*<sup>44</sup>—MINIMUM SENTENCES CAN BE LOWERED

The Supreme Court of Canada ruled that, in exceptional circumstances where a person's rights under the Canadian Charter of Rights and Freedoms (hereinafter "Charter"), judges are empowered to reduce the sentence below the mandatory minimum prescribed by statute.<sup>45</sup> The case centered on the 2004 arrest of Lyle Nasogaluak for drunk driving and fleeing police.<sup>46</sup> During the arrest, members of the Royal Canadian Mounted Police (RCMP) knocked Nasogaluak to the ground and struck him twice in the ribs resulting in several broken ribs and a punctured lung.<sup>47</sup>

Nasogaluak pled guilty to the drunk driving charge, but the judge found that police had used excessive force, thus violating Nasogaluak's rights under the Charter, and reduced his sentence below what otherwise would have been imposed in accordance with Section 24(1) of the Charter.<sup>48</sup> According to the terms of Sec. 24(1), "any whose rights or freedoms, as guaranteed by this Charter, have been infringed or denied may apply to a court of competent jurisdiction to obtain SUCH REMEDY AS THE COURT CONSIDERS APPROPRIATE AND JUST IN THE CIRCUMSTANCES."<sup>49</sup> The Supreme Court of Canada's decision focused on what would constitute an "appropriate" remedy within the meaning of Sec. 24(1).<sup>50</sup>

Although the Court of Appeal agreed that there was sufficient evidence to show that the police had used excessive force and violated Nasogaluak's rights under the Charter, they found that the judge did not have the discretion to reduce the sentence below the statutory mandated minimum.<sup>51</sup> The Supreme Court of Canada reversed the Court of Appeal holding that judges have broad discretion in sentencing and, in certain exceptional cases, may reduce a sentence below the statutorily mandated minimums.<sup>52</sup> According to the Court, these exceptional cases generally

42. *Id.* at 49-53.

43. *Id.* at 46.

44. *R. v. Nasogaluak*, [2010] SCC 6, at 4.

45. *Minimum Sentences Can Be Lowered: Top Court*, CBC NEWS, Feb. 19, 2010, <http://www.cbc.ca/canada/story/2010/02/19/nasogaluak-court.html#ixzz0g0DxtQZq>.

46. *Id.*

47. *Id.*

48. *Nasogaluak*, [2010] SCC 6, at 4.

49. Constitution Act Part I, Canadian Charter of Rights and Freedoms, 1982, Sec. 24(1) (U.K.) (emphasis added).

50. *Nasogaluak*, [2010] SCC 6, at 3.

51. *Id.* at 4.

52. *Id.* at 7.



arise when the constitutionality of the limit itself is challenged.<sup>53</sup>

Ultimately, while the Court recognized that a judge may reduce a sentence below the mandatory minimum, it declined to apply such power in this case.<sup>54</sup> While the Court affirmed the trial judge's holding that the police had used excessive force and recognized that the judge may take this into account when issuing a sentence, it also found that this case was not one of the "exceptional" cases in which a judge may reduce a sentence below the statutory minimum.<sup>55</sup> Accordingly, it upheld the Court of Appeal's substitution of conditional discharge with the minimum fine mandated by the statute.<sup>56</sup>

C. R. v. CUNNINGHAM<sup>57</sup>—ATTORNEY COMPELLED TO REPRESENT CLIENT

*R. v. Cunningham* concerned whether a court can compel criminal defense attorneys to represent a client who cannot pay the legal fees owed. Cunningham was a defense lawyer employed by Yukon Legal Aid who was assigned to represent a defendant charged with sexual offenses against a child.<sup>58</sup> As a condition of obtaining legal aid, the defendant was required to update his financial records or risk having his representation suspended.<sup>59</sup> The defendant failed to meet this obligation and Yukon Legal Aid suspended his funding. Cunningham subsequently petitioned the Territorial Court to allow her to withdraw as counsel on the sole basis of the suspension of the defendant's funding.<sup>60</sup> Her request was denied by both the Territorial Court and the Supreme Court of the Yukon Territory, but was ultimately allowed by the Court of Appeal, which found that the Territorial Court did not have the discretion to refuse Cunningham's application to withdraw.<sup>61</sup>

The Court of Appeal held that courts should not compel attorneys to continue to represent clients who cannot pay for legal services.<sup>62</sup> It based its decision on three primary factors. First, that court oversight of withdrawal petitions could cause an unreasonable conflict between the court's decision and any disciplinary action taken by law societies, which hold the primary interest in the regulation and oversight of attorneys.<sup>63</sup> Second, the Court of Appeal held that judicial oversight of attorney withdrawal could jeopardize the solicitor-client privilege when the attorney may be

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53. *Id.* at 12.

54. *Id.* at 12-13.

55. *Id.* at 13.

56. *Nasogaluak*, [2010] SCC 6, at 13.

57. *R. v. Cunningham*, [2010] SCC 10, at 3.

58. *Id.* at 3.

59. *Id.*

60. *Id.*

61. *Id.*

62. *Supreme Court Hears Yukon Legal Aid Case*, CBC NEWS NORTH, Nov. 17, 2010, <http://www.cbc.ca/canada/north/story/2009/11/17/yukon-legal-scoc.html>.

63. *Cunningham*, [2010] SCC 10, at 11.

compelled to disclose the reasons for wishing to withdraw.<sup>64</sup> Finally, a compelled representation could create a conflict between the client's best interests and the attorney's desire to reach a swift resolution.<sup>65</sup> Accordingly, the Court of Appeal advocated a hands-off approach in which it would assume that attorneys will generally not try to avoid their duties to their clients.<sup>66</sup> If they do, however, the Court of Appeal thought it best to leave the discipline of such attorneys to the discretion of the law societies.<sup>67</sup>

In its ruling, the Supreme Court of Canada reversed the Court of Appeal and reinstated the determination made by the Supreme Court of the Yukon Territory that the Territorial Court did, in fact, have the discretion to compel Cunningham to continue the representation despite the removal of legal aid funding.<sup>68</sup> The SCC was careful to note that while a judge does have the authority to compel an attorney to continue to represent an accused, such authority must only be exercised "only when necessary to prevent serious harm to the administration of justice."<sup>69</sup> This decision answered a question that had divided courts across Canada.<sup>70</sup> Justice Marshall Rothstein, writing for the majority, based his decision primarily on the "inherent jurisdiction" of courts.<sup>71</sup> According to Rothstein, "inherent jurisdiction includes the authority to control the process of the court, prevent abuses of process, and ensure the machinery of the court functions in an orderly and effective manner."<sup>72</sup> Since attorneys are a vital component of this "machinery of the court," a court may "exercise some control over counsel when necessary to protect its process."<sup>73</sup>

The predominant standard for a court's refusal of an attorney's request for withdrawal, as articulated by the SCC in this case, is "whether allowing the withdrawal would cause serious harm to the administration of justice."<sup>74</sup> The Court then laid out several factors for judges to consider when answering this question including the feasibility of the accused representing himself or herself; other means for the client to obtain representation; the impact of the resulting delay in the proceedings on the accused, especially if the accused is incarcerated during the pendency of

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64. *Id.*

65. *Id.*

66. *Id.* at 11-12.

67. *Id.*

68. *Id.* at 5.

69. *Cunningham*, [2010] SCC 10, at 9.

70. *Id.* at 13-16 (Noting the divergent lines of authority on the issue among provincial and territorial courts. The British Columbia and Yukon Territory Courts of Appeal have held that a judge does not have the authority to prevent a defense attorney from withdrawing representation based on non-payment of legal fees, while the Courts of Appeal of Alberta, Saskatchewan, Manitoba, Ontario, and Quebec have all held that the judge may refuse counsel's petition for withdrawal).

71. *Id.* at 16.

72. *Id.*

73. *Id.*

74. *Id.* at 30.

the proceeding; the conduct of counsel in seeking withdrawal; the impact of granting the withdrawal on the Crown and any other co-defendants; the impact on complainants, witnesses, and jurors; fairness to the defense counsel, taking into account the length and complexity of the case; and the history of the matter.<sup>75</sup> These standards, like many others designed to guide judicial decision making, are not exhaustive, but provide a basic framework for the exercise of the judicial discretion to refuse counsel's request for withdrawal.

D. *MININGWATCH CANADA v. CANADA*<sup>76</sup> (FISHERIES AND OCEANS)

In a case testing the extent of the federal government's obligations under the Canadian Environmental Assessment Act, the Supreme Court of Canada ruled that future development projects must go through full environmental screening before moving forward.<sup>77</sup> The case focused on a mining company's petition to the British Columbia Environmental Assessment Office (the Office) for the establishment of an open pit copper and gold mine.<sup>78</sup> Following the submission of the project, the Office sought public comment on the project and conducted an initial environmental screening of the plan, but determined that a full study would not be required because it was unlikely that the project would cause "significant adverse, environmental, heritage, social, economic or health effects."<sup>79</sup> The project was approved and MiningWatch Canada, a mining industry watchdog, brought suit challenging the decision by the Office to conduct a screening rather than a comprehensive review.<sup>80</sup>

The Federal Court ruled in favor of MiningWatch and held that the Office had breached its duty to conduct a comprehensive review under the Canadian Environmental Assessment Act and prohibited further action on the mine until the review could be completed.<sup>81</sup> The Court of Appeal, however, reversed the Federal Court's decision and the case was appealed to the Supreme Court of Canada.

The SCC's decision in this case was mixed. Although the Supreme Court agreed with MiningWatch that the Office had breached its duty under the CEAA, it also held that because MiningWatch had "no proprietary or pecuniary interest in outcome of the proceedings" the mining operation could move forward despite the failure of the Office to conduct the necessary assessments.<sup>82</sup> Although the SCC allowed the mining project to continue, its decision ultimately stands for the proposition that the

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75. *Cunningham*, [2010] SCC 10, at 30.

76. *MiningWatch Canada v. Canada (Fisheries and Oceans)*, [2010] SCC 2, at 1.

77. *See, e.g., Ottawa Erred on B.C. Mine Review: Court*, CBC NEWS, Jan. 21, 2010, <http://www.cbc.ca/canada/british-columbia/story/2010/01/21/bc-red-chris-mine-supreme-court.html>.

78. *MiningWatch*, [2010] SCC 2, at 4.

79. *Id.*

80. *Id.* at 5.

81. *Id.*

82. *Id.* at 5-7; *Ottawa Erred on B.C. Mine Review: Court*, *supra* note 77.

procedures outlined in the CEEA for the approval of projects that may be harmful to the environment are mandatory and must be followed in all instances by federal authorities.

# RECENT DEVELOPMENTS IN NAFTA LAW-SPRING UPDATE 2010

*Olivia Howe*

## I. INTRODUCTION

CHAPTER 19 of the North American Free Trade Agreement (“NAFTA”) provides an alternative forum for parties seeking judicial review of antidumping and countervailing duty orders from the Court of International Trade.<sup>1</sup> Specifically, under article 1904(2) these parties have the option to bring appeals before an independent NAFTA Binational Panel instead of the national courts of the importing country.<sup>2</sup> The panel acts in the place of national courts to decide whether a previous determination regarding antidumping or countervailing duty orders was made in accordance with the laws of the determining country.<sup>3</sup> This article serves as a brief update of matters decided by the NAFTA Binational Panel from January 2010 through May 2010.

## II. IN THE MATTER OF STAINLESS STEEL SHEET AND STRIP COILS FROM MEXICO

In this case, Respondents ThyssenKrupp Mexinox S.A. de C.V. and Mexinox USA, Inc. (“Mexinox”) requested that a Panel be convened to review the Final Administrative Review *Stainless Steel Sheet and Strip in Coils from Mexico* that was issued by the U.S. Department of Commerce (“Commerce”) under section 751 of the Tariff Act.<sup>4</sup>

### A. STANDARD OF REVIEW

The Panel is to apply “the relevant statutes, legislative history, regulations, administrative practice, and judicial precedents” to the same degree that the importing Party would if reviewing a final determination of the investigating authority.<sup>5</sup> The application involves implementing the standard of review and legal principles that a court of the United States would apply when reviewing a determination of its Department of Commerce.<sup>6</sup> This standard is set out in Section 516A(b)(1)(B) of the Tariff

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1. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 605, 683 [hereinafter NAFTA].

2. *Id.* art. 1904.2.

3. *Id.* art. 1904.1.

4. Tariff Act § 751, 19 U.S.C. § 1675 (1999).

5. NAFTA, art. 1904.2.

6. *Id.* art. 1904.3.

Act, and states that the reviewing authority must “hold unlawful any determination, finding, or conclusion found . . . to be unsupported by substantial evidence on the record, or otherwise not in accordance with law.”<sup>7</sup>

The Panel must also look to the Congressional intent behind the statute when it was written. If the statute is ambiguous, the Panel must determine if the “agency’s construction of the statute is reasonable given the express terms of the relevant statutory provision and the objectives of the scheme as a whole.”<sup>8</sup>

## B. ISSUES ARISING IN THE REVIEW

### 1. *Whether Commerce’s Application of Zeroing is Not Supported by Substantial Evidence and/or is Not in Accordance with Law*

Mexinox claimed that Commerce’s use of zeroing is against American law because no law exists “direct[ing] the DOC to apply zeroing in calculating dumping margins.”<sup>9</sup> It additionally claimed that if the law were interpreted so that there was a question regarding zeroing, it should be interpreted consistently with international obligations according to the *Charming Betsy* doctrine where possible.<sup>10</sup>

Commerce, on the other hand, argued that the practice of zeroing is in accordance with American law and has been upheld by the courts.<sup>11</sup> It also argued that the *Charming Betsy* doctrine is inapplicable and that the reviewing body should defer on matters of statutory interpretation according to *Chevron*.<sup>12</sup> The Panel ultimately had to determine whether the Commerce’s “interpretation of 19 U.S.C. § 1677(35) [wa]s permissible under American antidumping duty law.”<sup>13</sup>

#### a. The Statute

The Panel determined that Commerce’s interpretation of the statute excluded positive value sales in direct contradiction to the wording of the statute that specifically requires Commerce to employ a “methodology which analyzes all sales.”<sup>14</sup> It also determined that the agency’s interpretation goes against the purpose of the statute to “accurately determine dumping margins” by eliminating sales that should be counted and distorting the dumping averages.<sup>15</sup> The Panel also found several WTO deci-

7. Tariff Act § 516A(b)(1)(B), 19 U.S.C. § 1516a(b)(1) (2006).

8. NAFTA Binational Panel Report, *In the Matter of: Stainless Steel Sheet and Strip in Coils from Mexico: Final Results of 2004/2005 Antidumping Review*, USA-MEX-2007-1904-01,2 (Apr. 14, 2010), available at <http://registry.nafta-sec-alena.org/cmdocuments/edce701c-9720-424b-b232-1fd714d318ba.pdf>.

9. *Id.* at 3.

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.* at 4.

14. NAFTA Binational Panel Report, *supra* note 8, at 6.

15. *Id.*

sions persuasive which “held that the use of zeroing is inconsistent with US obligations under the WTO Agreement.”<sup>16</sup>

b. *Chevron* and *Charming Betsy* Are Not Mutually Exclusive

The Panel then determined that the U.S. Supreme Court cases *Charming Betsy* and *Chevron* did not conflict and that thus, they are not mutually exclusive. It first recalled that courts should examine Congressional intent and compare this with the way the agency interpreted the law, giving deference to agency interpretations.<sup>17</sup> If the Congressional intent is not clear the court must determine whether the agency had a “permissible construction of the statute.”<sup>18</sup> The Panel also recalled that under *Charming Betsy* a law should not be construed to “violate the laws of nations if any other construction remains.”<sup>19</sup> Therefore, an interpretation that is permissible under *Chevron* may violate U.S. international legal obligations and so be contrary to the law.<sup>20</sup>

The relevant international obligation in this case was determined to be “the obligation of the U.S. under the Antidumping Agreement to make ‘fair comparisons’ in determining dumping margins.”<sup>21</sup> Specifically, the Panel found that WTO Agreements are considered international legal obligations and presumed that Congress intended statutes to comply with these Agreements.<sup>22</sup>

c. U.S. Legislation Does Not Prevent the Application of *Charming Betsy*

The Panel then determined that U.S. Legislation allows for the application of *Charming Betsy*. Contrary to the view of Commerce, the Panel found that the Uruguay Round Agreements Act is partially inapplicable because 19 U.S.C. § 3512(a) is limited to statutes, and the legislation does not prevent the Panel from applying the *Charming Betsy* doctrine.<sup>23</sup> Instead, the doctrine requires the panel “to assess agency actions, in light of American international obligations.”<sup>24</sup> The Panel pointed out that sections 123 and 129 of the URAA “establish a statutory scheme for dealing with WTO determinations.”<sup>25</sup> But, it held that neither was applicable in this case because zeroing is not a regulation or practice and the U.S. has consistently shown its commitment to upholding international obligations.<sup>26</sup>

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16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 7 (quoting *Murray v. Charming Betsy*, 6 U.S. 64, 118 (1804)).

20. NAFTA Binational Panel Report, *supra* note 8, at 7.

21. *Id.* at 8.

22. *Id.*

23. *Id.* at 9.

24. *Id.*

25. *Id.*

26. NAFTA Binational Panel Report, *supra* note 8, at 9.

d. *Timken* and *Corus* Do Not Preclude a Remand

The Panel then noted the existence of two competing liens of jurisprudence at the Court of International Trade and the Federal Circuit relating to “the relevance of WTO jurisprudence to judicial review.”<sup>27</sup> The Panel determined that it was free to follow either line of authorities as the issue had not been resolved at the Federal Circuit level; thus, the Panel could examine international jurisprudence for guidance.<sup>28</sup> It decided that both the *Timken* and *Corus* cases were distinguishable from the case at hand and that because of this, the available jurisprudence did not preclude a remand.<sup>29</sup> Ultimately, the Panel remanded back to Commerce on this issue to calculate the dumping margins of Mexinox without zeroing.<sup>30</sup>

2. *Whether Commerce’s Adjustments to the U.S. Indirect Selling Expense Ratio are Not in Accordance with Law*

The Panel next examined the calculation of service fees by both Mexinox and Commerce. It determined that Mexinox failed to carry its burden of showing “how the service fee amounts were calculated and why these amounts accurately reflect the indirect selling expenses.”<sup>31</sup> It concluded that Commerce erred by “reject[ing] the fee revenue as an offset to the selling expenses, yet [using] the same rejected fee amounts as an allocation factor,” effectively double-counting selling expenses.<sup>32</sup> Therefore, the Panel rejected both Mexinox original calculation and Commerce’s recalculation of service fees.<sup>33</sup> The Panel also remanded to Commerce on this issue with instructions “to recalculate the indirect selling expense ratio” according to the alternative method of calculation proposed by Mexinox.<sup>34</sup>

3. *Whether Commerce’s Adjustments to the Net Financial Expenses Ratio are Not Supported by Substantial Evidence and/or are Not in Accordance with Law*

The Panel then examined three adjustments that Commerce made to the financial expense ratio calculations.

a. *Commerce Rejected Mexinox’s Claimed Reduction to Interest Expenses for “Other Interest Income”*

First, the Panel agreed with Commerce that Mexinox failed to produce the information necessary to show that its “income consisted of short-term interest from the investment of working capital” as required by the

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27. *Id.* at 11.

28. *Id.*

29. *Id.* at 12-13.

30. *Id.* at 13.

31. *Id.* at 14.

32. NAFTA Binational Panel Report, *supra* note 8, at 15.

33. *Id.*

34. *Id.*



Department of Commerce's regulations.<sup>35</sup> By only providing "a short excerpt from an accounting manual," Mexinox failed to meet its burden.<sup>36</sup> Therefore, Commerce's decision to reject the offset for interest income requested by Mexinox was affirmed by the Panel.<sup>37</sup>

b. Commerce Included Expenses Described as "Miscellaneous Net Financial Expenses" in the Calculation of the Financial Expense Ratio

The Panel also agreed with Commerce's decision to include gains and losses in its financial expense calculation.<sup>38</sup> It found Mexinox's arguments about factoring receivables to be irrelevant.<sup>39</sup> The Panel determined that according to relevant legislation, the normal administrative practice of Commerce, and substantial evidence, it was proper for Commerce to include "miscellaneous net financial expenses" in its Financial Expense Calculation.<sup>40</sup>

c. Commerce used Packing Costs and Cost of Sales Data to Estimate the Amount of Packing Expenses Included in the Cost of Sales Denominator in Order to Calculate the Financial Expense Ratio

Though Mexinox agreed that Commerce should exclude packing expenses when calculating the financial expense rate, it disagreed as to how Commerce should make this calculation.<sup>41</sup> Because Mexinox did not give Commerce the actual packing costs, and Commerce used a reasonable and "accepted common methodology" to make the calculation, the Panel deferred to Commerce's calculation.<sup>42</sup> Therefore, the Panel also upheld the adjustments Commerce made to the Net Financial Expenses Ratio.<sup>43</sup>

4. *Whether Commerce's Level of Trade ("LOT") Analysis Was Supported by Substantial Evidence and Was in Accordance with Law.*

a. Commerce's Level of Trade Analysis is Consistent with the Antidumping Statute.

The Panel examined 19 U.S.C. § 1677a and determined that Commerce correctly "beg[an] its analysis with the starting price to the first unaffiliated purchaser and deduct[ed] the expenses incurred between importation and resale."<sup>44</sup> The Panel also approved of Commerce's second step

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35. *Id.* at 16.

36. *Id.*

37. *Id.*

38. NAFTA Binational Panel Report, *supra* note 8, at 17.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at 18.

43. *Id.*

44. NAFTA Binational Panel Report, *supra* note 8, at 20.

of examining “selling functions remaining in the CEP transaction data after deduction of subsection (d) expenses and examin[ing] the data on the NV side for evidence of similar selling functions” as set forth in *Torrington*.<sup>45</sup> Finally, the Panel determined that Commerce correctly granted a CEP offset in accordance with 19 U.S.C. § 1677 b(a)(7)(A), 19 C.F.R. § 351.412 (b) and (d), and 19 C.F.R. § 351.412(d) and (f).<sup>46</sup> Thus, the Panel found that Commerce’s analysis and subsequent CEP offset were correctly made using methodology that was based on legislation and the administrative practice of Commerce.<sup>47</sup>

b. The Department’s Administrative Practice and Substantial Evidence of Commerce’s Level of Trade Analysis

When conducting its trade analysis, Commerce’s “beg[an] with the starting price to the first unaffiliated purchaser and then deduct[ed] from it the expenses incurred between importation and resale;” it subsequently codified this practice.<sup>48</sup> Commerce pointed out that this practice is supported by the Court of International Trade in *Torrington*.<sup>49</sup> It then “examine[d] selling functions and determine[d] if the functions performed in the CEP transaction are similar to the data on the Normal Value side.”<sup>50</sup>

The Panel found that Commerce put its practice into law and applied it in several cases.<sup>51</sup> It additionally concluded that Commerce’s conclusion was in line with other administrative reviews of this case.<sup>52</sup> Based on this practice and the data submitted by Mexinox, Commerce had concluded that there was one LOT in the home market.<sup>53</sup> The Panel affirmed Commerce’s determination on the Level of Trade after determining that Commerce’s analysis was consistent with both legislation and substantial evidence and was in line with its typical administrative practice.<sup>54</sup>

5. *Whether Commerce’s Treatment of Mexinox’s Inventory Carrying Costs for Certain of its U.S. Inventory (Channel 3) as Indirect Selling Expenses Is Not Supported by Substantial Evidence*

Mexinox’s sales to unaffiliated customers, or Channel 3 sales, involved inventory carrying costs that Commerce determined were indirect selling expenses.<sup>55</sup> The Domestic Industry felt these sales should be treated as direct U.S. selling expenses because they relate to sales to U.S. customers

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45. *Id.*

46. *Id.*

47. *Id.* at 21.

48. *Id.*

49. *Id.*

50. NAFTA Binational Panel Report, *supra* note 8, at 21.

51. *Id.* at 22

52. *Id.*

53. *Id.*

54. *Id.* at 23.

55. *Id.*

and are consignment inventories.<sup>56</sup> Commerce, on the other hand, argued that it had discretion in deciding how to classify indirect selling expenses.<sup>57</sup> Mexinox agreed with Commerce that there was substantial evidence in support of Commerce's findings and argued that the Domestic Industry failed to recognize the fact that Commerce typically treats carrying costs as indirect selling expenses.<sup>58</sup>

The Panel first agreed that Commerce has discretion when making a decision on how to treat indirect selling expenses and does not have to consider the geographical location of the sales in making its classification.<sup>59</sup> Thus, it found Commerce was correct to abide by its typical procedures and classify pre-sale expenses as indirect selling expenses.<sup>60</sup> The Panel then found substantial evidence to support Commerce's determination that the inventory carrying expenses were incurred pre-sale.<sup>61</sup> Therefore, the Panel found it reasonable for Commerce to treat the inventory carrying costs as indirect selling expenses and upheld Commerce's treatment of the inventory carrying costs of Mexinox.<sup>62</sup>

#### 6. Dissent

The dissenting opinion began by reviewing the arguments of both Mexinox and Commerce, including the debate regarding the application of the *Chevron* test and the *Charming Betsy* canon of statutory interpretation.<sup>63</sup> The dissent also applied *Chevron* but contrary to the majority Panel decision, found that 19 U.S.C. § 1677(35) is ambiguous, a fact which gives rise to the deference that is to be shown to the agency determination.<sup>64</sup> It found this point further exemplified by decisions of the U.S. Court of Appeals for the Federal Circuit and lower court decisions that found 19 U.S.C. § 1677(35) to be ambiguous.<sup>65</sup>

The dissent found the primary issue to be whether Commerce was reasonable in the use of its methodology as set out in *Charming Betsy*.<sup>66</sup> Further, it disagreed with the majority's use of cases finding that the majority applied distinguishable or completely irrelevant cases and selectively quoted *Charming Betsy* such that it applied an incomplete standard.<sup>67</sup> The dissent also determined that *Charming Betsy* was not applicable in the way that the majority used it, and that if it was not applicable, then "the *Timken* and *Corus Staal* lines of cases are controlling,

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56. NAFTA Binational Panel Report, *supra* note 8, at 23-24.

57. *Id.* at 24.

58. *Id.* at 25.

59. *Id.*

60. *Id.* at 26.

61. *Id.*

62. NAFTA Binational Panel Report, *supra* note 8, at 26.

63. *Id.* at 27-28.

64. *Id.* at 28-29.

65. *Id.* at 29.

66. *Id.*

67. *Id.* at 29-30.

binding precedent and must be followed by the Panel here.”<sup>68</sup> In the alternative, the dissent found that even if the precedents of the Federal Circuit are not binding, the cases should be more persuasive than those used by the majority to support its reasoning; thus, Commerce’s decision to use zeroing should be upheld.<sup>69</sup> The dissent then went on to explain its view “that when there is a clear conflict between a treaty and Congress’ implementation of that treaty. . .the contemporaneous or subsequent legislation rules.”<sup>70</sup>

Section three of the majority opinion was then addressed. According to the dissent, the majority ignored the fact that it was to evaluate “the use by Commerce in a particular administrative review of its calculation of the anti-dumping duties during the period of the review applicable to imports from Mexinox by a particular zeroing methodology, no more and no less.”<sup>71</sup> Thus, any arguments on the internal obligations of the United States in relation to WTO dispute resolution reports should have been subject to only section 129 of the URAA and not section 123.<sup>72</sup>

The dissent also took issue with the majority’s treatment of WTO Panel and Appellate Body reports as binding.<sup>73</sup> It stated that the applicable law for “the United States’ international obligations under the WTO Anti-Dumping Agreement is what United States law says are its obligations, not what a WTO Panel or the Appellate Body says are United States obligations.”<sup>74</sup> If the international obligation is a non-self-executing treaty, however, the dissent found the obligations of the treaty are what Congress states they are when passing the legislation.<sup>75</sup> In situations involving anti-dumping, the authority to interpret the statute has been delegated to the Department of Commerce.<sup>76</sup> Because 19 U.S.C. § 1677(35) does not permit or forbid zeroing, Commerce therefore gets to choose its methodology so long as it does not conflict with Congress’s direction.<sup>77</sup> The dissent further explained that according to *Whitney*, U.S. courts ruling on non-self-executing treaties are to look to the statute incorporating the treaty into U.S. law and if the statute is unclear, and its interpretation has been delegated to an agency, the court must examine the agency’s interpretation for its reasonableness.<sup>78</sup>

The dissent then analyzed the *Medellin* case to determine “what effect to give under domestic law to decisions of international decision makers making determinations in a dispute resolution system set up by a treaty to

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68. NAFTA Binational Panel Report, *supra* note 8, at 30.

69. *Id.*

70. *Id.* at 31.

71. *Id.*

72. *Id.*

73. *Id.* at 32.

74. NAFTA Binational Panel Report, *supra* note 8, at 32.

75. *Id.* at 33.

76. *Id.*

77. *Id.*

78. *Id.* at 35.

which the U.S. has adhered.”<sup>79</sup> Based on the reasoning in that case, the dissent found that “dispute resolution reports under the DSU interpreting the treaties do not have domestic legal effect and do not constitute international obligations subject to the *Charming Betsy* canon.”<sup>80</sup> Instead, the reports should act as interpretative guides in domestic law when evaluating the actions of the agency.<sup>81</sup> Therefore, according to the dissent, the Panel is required to accept the interpretation of Commerce unless it is forbidden by the United States domestic statute.<sup>82</sup> It found that Commerce’s interpretation is not patently forbidden by 19 U.S.C. § 1677(35).<sup>83</sup> Thus, the dissent found that,

to attempt to use the *Charming Betsy* to assert that this Panel must remand to Commerce its determination in the administrative review under consideration for decision without zeroing because the Appellate Body of the DSU has declared zeroing to be illegal is simply a complete misunderstanding of the requirements of United States law, and upheld Commerce’s use of zoning.<sup>84</sup>

The dissent also pointed out that many Federal judges have examined the statute and found it ambiguous.<sup>85</sup> Therefore, it found Commerce was justified in interpreting the statute in the way that it did and that there was “absolutely no justification for this Panel to start anew, as if those decisions did not exist, and make a *de novo* determination that the statute is clear and unambiguous.”<sup>86</sup>

Ultimately the dissent felt that the majority chose its own vision of what the law was instead of following what was actually enacted by Congress.<sup>87</sup> It found this to be improper and stated that “the decision of Commerce to apply zeroing should be affirmed.”<sup>88</sup>

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79. *Id.* at 37.

80. NAFTA Binational Panel Report, *supra* note 8, at 38.

81. *Id.*

82. *Id.* at 40.

83. *Id.*

84. *Id.* at 41.

85. *Id.* at 42.

86. NAFTA Binational Panel Report, *supra* note 8, at 42.

87. *Id.* at 43.

88. *Id.* at 46.



# **Document**





# THE G-20 TORONTO SUMMIT DECLARATION JUNE 26–27, 2010

## PREAMBLE

1. In Toronto, we held our first Summit of the G-20 in its new capacity as the premier forum for our international economic cooperation.
2. Building on our achievements in addressing the global economic crisis, we have agreed on the next steps we should take to ensure a full return to growth with quality jobs, to reform and strengthen financial systems, and to create strong, sustainable and balanced global growth.
3. Our efforts to date have borne good results. Unprecedented and globally coordinated fiscal and monetary stimulus is playing a major role in helping to restore private demand and lending. We are taking strong steps toward increasing the stability and strength of our financial systems. Significantly increased resources for international financial institutions are helping stabilise and address the impact of the crisis on the world's most vulnerable. Ongoing governance and management reforms, which must be completed, will also enhance the effectiveness and relevance of these institutions. We have successfully maintained our strong commitment to resist protectionism.
4. But serious challenges remain. While growth is returning, the recovery is uneven and fragile unemployment in many countries remains at unacceptable levels, and the social impact of the crisis is still widely felt. Strengthening the recovery is key. To sustain recovery, we need to follow through on delivering existing stimulus plans, while working to create the conditions for robust private demand. At the same time, recent events highlight the importance of sustainable public finances and the need for our countries to put in place credible, properly phased and growth-friendly plans to deliver fiscal sustainability, differentiated for and tailored to national circumstances. Those countries with serious fiscal challenges need to accelerate the pace of consolidation. This should be combined with efforts to rebalance global demand to help ensure global growth continues on a sustainable path. Further progress is also required on financial repair and reform to increase the transparency and strengthen the balance sheets of our financial institutions, and support credit availability and rapid growth, including in the real economy. We took new steps to build a better regulated and more resilient financial system that serves the needs of our citizens. There is also a pressing need to complete the reforms of the international financial institutions.
5. Recognizing the importance of achieving strong job growth and providing social protection to our citizens, particularly our most vulnera-

ble, we welcome the recommendations of our Labour and Employment Ministers, who met in April 2010, and the training strategy prepared by the International Labour Organization (ILO) in collaboration with the Organisation for Economic Co-operation and Development (OECD).

6. We are determined to be accountable for the commitments we have made, and have instructed our Ministers and officials to take all necessary steps to implement them fully within agreed timelines.

#### THE FRAMEWORK FOR STRONG, SUSTAINABLE AND BALANCED GROWTH

7. The G-20's highest priority is to safeguard and strengthen the recovery and lay the foundation for strong, sustainable and balanced growth, and strengthen our financial systems against risks. We therefore welcome the actions taken and commitments made by a number of G-20 countries to boost demand and rebalance growth, strengthen our public finances, and make our financial systems stronger and more transparent. These measures represent substantial contributions to our collective well-being and build on previous actions. We will continue to co-operate and undertake appropriate actions to bolster economic growth and foster a strong and lasting recovery.

8. The Framework for Strong, Sustainable and Balanced Growth that we launched in Pittsburgh is the means to achieving our shared objectives, by assessing the collective consistency of policy actions and strengthening policy frameworks.

9. We have completed the first stage of our Mutual Assessment Process and we concluded that we can do much better. The IMF and World Bank estimate that if we choose a more ambitious path of reforms, over the medium term:

- global output would be higher by almost \$4 trillion;
- tens of millions more jobs would be created;
- even more people would be lifted out of poverty; and global imbalances would be significantly reduced.

Increasing global growth on a sustainable basis is the most important step we can take in improving the lives of all of our citizens, including those in the poorest countries.

10. We are committed to taking concerted actions to sustain the recovery, create jobs and to achieve stronger, more sustainable and more balanced growth. These will be differentiated and tailored to national circumstances. We agreed today on:

- Following through on fiscal stimulus and communicating "growth friendly" fiscal consolidation plans in advanced countries that will be implemented going forward. Sound fiscal finances are essential to sustain recovery, provide flexibility to respond to new shocks, ensure the capacity to meet the challenges of aging populations, and avoid leaving future generations with a legacy of deficits and

debt. The path of adjustment must be carefully calibrated to sustain the recovery in private demand. There is a risk that synchronized fiscal adjustment across several major economies could adversely impact the recovery. There is also a risk that the failure to implement consolidation where necessary would undermine confidence and hamper growth. Reflecting this balance, advanced economies have committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016. Recognizing the circumstances of Japan, we welcome the Japanese government's fiscal consolidation plan announced recently with their growth strategy. Those with serious fiscal challenges need to accelerate the pace of consolidation. Fiscal consolidation plans will be credible, clearly communicated, differentiated to national circumstances, and focused on measures to foster economic growth.

- Strengthening social safety nets, enhancing corporate governance reform, financial market development, infrastructure spending, and greater exchange rate flexibility in some emerging markets;
- Pursuing structural reforms across the entire G-20 membership to increase and sustain our growth prospects; and
- Making more progress on rebalancing global demand.

Monetary policy will continue to be appropriate to achieve price stability and thereby contribute to the recovery.

11. Advanced deficit countries should take actions to boost national savings while maintaining open markets and enhancing export competitiveness.
12. Surplus economies will undertake reforms to reduce their reliance on external demand and focus more on domestic sources of growth.
13. We are committed to narrowing the development gap and that we must consider the impact of our policy actions on low-income countries. We will continue to support development financing, including through new approaches that encourage development financing from both public and private sources.
14. We recognize that these measures will need to be implemented at the national level and will need to be tailored to individual country circumstances. To facilitate this process, we have agreed that the second stage of our country-led and consultative mutual assessment will be conducted at the country and European level and that we will each identify additional measures, as necessary, that we will take toward achieving strong, sustainable, and balanced growth.

#### FINANCIAL SECTOR REFORM

15. We are building a more resilient financial system that serves the needs of our economies, reduces moral hazard, limits the build-up of systemic risk, and supports strong and stable economic growth. We have strengthened the global financial system by fortifying prudential

oversight, improving risk management, promoting transparency, and reinforcing international cooperation. A great deal has been accomplished. We welcome the full implementation of the European Stabilization Mechanism and Facility, the EU decision to publicly release the results of ongoing tests on European banks, and the recent U.S. financial reform bill.

16. But more work is required. Accordingly, we pledge to act together to achieve the commitments to reform the financial sector made at the Washington, London and Pittsburgh Summits by the agreed or accelerated timeframes. The transition to new standards will take into account the cumulative macroeconomic impact of the reforms in advanced and emerging economies. We are committed to international assessment and peer review to ensure that all our decisions are fully implemented.
17. Our reform agenda rests on four pillars.
18. The first pillar is a strong regulatory framework. We took stock of the progress of the Basel Committee on Banking Supervision (BCBS) towards a new global regime for bank capital and liquidity and we welcome and support its work. Substantial progress has been made on reforms that will materially raise levels of resilience of our banking systems. The amount of capital will be significantly higher and the quality of capital will be significantly improved when the new reforms are fully implemented. This will enable banks to withstand—without extraordinary government support—stresses of a magnitude associated with the recent financial crisis. We support reaching agreement at the time of the Seoul Summit on the new capital framework. We agreed that all members will adopt the new standards and these will be phased in over a timeframe that is consistent with sustained recovery and limits market disruption, with the aim of implementation by end-2012, and a transition horizon informed by the macroeconomic impact assessment of the Financial Stability Board (FSB) and BCBS. Phase-in arrangements will reflect different national starting points and circumstances, with initial variance around the new standards narrowing over time as countries converge to the new global standard.
19. We agreed to strengthen financial market infrastructure by accelerating the implementation of strong measures to improve transparency and regulatory oversight of hedge funds, credit rating agencies and over-the-counter derivatives in an internationally consistent and non-discriminatory way. We re-emphasized the importance of achieving a single set of high quality improved global accounting standards and the implementation of the FSB's standards for sound compensation.
20. The second pillar is effective supervision. We agreed that new, stronger rules must be complemented with more effective oversight and supervision. We tasked the FSB, in consultation with the IMF, to report to our Finance Ministers and Central Bank Governors in October 2010 on recommendations to strengthen oversight and supervi-

sion, specifically relating to the mandate, capacity and resourcing of supervisors and specific powers which should be adopted to proactively identify and address risks, including early intervention.

21. The third pillar is resolution and addressing systemic institutions. We are committed to design and implement a system where we have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden, and adopted principles that will guide implementation. We called upon the FSB to consider and develop concrete policy recommendations to effectively address problems associated with, and resolve, systemically important financial institutions by the Seoul Summit. To reduce moral hazard risks, there is a need to have a policy framework including effective resolution tools, strengthened prudential and supervisory requirements, and core financial market infrastructures. We agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution, and reduce risks from the financial system. We recognized that there are a range of policy approaches to this end. Some countries are pursuing a financial levy. Other countries are pursuing different approaches.
22. The fourth pillar is transparent international assessment and peer review. We have strengthened our commitment to the IMF/World Bank Financial Sector Assessment Program (FSAP) and pledge to support robust and transparent peer review through the FSB. We are addressing non-cooperative jurisdictions based on comprehensive, consistent, and transparent assessment with respect to tax havens, the fight against money laundering and terrorist financing and the adherence to prudential standards.

#### INTERNATIONAL FINANCIAL INSTITUTIONS AND DEVELOPMENT

23. The International Financial Institutions (IFIs) have been a central part of the global response to the financial and economic crisis, mobilizing critical financing, including \$750 billion by the IMF and \$235 billion by the Multilateral Development Banks (MDBs). This has underscored the value of these institutions as platforms for our global cooperation.
24. We commit to strengthening the legitimacy, credibility and effectiveness of the IFIs to make them even stronger partners for us in the future.
25. Towards this end, we have fulfilled our Pittsburgh Summit commitment on the MDBs. This includes \$350 billion in capital increases for the MDBs, allowing them to nearly double their lending. This new capital is joined to ongoing and important reforms to make these institutions more transparent, accountable and effective, and to

- strengthen their focus on lifting the lives of the poor, underwriting growth, and addressing climate change and food security.
26. We will fulfill our commitment to ensure an ambitious replenishment for the concessional lending facilities of the MDBs, especially the International Development Association and the African Development Fund.
  27. We have endorsed the important voice reforms agreed by shareholders at the World Bank, which will increase the voting power of developing and transition countries by 4.59% since 2008.
  28. We underscore our resolve to ensure ratification of the 2008 IMF Quota and Voice Reforms and expansion of the New Arrangements to Borrow (NAB).
  29. We called for an acceleration of the substantial work still needed for the IMF to complete the quota reform by the Seoul Summit and in parallel deliver on other governance reforms, in line with commitments made in Pittsburgh.
  30. Today we build on our earlier commitment to open, transparent and merit-based selection processes for the heads and senior leadership of all the IFIs. We will strengthen the selection processes in the lead up to the Seoul Summit in the context of broader reform.
  31. We agreed to task our Finance Ministers and Central Bank Governors to prepare policy options to strengthen global financial safety nets for our consideration at the Seoul Summit. Our goal is to build a more stable and resilient international monetary system.
  32. We stand united with the people of Haiti and are providing much-needed reconstruction assistance, including the full cancellation of all of Haiti's IFI debt. We welcome the launching of the Haiti Reconstruction Fund.
  33. We have launched the SME Finance Challenge and commit to mobilizing funding for implementation of winning proposals, including through the strong support of the MDBs. We have developed a set of principles for innovative financial inclusion.
  34. We welcome the launch of the Global Agriculture and Food Security Program in fulfillment of our Pittsburgh commitment on food security, an important step to further implement the Global Partnership for Agriculture and Food Security, and invite further contributions. Looking ahead, we commit to exploring innovative, results-based mechanisms to harness the private sector for agricultural innovation. We call for the full implementation of the L'Aquila Initiative and the application of its principles.

#### FIGHTING PROTECTIONISM AND PROMOTING TRADE AND INVESTMENT

35. While the global economic crisis led to the sharpest decline of trade in more than seventy years, G-20 countries chose to keep markets

open to the opportunities that trade and investment offer. It was the right choice.

36. As such, we renew for a further three years, until the end of 2013, our commitment to refrain from raising barriers or imposing new barriers to investment or trade in goods and services, imposing new export restrictions or implementing World Trade Organization (WTO)-inconsistent measures to stimulate exports, and commit to rectify such measures as they arise. We will minimize any negative impact on trade and investment of our domestic policy actions, including fiscal policy and action to support the financial sector. We ask the WTO, OECD and UNCTAD to continue to monitor the situation within their respective mandates, reporting publicly on these commitments on a quarterly basis.
37. Open markets play a pivotal role in supporting growth and job creation, and in achieving our goals under the G-20 Framework for Strong, Sustainable and Balanced Growth. We ask the OECD, the ILO, World Bank, and the WTO to report on the benefits of trade liberalization for employment and growth at the Seoul Summit.
38. We therefore reiterate our support for bringing the WTO Doha Development Round to a balanced and ambitious conclusion as soon as possible, consistent with its mandate and based on the progress already made. We direct our representatives, using all negotiating avenues, to pursue this objective, and to report on progress at our next meeting in Seoul, where we will discuss the status of the negotiations and the way forward.
39. We commit to maintain momentum for Aid for Trade. We also ask international agencies, including the World Bank and other Multilateral Development Banks to step up their capacity and support trade facilitation which will boost world trade.

#### OTHER ISSUES AND FORWARD AGENDA

40. We agree that corruption threatens the integrity of markets, undermines fair competition, distorts resource allocation, destroys public trust and undermines the rule of law. We call for the ratification and full implementation by all G-20 members of the United Nations Convention against Corruption (UNCAC) and encourage others to do the same. We will fully implement the reviews in accordance with the provisions of UNCAC. Building on the progress made since Pittsburgh to address corruption, we agree to establish a Working Group to make comprehensive recommendations for consideration by Leaders in Korea on how the G-20 could continue to make practical and valuable contributions to international efforts to combat corruption and lead by example, in key areas that include, but are not limited to, adopting and enforcing strong and effective anti-bribery rules, fighting corruption in the public and private sectors, preventing access of corrupt persons to global financial systems, cooperation in visa de-

nial, extradition and asset recovery, and protecting whistleblowers who stand-up against corruption.

41. We reiterate our commitment to a green recovery and to sustainable global growth. Those of us who have associated with the Copenhagen Accord reaffirm our support for it and its implementation and call on others to associate with it. We are committed to engage in negotiations under the UNFCCC on the basis of its objective provisions and principles including common but differentiated responsibilities and respective capabilities and are determined to ensure a successful outcome through an inclusive process at the Cancun Conferences. We thank Mexico for undertaking to host the sixteenth Conference of the Parties (COP 16) in Cancun from November 29 to December 20, 2010 and express our appreciation for its efforts to facilitate negotiations. We look forward to the outcome of the UN Secretary-General's High-Level Advisory Group on Climate Change Financing which is, *inter alia*, exploring innovative financing.
42. Following the recent oil spill in the Gulf of Mexico we recognize the need to share best practices to protect the marine environment, prevent accidents related to offshore exploration and development, as well as transportation, and deal with their consequences.
43. We recognize that 2010 marks an important year for development issues. The September 2010 Millennium Development Goals (MDG) High Level Plenary will be a crucial opportunity to reaffirm the global development agenda and global partnership, to agree on actions for all to achieve the MDGs by 2015, and to reaffirm our respective commitments to assist the poorest countries.
44. In this regard it is important to work with Least Developed Countries (LDCs) to make them active participants in and beneficiaries of the global economic system. Accordingly we thank Turkey for its decision to host the 4th United Nations Conference on the LDCs in June 2011.
45. We welcome the Global Pulse Initiative interim report and look forward to an update.
46. Narrowing the development gap and reducing poverty are integral to our broader objective of achieving strong, sustainable and balanced growth and ensuring a more robust and resilient global economy for all. In this regard, we agree to establish a Working Group on Development and mandate it to elaborate, consistent with the G-20's focus on measures to promote economic growth and resilience, a development agenda and multi-year action plans to be adopted at the Seoul Summit.
47. We will meet next in Seoul, Korea, on November 11-12, 2010. We will convene in November 2011 under the Chairmanship of France and in 2012 under the Chairmanship of Mexico.
48. We thank Canada for hosting the successful Toronto Summit.



## ANNEX I

THE FRAMEWORK FOR STRONG, SUSTAINABLE AND  
BALANCED GROWTH

1. As a result of the extraordinary and highly coordinated policy actions agreed to at the Washington, London and Pittsburgh G-20 Summits, the global economy is recovering faster than was expected. Our decisive and unprecedented actions over the past two years have limited the downturn and spurred recovery.
2. Yet risks remain. Unemployment remains unacceptably high in many G-20 economies. The recovery is uneven across G-20 members both across advanced economies and between advanced and emerging economies. This poses risks to the continued economic expansion. There is a risk that global current account imbalances will widen again, absent further policy action. While considerable progress has been made in moving ahead on our financial sector repair and reform agenda, financial markets remain fragile and credit flows restrained. Concerns over large fiscal deficits and rising debt levels in some countries have also become a source of uncertainty and financial market volatility.
3. The G-20's highest priority is to safeguard and strengthen the recovery and lay the foundation for strong, sustainable and balanced growth, including strengthening our financial systems against risks. We therefore welcome the actions taken and commitments made by a number of G-20 countries. Among more recent measures, we particularly welcome the full implementation of the European Financial Stability Mechanism and Facility; the EU decision to publicly release the results of ongoing tests on European banks; and the recent announcements of fiscal consolidation plans and targets by a number of G-20 countries. These represent substantial contributions to our collective well-being and build on our previous actions. We will continue to cooperate and undertake appropriate actions to bolster economic growth and foster a strong and lasting recovery.
4. The Framework for Strong, Sustainable and Balanced Growth we launched in Pittsburgh is the means to achieving our shared objectives. G-20 members have a responsibility to the community of nations to assure the overall health of the global economy. We committed to assess the collective consistency of our policy actions and to strengthen our policy frameworks in order to meet our common objectives. Through our collective policy action, we will ensure growth is sustained, more balanced, shared across all countries and regions of the world, and consistent with our development goals.
5. We have completed the first stage of our Mutual Assessment Process. As we requested in Pittsburgh, G-20 Finance Ministers and Central Bank Governors, with the support of the IMF, World Bank, OECD, ILO and other international organisations, have assessed the collec-

tive consistency of our individual policy frameworks and global prospects under alternative policy scenarios.

6. The assessment is that in the absence of a coordinated policy response: global output is likely to remain below its pre-crisis trend; unemployment remains above pre-crisis levels in most countries; fiscal deficits and debt in some advanced economies reach unacceptably high levels; and, global current account imbalances, which narrowed during the crisis, widen again. Moreover, this outlook is subject to considerable downside risks.
7. We concluded that we can do much better. The IMF and World Bank estimate that if we choose a more ambitious path of reforms, over the medium term, we could:
  - raise global output by up to \$4 trillion;
  - create an estimated 52 million jobs;
  - lift up to 90 million people out of poverty; and
  - significantly reduce global current account balances.

If we act in a coordinated manner, all regions are better off, now and in the future.

Moreover, increasing global growth on a sustainable basis is the most important step we can take in improving the lives of all, including those in the poorest countries.

8. We are committed to taking concerted actions to sustain the recovery, create jobs and to achieve stronger, more sustainable and more balanced growth. These will be differentiated and tailored to national circumstances. We agreed today on:
  - Following through on fiscal stimulus and communicating “growth-friendly” fiscal consolidation plans in advanced countries and that will be implemented going forward;
  - strengthening social safety nets, enhancing corporate governance reform, financial market development, infrastructure spending, and increasing exchange rate flexibility in some emerging markets;
  - pursuing structural reforms across the entire G-20 membership to increase and sustain our growth prospects; and
  - Making further progress on rebalancing global demand.

Monetary policy will continue to be appropriate to achieve price stability and thereby contribute to the recovery.

9. We agreed to follow through on fiscal stimulus and communicating “growth friendly” fiscal consolidation plans in advanced countries that will be implemented going forward. Sound fiscal finances are essential to sustain recovery, provide flexibility to respond to new shocks, ensure the capacity to meet the challenges of aging populations, and avoid leaving future generations with a legacy of deficits and debt. The path of adjustment must be carefully calibrated to sustain the recovery in private demand. There is a risk that synchronized fiscal adjustment across several major economies could adversely impact the recovery. There is also a risk that the failure to implement consolidation where necessary would undermine confi-

dence and hamper growth. Reflecting this balance, advanced economies have committed to fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016. Recognizing the circumstances of Japan, we welcome the Japanese government's fiscal consolidation plan announced recently with their growth strategy. Those with serious fiscal challenges need to accelerate the pace of consolidation. Fiscal consolidation plans will be credible, clearly communicated, differentiated to national circumstances, and focused on measures to foster economic growth.

10. We have agreed on a set of principles to guide these fiscal consolidation plans by advanced economies:
  - *Fiscal consolidation plans will be credible.* They will be based on prudent assumptions with respect to economic growth and our respective fiscal positions, and they will identify specific measures to achieve a target path that ensures fiscal sustainability. Strengthened budgetary frameworks and institutions can help underpin the credibility of consolidation strategies.
  - *The time to communicate our medium-term fiscal plans is now.* We will elaborate clear and credible plans that put our fiscal finances on a sustainable footing. The speed and timing of withdrawing fiscal stimulus and reducing deficits and debt will be differentiated for and tailored to national circumstances, and the needs of the global economy. However, it is clear that consolidation will need to begin in advanced economies in 2011, and earlier for countries experiencing significant fiscal challenges at present.
  - *Fiscal consolidation will focus on measures that will foster economic growth.* We will look at ways to use our fiscal resources more efficiently, to help reduce the overall cost of our interventions while targeting resources to where they are most needed. In addition, we will focus on structural reforms that will promote long-term growth.
11. Advanced deficit countries should take actions to boost national savings while maintaining open markets and enhancing export competitiveness.
12. Surplus economies will undertake reforms to reduce their reliance on the external demand and focus more on domestic sources of growth. This will help strengthen their resilience to external shocks and promote more stable growth. To do this, advanced surplus economies will focus on structural reforms that support increased domestic demand. Emerging surplus economies will undertake reforms tailored to country circumstances to:
  - Strengthen social safety nets (such as public health care and pension plans), corporate governance and financial market development to help reduce precautionary savings and stimulate private spending;
  - Increase infrastructure spending to help boost productive capacity and reduce supply bottlenecks; and

- Enhance exchange rate flexibility to reflect underlying economic fundamentals. Excess volatility and disorderly movements in exchange rates can have adverse implications for economic and financial stability. Market-oriented exchange rates that reflect underlying economic fundamentals contribute to global economic stability.
13. Across all G-20 members, we recognise that structural reforms can have a substantial impact on economic growth and global welfare. We will implement measures that will enhance the growth potential of our economies in a manner that pays particular attention to the most vulnerable. Reforms could support the broadly-shared expansion of demand if wages grow in line with productivity. It will be important to strike the right balance between policies that support greater market competition and economic growth and policies that preserve social safety nets consistent with national circumstances. Together these measures will also help unlock demand. These include:
- Product, service and labour market reforms in advanced economies, particularly those economies that may have lost some productive capacity during the crisis. Labour market reforms might include: better targeted unemployment benefits and more effective active labour market policies (such as job retraining, job search and skills development programs, and raising labour mobility). It might also include putting in place the right conditions for wage bargaining systems to support employment. Product and service market reforms might include strengthening competition in the service sector; reducing barriers to competition in network industries, professional services and retail sectors, encouraging innovation and further reducing the barriers to foreign competition.
  - Reducing restrictions on labour mobility, enhancing foreign investment opportunities and simplifying product market regulation in emerging market economies.
  - Avoiding new protectionist measures.
  - Completing the Doha Round to accelerate global growth through trade flows. Open trade will yield significant benefits for all and can facilitate global rebalancing.
  - Actions to accelerate financial repair and reform. Weaknesses in financial sector regulation and supervision in advanced economies led to the recent crisis. We will implement the G-20 financial reform agenda and ensure a stronger financial system serves the needs of the real economy. While not at the centre of the crisis, financial sectors in some emerging economies need to be developed further so that they can provide the depth and breadth of services required to promote and sustain high rates of economic growth and development. It is important that financial reforms in advanced economies take into account any adverse effects on financial flows to emerging and developing economies. Vigilance is

also needed to ensure open capital markets and avoid financial protectionism.

14. We welcome the recommendations of our Labour and Employment Ministers, who met in April 2010, on the employment impacts of the global economic crisis. We reaffirm our commitment to achieving strong job growth and providing social protection to our most vulnerable citizens. An effective employment policy should place quality jobs at the heart of the recovery. We appreciate the work done by the International Labour Organization in collaboration with the OECD on a training strategy that will help equip the workforce with the skills required for the jobs of today and those of tomorrow.
15. We are committed to narrowing the development gap and that we must consider the impact of our policy actions on low-income countries. We will continue support development financing, including through new approaches that encourage development financing from both public and private sources. The crisis will have long lasting impact on the development trajectories of poor countries in every region of the world. Among these effects, developing countries are likely to face increased challenges in securing financing from both public and private sources. Many of us have already taken steps to help address this shortfall by implementing innovative approaches to financing, such as advance market commitments, the SME challenge and recent progress with respect to financial inclusion. Low-income countries have the potential to contribute to stronger and more balanced global growth, and should be viewed as markets for investment.
16. These measures need to be implemented at the national level and tailored to individual country circumstances. We welcome additional measures announced by some G-20 members aimed at meeting our shared objectives.
17. To facilitate this process, the second stage of our country-led, consultative mutual assessment will be conducted at the country and European level. Each G-20 member will identify the measures it is taking to implement the policies we have agreed upon today to ensure stronger, more sustainable and balanced growth. We ask our Finance Ministers and Central Bank Governors to elaborate on these measures and report on them when we next meet. We will continue to draw on the expertise of the IMF, World Bank, OECD, ILO and other international organisations, as necessary. These measures will form the basis of our comprehensive action plan that will be announced in the Seoul Summit. As we pursue strong, sustainable and more balanced growth, we continue to encourage work on measurement methods to take into account social and environmental dimensions of economic development.
18. The policy commitments we are making today, along with the significant policy measures we have already taken, will allow us to reach

our objective of strong, sustainable and balanced growth, the benefits of which will be felt both within the G-20 and across the globe.

## ANNEX II FINANCIAL

### SECTOR REFORM

1. The financial crisis has imposed huge costs. This must not be allowed to happen again. The recent financial volatility has strengthened our resolve to work together to complete financial repair and reform. We need to build a more resilient financial system that serves the needs of our economies, reduces moral hazard, limits the build-up of systemic risk and supports strong and stable economic growth.
2. Collectively we have made considerable progress toward strengthening the global financial system by fortifying prudential oversight, improving risk management, promoting transparency and continuously reinforcing international cooperation. We welcome the strong financial regulatory reform bill in the United States.
3. But there is more to be done. Further repair to the financial sector is critical to achieving sustainable global economic recovery. More work is required to restore the soundness and enhance the transparency of banks' balance sheets and markets; and improve the corporate governance and risk management of financial firms in order to strengthen the global financial system and restore the credit needed to fuel sustainable economic growth. We welcome the decision of EU leaders to publish the results of ongoing tests on European banks to reassure markets of the resilience and transparency of the European banking system.
4. We pledge to act together to achieve the commitments to reform the financial sector made at the Washington, London and Pittsburgh Summits by the agreed or accelerated timeframes. Transition horizons will take into account the cumulative macroeconomic impact of the reforms in advanced and emerging economies

### CAPITAL AND LIQUIDITY

5. We agreed that the core of the financial sector reform agenda rests on improving the strength of capital and liquidity and discouraging excessive leverage. We agreed to increase the quality, quantity, and international consistency of capital, to strengthen liquidity standards, to discourage excessive leverage and risk taking, and reduce procyclicality.
6. We took stock of the progress of the Basel Committee on Banking Supervision (BCBS) towards a new global regime for bank capital and liquidity and we welcome and support its work. Substantial progress has been made on reforms that will materially raise levels of resilience of our banking systems.
  - The amount of capital will be significantly higher when the new reforms are fully implemented.

- The quality of capital will be significantly improved to reinforce banks' ability to absorb losses.
7. We support reaching agreement, at the time of the Seoul Summit, on a new capital framework that would raise capital requirements by:
    - establishing a new requirement that each bank hold in Tier 1 capital, at a minimum, an increasing share of common equity, after deductions, measured as a percentage of risk-weighted assets, that enables them to withstand with going concern fully-loss-absorbing capital—without extraordinary government support—stresses of a magnitude associated with the recent financial crisis.
    - moving to a globally consistent and transparent set of conservative deductions generally applied at the level of common equity, or its equivalent in the case of non-joint stock companies, over a suitable globally-consistent transition period.
  8. Based on our agreement at the Pittsburgh Summit that Basel II will be adopted in all major centers by 2011, we agreed that all members will adopt the new standards and these will be phased in over a timeframe that is consistent with sustained recovery and limits market disruption, with the aim of implementation by end-2012, and a transition horizon informed by the macroeconomic impact assessment of the Financial Stability Board (FSB) and BCBS.
  9. Phase-in arrangements will reflect different national starting points and circumstances, with initial variance around the new standards narrowing over time as countries converge to the new global standard. Existing public sector capital injections will be grandfathered for the extent of the transition.
  10. We reiterated support for the introduction of a leverage ratio as a supplementary measure to the Basel II risk-based framework with a view to migrating to Pillar I treatment after an appropriate transition period based on appropriate review and calibration. To ensure comparability, the details of the leverage ratio will be harmonized internationally, fully adjusting for differences in accounting.
  11. We acknowledged the importance of the quantitative impact study currently being conducted by the BCBS that measures the potential impact of the new Basel standards and will ensure that the new capital and liquidity standards are of high quality and adequately calibrated. The BCBS-FSB macroeconomic impact study will inform the development of the phase-in period of the new standards.
  12. We welcomed the BCBS agreement on a coordinated start date not later than 31 December 2011 for all elements of the revised trading book rules.
  13. We support the BCBS' work to consider the role of contingent capital in strengthening market discipline and helping to bring about a financial system where the private sector fully bears the losses on their investments. Consideration of contingent capital should be included as part of the 2010 reform package.

14. We called upon the FSB and the BCBS to report on progress of the full package of reform measures by the Seoul Summit. We recognize the critical role of the financial sector in driving a robust economy. We are committed to design a financial system which is resilient, stable and ensures the continued availability of credit.

#### MORE INTENSIVE SUPERVISION

15. We agreed that new, stronger rules must be complemented with more effective oversight and supervision. We are committed to the Basel Committee's Core Principles for Effective Banking Supervision and tasked the FSB, in consultation with the International Monetary Fund (IMF), to report to our Finance Ministers and Central Bank Governors in October 2010 on recommendations to strengthen oversight and supervision, specifically relating to the mandate, capacity and resourcing of supervisors and specific powers which should be adopted to proactively identify and address risks, including early intervention.

#### RESOLUTION OF FINANCIAL INSTITUTIONS

16. We are following through on our commitment to reduce moral hazard in the financial system. We are committed to design and implement a system where we have the powers and tools to restructure or resolve all types of financial institutions in crisis, without taxpayers ultimately bearing the burden. These powers should facilitate "going concern" capital and liquidity restructuring as well as "gone concern" restructuring and wind-down measures. We endorsed and have committed to implement our domestic resolution powers and tools in a manner that preserves financial stability and are committed to implement the ten key recommendations on cross-border bank resolution issued by the BCBS in March 2010. In this regard, we support changes to national resolution and insolvency processes and laws where needed to provide the relevant national authorities with the capacity to cooperate and coordinate resolution actions across borders.
17. We agree that resolution regimes should provide for:
- Proper allocation of losses to reduce moral hazard and protect taxpayers;  
Continuity of critical financial services, including uninterrupted service for insured depositors;
  - Credibility of the resolution regime in the market;
  - Minimization of contagion;
  - Advanced planning for orderly resolution and transfer of contractual relationships; and,
  - Effective cooperation and information exchange domestically and among jurisdictions in the event of a failure of a cross-border institution.



## ADDRESSING SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

18. We welcomed the FSB's interim report on reducing the moral hazard risks posed by systemically important financial institutions. We recognized that more must be done to address these risks. Prudential requirements for such firms should be commensurate with the cost of their failure. We called upon the FSB to consider and develop concrete policy recommendations to effectively address problems associated with and resolve systemically important financial institutions by the Seoul Summit. This should include more intensive supervision along with consideration of financial instruments and mechanisms to encourage market discipline, including contingent capital, bail-in options, surcharges, levies, structural constraints, and methods to haircut unsecured creditors.
19. We welcomed the substantial progress that has been made regarding the development of supervisory colleges and crisis management groups for the major complex financial institutions identified by the FSB.
20. We continue to work together to develop robust agreed-upon institution-specific recovery and rapid resolution plans for major cross-border institutions by the end of 2010. We further committed to continue working on ensuring cooperation among jurisdictions in financial institution resolution proceedings.

## FINANCIAL SECTOR RESPONSIBILITY

21. We agreed the financial sector should make a fair and substantial contribution towards paying for any burdens associated with government interventions, where they occur, to repair the financial system or fund resolution.
22. To that end, we recognized that there is a range of policy approaches. Some countries are pursuing a financial levy. Other countries are pursuing different approaches. We agreed the range of approaches would follow these principles:
  - Protect taxpayers;
  - Reduce risks from the financial system;
  - Protect the flow of credit in good times and bad times;
  - Take into account individual countries' circumstances and options; and
  - Help promote a level playing field.
23. We thanked the IMF for its work in this area.

## FINANCIAL MARKET INFRASTRUCTURE AND SCOPE OF REGULATION

24. We agreed on the need to strengthen financial market infrastructure in order to reduce systemic risk, improve market efficiency, transparency and integrity. Global action is important to minimize regulatory arbitrage, promote a level playing field, and foster the

14. We called upon the FSB and the BCBS to report on progress of the transparency.
25. We pledged to work in a coordinated manner to accelerate the implementation of over-the-counter (OTC) derivatives regulation and supervision and to increase transparency and standardization. We reaffirm our commitment to trade all standardized OTC derivatives contracts on exchanges or electronic trading platforms, where appropriate, and clear through central counterparties (CCPs) by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories (TRs). We will work towards the establishment of CCPs and TRs in line with global standards and ensure that national regulators and supervisors have access to all relevant information. In addition we agreed to pursue policy measures with respect to haircut-setting and margining practices for securities financing and OTC derivatives transactions that will reduce procyclicality and enhance financial market resilience. We recognized that much work has been done in this area. We will continue to support further progress in implementing these measures.
26. We committed to accelerate the implementation of strong measures to improve transparency and regulatory oversight of hedge funds, credit rating agencies and over-the-counter derivatives in an internationally consistent and non-discriminatory way. We also committed to improve the functioning and transparency of commodities markets. We call on credit rating agencies to increase transparency and improve quality and avoid conflicts of interest, and on national supervisors to continue to focus on these issues in conducting their oversight.
27. We committed to reduce reliance on external ratings in rules and regulations. We acknowledged the work underway at the BCBS to address adverse incentives arising from the use of external ratings in the regulatory capital framework, and at the FSB to develop general principles to reduce authorities' and financial institutions' reliance on external ratings. We called on them to report to our Finance Ministers and Central Bank Governors in October 2010.
28. We acknowledged the significant work of the International Organization of Securities Commission (IOSCO) to facilitate the exchange of information amongst regulators and supervisors, as well as IOSCO's principles regarding the oversight of hedge funds aimed at addressing related regulatory and systemic risks.
29. We called on the FSB to review national and regional implementation of prior G-20 commitments in these areas and promote global policy cohesion and to assess and report to our Finance Ministers and Central Bank Governors in October 2010 if further work is required.

#### ACCOUNTING STANDARDS

30. We re-emphasized the importance we place on achieving a single set of high quality improved global accounting standards. We urged the

International Accounting Standards Board and the Financial Accounting Standards Board to increase their efforts to complete their convergence project by the end of 2011.

31. We encouraged the International Accounting Standards Board to further improve the involvement of stakeholders, including outreach to emerging market economies, within the framework of the independent accounting standard setting process.

#### ASSESSMENT AND PEER REVIEW

32. We pledged to support robust and transparent independent international assessment and peer review of our financial systems through the IMF and World Bank's Financial Sector Assessment Program and the FSB peer review process. The mutual dependence and integrated nature of our financial system requires that we all live up to our commitments. Weak financial systems in some countries pose a threat to the stability of the international financial system. International assessment and peer review are fundamental in making the financial sector safer for all.
33. We reaffirmed the FSB's principal role in the elaboration of international financial sector supervisory and regulatory policies and standards, co-ordination across various standard-setting bodies, and ensuring accountability for the reform agenda by conducting thematic and country peer reviews and fostering a level playing field through coherent implementation across sectors and jurisdictions. To that end, we encourage the FSB to look at ways to strengthen its capacity to keep pace with growing demands.
34. We called upon the FSB to expand upon and formalize its outreach activities beyond the membership of the G-20 to reflect the global nature of our financial system. We recognized the prominent role of the FSB, along with other important organizations including, the IMF and World Bank. These organizations, along with other international standard setters and supervisory authorities, play a central role to the health and well-being of our financial system.
35. We fully support the FSB's thematic peer reviews as a means of fostering consistent cross-country implementation of financial and regulatory policies and to assess their effectiveness in achieving their intended results. We welcomed the FSB's first thematic peer review report on compensation, which showed progress in the implementation of the FSB's standards for sound compensation, but full implementation is far from complete. We encouraged all countries and financial institutions to fully implement the FSB principles and standards by year-end. We call on the FSB to undertake ongoing monitoring in this area and conduct a second thorough peer review in the second quarter of 2011. We also look forward to the results of the FSB's thematic review of risk disclosures.

36. We acknowledged the significant progress in the FSB's country review program. These reviews are an important complement to the IMF/World Bank Financial Sector Assessment Program and provide a forum for peer learning and dialogue to address challenges. Three reviews will be completed this year.

OTHER INTERNATIONAL STANDARDS AND NON-  
COOPERATIVE JURISDICTIONS

37. We agreed to consider measures and mechanisms to address non-cooperative jurisdictions based on comprehensive, consistent and transparent assessment, and encourage adherence, including by providing technical support, with the support of the international financial institutions (IFIs).
38. We fully support the work of the Global Forum on Transparency and Exchange of Information for Tax Purposes, and welcomed progress on their peer review process, and the development of a multilateral mechanism for information exchange which will be open to all interested countries. Since our meeting in London in April 2009, the number of signed tax information agreements has increased by almost 500. We encourage the Global Forum to report to Leaders by November 2011 on progress countries have made in addressing the legal framework required to achieve an effective exchange of information. We also welcome progress on the Stolen Asset Recovery Program, and support its efforts to monitor progress to recover the proceeds of corruption. We stand ready to use countermeasures against tax havens.
39. We fully support the work of the Financial Action Task Force (FATF) and FATF-Style Regional Bodies in their fight against money laundering and terrorist financing and regular updates of a public list on jurisdictions with strategic deficiencies. We also encourage the FATF to continue monitoring and enhancing global compliance with the anti-money laundering and counter-terrorism financing international standards.
40. We welcomed the implementation of the FSB's evaluation process on the adherence to prudential information exchange and international cooperation standards in all jurisdictions.

ANNEX III

ENHANCING THE LEGITIMACY, CREDIBILITY AND EFFECTIVENESS OF  
THE IFIS AND FURTHER SUPPORTING THE NEEDS OF THE  
MOST VULNERABLE

1. The global economic and financial crisis has demonstrated the value of the International Financial Institutions (IFIs) as instruments for coordinating multilateral action. These institutions were on the front-line in responding to the crisis, mobilizing \$985 billion in critical fi-

nancing. In addition, the international community and the IFIs mobilized over \$250 billion in trade finance.

2. The crisis also demonstrated the importance of delivering further reforms. As key platforms for our cooperation, we are committed to strengthening the legitimacy, credibility and effectiveness of the IFIs, to ensure that they are capable of helping us maintain global financial and economic stability and supporting the growth and development of all their members.
3. To enhance the legitimacy and effectiveness of the IFIs, we committed in London and Pittsburgh to support new open, transparent and merit-based selection processes for the heads and senior leadership of all International Financial Institutions. We will strengthen these processes in the lead up to the Seoul Summit in the context of broader reform.

#### MDB FINANCING

4. Since the start of the global financial crisis, the MDBs have been playing an important role in the global response by exceeding our London commitment, in providing \$235 billion in lending, more than half of which has come from the World Bank Group. At a time when private sector sources of finance were diminished, this lending was critical to global stabilization. Now more than ever, the MDBs are key development partners for many countries.
5. We have fulfilled our commitment to ensure that the MDBs have appropriate resources through capital increases for the major MDBs, including the Asian Development Bank (AsDB), the African Development Bank (AfDB), the Inter-American Development Bank (IADB), the European Bank for Reconstruction and Development (EBRD), the World Bank Group, notably the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC). As major shareholders at these institutions, we have worked together with other members to increase their capital base by 85%, or approximately \$350 billion. Overall, their total lending to developing countries will grow from \$37 billion per year to \$71 billion per year. This will improve their ability to address the increasing demand in the short and medium terms and to have enough resources to support their members. We support efforts to implement these agreements as quickly as possible.

36. We acknowledged the significant progress in the FSB's country re-

<b>MDB</b>	<b>Capital Increase</b>	<b>Lending<sup>a</sup></b>	<b>Lending<sup>b</sup></b>
AfDB	200% increase	\$1.8 B	\$6 B
AsDB	200% increase	\$5.8 B	\$10 B
EBRD <sup>c</sup>	50% increase	\$5.3 B	\$11 B
IADB <sup>d</sup>	70% increase	\$6.7 B	\$12 B
IBRD	30% increase	\$12.1 B	\$15 B
IFC	\$200M selective capital increase	\$5.4 B	\$17 B
<b>Total</b>	<b>85% increase in MDB capital</b>	<b>\$37 B</b>	<b>\$71 B</b>

\* All dollar figures USD

<sup>a</sup> 2000-2008. <sup>b</sup> 2012-2020. <sup>c</sup> mostly callable, of a temporary nature, for CRR4; <sup>d</sup> Includes agreement to relieve Haiti's debt to the IADB.

6. We recognize the acute development needs in Africa, the region the furthest behind on the Millennium Development Goals. For this reason, the African Development Bank will be capitalized for substantial growth, with a 200% increase in its capital and corresponding tripling of its annual lending levels, to strengthen capacity to support the region's long-term growth and development.
7. To ensure that the IFC has the resources necessary for its continued growth, we will consider a long-term hybrid instrument to shareholders and earnings retention, to complement the recent selective capital increase linked to voice reforms.
8. In order to support low income countries, given their need to borrow at more concessional terms, we will fulfill our commitment to ensure an ambitious replenishment for the concessional lending facilities of the MDBs, especially the International Development Association (IDA) and the African Development Fund, which are undergoing financial replenishments this year. We welcome the fact that many G-20 members have taken important steps to join as donors to these institutions. We reiterated our support for fairer and wider burden sharing.

#### MDB REFORMS

9. We have also fulfilled our commitment to ensure that these capital increases are joined to ongoing and important institutional reforms to make the MDBs more effective, efficient and accountable. These include:
  - Commitments to further support the poorest countries in a financially prudent way, including by transferring resources, where feasible, from MDB net income to their respective lending facilities for low income countries and increasing their investment activities in low income countries and frontier regions. This will ensure that the new capital resources benefit both low income and middle income countries.
  - Specific actions for greater transparency, stronger accountability, improved institutional governance deeper country ownership, more

decentralization and use of country systems where appropriate, and enhanced procurement guidelines, new ways of managing and tracking results and financial contributions, strengthen knowledge management, ensuring the right human resources with appropriate diversity, better implementing environmental and social safeguards, sound risk management, and ensuring financial sustainability with pricing linked to expenses, and a commitment to continue to reduce administrative expenses and make them more transparent.

- Deeper support for private sector development, including through more private sector operations and investment, as a vital component of sustainable and inclusive development.
  - Recommitting to their core development mandates and taking up a greater role in the provision of global solutions to transnational problems, such as climate change and food security.
10. With these reform commitments, we are building not just bigger MDBs, but better MDBs, with more strategic focus on lifting the lives of the poor, underwriting growth, promoting security, and addressing the global challenges of climate change and food security. Implementation of these reforms has already begun, and we will continue to ensure that this work is completed and that further reforms are undertaken where necessary.

#### WORLD BANK GROUP VOICE REFORMS

11. We welcomed the agreement on the World Bank's voice reform to increase the voting power of developing and transition countries by 3.13% consistent with the agreement at the Pittsburgh Summit. When combined with the 1.46% increase agreed in the previous phase of the reforms, this will provide a total shift of 4.59% to DTCs, bringing their overall voting power to 47.19%. We committed to continue moving over time towards equitable voting power, while protecting the smallest nations, by arriving at a dynamic formula which primarily reflects countries' evolving economic weight and the World Bank's development mission. We also endorsed voice reforms at the IFC which will provide a total shift of 6.07%, to bring DTC voting power to 39.48%.

#### DEBT RELIEF FOR HAITI

12. We stand united with the people of Haiti as they struggle to recover from the devastation wrought by the earthquake in January, and we join other donors in providing assistance in this difficult time, including through the Haiti Reconstruction Fund set up by the World Bank, the Inter-American Development Bank and the United Nations. To ensure that Haiti's recovery efforts can focus on its reconstruction action plan, rather than the debt obligations of its past, our Finance Ministers agreed last April to support full cancellation of Haiti's

debts to all IFIs, including through burden sharing of the associated costs, where necessary. We are pleased that an agreement on a framework for cancelling such debt has been reached at the IMF; the World Bank, the International Fund for Agriculture Development, and soon at the Inter-American Development Bank. We will contribute our fair shares of the associated costs as soon as possible. We will report on progress at the Seoul Summit.

#### IMF REFORMS

13. We are committed to strengthening the legitimacy, credibility and effectiveness of the IMF to ensure it succeeds in carrying out its mandate. Important actions have been taken by the G-20 and the international community since the onset of the crisis, including the mobilization of \$750 billion to support IMF members' needs for crisis financing. The IMF raised \$250 billion in new resources through immediate bilateral loans and note purchase agreements, to be subsequently incorporated into a \$500 billion expansion of the New Arrangements to Borrow (NAB). The IMF also implemented a \$250 billion new general allocation of SDRs to bolster the foreign exchange reserves of all members. Along with important surveillance and lending reforms, including a new early-warning exercise and the creation of new precautionary instruments such as the Flexible Credit Line, these actions have significantly increased the IMF's crisis response capacity. However, important work remains to be completed to fully reform the IMF.
14. We called for an acceleration of the substantial work still needed for the IMF to complete the quota reform by the Seoul Summit and in parallel deliver on other governance reforms, in line with commitments made in Pittsburgh. Modernizing the IMF's governance is a core element of our effort to improve the IMF's credibility, legitimacy, and effectiveness. We recognize that the IMF should remain a quota-based organization and that the distribution of quotas should reflect the relative weights of its members in the world economy, which have changed substantially in view of the strong growth in dynamic emerging market and developing countries. To this end, we are committed to a shift in quota share to dynamic emerging market and developing countries of at least five percent from over-represented to under-represented countries using the current IMF quota formula as the basis to work from. We are also committed to protecting the voting share of the poorest in the IMF. As part of this process, we agree that a number of other critical issues will need to be addressed, including: the size of any increase in IMF quotas, which will have a bearing on the ability to facilitate change in quota shares; the size and composition of the Executive Board; ways of enhancing the Board's effectiveness; and the Fund Governors' involvement in



the strategic oversight of the IMF. Staff diversity should be enhanced.

15. We underscored our resolve to ensure the IMF has the resources it needs so that it can play its important role in the world economy. The majority of G-20 members have ratified the 2008 IMF Quota and Voice Reforms, fulfilling an important commitment made in London. Those members who have yet to ratify commit to doing so by the Seoul Summit. This action will not just enhance the legitimacy of the IMF by increasing the voice and participation of developing countries, it will also provide the IMF with \$30 billion in new quota resources. We call on all IMF members to ratify the agreement this year.
16. A number of G-20 members have already formally accepted the recently agreed reforms to the expanded NAB, which will provide a significant back-stop to IMF quota resources, consolidating over \$500 billion for IMF lending to countries in crisis. Other participating G-20 members will complete the acceptance process by the next meeting of G-20 Finance Ministers and Central Bank Governors. We call on all existing and new NAB participants to do the same.
17. G-20 members committed to ensure that the IMF's concessional financing for the poorest countries be expanded by \$6 billion through the proceeds from the agreed sale of IMF gold, consistent with the IMF's new income model, and the employment of internal and other resources. We are delivering. Some G-20 members have supported this commitment with additional loan and subsidy resources for the Poverty Reduction and Growth Trust (PRGT) and some others plan to contribute in the coming months.
18. We acknowledged a need for national, regional and international efforts to deal with capital flow volatility, financial fragility, and prevent crisis contagion. We task our Finance Ministers and Central Bank Governors to prepare policy options, based on sound incentives, to strengthen global financial safety nets for our consideration at the Seoul Summit. In line with these efforts, we also call on the IMF to make rapid progress in reviewing its lending instruments, with a view to further reforming them as appropriate. In parallel, IMF surveillance should be enhanced to focus on systemic risks and vulnerabilities wherever they may lie. Our goal is to build a more stable and resilient international monetary system.

#### FURTHER SUPPORTING THE NEEDS OF THE MOST VULNERABLE

19. We have made significant progress in supporting the poorest countries during the crisis and must continue to take measures to assist the most vulnerable and must ensure that the poorest countries benefit from our efforts to restore global growth. We recognize the urgency of this, and are committed to meeting the Millennium Development

Goals by 2015 and will reinforce our efforts to this end, including through the use of Official Development Assistance.

20. We have made concrete progress on our commitment to improving access to financial services for the poor and to increasing financing available to small-and medium-sized enterprises (SMEs) in developing countries.
21. Adequately financed small and medium-sized businesses are vital to job creation and a growing economy, particularly in emerging economies. We have launched the SME Finance Challenge aimed at finding the most promising models for public-private partnerships that catalyze finance for SMEs. We are committed to mobilizing the funding needed to implement winning proposals, including through the strong support of the MDBs. We welcome the strong support of the MDBs for scalable and sustainable SME financing proposals, including those from the Challenge in partnership with the private sector. We look forward to announcing the winning proposals of the SME Finance Challenge and to receiving recommendations to scale-up successful SME finance models at the Seoul Summit.
22. We have developed a set of principles for innovative financial inclusion, which will form the basis of a concrete and pragmatic action plan for improving access to financial services amongst the poor. This action plan will be released at the Seoul Summit.
23. At the Pittsburgh Summit, we recognised the importance of sustained funding and targeted investments to improve long-term food security in low income countries. We welcome the launch of the Global Agriculture and Food Security Program (GAFSP), which will provide predictable financing for low income countries to improve agricultural productivity, raise rural incomes, and build sustainable agricultural systems. We are particularly pleased that the fund has approved inaugural grants totalling \$224 million for Bangladesh, Rwanda, Haiti, Togo, and Sierra Leone. We also support the development of the private sector window of the GAFSP, which will increase private sector investments to support small and medium sized agri-businesses and farmers in poor countries. We welcome the support already received, and encourage additional donor contributions to both the public and private sector windows of the GAFSP.
24. There is still an urgency to accelerate research and development to close agricultural productivity gaps, including through regional and South-South cooperation, amidst growing demands and mounting environmental stresses, particularly in Africa. The private sector will be critical in the development and deployment of innovative solutions that provide concrete results on the ground. We commit to exploring the potential of innovative, results-based mechanisms such as advance market commitments to harness the creativity and resources of the private sector in achieving breakthrough innovations in food security and agriculture development in poor countries. We will report on progress at the Seoul Summit.



