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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
Joint Statement by President Barack Obama and President Sebastián Piñera on the Occasion of President Obama’s Visit to Santiago, Chile

THE WHITE HOUSE
Office of the Press Secretary
March 21, 2011

Joint Statement by President Barack Obama and President Sebastián Piñera on the occasion of President Obama’s Visit to Santiago, Chile:

The President of the Republic of Chile Sebastián Piñera and the President of the United States, Barack Obama, held a working meeting in which they discussed the main aspects of the bilateral relation between the two countries, as well as the principles and values upon which the U.S.-Chile partnership is based.

The Leaders committed to strengthen coordination on aspects of mutual interests in multilateral forums, reaffirming the commitment of both governments and people to the Rule of Law, democracy and full respect for human rights and fundamental liberties. In this latter regard, they noted their growing cooperation as members of the UN Human Rights Council, as reflected in their recent decision to co-sponsor a resolution creating a new special rapporteur on the human rights situation in Iran, and as members of the Community of Democracies where they have agreed to jointly support a new global fund to assist embattled civil society organizations. They also highlighted their joint commitment to combat trafficking in persons, as manifested by the Chilean legislature’s recent decision to adopt essential legislation on this issue.

The Presidents exchanged their opinions on the diverse topics of the international agenda, with a special focus on new threats such as terrorism, transnational organized crime, drug trafficking, and nuclear proliferation. Likewise, they highlighted the important role of the international community in enhancing the capacity to respond to natural disasters, a threat for the development of nations. They expressed the solidarity of both countries toward the Japanese people after the tragic occurrences of the earthquake and tsunami on March 11.

In the regional sphere, they further underscored the relevance of regional integration, highlighting the Organization of American States as the main hemispheric forum, as well as the importance of strengthening
the Inter-American Democratic Charter. They also reiterated their commitment to the reconstruction and democratic development in Haiti.

Noting that the United States and Chile can learn from each other regarding disaster preparedness, mitigation, and response, the Presidents highlighted a Memorandum of Understanding between the Oficina Nacional de Emergencia (ONEMI) and the Federal Emergency Management Agency (FEMA) signed in connection with President Obama’s visit. They also underscored the importance of the Council of Defense Ministers of the Americas initiative to enhance coordination among militaries in the Americas in support of civilian response to disasters.

The Presidents welcomed the launch of the U.S.-Chile Energy Business Council, a new energy partnership focused on clean energy infrastructure to advance clean energy development, identify business and investment opportunities in both countries, and pursue collaboration on energy infrastructure resilience, technology innovation, and incorporation of energy efficiency and renewables in industry, transportation, building and public sectors. One of the priorities of this partnership will be to work on preparedness and mitigation of the effects of natural disasters on energy infrastructure.

Both Presidents reiterated their belief that a more efficient use of energy, and the use of cleaner and renewable sources and technology are fundamental elements for energy security, which contributes to sustainable economic growth and the protection of the environment. They valued the joint efforts made by both countries in this area, and decided to deepen cooperation on clean energy, energy security, economic growth, and climate change. They committed to work together this year toward a successful outcome in Durban and to implement the Cancun agreements, including on transparency, adaptation, technology, finance, and forest protection.

In support of the Energy and Climate Partnership of the Americas (ECPA), the leaders launched a new Andean Glacier Monitoring and Research Center, a regional research network for glacier monitoring and modeling. In support of environmental cooperation on natural reserves and ecotourism, they noted the recently signed Agreement twinning the protected Marine Coastal Area Francisco Coloane in Chile and the Glacier Bay National Park and Preserve in Alaska, with the purpose of intensifying the collaboration and mutual support for their protection and conservation.

 Likewise, the Presidents welcomed the recent signing of the Memorandum of Understanding on the peaceful use of the nuclear energy. This agreement will encourage the development of nuclear expertise and professionals in Chile and advance bilateral cooperation on nuclear safety, security, and safeguards in line with the highest international standards. Both Presidents recalled the commitments made during the April 2010 Washington Nuclear Security Summit, and President Obama welcomed
Chile’s commitment to host a regional meeting to promote the Summit’s agenda.

Both Presidents underscored that in the seven years since the U.S.-Chile Free Trade Agreement (FTA) first entered into force, not only have the conditions of exchange of goods and services improved, but also new business opportunities have been formed, leading to the diversification of products and a greater access for agricultural products. They also showed satisfaction that the bilateral trade has doubled since 2004, and they welcomed the commitment to full implementation of the FTA, including achieving significant progress on intellectual property in 2011. They also welcomed the commitment to continue the discussions on specific proposals for deepening the trade relationship. The Presidents also noted the economic opportunities the Trans Pacific Partnership Free Trade Agreement presents for Chile and the United States and the importance of negotiating a high standard, comprehensive agreement as rapidly as possible.

With the objective to continue to promote trade as the main driving force behind economic development and employment creation for Small and Medium-sized Enterprises, both Heads of State supported the formation of an alliance between the Dirección de Promoción de Exportaciones (PROCHILE) and the International Trade Administration to establish a system of cooperation and exchange, as a way to train business representatives and government employees in both countries.

In the sphere of education, both Presidents expressed their interest in expanding the already existing bilateral programs in English education. The government of the United States will work with the government of Chile to support initiatives such as Inglés Abre Puertas (English Opens Doors), among others, by providing education experts from the United State to work with Chilean educators to enhance English language programs in Chilean public schools.

Additionally, both Presidents noted the importance of innovation and entrepreneurship as the driving force for increased productivity and competitiveness. They recognized and discussed the new programs Start-up Chile and Start-up America, as well as to continue promoting collaboration between universities and through agreements exchanges and joint research programs.

Both Heads of State highlighted the effective collaboration in the fields of astronomy and astro-engineering which will allow the operation of the LSST and ALMA telescopes in the northern Chile, involving an investment of 1.5 billion dollars, with a close collaboration between public and private academic and research institutions in both countries.

In the sphere of regional cooperation, the Heads of State underscored the joint efforts of both countries in terms of institutional development of the States. They highlighted the recent signing of the Memorandum of Understanding between the Agencia Chilena de Cooperación Internacional (AGCI) and the United States Agency for International Develop-
ment (USAID), which will establish the means of joint cooperation to promote the development of less developed countries in the region.

President Obama commended Chile for its valuable contributions to the United Nations Stabilization Mission in Haiti. The Presidents also noted the importance of supporting regional efforts to confront transnational organized crime and President Obama welcomed Chile’s offer to provide training on combating public corruption and to strengthen public security in the region.

The Leaders also noted the Memorandum of Understanding for cooperation on cultural matters between the Dirección de Bibliotecas, Archivos y Museos (DIBAM) and the Smithsonian Institution.

Finally, President Barack Obama thanked President Sebastian Piñera for the warm welcome that he and his family received during their visit to Chile, as well for as the affection and friendship of the Chilean people.
Articles
Goverment’s Misuse of Competition Laws: Discussing the Telecom Italia Case in Argentina

Félix E. Mezzanotte*

ABSTRACT

An increasing number of countries around the world have enacted competition laws on the premise that competitive markets can deliver substantial benefits to their economies. But there are risks, for these very laws can be used not to protect but rather to suppress competition. The goal of this article is to illustrate how governments can misuse competition laws. To this effect, I discuss the Telecom Italia case. In this case, the Argentine Competition Authority (CNDC) investigated a foreign transaction by which Telefónica de España indirectly acquired shares in Telecom Italia. Although this transaction had taken place in Europe, it nonetheless created competition concerns in Argentina because these two telecoms operated as major rivals in the Argentine telecommunications market. The CNDC found that this deal was a concentration that lessened competition and made its approval conditional on Telecom Italia divesting all of its assets in the relevant markets. I argue that the CNDC’s decision was arbitrary and inclined to discriminate against Telecom Italia and in favor of local investors. This article shows how easily disingenuous politics can derail the enforcement of competition laws and why competition authorities ought to function independently and under strict judicial control.

I. INTRODUCTION

An increasing number of countries are adopting a regime of competition. In the 1980s, about forty countries had competition laws and agencies in charge of enforcing such laws; today this number is at least a hundred.1 Most of this expansion took place as coun-

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* Assistant Professor in Law, School of Accounting and Finance, Hong Kong Polytechnic University.

tries underwent economic reform and recognized the benefits of competition. A competition regime sets a level playing field upon which firms can surpass each other in the race for more clients, sales, and profits. This market rivalry creates efficiencies that feed into the economy and benefit society and consumers with better deals and more choices. Competition laws protect this process by punishing conduct that harms competition. In the context of globalization, these laws restrict the conduct of not only local firms but also multinational firms operating in domestic economies.

But a competition regime may fall short of its promises and may work ineffectively. Moreover, firms that want to protect their rents may deploy competition laws as a tool to subvert competition. They may want to stop a more efficient rival from pricing lower by accusing it of predatory conduct; or challenge as anticompetitive a merger that brings in vast efficiencies because it threatens to diminish their rents. Governments can also misuse competition laws to control prices or—acting alone or in collusion with friendly business groups—to protect vested interests. The goal of this article is to illustrate some misconduct by government in enforcing competition law. More particularly, I will discuss the recent Telecom Italia case in Argentina as an example of how a government can utilize competition laws to protect not competition, but competitors instead.

In this case, the Argentine Competition Commission (CNDC) investigated a foreign transaction by which Telefónica de España indirectly acquired shares in Telecom Italia. Although this transaction took place in Europe, the CNDC worried that it could affect competition locally because these two telecom operators were rivals in the Argentine telecommunications market. The CNDC deemed this transaction to be a concentration, found that it restricted competition, and made its approval conditional on Telecom Italia divesting all its assets in this market.

2. Palim, supra note 1, at 111.
8. Palim, supra note 1, at 139-41.
10. Id.
will argue, however, the arbitrariness of the CNDC’s decision is so apparent that suspicions of discrimination against Telecom Italia (a foreign investor) in favor of local investors are inevitable.

Section B of this article presents the facts of the Telecom Italia case, while sections C and D outline the relevant CNDC decisions and court ruling. Section E offers a critical discussion of the case. It identifies the errors made by the CNDC and uncovers possible political motivations driving the outcome of this case. In conclusion, this article warns us that a policy of competition is far less likely to meet its conventional objectives when politicians dismiss the rigorous enforcement of competition laws and competition agencies fall prey to this political influence.

II. THE TELECOM CASE: FACTS AND PROBLEM OF COMPETITION

In May 2007, Telco S.p.A. (the buyer) purchased the firm Olimpia S.p.A from Pirelli & C. S.p.A., Sintonia S.p.A y Sintonia S.A. (the sellers). Both the buyer and seller were Italian firms, and the transaction (“the Telco transaction”) took place in Italy.

The Telco transaction is relevant to competition because it created a close relationship between two major rival telecoms, namely Telecom Italia (TI) and Telefónica de España S.A (TE). It did so because TE owns 42.3% of Telco. Telco purchased Olimpia, which owned shares in TI (Telco ended up holding a total of 24.5% of the shares with voting rights in TI). Therefore, through the Telco transaction TE gained influence in TI.

Although the European Commission found no reason to intervene, other competition authorities—notably those in Brazil and Argentina, where TE and TI are sizable market players, and rivals—found sufficient reasons to act. We will concentrate on how the Telco transaction affected competition in the telecommunications market in Argentina.

Two features define the problem of competition in the Argentine telecommunications market. The first one is that TE is of itself a strong actor in this market where it operates through its subsidiaries including Telefónica de Argentina S.A. (fixed phone and internet) and Telefónica Móviles Argentina S.A. (mobile phones), among other local firms (for the purpose of simplicity I will denote the group of subsidiaries of TE in

12. Telefónica de España a, supra note 9, at 1-4.
13. Ministerio de Economía y Finanzas Públicas, supra note 11, ¶¶ 1-75; Telefónica de España a, supra note 9, at 1-42.
15. Id. ¶ 1-5.
Argentina as TELA). The second feature is that TE not only controls TELA but also gained influence, through the Telco transaction, in TELA’s major competitor in Argentina, which is Telecom Argentina S.A. (TA).

TI owns 50% of the shares in the Argentine holding company Sofora Telecomunicaciones S.A (TI owns 32.5% of the shares directly and the other 17.5% indirectly through Telecom International N.V. [TIN]); and Sofora indirectly controls TA, which is a major player in the telecommunication market (Sofora owns 67.78% of Nortel Inversora S.A., which in turn holds 64.74% of shares in TA). In brief, TE, through Telco and Telco’s purchase of Olimpia, acquired influence in both TI and TA.

This dual position of TE (controlling TELA and influencing TA) worried the CNDC, which decided to investigate to what extent the Telco transaction could lessen the competition between TELA and TA.

III. THE INVESTIGATION BY THE COMPETITION COMMISSION OF ARGENTINA (CNDC)

After the Telco transaction became public, the CNDC started a preliminary investigation in order to find out whether the transaction was a concentration and whether the parties were obligated to notify the CNDC under Article 6 and Article 8 of the Argentine Competition Act (LDC). In Decision CNDC 4/09 it concluded that the acquisition by Telco of 100 percent of the shares in Olimpia constituted an economic concentration pursuant to Article 6(c) of the LDC because it caused a change of control in both TI and TA. It also ordered notification insofar as the turnover of the merging firms was sufficiently high and because no exceptions to the notification requirement applied.

The parties to the Telco transaction disagreed with the CNDC’s findings. They argued that the transaction was not a concentration under the LDC and, to this extent, that the CNDC could not restrict it using the merger regime nor could it sanction the parties for failing to notify. On this basis, they challenged the Decision CNDC 4/09 before the Court of Appeals (Cámara Nacional en lo Civil y Comercial Federal). But the CNDC paid little attention to this legal challenge—the resolution of which is still pending as of June 2010—and moved to investigate the Telco transaction’s effects on competition using the legal rules that apply to

18. Id.
19. Id. ¶ 63-71.
20. Id. ¶ 202-03.
22. Telefónica de España, supra note 9, at 143-47.
23. Id.
25. Id.
concentrations.26

In Decision CNDC 744, the CNDC concluded that the concentration, if approved without conditions, would substantially lessen competition in the relevant markets.27 This finding drew from the information provided by the parties through notification (that the CNDC ordered them to do in Decision CNDC 4/09), interviews conducted by the CNDC, reports from the Secretary of Communications (SECOM), and the CNDC’s own economic analysis.28 In the latter analysis, the CNDC followed ordinary procedures: it defined the relevant markets and then evaluated the levels of market concentration, the conditions of market entry, and the possible efficiencies that the concentration may introduce.29

The CNDC found that the Telco transaction would increase market concentration dramatically at both the retail and wholesale levels in Argentina.30 It also found that TELA and TA would act as a single firm and supply sixty-seven percent of all telecommunication services in the country.31 In some individual markets they would acquire significant market shares, such as in local fixed phone (90%), internet access (72%), national calls (58%), international calls (70%), mobile phones (64%) and wholesale internet access (100%), among others.32 It was also determined that new entry was unlikely due to high entry barriers33 and that no clear efficiency gains would follow from the transaction.34

On this basis, the CNDC concluded that the Telco transaction would increase the market power of TELA and TA in Argentina significantly, which may lead to abuse in the form of high prices and/or market foreclosure.35 Yet the CNDC did not recommend a full rejection of the concentration. Instead it advised the Secretary of Internal Commerce (SCI—the government agency to which the CNDC belongs) to approve it with conditions (pursuant to Article 13[b] LDC).36 More particularly, the SCI would approve the merger only if TI and TIN divested all their assets in Sofora within a one-year period.37 Only this measure, the CNDC concluded, would assure that the pre-merger conditions of competition in the relevant markets would remain post-merger.38

The SCI acted accordingly, and in decision SCI 483/09, it ordered TI

26. See Ministerio de Economia y Finanzas Publicas, supra note 11.
27. Id. ¶ 258-60.
28. Id. ¶ 257-1004.
29. Id.
30. Id. ¶ 286-954.
31. Id.
32. Id.
33. Id. ¶ 955-93 (including economies of scale, high-investment costs, vertical integration, and essential facilities).
34. Id. ¶ 994-1003.
35. Id. ¶ 1004-18.
36. Id. ¶ 1043-44.
37. Id. ¶ 203-04.
38. Id.
and TIN to divest their assets in Sofora. This decision generated a great deal of controversy, and each of the parties to the Telco transaction, as well as TI and TIN, decided to challenge it in court.

IV. COURT REVISION

On February 1, 2010, the Federal Court of Appeals for Economic Crime annulled the Decision SCI 483/09 by a majority vote. The judges, Hendler and Repetto, held that the CNDC’s investigation violated the rights of TI and TIN to due process and defense. According to these judges, the divestiture order amounted to a sanction depriving TI and TIN of their property rights in Sofora. Such a grave measure, the judges went on, was illegitimate, for the CNDC did not give TI and TIN direct participation in the antitrust administrative proceedings; nor did the CNDC explain why the divestiture order fell on TI and TIN when these two firms played no role in the Telco transaction.

In the dissenting vote, Judge Bonzón validated the actions of the CNDC and the contested Decision SCI 483/09. The judge rejected the notion that the CNDC violated the rights of TI and TIN to due process and defense by arguing that the rules of procedures for concentrations are less stringent than those governing the more general framework of anticompetitive conduct.

Unlike the majority vote—that had annulled the decision on grounds of procedure without entering to consider the substantive issues of competition—Judge Bonzón conducted an extensive evaluation of the effects of the Telco transaction on competition and relied on it to confirm the Decision CNDC 744. The judge deemed the order to divest against TI and TIN as legitimate, adequate, and proportionate.

TE had committed in Article 5 of Telco’s Shareholders Agreement that its representatives, including its appointed directors in TI, would neither vote nor participate in meetings discussing polices, management, or operations concerning the firms that TI controls directly or indirectly. By self-limiting its conduct contractually, TE had sought to assure compliance

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41. Id. § 3.1.
42. Id.
43. Id. ¶¶ 16-18.
44. Id. ¶¶ 7-16.
45. Id. § 3.1.
46. Id. ¶¶ 7-16.
47. Id.
with competition laws. But Judge Bonzón concluded that such clauses were ineffective and could not defeat the fact that, as a result of the Telco transaction, TE had gained control over TI and TA.48

V. ANALYSIS OF THE CASE

A. EXTRATERRITORIAL APPLICATION OF THE ARGENTINE COMPETITION LAW

The notion of extraterritoriality means that a State can apply and enforce its own national law over foreign conduct, that is, conduct committed in another State.49 This concept is critical to our discussion, for in the Telecom Italia case, the CNDC applied the LDC extraterritorially.50 According to Article 3 LDC, the scope of the LDC encompasses foreign conduct that may reduce competition in the Argentine markets.51 Although the Telco transaction was initiated and completed by firms in Europe, the CNDC concluded that the LDC governs it because this transaction affected the local telecommunications market.52

To this extent, the LDC adheres to the so-called ‘effects doctrine.’ This doctrine was first adopted in U.S. antitrust law.53 According to the Foreign Trade Antitrust Improvements Act of 1982, the Sherman Act does not apply to foreign conduct unless such conduct has a “direct, substantial, and reasonably foreseeable effect” on U.S. commerce.54 In Hartford Fire Insurance Co. v. California the U.S. Supreme Court said that the Sherman Act applies to foreign conduct that was meant to produce, and did in fact produce, some substantial effect in the United States.55 The U.S. enforcement agencies also consider international comity when evaluating the costs of taking jurisdiction, in the sense that they assess the potential for conflict with foreign States.56 The principles above also apply to merger cases under the U.S. Clayton Act.57

Although both the LDC and the U.S. antitrust laws adopt the ‘effects doctrine’, the former does it far more broadly. The LDC makes no reference to limiting factors that constrain the meaning of ‘effects’ such as

48. Id. § 3.2.3.
50. Incidente, supra note 40, ¶ 4.
51. Id. No. 25156, art. 3.
52. Telefónica de España, supra note 9, at 143-47.
55. Id. § 3.11 (with respect to foreign import commerce).
56. Id. § 3.2.
‘intended’ or ‘substantial;’ nor does it account for the notion of comity. Rather, the LDC refers only to ‘potential effects.’ It suffices that the foreign conduct may produce effects in the national markets for the Argentine authorities and courts to gain jurisdiction. With this broad conception of the ‘effects doctrine,’ it is not surprising that the Argentine court of appeals did not object to the CNDC applying the LDC extraterritorially to this case.

B. Legal Characterization of the Telco Transaction: Concentration versus Anticompetitive Conduct

When looking at this case through the lens of competition law and through the legal characterization of the Telco transaction, the question of corporate control, namely to what extent TE controls Telco, TI, and TA, plays a key role.

Consider first a situation where, as a result of the Telco transaction, TE controls Telco, TI, and TA. Here, the Telco transaction is a concentration under the LDC, and the CNDC will thus scrutinize it using merger law. TELA and TA constitute one single firm (TE controlling both of them) and rivalry between them disappears. This is worrisome from the vantage point of competition because it leads to substantial market power and, hence, greater potential for abusive conduct. Moreover, in assessing mergers, the CNDC must comply with a less stringent set of rules of procedure when compared to the case of anticompetitive conduct.

Consider now a situation in which the control (or substantial influence) by Telco on TI and TA is absent or cannot be established sufficiently. Here, the Telco transaction cannot be characterized as a concentration under the LDC, and the CNDC can only scrutinize the effects of the transaction in the local telecommunications market using the more general rules of anticompetitive conduct. These rules apply regardless of the question of control, use a different set of economic assumptions, and require more stringent procedures.

They assume that TE, on the one side, and TI, on the other side, are independent firms that may engage in collusive conduct. Here, the Telco transaction can facilitate collusion between TELA and TA (if TE, through Telco, acquires shares in TI, TE and TI can exchange sensitive information more easily and in this way facilitate collusion between TELA and TA). A more serious concern is that, following the Telco transaction, TELA and TA may have effectively engaged in collusion through secret agreements or concerted actions.

58. Law No. 25156, art. 3.
59. Id.
A finding of anticompetitive conduct entails illegal conduct and grave sanctions may follow. For this reason, the legal proceedings dealing with anticompetitive conduct afford strong protections to the parties in order to ensure their rights to due process and defense. In addition, the competition authority must typically discharge a higher burden of proof to establish a violation of the law.

The analysis above suggests that the issue of corporate control matters a great deal for the treatment and resolution of the Telecom Italia case under the LDC. In the presence of control, the economic analysis assumes that TELA and TA are a single firm; the legal characterization of the Telco transaction is concentration; and less strict procedural rules apply. In the absence of control, or of sufficient proof of it, the economic analysis assumes that TELA and TA are independent groups that can eventually coordinate their conduct, instead of competing, by entering into collusive agreements; the legal characterization of the transaction may fall under the legal rules of anticompetitive conduct, and stricter procedural rules, which afford greater protection to the rights of the parties, apply. Said this way, the problem is that this critical question of control was very complex in this case and could not be clearly resolved.

As noted in section C of this article, the issue of corporate control has proved highly controversial in this case. The Decision CNDC 4/09 depicts a chain of corporate control between TE, Telco, TI, and TA which has been fiercely contested in court by all parties and remains, thus far, unsettled pending a court ruling. With the key issue of corporate control being unresolved, one would have expected that the CNDC would have decided to either stop the investigation until the court resolved this issue or, in the alternative, continue the investigation using the rules of anticompetitive conduct. Instead, the CNDC took neither of these steps. It stuck to its position as set out in the Decision CNDC 4/09 and escalated the investigation using the legal rules of concentration.

The CNDC’s strategy was puzzling. The CNDC knew that the issue of corporate control was critical as demonstrated by its analysis in the Decision CNDC 4/09. It also knew that its findings on this issue had created a great deal of opposition and sparked a sour legal dispute. It was also evident to the CNDC that an investigation built upon a disputed key fact of control is more likely to end up in error. Nor could the CNDC have ignored the fact that sanctioning TI, as the decision SCI 483/09 ultimately did, for the actions of TE would appear arbitrary absent an undisputed finding of control.

62. Incidente, supra note 40, § IV.
63. Id.
64. Telefónica de España, supra note 9, at 143-47.
The reasons why the CNDC acted the way it did are, therefore, not obvious. As I will discuss in the next section, one plausible explanation is that it was a deliberate strategy by the Argentine government directed at
forcing TI out of the Argentine telecommunication market for the benefit of local rivals.

C. Protecting Competitors Instead of Competition

A widely cited principle in the literature is that competition law ought to protect competition but not competitors. In stark contrast with this rule, there are reasons to believe that the investigation into the Telecom Italia case was a deliberate attempt by the local government to protect local firms from foreign rivals. More precisely, the government conducted a dubious, if not abusive, enforcement of competition laws in an effort to get TI to exit the market.

The Telecom Italia case emerged against the backdrop of an internal fight between the two shareholders of Sofora, namely TI and the local group Werthein de Argentina (each firm holding fifty percent of the shares in Sofora). TI owned a call option by which it could choose to buy the whole of Werthein’s participation in Sofora, and TI had publicly announced that it wanted to exercise this option. But the CNDC’s investigation into the Telco transaction frustrated TI’s plans.

In December 2008, the CNDC blocked the exercise of TI’s option to buy pending its investigation into the competition effects of the Telco transaction in Argentina. In April 2009, the CNDC went further and suspended the voting rights of TI’s directors in TA. All this created not only tensions between TI and Werthein but also a great opportunity for the latter to strengthen its position in Sofora and TA.

As some commentators reported, the troubles arising from the CNDC investigation might have caused TI to sell its assets in Sofora voluntarily. Because TI did not sell, the CNDC ordered TI to divest its Argentine assets on the basis of a breach of competition law. Eventually, TI’s exit would benefit both Werthein and the government. The former could retain or even increase its share in Sofora, which continues to be a

68. Romig, supra note 65. It made economic sense for TI to exercise the call option. Werthein’s share in Sofora is worth an estimated $800 million, whereas the option’s price was about $400 million (in U.S. dollars). Id.
69. Lennighan, supra note 65.
70. Id.
71. Romig, supra note 67.
73. Coloma, supra note 60, at 10.
very profitable business. The latter would benefit from having Werthein and other friendly local investors as allies in its bid to gain political muscle.

It is not surprising then that Werthein watched closely and spurred on the CNDC investigation, efforts that the Argentine government supported. Two factors facilitated political maneuvering in this case. First, the CNDC functions under the authority of the SCI, which is a highly political agency. Second, the creation of an independent competition law tribunal is long overdue.

If viewed through the lens of political plot, the actions of the CNDC make more sense. That the CNDC decided not to wait for a court resolution of the controversial question of corporate control may have been a response to political pressure.

That the CNDC sanctioned TI using the law of concentration rather than anticompetitive conduct, even when the legitimacy of using the former was not obvious but rather highly controversial, could be seen as a functional way to achieve the government’s goals. In the merger regime the CNDC enjoys not only greater discretion, for procedures are less formal and the standard of proof lower, but also extensive remedy powers that include asset divestiture.

That the CNDC directed its power against TI for the conduct of TE appears to be a deliberate attempt to drive TI out of the Argentine telecommunications market. The CNDC’s failure to notify TI during the administrative process can only nourish this suspicion.

In annulling the Decisions CNDC 744 y SCI 483/09, the national courts protected the rights of TI. Yet following this judgment many speculations emerged as to the future steps of TI in Argentina.


77. Romig, supra note 72; Romig, supra note 65.

78. Incidente, supra note 40, ¶¶ 9, 10, 18.

79. Id. § 3.1.


Given the frictions that this case created between TI and the local government, this favorable court judgment might not be sufficient for TI to stay in the country. In this sense, reports had indicated that TI planned to sell its assets in spite of winning this first legal battle as a way to avert high political risk.\textsuperscript{82} Other reports suggested that TI and TE would soon adopt a global business strategy and fully merge their businesses,\textsuperscript{83} a hypothesis that would support the position of the Argentine government. Yet recent events delivered an outcome that only a few could have anticipated. With the rumors of merger at a global scale between TI and TE dissipating, and with the relationship between Werthein and the government worsening, TI and Werthein struck a deal by which they agreed to cease hostilities, reassert their partnership, reform the governance of Sofora and TA, and withdraw existing legal disputes.\textsuperscript{84}

This TI-Werthein deal was a significant first step towards resolving the problem of competition because it set aside the obstacles of governance and politics that have hindered an objective solution for so long. The CNDC would finally validate this deal and approve the Telco transaction, yet not before negotiating with TE, TI, and Werthein a number of measures meant to remedy existing competition concerns.\textsuperscript{85} Among others, TE agreed not to participate in the making of decisions over TI’s assets in Argentina, and to allow the CNDC to monitor this by gaining access to its files and records in Europe.\textsuperscript{86} Moreover, while the TI-Werthein deal enabled TI to augment its participation in Sofora to fifty-eight percent, Werthein obtained the management of TA, which further curtails any possible influence of TE in TI and TA.\textsuperscript{87}

In light of the events and circumstances that influenced the Telecom case, the process of conflict that this case created between TI and the local government, this favorable court judgment might not be sufficient for TI to stay in the country. In this sense, reports had indicated that TI planned to sell its assets in spite of winning this first legal battle as a way to avert high political risk. Other reports suggested that TI and TE would soon adopt a global business strategy and fully merge their businesses, a hypothesis that would support the position of the Argentine government. Yet recent events delivered an outcome that only a few could have anticipated. With the rumors of merger at a global scale between TI and TE dissipating, and with the relationship between Werthein and the government worsening, TI and Werthein struck a deal by which they agreed to cease hostilities, reassert their partnership, reform the governance of Sofora and TA, and withdraw existing legal disputes. This TI-Werthein deal was a significant first step towards resolving the problem of competition because it set aside the obstacles of governance and politics that have hindered an objective solution for so long. The CNDC would finally validate this deal and approve the Telco transaction, yet not before negotiating with TE, TI, and Werthein a number of measures meant to remedy existing competition concerns. Among others, TE agreed not to participate in the making of decisions over TI’s assets in Argentina, and to allow the CNDC to monitor this by gaining access to its files and records in Europe. Moreover, while the TI-Werthein deal enabled TI to augment its participation in Sofora to fifty-eight percent, Werthein obtained the management of TA, which further curtails any possible influence of TE in TI and TA.

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86. Id.
VI. CONCLUSION

The Telecom Italia case tells us that governments can profit from competition laws to pursue goals other than fostering competition. More precisely, they can enforce these laws abusively in order to favor local investors at the detriment of foreign ones. To this purpose, most competition authorities have powers to remedy concerns of competition ordering firms to divest assets. Remedies of this type are very powerful, and if misused (i.e. through arbitrary actions), they can harm firms severely.

Institutionally, this case also reminds us that the independence of the competition authority as well as the close judicial control of its decisions matter. Absent these factors, the whole purpose of competition law and policy may miscarry.

In a context of globalization, this article warns us that, although national competition laws can play a legitimate role in the global economy, there can also be a downside. While the explosive expansion of competition laws worldwide can restrain the conduct of powerful multinational firms operating in local economies, there is a danger that governments may utilize these very laws to mistreat foreign investors.
LATIN AMERICA AND ICSID:
DAVID VERSUS GOLIATH?

Katia Fach Gómez

“Stranger and more pure than any hron is, at times, the ur: the object produced through suggestion, educed by hope”.

Tlön, Uqbar, Orbis Tertius Ficciones
Jorge Luis Borges

I. INTRODUCTION

N recent years, the International Center for the Settlement of Investment Disputes (ICSID) has witnessed a dramatic increase in the number of arbitration requests where Latin American countries are the respondents. Today, out of almost 130 cases pending, over sixty involve states from the Latin American region. This situation is paradigmatic, because Latin American countries initially showed a widespread rejection of the ICSID Convention. In the mid-sixties Latin America manifested its opposition, in bloc, to the World Bank’s project to create an international agency specializing in settling investment disputes. This opposition was christened “El No de Tokyo.” The Calvo Doctrine, named after Carlos Calvo, an Argentine jurist, was firmly established at

1. This article was completed in July 2010, and all sources, including websites, are current to that date. The author is Professor of Private International Law at the University of Zaragoza (Spain), is a member of the Spanish Research Projects DER2009-11 702 (Sub JUR1) and e-PROCIFIS (Ref S14 / 3), and can be reached at the following email address: katiafachgomez@gmail.com. Professor Fach Gómez is grateful to Joseph T. McLaughlin for his suggestions, and would like to express her appreciation and admiration for Alejandro Garro, who always offers his abundant support and wisdom.
5. As Professor Lowenfeld reports: “[w]hen the report of the regional meetings on the proposed 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.” Lowenfeld, supra note 4, at 54.
the time, imped[ing] foreign nationals from invoking the diplomatic protection to settle international disputes with Latin American states. This doctrine, presented in the second half of the nineteenth century, is two-fold: (1) sovereign states should not suffer from interference by other states and (2) foreigners are placed on an equal footing with nationals; thus, they can only seek redress for grievances before local courts. Applying this doctrine to the arbitration sphere means that international arbitration is precluded in favor of the forum’s jurisdiction. These theories were incorporated, under the form of “Calvo Clause requirements,” by several Latin American States in their constitutions, statutes and international contractual practices.

The eighties introduced a shift on the issue. Some Latin American countries privatized several of their energy and utility companies and at the same time began to sign bilateral investment treaties (BITs) in order to stimulate economic growth through direct investment. BITs typically offer investors a group of substantive rights (e.g., fair and equitable treatment to foreign investments, duty on host states to grant national and most-favored-nation treatment and a series of guarantees in case of expropriation). BITs also include provisions for dealing with disputes between a state and investors from another state. Some of these treaties allow private investors to resort to international arbitration, after exhausting efforts to comply with domestic judicial proceedings during a specific period of time. This prerequisite is known as the “soft Calvo Clause.” Other treaties allow direct access to arbitration. Almost always, BITs offer a menu of international arbitral forums where ICSID is one of the options.


9. Id.

10. Manning-Cabrol, supra note 7, at 1191.


12. Id.

13. Cremades, supra note 8, at 81.


15. Cremades, supra note 8, at 81.

In the last decade, the financial crisis in Argentina and several nationalizations carried out by young leftist and populist governments in South America has spawned a large number of claims before ICSID, brought primarily by U.S. and European investors.\(^\text{17}\) Developing countries and some scholars began to look at ICSID critically, formulating a list of complaints such as: ICSID’s lack of financial and management structure to face its increasing workload;\(^\text{18}\) ICSID’s umbilical cord with the World Bank;\(^\text{19}\) concerns by some Latin American states that hostility toward ICSID may hamper access to World Bank credit;\(^\text{20}\) the pressure on developing countries to resort to assistance from extremely expensive foreign law firms;\(^\text{21}\) non-commercial interests, such as health or environmental protection have not received adequate attention;\(^\text{22}\) a lack of transparency by arbitration panels;\(^\text{23}\) a shadow of arbitrator bias in favor of the investor, with different ad hoc tribunals analyzing similar cases reaching disparate results;\(^\text{24}\) the absence of an appeals process, but only a limited annulment procedure;\(^\text{25}\) failure to take into account situations of massive economic downturns;\(^\text{26}\) cracks in its system of voluntary enforcement and compliance with the award, with some foreign investors losing their faith in Argentina’s willingness to honor ICSID awards.\(^\text{27}\)

In connection with the latter, Argentina is the most significant example of how a member state of ICSID is making use of the tools provided by

\(^{17}\) ICSID \textit{Case Load Statistics}, supra note 2, at 7.


the Convention for challenging awards rendered against the host country. In the Argentine case, many foreign investors had obtained licenses from local government to operate public services. These licenses provided that the users’ rates were to be calculated in U.S. dollars, converted to Argentine pesos at the time of invoicing, and adjusted every six months according to the U.S. producer price index. These rates stopped being updated as a result of the economic crisis of 2001 and Argentina passed the Public Emergency and Currency Exchange Regulations Reform Act, which abolished the dollar-to-peso convertibility and devalued the latter currency. Emergency tariffs were henceforth fixed in pesos at the compulsory exchange rate of one peso per dollar, which became known as the “pesification” of tariffs.

Under these circumstances, many investors turned to ICSID alleging BIT violations (e.g., failure to honor commitments made by Argentina when it induced the claimants to make investments in Argentine industries; failure to accord fair and equitable treatment to claimants’ investments; adoption of arbitrary measures that discriminate against the claimants on the basis of their foreign nationality; indirect expropriation of the claimants’ investments without complying with the BIT’s requirements). In most of these cases, ICSID arbitral tribunals found Argentina liable, noting that the State had breached its obligations to give the investor fair and equitable treatment and also failed to respect other investment commitments in the BITs. In a few cases the arbitral tribunals accepted the defense of necessity alleged by Argentina. These awards generated great concern to the Argentine government, which has developed several strategies to prevent, or at least delay, the payment of compensation. Thus, the government resorted to Article 52 of the ICSID

31. Id.
34. Id.
Convention\textsuperscript{36} to seek the annulment of awards,\textsuperscript{37} requested a stay in the enforcement of the award based on Rule 54 of the ICSID Rules of Arbitration,\textsuperscript{38} and in cases governed by the UNCITRAL Rules, challenged the awards before the courts of the seat if the tribunal had applied the UNCITRAL Rules.\textsuperscript{39}

Nicaragua v. Barceló is another recent example of how the tables are now turning regarding the relationship between Latin America and ICSID. Host states are beginning to resort to ICSID for their own benefit, just as investors have been doing for decades. On June 25, 2008, the government of Nicaragua filed before ICSID a USD$30 million lawsuit against the Spanish company Barceló.\textsuperscript{40} The Nicaraguan government argued that Barceló did not comply with some yearly payments owed to the government regarding a Nicaraguan tourist center operated by Barceló.\textsuperscript{41} It is the third time in the history of ICSID—an organization that has more than 300 claims arbitrated to its credit—that a state, rather than a private investor, filed a claim before this international institution.\textsuperscript{42} In this case, the Spain-Nicaragua BIT was used as a “bargaining chip” by Nicaragua in order to force the investor to settle the case.\textsuperscript{43} The strategy

\begin{quote}

37. Some of these maneuvers have been successful for Argentina. For example, the recent Decision on annulment in Sempra v. Argentina stated that: “In consideration of the foregoing, the Committee unanimously decides to: Annul the Award of 28 September 2007 on the ground of manifest excess of powers (Article 52(1)(b) of the Convention) owing to the failure of the Arbitral Tribunal to apply Article XI of the BIT between the United States and the Argentine Republic concerning Reciprocal Encouragement and Protection of Investment of 14 November 1991: such annulment applies necessarily to the Award in its entirety, pursuant to Article 52(3) of the Convention. Order Sempra to reimburse to the Argentine Republic all of the expenses incurred by the Centre in connection with the Annulment proceeding, including the fees and expenses of the arbitrators”. See Sempra Energy Int’l, supra note 35.


42. Fernando Cabrera Diaz, supra note 40.

43. See generally Acuerdo Para la Promocion y Proteccion Reciproca de Inversiones Entre el Reino de Espana y la Republica de Nicaragua [Agreement between the
was successful. Nicaragua and Barceló reached an agreement, resulting in Barcelo’s reinvestment in Nicaraguan infrastructure.44

This introduction has focused on some actions undertaken by Latin American states within the framework of ICSID, which have reflected dissatisfaction with how this organization functions.45 I will now turn my attention to a complementary issue which has remained unexplored by previous academic papers: the legal and political ways in which Latin American nations are opposing the ICSID system from outside of its framework. The aim of this paper is to provide a response to the following question: Is the current displeasure with ICSID in some Latin American countries likely to continue and spread to other countries throughout the region, and if so, why?

II. LATIN AMERICA V. ICSID

A number of signs point to an increasing backlash in Latin America against ICSID. There are different ways in which Latin American nations are showing their reluctance to resort to ICSID arbitration and trying to “think out [sic] the ICSID box.” The discussion will focus first on a series of initiatives undertaken individually by some Latin American countries and will subsequently turn to some projects developed in Latin America at the regional level.


44. Interestingly, this Understanding provides that any disputes will be resolved, not resorting to ICSID arbitration but to the International Chamber of Commerce. Entendimiento Marco Entre el Gobierno de Nicaragua y el Grupo Barceló [Understanding Between the Government of Nicaragua and the Barcelo Group], Nicaragua-Barcelo Group, art. IV, June 2009, available at http://www.cornap.gob.ni/imagenes_notas/caso_motelimar_cornap_2009.pdf.

A. Resorting to the Constitution to Not Comply with ICSID Awards

Article 54 of the ICSID Convention states the following: “Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.”46 Despite the clear wording requiring automatic enforcement, representatives of the Argentine government and several local academics consider that ICSID awards should be subject to judicial scrutiny in Argentina. Dr. Horacio Rosatti, the former Argentine Minister of Justice, is a staunch supporter of this approach, now called the “Rosatti Doctrine.”47 His position is that ICSID favors foreign investors and therefore discriminates against local investors.48 Believing that this situation violates the Argentine Constitution’s principle of equality before the law, he contends that courts should review ICSID awards.49 From his point of view, Articles 27 and 75.22 of the Argentine Constitution lead to the conclusion that BITs and the ICSID Convention are subordinate to the Constitution.50

Although Rosetti’s tenets are considered unorthodox internationally,51 the Argentine government continues to defend these ideas today. On June 1, 2004, the Argentine Supreme Court decided the domestic case Jose Cartellone Construcciones Civiles S. A. v. Hidroelectrica Norpatagonica S.A. This decision is cited by Argentine scholars who propose its findings should be extrapolated to ICSID awards.52 In this case, the Supreme Court stressed that it is guardian of the Constitution and public policy and therefore it may review arbitral awards if it finds the awards “unconstitutional, unreasonable or illegal,” even when the parties involved had

46. ICSID Convention, Ch. IV, art. 54.
48. Id.
49. Id.
previously agreed to waive the right to appeal. The Argentine government made another argument to prove that ICSID awards generate constitutional violations. It asserted that the Argentine statutes on submitting disputes to ICSID are unconstitutional because they were approved without following the process established in the 1994 Constitutional reform. In addition, Argentine senators have presented some bills, Proyectos Capitanich, Falú, Marino and Müller, proclaiming that the country will not allow international awards that cannot be contested before the Supreme Court of Argentina.

These types of constitutional arguments have also been raised in relation to the BITs in Colombian and Bolivian courts. Although in these


57. In this sense, the court stated that: “Las disposiciones del Acuerdo que aquí se analizan encajan también dentro de lo dispuesto por los artículos 226 y 227 de la Constitución, que ordenan al Estado promover la internacionalización de las relaciones políticas, económicas, sociales y ecológicas sobre bases de equidad, reciprocidad y conveniencia nacional, al igual que la integración económica, social y política con las demás naciones.” [“These provisions discussed here fit well within the provisions of Articles 226 and 227 of the Constitution, which require the State to promote the internationalization of political, economic, social and ecological basis of equality, reciprocity and national interest, as the economic, social and political integration with other nations.”], Sentencia de la Corte Constitucional C-294/02 (Colo.) available at www.dmsjuridica.com/CODIGOS/LEGISLACION/Sentencias/C-294-02.rtf.

58. The court concluded that: “De acuerdo a los fundamentos del presente fallo, se concluye que las Leyes Ratificatorias sometidas a control de constitucionalidad a través de este recurso, no son contrarias a las normas contenidas en los arts. 135 y 228 de la CPE.” [“According to the fundamentals of this ruling, we conclude that the ratification laws subject to constitutional review through this appeal is not contrary to rules found in arts. 135 and 228 of the CPE.”], Sentencia Constitucional No. 0031/2006 (Colom.), (May 10, 2006), available at http://www.ciac-iacac.org/documentos/2007_3_6_9_17_49_SENTENCIA%200031%20DEL%202006.pdf.
cases, the courts have concluded that bilateral investment treaties do not violate the Constitution, new Latin American constitutions have been enacted introducing a number of outright anti-arbitration provisions that will have an important impact on the future of investment arbitration in these countries. For example, Article 366 of the 2009 Bolivian Constitution states that, “[a]ll foreign companies operating in the oil and gas sector are subject to the sovereignty of the State and under no circumstances will a foreign tribunal be recognized nor can international arbitration or diplomatic interventions be resorted to.” Article 422 of the 2008 Ecuadorian Constitution prohibits the enactment of treaties or international instruments in which Ecuador cedes sovereign jurisdiction to international arbitration. Based on this article, the Ecuadorian Constitutional Court declared in July 2010 the unconstitutionality of a number of BITs and others, such as the U.S.-Ecuadorian BIT, are still in process of revision.

B. NATIONAL COURTS RESISTING ICSID

The Venezuelan Supreme Tribunal Decision 1541/2008 and its subtleties can be summarized by the Spanish saying: “When you see your neighbor’s beard burn, soak your own.” In this case, the Venezuelan Republic presented a request for interpretation of Article 258.2 of the 1999 Constitution. This article asserts broadly that, “the law shall promote arbitration, conciliation, mediation and any other means of alternative dispute resolution.” In a record time of four months, the Constitutional Chamber of the Venezuelan Supreme Tribunal of Justice issued a decision on the matter, which was extended and densely riddled with scholarly references. Therein, the Court addresses several controversial issues of national and international arbitration, waiting until the end to deal with the issue that was possibly the most significant of all its reflections: Article 22 of the Law for the Promotion and Protection of Investment does not contain a unilateral general declaration of consent to ICSID arbitration.

This Venezuelan law of 1999, enacted during the Chavez era,

64. Id. El Tribunal Supremo, supra note 62.
65. Id.
Any dispute between an international investor, whose home country has a treaty or agreement on promotion and protection of investments with Venezuela, or disputes falling within the provisions of the ICSID Convention, will be submitted to international arbitration under the terms of the respective treaty or agreement, if so this is established, subject to the possibility of using, where appropriate, the litigation option referred to in the current Venezuelan legislation.  

Important effects arise if we connect the court’s interpretation that Article 22 does not contain a state offer to arbitrate with another assertion from the tribunal that: “[t]he single subscription of the ICSID Convention shall not, ipso jure, link the respective resolution of controversies with the procedures contained in the Convention, without the existence of the oft-alluded written and unequivocal manifestation of will.” Specifically, it is interesting to compare how both statements contended in the decision will have future influence on the way foreign countries are going to solve their investment disputes with Venezuela. For instance, the 1997 Venezuela-Spain BIT contains a general offer to submit to ICSID in Article XI.2.b. This means that a Spanish investor will be able to go to ICSID, even if ICSID’s denunciation has occurred, until the BIT’s survival clause is no longer in force. In contrast, the United States never signed a BIT with Venezuela. Consequently, U.S. investors will need the concurrence of an additional Venezuelan consent, in the form of a contract, for example, in order to arbitrate under the rules of the ICSID Convention. Considering the current state of the bilateral political relations between these States, it seems doubtful that Chavez’s government will be willing to enter into such binding contracts.


68. *El Tribunal Supremo, supra* note 62.


72. Discussed further in the next section of this paper.
In these last months, Venezuela has continued its process of “preventive soaking.”73 Once upon a time, Venezuelan courts showed, through decisions such as the Exploration Round case, support for international arbitration.74 Nevertheless, as an illustration of the present situation, the Supreme Court of Justice issued on June 15, 2009 a press release stressing its rejection of the classical configuration of international investment arbitration.75 Under the title of “Venezuela’s immunity against foreign courts is consolidating,” this public declaration, which theoretically has no legal validity,76 states unequivocally that:

[The submission of disputes related to investment arbitration or any other matter to international mechanisms must be approved by the President of Venezuela and the Treaty must be ratified by the National Assembly; on the basis of sovereignty, the state may denounce or modify those international Treaties where Venezuela was subject to a foreign jurisdiction; the enforcement of decisions rendered by foreign tribunals against Venezuela will depend on the national verification that the decision is not breaching the sovereignty of the country.77

Focusing on the exigency of this national control, there are presently two pending cases in ICSID against Venezuela: Brandes Inv. Partners v. Bolivarian Republic of Venezuela and CEMEX Caracas II Invs. B.V. v. Bolivarian Republic of Venezuela.78 In the future, Venezuela may resort to this “internal test” argument, borrowed from Argentina, to avoid complying with any award ICSID renders against it.79 If this happens, ICSID will be forced to address another legitimacy crisis. Taking into account the Venezuelan environment, the access to diplomatic protection stated in Article 27.1 of the ICSID Convention will not be effective. Therefore, foreign investors will probably see first-hand that Venezuela has managed to effectively shield itself from ICSID awards.

75. Venezuela’s Immunity, supra note 73.
77. Venezuela’s Immunity, supra note 73.
C. Contracts Avoiding ICSID Arbitration

Some Latin American countries have in recent years made a clear shift towards a so-called “resource nationalism,” which involves placing the world’s oil reserves under the control of national oil companies, out of the reach of international oil companies. This concerns countries like the United States that have a strong energy dependence on oil and natural gas from Latin America.

Bolivia serves as an example of this trend. The nationalization of the hydrocarbons sector undertaken in the last century had been viewed negatively in the international arena. Trying to change this situation, the Bolivian Congress passed Law Number 1689 in 1996, which sought to attract foreign investment by allowing mining exploration through joint venture contracts. These contracts granted rights to foreign companies for a period of forty years and included a clause to submit to international arbitration processes whose awards would be final and binding.

But, a few years later Evo Morales became President and approved the nationalization of these sectors through Decree Number 28701. This decree provides that the state assumes control of these resources and that if foreign companies want to continue operations in Bolivia, they would have to sign new contracts with the public company Yacimientos Petrolíferos Fiscales Bolivianos. The enactment of this Act generated a “psychological impact” on foreign companies that were forced to negotiate new, less profitable contracts—under which they have to pay up to eighty-two percent of profits to the state in taxes—that eliminated ICSID arbitration as a recourse.

The evolution of the hydrocarbons sector in Venezuela has been very similar to that of Bolivia. After the Hydrocarbons Law of 1943, which nationalized the concessions granted to foreign companies in the past, the nineties in Venezuela were known as the “Petroleum Opening” (Apertura Petrolera). During that time, the country promoted the creation of joint ventures with large foreign investors. But with the coming to power of Hugo Chavez in 1999, the energy policy of Venezuela changed and it focused on signing energy cooperation and integration agreements

81. Id. at 620.
83. Id. at 947, n. 4.
86. Id.
87. Id.
89. Id.
within Latin America and the Caribbean, bringing this key economic sector under state control. For example, in 2006, Venezuela adopted the Terms and Conditions for the Establishment and Operation of Mixed Enterprises. The government submitted this model contract, based on Article 151 of the Venezuelan Constitution, to the foreign oil companies working in Venezuela. It introduces a clause, which stressed that the “amicable settlement” is the preferred method to resolve future conflicts and if it is not possible, only the Venezuelan courts, and not international arbitrators, are the competent venues for resolution. This text, along with the Regularization Law of April 18, 2006, which makes foreign investors minority shareholders of a mixed company, and other rules contained in Venezuela’s new provisions mean that the “Petroleum Opening” has been completely reversed.

The current legal landscape in these countries has resulted in the rejection of ICSID as a means to resolve many of the latest disputes over natural resources. In recent years, there has been a significant increase in the recourse to direct negotiation between the state and the foreign investor (for example, in cases such as: Petrobras-Ecuador, Andes Petroleum-Ecuador, Perenco-Ecuador, Glencore-Bolivia, Aguas del Illimani S.A - Bolivia, Repsol YPF-Bolivia, Pluspetrol-Bolivia, Brit-
ish Gas-Bolivia, Matpetrol-Bolivia, Total SA-Venezuela, Statoil-Venezuela, BP PLC-Venezuela, and Eni-Venezuela, etc.).

The fact that the major oil companies are not choosing the option to go to ICSID arbitration when this institution’s awards have given them major financial backing on numerous occasions can be evaluated from different perspectives. Perhaps it is an indication that these Latin American countries are achieving an equal footing with large companies. Or perhaps foreign investors have seen that contract renegotiation is a process that can benefit both parties of the dispute. Investors are aware that the materials extracted in Latin America are scarce resources that will remain in high demand by the industry in the future. Therefore, it may be advisable, despite the reduction of profit margins, for these companies to continue to cooperate with the state in the medium and long term and to decline compensation in a particular arbitration.

There is a question as to what will happen in the Latin American energy sector in the coming years. While a country like Venezuela may have strained relations with many first-world countries, it remains an important oil exporter to countries like the United States. Thus, while political relations between these two particular countries are deteriorating, bilateral economic interests are still intense. As highlighted in this paper, the rising price of oil in recent years has led some countries in Latin America to impose unilateral changes to the drilling contracts, with the aim of taking control of this attractive sector. Many foreign investors have accepted a more secondary role and have opted not to resort to


110. Id.

111. Id.
ICSID, as they have considered it economically preferable to continue in the country on a long-term basis. If oil prices decline in the future, these Latin American countries may have to face a complicated situation: incomes will fall, foreign investors will struggle to survive in the country and will fail to make any new investments, and the technical and financial efficiency of the state-owned oil company will be questioned.\textsuperscript{112} If this situation occurs, it is possible that resource nationalism will fade again.

D. Withdrawing from the ICSID Convention

During its fifth Summit on May 29, 2007, the countries which at the time constituted the Bolivarian Alliance for the Peoples of Our America (ALBA-Bolivia, Venezuela and Nicaragua) agreed to denounced the ICSID Convention.\textsuperscript{113} As President Evo Morales held, this decision was taken in order to “... guarantee the sovereign right of countries to regulate foreign investment in their national territories.”\textsuperscript{114} In line with this decision, on February 13, 2008, the President of the Energy Commission in the Venezuelan National Assembly asked the government for an ICSID withdrawal.\textsuperscript{115} On April 14, 2008, Nicaragua’s Attorney General announced that the country was also pondering denouncing the ICSID Convention.\textsuperscript{116} Nevertheless, these two threats have not come to fruition since neither of the two states has officially begun the process required to denounce ICSID.

Bolivia and Ecuador, however, carried out the threat. On May 2, 2007, the World Bank received a written notice of denunciation of the ICSID


\textsuperscript{114} ALBA countries “vigorously reject legal, media, and diplomatic pressures from certain multinational companies, which have violated constitutional rules; domestic legislation; contractual agreements; and regulatory, environmental, and labour provisions; resist the application of sovereign decisions of the countries by threatening with arbitration and commencing international arbitration proceedings against the States before institutions such as ICSID.” Fernando Peláez-Pier et al., \textit{Venezuela, Arb. Rev. Am.}, 2008, available at http://www.globalarbitrationreview.com/reviews/4/sections/8/chapters/49/venezuela; Latin America Ponders Pullout of ICSID, \textit{Disp. Resol. J.}, May-Jul. 2007, available at http://findarticles.com/p/artic les/mi_qa3923/is_20070705.


Convention from the Republic of Bolivia.\textsuperscript{117} In the official note sent to President of the World Bank, Bolivia criticized a number of aspects of ICSID such as its complexity, opacity, lack of neutrality, high cost, no appeal of the award, and also emphasized Articles 24 and 135 of the Bolivian Constitution,\textsuperscript{118} arguably calling for a Bolivian withdrawal.\textsuperscript{119} Pursuant to Article 71 of this Convention, the denunciation took effect on November 3, 2007, six months after receipt of such notice.\textsuperscript{120}

The effects of denouncing this Convention have been broadly discussed by scholars. The starting point of this debate is the wording of Article 72 of the ICSID Convention, which reads:

\[\text{notices} 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.}\textsuperscript{121}

Academics are divided as to the effects of this notice and to the effects of consent. The debate can be summarized as follows: from a chronological standpoint, there are three possible moments when a foreign investor may not raise a claim before ICSID: (1) the date on which the Center receives the denunciation of the country, (2) the end of the six-months period cited in Article 71, or (3) the expiration date of the BIT for both parties, regardless of the State previously denouncing of the ICSID Convention.\textsuperscript{122} The first option implies that Bolivian BITs are a mere offer to consent that should be completed with a written acceptance given by the investor before May 2, 2007. The second option would allow investors to


\textsuperscript{120} “Any 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.” See ICSID Convention, Regulations and Rules, Ch. X, art. 71.

\textsuperscript{121} \textit{Id.} art. 72.

file a claim with ICSID until November 2, 2007. The third option would permit the investor to file a claim with ICSID as long as the relevant BIT remains in force.

On October 31, 2007, that is, four days before the end of the six-month period under Article 71 of ICSID Convention, ICSID Secretary General registered a request for arbitration against Bolivia by E.T.I. Euro Telecom International N.V. Despite Bolivian objections to this registration, the arbitral tribunal was constituted and held a first session and a later hearing.\(^{123}\) It was expected that the resolution of this case would address the questions noted above,\(^{124}\) but on October 21, 2009, the arbitral tribunal ordered the discontinuance of the proceeding\(^{125}\) pursuant to ICSID Arbitration Rule 44.\(^{126}\) Referencing the information provided by the U.S. law firm that represented Bolivia in this arbitration, it was the investor who unilaterally terminated the arbitration.\(^{127}\) But, Bolivia’s triumph in this case was marred by a somewhat bizarre epilogue: a former Bolivian Minister, the Minister of Legal Defense of the State, is now being investigated for corruption, after signing two arbitration agreements in 2009 with ETI governed by the UNCITRAL Rules.\(^{128}\)

Ecuador’s break with ICSID was less aggressive. In 2007, Ecuador sought to escape ICSID’s jurisdiction by resorting to Article 25.4 of the ICSID Convention, providing for the exclusion of “... differences arising on matters concerning the treatment of an investment, resulting from economic activities concerning the use of natural resources such as oil, gas, minerals or other ...” from ICSID’s jurisdiction.\(^{129}\) On July 6, 2009, Ecuador notified its withdrawal from the ICSID Convention. Ecuador’s withdrawal was decided in an Ecuadorian Executive Decree\(^{130}\) in which President Correa referred to the aforementioned Article 422 of the 2008

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123. Id.


126. See ICSID Arbitration Rules, ch. V, Rule 44.


Ecuadorian Constitution prohibiting Ecuador from concluding treaties or international instruments that submit the State of Ecuador to international arbitration.\textsuperscript{131} Ecuadorian denunciation took effect on January 7, 2010, pursuant to Article 71 of the Convention.\textsuperscript{132}

Law firms are trying to protect first-world investors from these Ecuadorian maneuvers. Before the deadline of six months provided in Article 71 of the Convention, investment lawyers advised their clients to carry out actions of a different nature, including the following: (1) perfect Ecuador’s general consent to ICSID jurisdiction by submitting a letter to the Ecuadorian government which accepts this consent measure of questionable efficacy taking into account the case of ETI Euro Telecom, (2) transfer the investment to an affiliate in a country that has a BIT with Ecuador which offers an effective dispute resolution mechanism, and (3) check the company’s political risk insurance coverage.\textsuperscript{133}

It goes without saying that foreign investors will do everything possible to shield themselves against Ecuadorian anti-ICSID animosity. But, there are more international arbitration mechanisms to solve disputes arising from investments and they are still in use for investors despite the ICSID withdrawal. For example, pursuant to Article VI of the Ecuadorian-U.S. BIT, investors may choose to submit their dispute in addition to ICSID to an ad hoc tribunal under the UNCTRAL Rules.\textsuperscript{134} Alternatively, both parties may choose a different arbitral institution or arbitral rules.\textsuperscript{135} This last alternative would also allow investors to begin arbitration under the ICSID Additional Facility rules (AF) against a non-signatory-ICSID State.\textsuperscript{136} Even investors whose BITs do not contain as many arbitral options may eventually benefit from arbitration if the most-favored-nation clause is to be applied to dispute settlement mechanisms.\textsuperscript{137} The elimination of these remaining options requires more laborious interventions from the Latin American states.


\textsuperscript{135} Id.


E. BITs as A Tool Against ICSID

1. Ostracizing ICSID in a new era of Latin American BITs?

It is interesting to study the most recent BITs adopted by several Latin American countries in order to assess the extent to which some of these countries have changed their policies about the settlement of international disputes. Inconclusive research suggests that the vast majority of Latin American states are still loyal to ICSID and therefore their BITs continue to reference this international institution as a possible option for investors willing to submit their disputes to a non-national organization.

In particular, these are some of the options included in recently adopted BITs: the complaining party may begin an investment arbitration either under ICSID or pursuant to ad hoc arbitration according to UNCTRAL rules (Chile/Iceland 2006);\(^\text{138}\) ICSID, ad hoc arbitration following UNCITRAL rules or the International Chamber of Commerce in Paris (Nicaragua/Belg-Luxemburg Economic Union 2005 and Paraguay/Belg-Luxemburg Economic Union 2005);\(^\text{139}\) ICSID or ad hoc arbitration (Guyana/China 2004 and Uruguay/Armenia 2008);\(^\text{140}\) State courts, ad hoc arbitration UNCITRAL, ICSID or ICSID Additional Facility (Colombia/Spain 2007);\(^\text{141}\) ad hoc arbitration UNCITRAL, ICSID or ICSID AF (Guatemala/Israel 2009);\(^\text{142}\) ICSID, ICSID AF, ad hoc arbitra-


\(^{141}\) Acuerdo Para la Promocion’n y Proteccion’n Reci’proca de Inversiones entre la Republica de Colombia y el Reino de Espana [Agreement for the Promotion and Reciprocal Protection of Investments Between the Republic of Colombia and the Kingdom of Spain], Colom.-Spain, art. XI, ¶ 2, June 9, 1995, available at http://wwwunctad.org/sections/dite/iaa/docs/bits/span_colombia_sp.pdf.

tion UNCITRAL or any other arbitration (Peru/Japan 2008);\textsuperscript{143} State courts, ad hoc arbitration UNCITRAL, ICSID or ICSID AF (Panama/Dominican Republic 2006);\textsuperscript{144} and only ICSID and ICSID AF (Suriname/Netherlands 2005).\textsuperscript{145}

Even Argentina, after its economic crisis, signed a BIT with Panama where both parties agreed to accept ICSID’s jurisdiction.\textsuperscript{146} This BIT provision relying on ICSID is likely to have been negotiated before ICSID commenced rendering the many awards against Argentina. Or even if Argentina’s reluctance towards the ICSID had already existed, Argentina did not want to show it with a “sister State” such as Panama.\textsuperscript{147}

It has not been easy to find updated information on BITs signed by Ecuador and Bolivia in recent years. The last references to these countries refer to BITs signed when Presidents Correa and Morales were in power.\textsuperscript{148} Probably for this reason, these texts also maintain that ICSID is an appropriate mechanism for solving disputes between one contracting party and an investor of the other contracting party (Bolivia/Belgo-Luxemburg Economic Union 2004 or Ecuador/Italy 2005).\textsuperscript{149}

Hugo Chavez’s policy on this issue has been much more explicit. Previously, Venezuelan BITs referred to ICSID (for example, Venezuela/UK


\textsuperscript{148} President Morales of Bolivia was first elected in 2005; President Correa of Ecuador was first elected in 2006.

In the last few years, the Bolivarian Republic has signed BITs with Cuba, Iran, the Russian Federation, and Belarus. These foreign states, apart from being key oil and gas producing countries, are also well known for not having a harmonious relationship with the United States. All of these BITs include a provision regarding the settlement of investor-state disputes, which eliminates the ICSID option in favor of other combinations: (1) state courts or ad hoc arbitration under the UNCITRAL Rules (Venezuela/Cuba 2004); (2) the third additional option of a Stockholm Chamber of Commerce arbitration (Venezuela/Russian Federation 2008); and (3) in the case of Venezuela/Iran 2006, the option between ad hoc UNCITRAL arbitration and International Chamber of Commerce in Paris followed by the reference to ICSID “if both parties are members of this Convention.”

As to the role that ICSID may develop in the prospective investment controversies with Latin American nations, Venezuela currently has the most firmly promoted anti-ICSID stance regarding new bilateral investment treaties. Time will tell if other countries in Latin America decide to follow this policy. Even if they do not, the same results may be obtained without negotiating new BITs with developed countries. In recent years, there has been a worldwide deceleration in the number of signatories of new BITs. These BITs are giving way to other types of agreements, such as free trade agreements among countries, which are supposed to

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152. Acuerdo Sobre Promoción y Protección Recíproca de Inversiones entre el República Bolivariana de Venezuela y el Gobierno de la República de Cuba [Agreement About the Promotion and Reciprocal Protection of Investments Between the Bolivarian Republic of Venezuela and the Republic of Cuba], Cuba-Venez., Dec. 11, 1996.


154. Iran-Venez. BIT, supra note 151, art. 11, ¶ 2. In reality, this is illusory because Iran is a non-member State and the future of Venezuela as a member of ICSID is quite dubious.

155. Emmanuel Gaillard, Anti-Arbitration Trends in Latin America, 239 N.Y.L.J. *1, at *1 (2008), available at http://www.shearmans.com/files/Publication/33b80659-ac58-4fd4-8217-2a92905f1f1c2/Presentation/PublicationAttachment/db188d5f-038b-4950-a9e1-2b7a752c94b1A_070208_03.pdf.
have more bargaining power to avoid the imposition of ICSID arbitration.\textsuperscript{156}

2. Widespread termination of BITs

In addition to this eventual ICSID ostracism, Venezuela and Ecuador have initiated another striking mechanism for reducing ICSID’s power—the formal termination of preexisting BITs.

In May 2008, Venezuela gave the Netherlands notice of termination of their BIT.\textsuperscript{157} The Venezuelan-Dutch BIT, which entered into force on November 1, 1993, had been highly criticized by the Venezuelan government, which argued that non-Dutch companies incorporated in Holland had fraudulently intended to profit from it.\textsuperscript{158} The breaking point was a claim filed on October 10, 2007, by the Exxon Mobil Corporation (Exxon) against Venezuela.\textsuperscript{159} Despite its U.S. origin, Exxon invoked ICSID protection under the Netherlands-Venezuela BIT, arguing that the oil project in Venezuela was meant to be developed by a Dutch shell company.\textsuperscript{160} It seems that Venezuela’s misgivings are not unfounded if one takes into account the professional practice of law firms specializing in international investment.\textsuperscript{161} One of the tips for drafting investor friendly arbitration clauses is to structure those claims in such a way so as to gain access to the arbitral jurisdiction provided under international investment treaties: if the investor is not located in a country that has signed an investment treaty with the host state, the client is advised to structure its investments through other countries, which have signed such a treaty with


\textsuperscript{157} Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Republic of Venezuela, Neth.-Venez., art. 9, ¶¶ 1-2, available at http://www.siec.oas.org/Investment/BITSbyCountry/BITs/VEN_Netherlands.pdf [hereinafter Neth.-Venez. BIT].


\textsuperscript{160} \textit{Id.} at 13.

\textsuperscript{161} \textit{Id.} at 5-10.
the host state.\textsuperscript{162}

In 2009, President Correa from Ecuador asked the National Assembly to authorize the denunciation of thirteen of its BITs.\textsuperscript{163} The debate within the legislative branch has been based on the new 2008 Constitution. Without much concern for the retroactivity issue, the Ecuadorean National Assembly declared recently that these BITs violate Articles 416.12, 419 and 422 of the Constitution and that, therefore, the denunciation should be made.\textsuperscript{164}

The measures taken by Venezuela and Ecuador have had a deep political impact.\textsuperscript{165} Yet, the legal effect of these denunciations remains unknown, as bilateral investment treaties usually contain a survival clause.\textsuperscript{166} This clause allows investments made before the BIT termination date to remain protected by the same text during an ample period of


\textsuperscript{163} Decio Machado, Ecuador y la Denuncia de Los Tratados Bilaterales de Inversion [Ecuador and the Denunciation of Bilateral Investment Treaties] \textsuperscript{\textsuperscript{4}} (2009), available at http://www.cadtm.org/spip.php?page=article_pdf&id_article=5095. See generally BITs with USA, Switzerland, Venezuela, Chile, Argentina, Canada, China, Netherlands, Germany, France, Finland and Sweden.

\textsuperscript{164} Republic of Ecuador: Constitution of 2008 art. 416, ¶ 12 (“Las relaciones del Ecuador con la comunidad internacional responderán a los intereses del pueblo ecuatoriano, al que le rendirán cuenta sus responsables y ejecutores, y en consecuencia: Fomenta un nuevo sistema de comercio e inversión entre los Estados que se sustente en la justicia, la solidaridad, la complementariedad, la creación de mecanismos de control internacional a las corporaciones multinacionales y el establecimiento de un sistema financiero internacional, justo, transparente y equitativo”); id. art. 419, ¶¶ 5-6 (“La ratificación o denuncia de los tratados internacionales requerirá la aprobación previa de la Asamblea Nacional en los casos que: 5. Comprometan la política económica del Estado establecida en su Plan Nacional de Desarrollo a condiciones de instituciones financieras internacionales o empresas transnacionales. 6. Comprometan al país en acuerdos de integración y de comercio”); id. art. 422 (No se podrá celebrar tratados o instrumentos internacionales en los que el Estado ecuatoriano ceda jurisdicción soberana a instancias de arbitraje internacional, en controversias contractuales o de índole comercial, entre el Estado y personas naturales o jurídicas privadas. . . . ); see generally Kate Joynes, Ecuador to Follow Bolivia, Amend All Bilateral Investment Treaties, GLOBAI INSIGHT, May 15, 2007, at 2, http://www.ihsglobalinsight.com/; Posting of Dr. Vethoven Chica Arévalo, to Asemblea Nacional Republica del Ecuador [National Assembly of the Republic of Ecuador], http://asambleanacional.gov.ec/blogs/vethoven_chica/2009/10/29/la-denuncia-de-instrumentos-internacionales/ (Oct. 29, 2009); Boletines de Prensa [Press Release], Intensifican debate sobre denuncia de Tratados de Protección Recíproca de Inversiones [Intensifying debate over denunciation of Reciprocal Investment Protection], Asemblea Nacional Republica del Ecuador [National Assembly of the Republic of Ecuador], (Nov. 5, 2009, 12:44 ECT) http://www.asambleanacional.gov.ec/200911051406/noticias/boletines/intensifican-debate-sobre-denuncia-de-tratados-de-proteccion-reciproca-de-inversiones.html.

\textsuperscript{165} Gillman, supra note 60.

time (for example, 10 years in the Ecuador-Switzerland BIT or fifteen years in the case of the Venezuela-Netherlands BIT).167 Hence, the effects of these decisions will only be felt in the next decade.

It is possible that other Latin American nations will follow this trend in the near future. For many years, the states of this region have envied the position of Brazil, which has received abundant foreign investment despite its complete lack of involvement in the international network of BITs.168 Consequently, Latin America will probably turn back the clock to a time when the Calvo doctrine will be reborn, or rather, will reawaken from lethargy. The ultimate goal is no longer to be obliged by this kind of BIT, which Latin American countries consider unfair.

3. Drafting New Model BITs

In their quest to encourage foreign investments, Latin American countries have signed BITs that have not been advantageous for them. But moving forward, Latin American nations have realized that the content of the BIT should better balance the rights and obligations of both parties.169 This is important because ICSID arbitral tribunals base their decisions on a detailed analysis of the contents of the BITs and “a word, or an absence of one, can make the difference between an arbitration won or lost.”170

As U.S. legal scholars report and as many of their Latin American counterpart have noted, the United States has used BITs to introduce substantial legal transplants in Latin America. BITs with Latin American countries contain dispute resolution mechanisms reflecting U.S. common law concepts that do not exist in the legal system of the host States.171 These legal transfers constitute a new form of unilateralism.172 From this perspective, the growing disappointment of the nations of Latin America with ICSID is understandable because the transfers of law contained in the BITs are “externally dictated transplants”, which are unlikely to grow “in its new body.”173

167. Id.
168. Brazil has signed fourteen BITs, but none of them has been ratified. Total Number of Bilateral Investment Treaties Concluded, United Nations Conference on Trade & Dev., June 1, 2010, http://www.unctad.org/sections/dite_pebb/docs/bits_brazil.pdf (last visited Aug. 28, 2010).
169. See Sara Lidia Feldstein de Cardenas, Arbitraje e Inversiones Extranjeras [Arbitration and Foreign Investments], CENTRO ARGENTINO DE ESTUDIOS INTERNACIONALES 23 (2005), available at www.caei.com.ar/es/programas/di/d14.pdf (indicating that the authorities have to weigh the implications that the signing of BITs can have for the future of the country).
172. Id. at 267.
173. Id. at 286-87.
Some Latin American countries have recently announced their willingness to create new Model BITs that are more favorable to developing countries. The text of the new Model BITs that are currently being drafted is unknown, but sparse information gathered from various sources provide forecast of the most outstanding characteristics of the future Model BITs.174

In 2006, the Bolivian government presented some guidelines for a fair trade and cooperation treaty with the United States.175 This proposal, untenable from the United States’ perspective, underscores Bolivia’s disadvantaged situation as “the history of Bolivia is one of an impoverished country that for centuries has been an exporter of raw materials” to the United States.176 Today, there is an enormous asymmetry between both countries where “the GNP of the U.S. is 1,200 times greater than the GNP of Bolivia.”177 Thus, any BIT between both nations should take the asymmetry into account.

Bolivia’s claims for a fair BIT should help Bolivia ensure poverty reduction and a healthy environment; promote the ecological and indigenous farming that is valued and supported for its contribution to cultural diversity; strengthen its “productive base and market systems so that Bolivian producers can take practical advantage of the new U.S. markets”; “preserve the property rights of the Bolivian State over its natural resources”; “secure effective revenues for the country”; “promote stability and sustainable growth”; “design trade rules based on special and differential treatment that take into consideration Bolivia’s economic reality”; “respect Bolivian sovereign rights to guarantee access to affordable generic medicines and to essential services”; “and protect Bolivia’s wealth of traditional knowledge and rich biodiversity.”178

Consistent with this framework, the Bolivian government has stated that mechanisms for setting international investment disputes must be transparent, accessible, efficient and effective in addition to respecting the framework established by the Bolivian Constitution and national laws.179 After this Bolivian proposal was referred to the United States, both countries did not conclude a BIT and in June 2009, President Evo Morales declared his wish to conclude a “Peoples Trade Agreement” with the United States, rather than a traditional “classical” free trade agreement.180 Nevertheless, President Morales acknowledged this process as a

174. Damon Vis-Dunbar, supra note 170.
176. Id.
177. Id.
178. Id.
179. Id.
difficult and slow-evolving objective.\textsuperscript{181} There are three innovative aspects of the 2007 Colombian BIT Model.\textsuperscript{182} First, the model states that the “sole fact of a measure or series of measures having adverse effects on the economic value of an investment does not necessarily imply that an indirect expropriation has occurred.”\textsuperscript{183} Second, the settlement of disputes section establishes a “fork-in-the-road” between national courts and national or international arbitration.\textsuperscript{184} Third, the new BIT condemns frivolous claims and does not include an umbrella clause, precluding that a breach of a contract between a state and a foreign investor becomes a breach of the BIT.\textsuperscript{185}

The BIT Model that is being developed by Ecuador has been predetermined by the content of the new Constitution of 2008. For example, priority will be given to national investment over foreign investment, rigid rules on sovereignty over strategic resources and special sectors should be set and international disputes will not be solved in extra-regional forums.\textsuperscript{186}

In the preparation of these new models, Latin American countries should take into account the Model of International Agreement on Investment for Sustainable Development (IISD Model) developed by the International Institute for Sustainable Development (IISD).\textsuperscript{187} This 2005 text presents itself as a living model aiming to “foster international investment that is supportive of sustainable development aspirations and requirements in both the North and South.”\textsuperscript{188} The IISD Model “develops provisions that balance the rights and obligations of investors, host states and home states.”\textsuperscript{189} The institutional mechanism for the settlement of disputes included in the IISD Model is very different from the ICSID system.\textsuperscript{190}

The United States has not remained immune to this revisionist trend. In 2004, several U.S. civil society groups presented a set of alternatives to the bilateral investment treaty model.\textsuperscript{191} Among them is a proposal to

\begin{thebibliography}{99}
\bibitem{181} Id.
\bibitem{183} See id. art. VI.
\bibitem{184} See id. art. IX.
\bibitem{185} See id.
\bibitem{188} Id.
\bibitem{189} Id.
\bibitem{190} This model does not allow recourse to arbitral institutions such as ICSID and creates a new system of arbitration inspired by the WTO system. Konrad von Moltke, A Model International Investment Agreement for the Promotion of Sustainable Development 28 (2004), available at http://www.iisd.org/pdf/2004/trade_model_inv.pdf.
\bibitem{191} Letter from Jake Caldwell et al., Trade & Environment Program Manager, National Wildlife Federation to Wesley Scholz, U.S. Department of State, Office of
\end{thebibliography}
require the exhaustion of local remedies before going to international arbitration, which is a stark reminder of the Calvo doctrine. In relation to this issue, Latin American scholars acknowledge that if national courts want to substitute ICSID tribunals in deciding these claims on international investments, the legal systems of these countries must be improved considerably. Ultimately, the deficiencies currently attributed to Latin American legal systems (weak judiciary, culture of impunity, absence of the rule of law culture, etc.) must be overcome. Being aware that it is a long-term aspiration, along with a modernization of the substantive laws, entire justice systems must be modernized, making them faster, more transparent and more effective in order to avert the threat of a denial of justice.

F. CREATION OF SPECIALIZED PUBLIC AGENCIES TO PROTECT DEVELOPING COUNTRIES FROM ICSID ARBITRATIONS

In recent years, several Latin American governments have created groups specializing in addressing the legal aspects of the complaints filed by foreign investors in international arbitration forums. A pioneering initiative in this area was the “Argentine Assistance Unit for the Arbitral Defense,” established on October 24, 2003. The Unit aimed to develop and implement strategies both at the stage of amicable negotiation of disputes arising from foreign investors and also in the arbitration proceedings arising from the BITs. The effectiveness of this Unit has been questioned in Argentina, since the cases before ICSID seem to be still partially managed by foreign law firms. Nevertheless, this governmental structure has inspired other countries in the region.

On April 10, 2007, Nicaragua created the “Interinstitutional Commission for the Defense of the Nicaraguan State against Investment Disputes.” The objective of this entity is to coordinate actions among

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194. Id. at 323-27.


198. Decreto No. 28-2007, 9 Mar. 2007, Decreto creador de la comisión interinstitucional para la defensa del Estado de Nicaragua por diferencias relativas a inver-
different public administrations involved in the defense of Nicaragua in international processes of alternative dispute resolution between the state and foreign investors.\footnote{Id.} On June 5, 2008, the Bolivian Government created a new Ministry, responsible for the legal defense of the state (“Ministerio Sin Cartera Responsable de la Defensa Legal de las Recuperaciones Estatales”).\footnote{Id.} Under the motto, “la patria no se vende, se defiende” (the motherland is not for sale, but to be defended),\footnote{Id.} its current head, Ms. Elizabeth Arismendi Chumacero, declared on January 25, 2010, “her commitment to work with honesty and responsibility in defending national interests, dealing with international arbitrations, so as to obtain clear answers on behalf of Bolivia.”\footnote{Id.} Peru has also developed a series of measures to react in a coordinated manner against international investment disputes.\footnote{Id.} It has created a committee that will represent the state during the whole process of the investment claim.\footnote{Id.} This entity will also be responsible for managing and communicating public information about contracts containing clauses on international disputes settlement.\footnote{Id.}

G. Regional Initiatives

In recent times, states in Latin America are pointing to the possibility of different national Model BITs being replaced by a regional template. Countries want a Model BIT to give them greater protection by, for example, restoring the principles of the Calvo doctrine.\footnote{Id.} Governmental experts from various Latin American countries have proposed to adopt a “Latin American Agreement on Investments Promotion and Protection” (Acuerdo Latinoamericano de Promoción y Protección de Inversiones).\footnote{Id.} The purpose of this Agreement is to create “the most extensive area of uniform treatment of foreign investment, because the geographic area will span from Mexico to Tierra del Fuego and give coherence to the region in its approach.”\footnote{Id.} To obtain consensus on
projects such as a supranational Model BIT, states need the support of a regional organization that enables them to carry out this type of joint initiatives. In this sense, we must take into account the existence of the “Bolivarian Alternative for the Americas” (ALBA).209 This regional organization, currently consisting of nine countries, presents itself as a scheme of integration based on principles of cooperation, solidarity and complementariness.210 ALBA looks to overcome the obstacles that prevent true integration, such as poverty, aiming to compensate for the existing asymmetries between its members.211 Following upon a proposal of Hugo Chavez in 2001, ALBA has promoted some initiatives in the field of international investment, like the creation of a regional petroleum company called Petroamérica or the establishment of a Society of Latin American Reciprocal Guarantees to reduce the dependency on foreign investment.212

In the area of international dispute resolution, the seventh ALBA summit of 2009 proposed the creation of a regional center to replace ICSID arbitration, instructing a dispute resolution group to work on this issue.213 This working group has made the objectives underlying the creation of this regional body public by setting up a dispute settlement mechanism that is fair, equitable, impartial and able to understand the social, economic and political realities of the peoples of Latin America. This entity would achieve a breakthrough in the consolidation of ALBA, the region would also shield itself legally and socially and Latin America could dispense with international entities, such as ICSID, that ignore the primacy of public interest over private interest.214

Together with this proposal by ALBA, similar initiatives are being developed in Latin America. For some time, the region wanted to have an organization that encompasses all of the states in South America. Thus, in May 2008, the “Constitutive Treaty of the Union of South American Nations” (UNASUR) was created for the purpose of merging the Andean Community, MERCOSUR and Chile, together with Guyana and


\[210. \text{See id.}

\[211. \text{Id.}


\[214. \text{En la Procuraduría General de la República, Representantes Del Alba-TPC Trabajaron Sobre la Instancia de Resolucion de Controversias [In the Attorney General of the Republic, Representatives of the Alba-TPC Instance Worked on the Resolution of Disputes], Gobierno Bolivariano de Venezuela http://www.pgr.gob.ve/biblioteca.htm (last visited Sept. 12, 2010).}
Suriname. In June 2009, at the thirty-ninth Session of the General Assembly of the Organization of American States, Ecuador’s Foreign Minister Fander Falconi proposed that UNASUR create an arbitration center, which would allow Latin America to free itself from any foreign tutelage. During his term as temporary president of UNASUR, Rafael Correa has endeavored to promote this project that limits dispute resolution proceedings to regional forums. On June 25th, 2009, President Correa declared at the U.N., “if a system has failed, we cannot expect a solution from those who created that system. Instead, we have to look to others like our own people.” Therefore, UNASUR shares the objectives of ALBA on resolution of disputes arising from international investment and advocates the creation of conciliation and arbitration tribunals. They should be composed of jurists of each country in the region and deal with “the leniency [for] transnational capital [that] has [been] able to exercise [greater] rights than people.” From a sectorial perspective, in April 2007, the first South American Energy Summit took place. It established the South American Energy Council and set out to create an Energy Security Treaty, which would establish, among other things, an entity to resolve energy disputes in the region.


220. Intervencion del Canciller ecuatoriano, Dr. Fander Falconi, en la sesion de la OEA de 2 de junio de 2009 [Intervention of the Ecuadorian Chancellor, Dr. Fander Falconi, at the session of the OAS, June 2, 2009], www.scm.oas.org/idms_public/SPANISH/Hist_09/ac01392f64.doc.


A few months ago, leaders of more than thirty Latin American states have announced that they will create a new regional bloc, including every country in the Americas except for the United States and Canada. It is debatable that this proposal, presented at the Rio Group Summit in Mexico in late February 2010, aims to reduce the power of the Organization of American States, to which the United States and Canada belong.²²³

### III. CONCLUSION

As it has been pointed out throughout this paper, Latin America²²⁴ is currently going back to approaches that belong to the Calvo doctrine.²²⁵ This stance is considered to be beneficial by these countries, as the Calvo doctrine fosters the region’s independence from the United States and strengthens Latin American sovereignty and regionalism. Nevertheless, it must be taken into account that Latin America is not a harmonious bloc.²²⁶ This is demonstrated through a number of factors, including its


²²⁴ It is interesting to note that nowadays this Calvo doctrine is also starting to develop in countries that were traditionally opposed to it, like the United States. In recent years, NAFTA has given rise to some international arbitration cases where the respondent was the U.S. government. From the defendant’s perspective, a recent example of how the United States is supporting the reduction of the protection level granted to foreign investors is the case Glamis Gold Ltd. v. United States of America. The arbitral tribunal held that “to violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105(1).” Glamis Gold, Ltd. v. United States, ICSD (W. Bank) 10 (2009), available at http://ita.law.uvic.ca/documents/Glamis_Award.pdf. Furthermore, in the process of reform of the U.S. Model BIT which started in 2009, one of the crucial issues for discussion is whether foreign investors in the United States can enjoy a better legal status than domestic entrepreneurs. Press Release, United States Department of Justice, Public Meeting Regarding the Public Meeting Regarding the U.S. Model Bilateral Investment Treaty Review (July 22, 2009), available at http://www.state.gov/r/pa/prs/ps/2009/july/126304.htm; U.S. Model Bilateral Investment Treaty Review (July 22, 2009), available at http://www.state.gov/r/pa/prs/ps/2009/july/126304.htm.


²²⁶ Rozas, supra note 225.
level of development, its political allies and its economic policies. While some countries of Latin America continue to develop liberal economic policies (Chile, Costa Rica, Dominican Republic, and Colombia), others (Venezuela, Bolivia, and Ecuador) have shown their reluctance to conform to this model, and are adopting a different model of economic regulation. The first set of neo-liberal proposals is based on free market access, institutional efficiency, and investor protection, while, on the other hand, the anti-Free Trade Agreement countries rely on a strong state, capable of creating wealth through its control over natural resources and the economy. A clear example of the important differences that exist within this region are the many recent clashes between Hugo Chavez and Alvaro Uribe, president of Venezuela and former president of Colombia, respectively. Both leaders represent the various tendencies that coexist, and sometimes collide, within Latin America.

Similar conclusions can be drawn if we analyze the specific sector of investment arbitration in Latin America. On the one hand, this paper has shown that in recent years there have been many conflicts in this field. Due to a wide number of cited reasons, the system established by ICSID has been considered detrimental by the countries of Latin America. On the other hand, despite this general anti-ICSID sentiment in Latin America, each nation is developing its own position according to its socio-political characteristics.

The countries examined most thoroughly in this paper are: Argentina, Venezuela, Ecuador and Bolivia. Argentina’s resistance to ICSID is a result of a series of ICSID awards issued against the country as a consequence of an economic crisis that Argentina has considered to be a state of necessity. On the other hand, Venezuela, Ecuador, and Bolivia have leftist regimes, which can be considered politically volatile by powers

227. Id.
228. Id.
like the United States.\textsuperscript{233} The control of valuable natural resources has become a national issue in these countries.\textsuperscript{234} From their perspective, the exploitation of these resources by foreign companies shows the abuse committed by the first world in Latin America.

As a part of their “retaliation campaign”, Venezuela, Ecuador, and Bolivia are developing a series of initiatives aimed at eliminating ICSID as a forum for resolving international investment disputes.\textsuperscript{235} This paper has analyzed in detail these initiatives and their legal implications including the following: (1) resorting to the Constitution to ignore ICSID awards, (2) promoting national courts’ reactions against ICSID, (3) drafting international contracts that avoid ICSID arbitration, (4) withdrawing from the ICSID Convention, (5) using Bilateral Investment Treaties to combat ICSID, (6) creating national agencies to react against ICSID arbitrations, and (7) developing a regional arbitration center aimed at replacing ICSID.

Within this more reactionary bloc, there are also differences in the intensity of the nations’ responses and there is some precedent for international investment disputes between South American countries that, theoretically, share approaches.\textsuperscript{236} At this time, the most radical position is that taken by Venezuela.\textsuperscript{237} In recent months, President Chavez expropriated several foreign companies operating in key sectors of the country,\textsuperscript{238} “and created a joint venture with Russia to drill for heavy crude oil in Venezuela’s Orinoco River Basin.”\textsuperscript{239} Chavez also announced his intention to withdraw Venezuela from the Inter-American Commission on Human Rights after this organization accused him of endangering democracy in Venezuela.\textsuperscript{240} This kind of news certainly worries the interna-


\textsuperscript{234} Id.


\textsuperscript{237} In Ecuador, however, the international political and economic press considers that, during his second presidential term, Correa will deploy a more radical rhetoric, but his policies will be more moderate and are going to try to approach the United States. Christian Volkel, \textit{President Promises Swift Changes in Equador Ahead of Inaugural Ceremony}, Global Insight, Aug. 2009, www.ihsglobalinsight.com.


tional community and investors, particularly those in the United States and Europe.

Additionally, the possible negative effects of reviving some aspects of the Calvo doctrine should not be ignored. The leaders of these Latin American countries are introducing abrupt changes in legislation, making their legal systems unstable. Foreign investors reject this lack of clarity because, from their perspective, it raises their investment’s risks. Other actions of these Latin American governments, such as unilateral modification or forced renegotiation of oil contracts with foreign companies as well as the elimination of the ICSID reference in new BITs, lead to the same conclusion: the loss of security will possibly decrease foreign direct investment in Latin America in the coming years. Currently, production and trade are global phenomena. If Latin America becomes a difficult region for investors, they will go to other developing countries located in Asia or Africa that are eager to attract foreign investments.

Furthermore, the consolidation of this anti-ICSID policy generates fear from the perspective of social development in the region. There are historical precedents in Latin America showing that the reduction of foreign investments in the region has negative effects on the welfare of the general population. Many of these countries have alarming rates of poverty, unemployment, life expectancy, and illiteracy. Assuming that direct foreign investments generate revenues in the host states and that it is appropriately used to support the development of the country, the loss of this financial support would make Latin American countries fall under desirable international standards of development.

To avoid this undesirable situation, Latin American political leaders must be able to foresee the potential costs of their actions and act with historical responsibility. Populist measures can ingratiate the ruling political party with the electorate and facilitate these leaders’ re-election. But if these kinds of measures are not beneficial globally, in the medium-to-long term, their personal interests will harm the community. Recently, different sectors have been demanding that investment arbitration take into account the collective interests that are involved in such international operations. If the arbitration system represented by ICSID is heavily criticized by some Latin America countries, the introduction of a new and more balanced system of international investment must be espe-


244. Miguel D. Ramirez, Foreign Direct Investment in Mexico During the 1990s: An Empirical Assessment, 28 ECON. J. 409, 411-12 n.3 (2002).
cially careful in protecting the future welfare of developing countries. Only if this requirement is met will it be possible to say that the advantages of a “new order” outweigh any disadvantages.

Therefore, recent proposals made from the “first world” to improve the current system—such as the elaboration of a Multilateral Agreement on Foreign Investment or a Restatement of International Investment Law—will probably be rejected by Latin Americans, since they assume that these proposals will, like previous ones, be opposed to their interests. On the other hand, more development-oriented proposals, such as “the creation of an Advisory Center for International Investment Law to provide a range of services to under resourced developing countries,” the foundation of a permanent roster of arbitrators in which developing countries would be prominently represented, and/or greater intervention from the Inter-American Development Bank may be interesting to the Latin American states, but it is unlikely that they will be considered sufficient by all Latin American countries.

Upon analyzing Latin America’s past, it seems that its relationship with foreign investments is tilting and a phase of market opening is being followed by abrupt nationalization measures and vice versa. It would be good if Latin America finds a more measured and steady approach. Latin American countries have to make a serious effort to first assume that if they want to improve their rates of development, they have to let foreign companies invest and develop their business in their territory. On the other hand, they should be aware that there are certain types of investments that can harm their countries such as investments, which are detrimental to the citizens’ health as well as the environment and may deplete nonrenewable resources. Therefore, Latin American countries have to work intensively to develop a set of tools, including legal ones, which would ultimately allow them to refuse unwanted investments. Thus, it is essential that the international investment laws be reconstructed in order to take into account the wishes and needs of the host states.

To achieve this goal, Latin America could implement measures such as the creation of a regional center for the settlement of international investment disputes. This possible organization, located in Latin America and built on more favorable principles for developing countries, would be able to oppose ICSID’s influence in the region, especially if there are many countries that are politically, economically, and legally involved in this project, and if they are determined to develop a common strategy.

An essential aspect of this future arbitral court is that it must be able to help these developing States to free themselves from a “trap of low-quality institutions.” The legal status of some Latin American institutions has been criticized from the outside and it is a fact that the dispute settlement bodies of MERCOSUR and the Andean Community have not been successful. Therefore, a new organization that serves as a genuine alternative to ICSID must meet a number of difficult requirements in order to be universally considered superior to its predecessor. This new organization should, for example, establish a fast, economical, and transparent system. Moreover, these features should not be incompatible with the possibility of offering an appeal to the losing party. It can’t be forgotten that member states of this regional entity must perform a Herculean task: generally withdraw from ICSID, denounce their BITs referring to ICSID, and refer to this new arbitral court in their BITs, international contracts, or even constitutions. Therefore, time will tell if the proposals outlined above will eventually become a Latin American entity, capable of providing answers that satisfy both parties to an international investment dispute.

In the future, together with this renewed system of international investment arbitration, it would be very beneficial to increase the use of ADR mechanisms such as mediation, conciliation, or negotiation. If they are used from the beginning of the investment project, they will reduce the number of conflicts requiring arbitration, and thus also avoid the implementation of expropriatory measures that are in vogue today in some Latin American countries. If Latin American states decide in the future to cede their sovereignty to a regional arbitration center, which is able to replace and improve the ICSID system, the same institutional structure would also be able to accommodate wider purposes, advantageous for the region. For this proposal to succeed, it will be necessary for these measures to be applied by ADR neutral entities which are immune from political influences and which maintain their independence and stability, regardless of political changes that may occur in different countries in the region.


249. See Herrera, supra note 229.

250. For example, Article 422 of the Ecuadorian Constitution 2008 already states that the government is not authorized to cede its sovereignty to international arbitral tribunals, but that the government can be subject to regional arbitral panels. Constitución de Ecuador, art. 422.

DELEGATED DECREE AUTHORITY IN CONTEMPORARY SOUTH AMERICA: COMPARATIVE STUDY OF THE RADICAL LEFT AND THEIR THREAT TO THE RULE OF LAW

Kerry Mohan*

ABSTRACT

International attention regarding executive decree authority within Latin America has significantly increased following Hugo Chávez’ 2007 Enabling Law in Venezuela. This attention has largely been negative, as the international media has often vilified Chávez for promulgating decrees with the force of law. What the international media has continually failed to discuss, however, is that Chávez’ form of decree authority, “delegated decree authority” (DDA), has been common throughout Venezuela’s history, as well as that of most of South America. This article seeks to determine DDA’s prevalence within South America, in particular within Venezuela and Ecuador, and determine whether DDA poses a threat to the rule of law within these nations. By focusing on Hugo Chávez of Venezuela and Rafael Correa of Ecuador, we have a unique opportunity to see whether these charismatic leaders have used DDA to increase their law-making authority and consolidate powers within the Executive branch.

I. INTRODUCTION

INCE 2000, Hugo Chávez has captured international attention through his continued desire to enact broad, sweeping decrees with the force of law under Venezuela’s “Enabling Law.”1 This media attention increased to new heights in August 2008, after Chávez promulgated twenty-six decrees in a single day—the last day of the eighteen-month enabling law—causing the international media to label Chávez as a socialist, a dictator, and an authoritarian.2

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2. Id.
What the international media has continuously failed to report, however, is that Chávez’ form of decree authority, “delegated decree authority” (DDA), has been common throughout Venezuela’s history and most of South America. In fact, eight constitutions in South America specifically provide their Executives lawmakership authority through DDA. Thus, while it may be fair to criticize Chávez for some of his actions, it may not be fair to criticize him for using DDA, considering its relatively frequent use both by his predecessors in Venezuela and by other Latin American leaders.

This article seeks to determine the prevalence of DDA within South America and whether DDA presents a threat to the rule of law. In particular, this article focuses on DDA in Venezuela under Hugo Chávez and Ecuador under Rafael Correa. The focus on Venezuela is a result of the amount of media attention given to Chávez’ enabling laws and his decree authority. Additionally, the focus on Ecuador is due to the fact that Ecuador presents a different form of DDA than Venezuela—post-approval DDA—that will help enrich our overall understanding of DDA. Furthermore, Ecuador’s current president, Rafael Correa, is a leader who has often been placed in the same “radical left” category as Chávez. While this categorization may be appropriate due to Correa’s leftist political ideology, this article seeks to determine whether Correa has acted similarly to Chávez regarding the use of DDA.

Moreover, I selected Chávez and Correa because I consider them to be the most charismatic and popular leaders in their nations’ modern histories—for instance, each has been elected multiple times, an unusual occurrence in both of their nations’ recent histories. Both leaders have also succeeded in re-writing their respective nations’ constitutions to pro-

3. Delegated decree authority may also have a more specific name depending on the country, i.e., the decretazo in Argentina or the “enabling law” in Venezuela. See John M. Carey & Matthew S. Shugart, Appendix of Constitutional Provisions Regarding Decree, in EXECUTIVE DECREES AUTHORITY app. at 299 (John M. Carey & Matthew S. Shugart eds., 1998); Brian F. Crisp, Presidential Decree Authority in Venezuela, in EXECUTIVE DECREES AUTHORITY 142, 145-46 (John M. Carey & Matthew S. Shugart eds., 1998); Delia F. Rubio & Matteo Goretii, When the President Governs Alone: The Decretazo in Argentina, 1989-93, in EXECUTIVE DECREES AUTHORITY 33, 33 (John M. Carey & Matthew S. Shugart eds., 1998).

4. Counting only the Latin American nations within South America, this is eight out of ten nations. Carey & Shugart, supra note 3, at 299; John M. Carey & Matthew S. Shugart, Calling Out the Tanks or Filling Out the Forms?, in EXECUTIVE DECREES AUTHORITY 10 (John M. Carey & Matthew S. Shugart eds., 1998).


vide for consecutive or longer presidential terms with greater Executive powers. Accordingly, these leaders possess substantial political capital that can be used to obtain powerful forms of DDA. Thus, the current political landscape within Venezuela and Ecuador provides a unique opportunity to analyze DDA and determine whether these leaders have used DDA to increase their lawmakers authority and consolidate power within the Executive branch.

This article is divided into six sections. After this introduction, Section II provides definitions of Latin American democracy and the rule of law. Because the rule of law is a contested concept, the Section’s goal is to provide a generalized definition of the rule of law to create the framework for the subsequent analysis regarding whether Chávez and Correa’s DDA use poses a threat to the rule of law.

Next, Section III focuses on delegated decree authority by first defining DDA, then by providing an analysis of what DDA is and, perhaps more importantly, what DDA is not. Section III also discusses critiques of the current state of academic literature concerning DDA. Finally, the Section addresses the theoretical threat DDA poses to the rule of law.

Section IV provides a textual analysis of the constitutional grants of DDA within Venezuela and Ecuador. By examining the language of Venezuela and Ecuador’s old and new constitutions, Section IV determines just how DDA powers have changed through new constitutions drafted under the tutelage of Chávez and Correa.

Section V analyzes how DDA has been used in practice in Venezuela and Ecuador. For each country, Section V analyzes how DDA has been used before and under these leaders. Accordingly, Section V seeks to determine whether these leaders’ use of DDA has been an unprecedented grab of lawmaker power by the Executive, or if these leaders are exercising the same scope of decree authority as their predecessors.

Finally, Section VI analyzes whether Chávez or Correa’s use of DDA poses a threat to the rule of law. As such, Section VI applies the principles adopted in Section II to the facts found in Section V. Section VI will finish with a prescription of what limits must be placed on DDA in South America to protect the rule of law.

II. DEMOCRATIC RULE OF LAW

Contemporary democracy “is distinctive in being based on the rule of law.” Accordingly, it can be argued that democracy fails without the rule of law. But before we can begin an analysis over what the rule of law means, it is necessary to define what democracy means in Latin America. Democracy in Latin America requires: “(1) contestation over policy and political competition for office; (2) participation of the citizenry through partisan, associational, and other forms of collective action; (3) accounta-

10. Healy, supra note 8; Ecuador’s Correa, supra note 8.
11. The Rule of Law 2 (Ian Shapiro, ed., 1994); see Lendman, supra note 1.
bility of rulers to the ruled through mechanisms of representation and the rule of law; and (4) civilian control over the military.”12 Although DDA can have negative effects on many of these requirements, this article focuses solely on how DDA affects the rule of law in Latin American democracies.

Although the rule of law is universally recognized, it is a “notoriously contested concept.”13 As such, this article does not seek to challenge the current understanding of the rule of law throughout Latin America. Instead, this paper simply seeks to use the generalized concept of the rule of law as a measuring-stick for determining DDA’s threat in Venezuela and Ecuador.

Despite being a contested concept, the rule of law is universally defined to require that “law matters and should matter.”14 For laws to matter, they should be “general, public, prospective, clear, consistent, capable of being followed, stable, impartially applied, and enforced.”15 The rule of law also requires that all actors within society, including the Executive, “be subject to limitation by law.”16 This requirement exists because the democratic rule of law works only when “horizontal accountability function[s] effectively, without obstruction and intimidation from powerful state actors.”17 In the context of DDA, such horizontal accountability prevents the consolidation of lawmaking power within the Executive branch.18

One key aspect of the rule of law in relation to DDA is the argument that the rule of law demands that all political actors, regardless of their political orientation, have a “voice” and are able to participate in the creation of legislation.19 Such “formal equality” in the legislative process requires that legislation be sanctioned following “previously and carefully dictated procedures.”20 Without the use of carefully dictated procedures, politically powerful voices can silence weaker ones, effectively excluding

12. Terry Lynn Karl, Dilemmas of Democratization in Latin America, 23 COMP. POL. 1, 2 (1990). Karl’s definition of democracy is used because it is particularly relevant to Latin America and its long history of military governments.
15. Id. at 440.
19. Id. at 757.
portions of society from contributing to legislative content. Such exclusion, in turn, can result in sections of society removing themselves from the political process because they no longer believe that their interests are being represented. Over time, without formal equality, political competition turns into a one-party game where the politically powerful actors are able to skew the rules of the game to permanently hinder political participation from opposing voices.

III. DELEGATED DECREE AUTHORITY

A. WHAT IS DDA?

Delegated decree authority (DDA) is a constitutionally-provided power permitting the Legislature to grant the Executive the authority to change the nation’s status quo by promulgating decrees with the force of law. DDA exists in two forms: (1) pre-approval DDA and (2) post-approval DDA. The two differ in that while one form requires legislative approval prior to the decrees (“pre-approval DDA”), the other requires legislative action after the decree (“post-approval DDA”). In both forms of DDA, the key component is the Executive-Legislative interplay, whereby the Legislature effectively grants the Executive the right to enact decrees with the force of law. In pre-approval DDA, this Executive-Legislative interplay occurs before the Executive has DDA powers, with the Legislature granting DDA powers in a piece of legislation containing the scope and time-length of the DDA grant. In post-approval DDA, the Executive-Legislative interplay occurs after the Executive sends his decree to the Legislature, whereby the Legislature has a specific amount of time—i.e., thirty days—to approve, modify, reject, or acquiesce to the Executive’s decree.

The substantive scope and time length of both forms of DDA are limited by a nation’s constitution and the Legislature. For instance, while a constitution may provide a broad scope of DDA powers, the Legislature can limit the scope to specific areas of law.

Because Executive decrees under DDA have the force of law, those decrees become the new status quo for the nation. As such, decrees passed under DDA nullify prior laws of the same subject matter and es-

22. See generally Walker, supra note 18, at 757.
24. Id. at 10.
25. Id.
26. Id.
27. Id.
28. Id.
29. Id.
30. Id.
31. Scott Mainwaring & Matthew S. Shugart, Presidentialism and Democracy in Latin America: Rethinking the Terms of the Debate, in PRESIDENTALISM & DEMOCRACY IN LATIN AMERICA 12, 44 (Scott Mainwaring & Matthew S. Shugart eds., 1997).
establish new rights or obligations. Moreover, because decrees enacted under DDA have the force of law, they can only be repealed or altered by subsequent legislation or a Supreme Court decision.

Both pre-approval and post-approval DDA are prevalent throughout South America (see Figure 1). Although prevalent, it is important to note that each country maintains its own unique system of DDA. As such, the amount of relative freedom the Executive has in issuing decrees under DDA differs substantially throughout the region. Nonetheless, the key aspect common through all of these countries’ forms of DDA is the Executive-Legislative interplay.

Figure 1: Constitutionally-Established DDA in South America

<table>
<thead>
<tr>
<th>Type of DDA</th>
<th>Length of DDA</th>
<th>Scope</th>
<th>Other Limitations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>No limit</td>
<td>Pre-Approval: Administration and Public Emergency</td>
<td>None</td>
</tr>
<tr>
<td>Brazil</td>
<td>Legislature has 30 days to act</td>
<td>No limit</td>
<td>None</td>
</tr>
<tr>
<td>Chile</td>
<td>1 year</td>
<td>No limit</td>
<td>Post-approval decrees must be used to prevent serious detriment to the country</td>
</tr>
<tr>
<td>Colombia</td>
<td>6 months</td>
<td>Economic and Financial</td>
<td>None</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Legislature has 30 days to act</td>
<td>Economically Urgent</td>
<td>1 DDA decree at a time</td>
</tr>
<tr>
<td>Peru</td>
<td>No limit</td>
<td>No limit</td>
<td>None</td>
</tr>
<tr>
<td>Uruguay</td>
<td>Legislature has 45 days to act</td>
<td>No limit</td>
<td>1 DDA decree at a time</td>
</tr>
<tr>
<td>Venezuela</td>
<td>No limit</td>
<td>No Limit</td>
<td>None</td>
</tr>
</tbody>
</table>

32. Id.
33. Id. at 45.
34. For instance, while post-approval DDA in Ecuador provides the Legislature thirty days to respond to the president’s decree, Uruguay’s post-approval DDA provides its Legislature forty-five days to respond. See Mainwaring & Shugart, supra note 31, at 44.
35. Carey & Shugart, supra note 3, at 299.
37. SCOTT MORGENSTERN & BENITO NACIF, LEGISLATIVE POLITICS IN LATIN AMERICA 101 (2002).
38. Mainwaring & Shugart, supra note 31, at 45, 47; Carey & Shugart, supra note 4, at 11.
40. Id.
41. Id. at 46.
42. Crisp, supra note 3, at 146; Carey & Shugart, supra note 3, at 307.
The purposes behind pre-approval and post-approval DDA differ dramatically. Pre-approval DDA is often used during times of political, social, or economic change. For instance, pre-approval DDA allows a leader to dramatically change a country’s political institutions to increase popular involvement, restructure state resources, and even change the country’s political ideology. Moreover, by granting pre-approval DDA, a Legislature can avoid political bickering and allow more change to occur than would likely happen under the traditional lawmaking process.

Post-approval DDA, on the other hand, is not as useful in creating wide-spread change. Rather, Executives often use post-approval DDA to force a deadlocked Legislature to address pressing issues that may be politically unpopular. Because the Legislature has a limited time to respond to a proposed decree, it often must shift its focus from other issues to the Executive’s decree to ensure a proper discussion of the subject.

DDA is arguably beneficial in several situations. Many individuals favor the use of DDA during times of economic crisis because it enables the quicker decision-making that is necessary to address the constantly evolving economic climate. DDA is additionally seen to be beneficial in situations involving legislative deadlock, particularly when the legislation’s subject matter is contentious and politically unpopular.

B. What DDA Is Not

To better understand what DDA is, it is important to understand what DDA is not. Nearly every democracy in the world provides its Executive with some constitutional authority to issue decrees that affect the status quo of the nation. This broad grant of decree authority is known as “constitutional decree authority” (CDA). Within the broad grant of CDA exist several different decree powers, one of which is DDA. Thus, it is necessary to recognize that while DDA is a part of the broad package of CDA, it is only one small component of it, and, as such, it is necessary to distinguish DDA from the other forms of constitutional decree authority.

43. See Crisp, supra note 3, at 148.
44. See id.
45. As will be later shown, pre-approval DDA has been used by Chávez in Venezuela as a tool to compliment the country’s constitutional re-writing process.
47. Id.
48. See William E. Scheuerman, Exception and Emergency Powers: The Economic State of Emergency, 21 CARDOZO L. REV. 1869, 1892 (2000). “[I]t is no surprise that even liberal politicians tend to delegate vast discretionary authority to executive...bodies typically seen as better suited to the tasks of quick, flexible forms of action” in capitalist economies. Id.
49. Sala, supra note 46, at 256.
50. Carey & Shugart, supra note 4, at 10.
51. Id. at 13-14.
52. Id. at 13.
First, DDA is not “regulatory” decree authority, which permits the Executive to enact decrees to ensure the enforcement of pre-existing legislation.\textsuperscript{53} Second, DDA is not “administrative” decree authority, which allows the Executive to manage the effectiveness of the federal government.\textsuperscript{54} Although both “regulatory” and “administrative” decrees can affect the status quo through rules and regulations, “these decrees are not the law; they are subordinate to the law.”\textsuperscript{55} Moreover, it is often much easier to annul regulatory and administrative decrees than it is to annul a DDA decree.\textsuperscript{56} Finally, and most importantly, regulatory and administrative decree authority does not involve the Executive-Legislative interplay that is present under DDA. Instead, the Executive can act upon regulatory and administrative decree authority without Legislative involvement.\textsuperscript{57}

DDA also differentiates from decrees enacted under “emergency powers,” which allow the Executive to suspend specific constitutional rights during a time of national security or economic emergency.\textsuperscript{58} A major difference between emergency decrees and DDA is that emergency decrees are temporary in nature to cure the national crisis and typically expire once the emergency threat has been extinguished.\textsuperscript{59} DDA, on the other hand, is a permanent change in the status quo that can only be removed through future legislative action.\textsuperscript{60} A simple way to distinguish the two according to Mainwaring and Shugart is “if the power is understood as enabling the president to new policy departures, we call it [DDA]. If it is understood to pertain to temporary suspension of some rights, we call it emergency power.”\textsuperscript{61}

It is, additionally, important to clarify the difference between an economic emergency and DDA that is used during times of economic crisis. This distinction is important because economic crises have been the main rationale for DDA in Latin America’s history, as can be seen through the neo-liberal “shock treatments” that occurred in the late 1980s and early 1990s in Latin America.\textsuperscript{62} The most notable difference is that whereas DDA used to solve an economic crisis results in permanent, long-lasting economic laws that remain in force until they are overturned by a later administration, decrees enacted during a state of economic emergency cease once the emergency ends.\textsuperscript{63} Moreover, decrees enacted under an economic emergency often lack the Executive-Legislative interplay that is essential to DDA. For instance, while an economic emergency may be

\begin{footnotesize}
\begin{enumerate}
\item 53. Mainwaring & Shugart, supra note 31, at 46.
\item 54. Id.
\item 55. Carey & Shugart, supra note 4, at 13.
\item 56. Id.
\item 57. See Mainwaring & Shugart, supra note 31, at 46.
\item 58. Id. at 46-47.
\item 59. Id.
\item 60. Id.
\item 61. Id. at 47.
\item 62. Rubio & Giorgetti, supra note 3, at 38; Scheuerman, supra note 48, at 1872.
\item 63. Scheuerman, supra note 48, at 1872.
\end{enumerate}
\end{footnotesize}
declared by the Executive without legislative involvement, DDA used during an economic crisis always involves legislative approval.\textsuperscript{64}

To truly understand DDA, it is necessary to conceptualize how DDA fits within CDA. Figure 2 below is a conceptualization of CDA, containing DDA, emergency decrees, administrative decrees, and regulatory decrees. Moreover, each sub-category contains its own group of “sub-sub-categories” of decree authority. For example, DDA includes both pre-approval and post-approval DDA. Alternatively, emergency decree authority includes both states of emergency and economic emergencies. Accordingly, it is necessary to understand that while DDA is CDA, CDA is not always DDA.

Moreover, the space outside of these specific categories of CDA consists of the “gray” area of CDA. This “gray” area is important because Executives may have a constitutional right to issue decrees that do not cleanly fit into any of the above-described categories. Nonetheless, Executives have used this “gray” area to enact decrees that do, in fact, change the nation’s status quo. Such examples of the ability to issue decrees in this “gray” area include the creation of national companies, the canceling of contracts with private companies, and even the nationalization of private industry.\textsuperscript{65} This “gray” area may become the most worrisome form of CDA in the future, as the only true constraints of the Executive’s use of this decree authority is a country’s Supreme Court, which may be hesitant to invalidate an Executive’s decree due to political or social pressures. Although this “gray” area of CDA is beyond the scope of the current analysis, further investigation into the prevalence of “gray” area should be made to further develop and understand CDA’s nuances.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{CDA.png}
\caption{CDA}
\end{figure}

\begin{footnotesize}
\footnotesubtext{64. See id. at 1881.}
\end{footnotesize}
C. Critique Of Current Theory Of DDA

Although I agree with the majority of the current literature regarding DDA, I must clarify what I consider to be two problems with the current state of DDA analysis. First, some authors argue that post-approval DDA is not a form of DDA, but instead a separate form of CDA. The rationale behind their argument is that because the decree is made without prior Legislative approval, the only authority permitting such a decree is the constitution, thus leading to CDA. I reject such an argument because it ignores the fact that both pre-approval and post-approval DDA are constitutionally provided for. Without the constitutional grant, it would be unlawful for a nation’s Legislature to grant DDA, in any form, to the Executive. Moreover, the argument further ignores the fact that in both pre-approval and post-approval DDA the decrees are without effect without Legislative approval of some form. Thus, while post-approval DDA allows the Executive to promulgate decrees without Legislative approval, those decrees enjoy the force of law only after the Executive-Legislative interplay occurs. It is this Executive-Legislative interplay that makes DDA unique from the other forms of CDA and what makes post-approval DDA a form of DDA.

Second, although Mainwaring and Shugart provide an accurate analysis of the prevalence of DDA within Latin America, the authors fail in their attempt to distinguish between the dangers of pre-approval and post-approval DDA. They argue that post-approval DDA provides a greater danger than pre-approval DDA because pre-approval DDA involves a situation where “what congress delegates it can retract—or it can choose to not delegate in the first place.”66 On the other hand, the Legislature is not free to retract post-approval DDA from the Executive, but instead must wait to react once the Executive has issued such a decree.67 As a result, the authors argue that Latin American Legislatures are more tightly bound by post-approval DDA since the Legislature’s powers are retroactive and not proactive.68 The authors’ distinction turns out to be weak as both pre-approval and post-approval DDA involve situations where the Legislature is tightly bound by Executive action. In pre-approval DDA, the Legislature is bound by all decrees promulgated by the Executive under the DDA grant.69 Meanwhile, post-approval DDA bounds the Legislature by requiring a response to the Executive’s decree.70 Additionally, the authors’ argument that post-approval DDA grants the Executive far more power than pre-approval DDA fails because the substantive scope of both forms of DDA are limited by a na-

66. See Mainwaring & Shugart, supra note 31, at 47.
67. See id.
68. The authors cite to Article 62 of Brazil’s 1988 Constitution as such an example. The Article permits an Executive to adopt “provisional measures” that must be immediately sent to Congress and are deemed ineffective unless they are approved by Congress within thirty days. Id. at 44.
69. See id. at 46-47.
70. Id.
tion’s constitution, which tends to provide the Executive roughly the same scope of activity to decree new legislation.

I reject Mainwaring and Shugart’s arguments and argue that pre-approval DDA currently contains a greater likelihood of abuse than post-approval DDA since many nations have amended their constitutions to provide the Legislature with greater power to nullify post-approval DDA. Although pre-approval DDA permits the Legislature to “choose not to delegate the power in the first place,” pre-approval DDA requires the Legislature to take much more action than post-approval DDA to rescind any decree, even when the Executive exceeds the established boundaries given by the Legislature.71 Moreover, as Executives have further consolidated power within the Legislative branch through new constitutions and the creation of a unicameral legislative branch, they have helped ensure that grants of pre-approval DDA provide the Executive with broader powers.72 Thus, as more assembly seats are won by an Executive’s political allies, the greater the likelihood that the Executive will be granted continually larger pre-approval DDA powers.

I do not mean to say that post-approval DDA poses no danger to democracy, but that, currently, post-approval DDA is not as dangerous as pre-approval DDA. While pre-approval DDA powers have been broadened over time, post-approval DDA powers have been constrained by constitutional changes providing longer time periods to address post-approval DDA decrees, and by restrictions on the use of the Executive’s post-approval DDA to one decree at a time, except during states of emergency.73 Accordingly, it is more difficult for the Executive to inundate the Legislature with post-approval DDA decrees, thereby forcing decrees into law simply because the Legislature is incapable of handling the legislative load within the constitutional time-frame. Finally, and possibly the most important characteristic, post-approval DDA is often constitutionally limited in terms of scope to areas of economic necessity, while the scope of pre-approval DDA can be left to the whims of the majority legislation.74 Thus, even while post-approval DDA can absolutely be abused under certain situations, the likelihood of abuse is much less than in pre-approval DDA.

D. Does DDA Threaten the Rule of Law?

Theoretically, DDA’s threat to the rule of law differs dramatically between pre-approval and post-approval DDA.75 Before beginning a theo-

71. But, it is fair to note that the authors’ work was conducted before the Chávez era in Venezuela, which has showcased an Executive’s ability to consolidate substantial power through pre-approval DDA.
72. See Crisp, supra note 3, at 149-50.
73. Mainwaring & Shugart, supra note 31, at 444; Republic of Ecuador Constitution of 2008 art. 140.
74. Mainwaring & Shugart, supra note 31, at 444.
75. The following subsection involves a theoretical analysis over pre-approval and post-approval DDA’s threat to the rule of law. Because this is solely a theoretical
etical analysis of DDA’s threat to the rule of law, it is important to note that DDA does not threaten the rule of law’s requirement that “laws matter.” This is because once a DDA decree has been granted the force of law through the Executive-Legislative interplay, the Executive decrees are facially no different from any other law. Because DDA does not undermine the rule of law’s requirement that “laws matter,” the focus of DDA’s threat to the rule of law is on “horizontal accountability” and “formal equality.”

1. Pre-Approval DDA

Pre-approval DDA, in general, threatens the rule of law. First, pre-approval DDA threatens the rule of law in that it can provide little horizontal accountability. After the pre-approval DDA grant, an Executive, particularly a strong charismatic leader, can issue decrees without being held accountable for how he uses his DDA powers. So long as the Executive acts within the DDA grant’s boundaries, he can decree whatever he chooses. Moreover, even when the Executive acts outside the DDA grant’s boundaries, the Legislature or opposition must take affirmative action to hold the Executive accountable. Such action, often done through a new law annulling the decree, may take months, thereby allowing the Executive’s unconstitutional decree to become the nation’s status quo for that time period.  

Pre-approval DDA also threatens the rule of law because it denies “formal equality” as it is a departure from the “carefully dictated procedures” that are present in other forms of legislation. In a sense, pre-approval DDA is the exception to the procedures that allow the rule of law to succeed since Executives can issue decrees with the force of law that have not been discussed with the Legislature or are not even in writing at the time of the decree. This lack of formal equality is particularly evident when the Executive is granted DDA by a majority Legislature. In such a situation, the majority Legislature can effectively exclude the opposition from any discussion regarding the scope and time-length of the DDA grant. Moreover, the Executive, after the DDA grant, has the ability to issue decrees without having to discuss the content of the legislation with minority parties. As a result, the political opposition is denied their voice both before and during the pre-approval DDA grant.

Furthermore, pre-approval DDA’s process of stifling opposition participation is significant as it can create a downward spiral of opposition participation and threaten both democracy and the rule of law. First, horizontal accountability disappears as the Legislature, particularly minority parties, demonstrates an incapacity or unwillingness to prevent the

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76. See Mainwaring & Shugart, supra note 31, at 444.
77. See O’Donnell, supra note 16, at 33.
78. See id.
Executive from obtaining lawmaking powers and issuing decrees without legislative involvement.\textsuperscript{79} In turn, voters, viewing the DDA decrees as being arbitrary and believing that their votes no longer count, decide to abstain from voting. This decrease in voter participation enables the majority, including the Executive, to become more powerful through greater election results, which, in turn, allows the Executive to obtain continuously broader DDA powers. As a result, an asymmetric equilibrium forms where only one political voice determines the country’s status quo, damaging the rule of law and democracy.

2. \textit{Post-Approval DDA}

Post-approval DDA’s threat to the rule of law is significantly less than pre-approval DDA’s threat. This difference occurs because laws enacted under post-approval DDA still follow carefully dictated procedures: all post-approval DDA decrees must go through the Legislature before they obtain the force of law, post-approval DDA, unlike pre-approval DDA, specifically allows for legislative involvement regarding the content of the Executive’s decree. Such legislative involvement inherently provides opposition leaders the opportunity to voice their opinion. Moreover, legislative involvement also ensures that horizontal accountability is in effect, as a Legislature can simply reject or modify the Executive’s decree when they believe that the Executive is acting outside of his post-approval DDA powers.

At the same time post-approval DDA provides greater protections for the rule of law, it can also threaten the rule of law in several ways. Because post-approval DDA provides the Legislature a limited time-frame to respond to the Executive’s decree, the Legislature must prioritize sections of the decree. Thus, the Legislature is often able to address only the major issues of the proposed law, which, in turn, means that it must ignore much of the law’s text.

Post-approval DDA is also problematic when the Executive enjoys strong majority support within the Legislature, which can effectively silence the political opposition in a manner similar to that under pre-approval DDA. Because the majority party or coalition often sets the legislative agenda and schedule, the majority can manipulate the schedule to limit minority participation by providing little to no public discussion over the Executive decree.

Finally, post-approval DDA can be problematic when the Executive inundates the Legislature with a continuous stream of decrees. While more recent constitutions have limited an Executive’s ability to inundate the Legislature with decrees by prohibiting the Legislature from having more than one post-approval decree at a time, the Executive can limit legislative action through constant decrees. For instance, the Executive can disrupt any agenda a Legislature may have by constantly sending de-

\textsuperscript{79} See id. at 37.
crees. Because the Legislature must act on the Executive’s decree within a certain time-period, it will continually have to reserve more resources to respond to the Executive’s decrees, leaving the Legislature less time towards drafting its own laws. Accordingly, by sending a continuous stream of decrees to the Legislature, the Executive effectively places itself as the country’s primary lawmaker, thereby limiting the Legislature’s lawmaking authority.

IV. CONSTITUTIONAL GRANTS OF DDA IN VENEZUELA AND ECUADOR

As previously mentioned, a nation’s constitution scopes the boundaries of the Executive’s DDA powers. The text can limit the duration of a pre-approval DDA or how many decrees an Executive can send at any moment under post-approval DDA.80 The text can also limit the scope of DDA to only economic or financial areas or be left intentionally vague to permit DDA in all areas of society.81 While the constitutional language does not dictate how DDA is used in practice, it provides guidelines as to how much power an Executive can consolidate under DDA.

The following analysis provides textual comparisons of the old and new constitutions in Venezuela and Ecuador. Because the new constitutions of Venezuela and Ecuador were drafted under the tutelage of Chávez and Correa, respectively, such a comparison permits us to view if, and how, these leaders crafted the new constitutions to provide themselves greater DDA powers. Accordingly, Venezuela’s analysis involves the country’s 1961 and 1999 Constitutions, while Ecuador’s analysis includes the country’s 1998 and 2008 Constitutions.

A. VENEZUELAN DDA—THE “ENABLING LAW”

1. 1961 Constitution’s DDA

Venezuela’s 1961 Constitution provided its Executives pre-approval DDA powers.82 Article 190, Section 8 provided the Executive to power to make decrees in economic or financial matters when the public interest required it and when it had been authorized by “special law.”*83 What is notable in Venezuela’s 1961 Constitution is that there are few limitations on this DDA grant. Aside from limiting the scope of DDA to economic or financial matters, there is no limitation on the time-length of the “special law.”*84 Instead, the time-length of the DDA grants was limited to the Legislature’s discretion.85

80. See Republic of Ecuador Constitution of 2008 art. 140.
81. See Crisp, supra note 3, at 166.
83. Id.
84. Id.
85. Even though the 1961 Constitution is silent on who has the authority to promulgate the “special law,” past practice shows that the Legislative branch had the sole authority to promulgate such a law. See Crisp, supra note 3, at 146-49.
2. **1999 Constitution’s DDA**

After Chávez became president in 1998, he acted upon his campaign promise to re-write Venezuela’s constitution. During the 1999 re-writing process, Chávez actively sought to increase the scope and power of Venezuela’s DDA because, to Chávez, the enabling law was the “Mother of All Laws,” which could enable him to bring social revolution to Venezuelan society. For Chávez, the enabling law went hand-in-hand with constitutional change, as the Constitution could bring large-scale change, while the Enabling Law could bring specific change. In fact, Chávez said:

The Enabling Law and the Constitutional Reform are like two sister motors, two motors of the same machine. It is required that we coordinate the two quickly because there are laws that we have in mind that will only be possible when the reform is done, when part of the constitution is reformed.

Similar to the 1961 Constitution, Venezuela’s 1999 Constitution provides the Executive pre-approval DDA powers. Article 203 states that the National Assembly, with three-fifths support of its members, can authorize the Executive to enact decrees limited in time and scope under an “enabling law.” Moreover, Article 236, Section 8 provides the Executive the power to dictate, with previous authorization under an “enabling law,” decrees with the force of law. Much like the 1961 Constitution, the 1999 Constitution is vague about the time-length of the DDA powers, leaving it to the Legislature’s discretion. Unlike the 1961 Constitution, however, the 1999 Constitution contains no textual language limiting DDA to economic or financial matters, permitting the Legislature to grant DDA powers in all areas of society.

3. **Comparing The 1961 And 1999 Constitutions**

When comparing the two Constitutions, it is clear that Chávez and Venezuela’s 1999 Constitution increased the Executive’s DDA powers. Although both Constitutions contained no time limits on the DDA grant, the 1999 Constitution provides the Executive a much broader scope of DDA powers since there is no limitation on solely economic or financial matters. Thus, the 1999 Constitution, which leaves the scope of the

89. See *Republic of Venezuela Constitution* of 1999 art. 236, § 8.
90. *Id.* The 1961 Constitution was vague as to whether a majority or three-fifths support was required.
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
DDA grant to the Legislature’s discretion, effectively provides the Executive DDA powers in any and every facet of society.

**B. Ecuadoran DDA—"El Proyecto Urgente"**

1. **1998 Constitution’s DDA**

Ecuador’s 1998 Constitution granted the Executive post-approval DDA.\(^9\) Article 155 provided the Executive the authority to send economically urgent legislation, or *proyectos urgentes*, to the National Congress.\(^9\) Once received, the National Congress had thirty days to approve, modify, or deny the *proyecto urgente*.\(^9\) If the National Congress failed to act within this thirty day period, the Executive’s proposed legislation became law.\(^9\)

Article 155 also provided that the Executive could only send one *proyecto urgente* at a time, except during a state of emergency.\(^9\) Accordingly, the Executive had to wait thirty days or until the Legislature was finished with the previous *proyecto urgente* before sending another.

2. **2008 Constitution’s DDA**

Ecuador’s 2008 Constitution did little to change the Executive’s DDA power. Similar to the 1998 Constitution, Article 140 of the Constitution provides the Executive post-approval DDA powers as he can send *proyectos urgentes* to the National Assembly.\(^9\) Once the National Assembly receives the *proyecto urgente*, they have up to thirty days to approve, modify, or reject the proposed legislation.\(^9\) If the National Assembly does not take proper action within the thirty day time period, the Executive can issue a decree making the *proyecto urgente* law.\(^9\) After the Executive’s decree, the National Assembly has the authority to modify or revoke the law just as if it is any other law.\(^9\)

Like the 1998 Constitution, the 2008 Constitution prohibits the Executive from sending more than one *proyecto urgente* at a time, except during states of emergency.\(^9\) Thus, Ecuador’s Executive cannot inundate the National Assembly with *proyectos urgentes* to effectively bypass the thirty-day requirement.

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\(^9\) Id.
\(^9\) Id.
\(^9\) Id.
\(^9\) Id.
\(^9\) See Republic of Ecuador Constitution of 2008 art. 140.
\(^9\) Id.
\(^9\) Id.
\(^9\) Id.
3. Comparing the 1998 and 2008 Constitutions

Comparing the 1998 and 2008 Constitutions, Ecuador’s DDA powers are essentially identical. In fact, the only difference between the two constitutions is that the 2008 Constitution explicitly authorizes the Executive to decree the *proyecto urgente* into law after thirty days, whereas the 1998 Constitution did not explicitly authorize such Executive action. Nonetheless, the end result of both the 1998 and 2008 Constitutions is the same, with all *proyectos urgentes* becoming law after being in the Legislature for more than thirty days. Based on this comparison, we see that Rafael Correa, unlike Chávez, did not use Ecuador’s 2008 constitutional re-writing process to grant himself broader DDA powers.

C. Overall Analysis of DDA Among These Countries

The constitutions of Venezuela and Ecuador provide very different forms of DDA. One country—Venezuela—permits pre-approval DDA, while one country—Ecuador—permits post-approval DDA. Moreover, in Venezuela there is a broad and powerful form of DDA, while Ecuador provides its Executive with a narrower, but still powerful, form of DDA that enables the Executive to send *proyectos urgentes* to the Legislature.

The previous analysis further shows how Chávez used the 1999 Constituent Assembly to substantially broaden his DDA powers. In fact, prior limitations on Chávez’ DDA powers have been removed altogether, as the scope of his DDA powers are limited only by Venezuela’s Legislature, which is controlled by Chávez’ allies.

On the other hand, Correa acted with restraint during Ecuador’s 2008 constitutional re-writing process. Instead of granting the Executive pre-approval DDA, Correa maintained the status quo and limited Ecuador’s 2008 Constitution to post-approval DDA. Moreover, the 2008 Constitution continues to limit the use of post-approval DDA to economically urgent matters and provides the Legislature thirty days to respond to any particular *proyecto urgente*. Finally, and perhaps most importantly, Ecuador’s 2008 Constitution continues to prohibit the Executive from inundating the Legislature with Executive decrees by limiting the Executive


V. DDA IN PRACTICE IN VENEZUELA AND ECUADOR

While constitutional text establishes DDA’s boundaries, the text does not explain how DDA is used in practice. For example, the constitutional language does not explain how often a Legislature grants pre-approval DDA to its Executive, or how often an Executive uses his post-approval DDA powers. Moreover, the constitutional text does not show how broad or long any particular DDA grant is. The following analysis addresses these issues in Venezuela and Ecuador. For each country, the analysis includes two eras: (1) the pre-leader era—i.e., Chávez and Correa; and (2) the leader era. By focusing on these two eras, this analysis seeks to determine how DDA has been used by these modern leaders and if these leaders have used their DDA powers differently from their predecessors.

A. VENEZUELA

1. Pre-Chávez Era

Possibly more than any other Latin American nation, Venezuela has had a strong history of granting its Executive DDA through its “enabling law.” From 1961, the first year of Venezuela’s former constitution, to 1998, the Venezuelan Legislature granted the enabling law five times. Three of the enabling laws occurred when the Executive enjoyed majority support within the Legislature: in 1961, 1974, and 1984. Each enabling law granted the Executive DDA for one year in areas designed to restructure the public administration and address financial and economic issues. Although these areas were relatively broad, they often included specific guidelines, limiting the substantive scope of the Executive’s decrees to areas specifically stated in the legislative grant. During the period in which these three enabling laws were in effect, the Executives enacted fifteen, fifty-three, and seventy-one decrees, respectively. The decrees were restricted to financial, economic, and public administration areas, such as distributing oil wealth, cutting public salaries, restructuring the central government, enacting new tax laws, issuing government bonds.

109. Id.
110. The following analysis of the pre-Chávez era is not intended to be as in-depth as the Chávez-era analysis. This is because the use of DDA during the pre-Chávez era has been thoroughly chronicled by Brian Crisp. See generally Crisp, supra note 3.
112. Crisp, supra note 3, at 148-49.
113. See id. at 146-49.
114. Id.; see also Garcia-Serra, supra note 111, at 278.
115. It is important to note that thirty-six of the seventy-one decrees were used for the purpose of selling government bonds to refinance the public debt. Crisp, supra note 3, at 146-49.
bonds, and nationalizing the country’s iron ore industry.\textsuperscript{116} The remaining two times the Legislature issued an enabling law from 1961 to 1998 were when the Executive enjoyed minority support in the Legislature.\textsuperscript{117} These grants occurred in 1993 and 1994 and were used by the majority Legislature to force the Executive to deal with unpopular or difficult economic legislation.\textsuperscript{118} Due to the minority support, the DDA grants involved a narrower scope of power, the decrees were more closely scrutinized by the Legislature, and the length of the DDA grant was significantly less.\textsuperscript{119} For example, the 1993 enabling law lasted six months, while the 1994 enabling lasted only thirty days.\textsuperscript{120} Because the minority-supported Executives were given far less freedom in their decree making, the Executives enacted only thirteen decrees in 1993 and four decrees in 1994.\textsuperscript{121} Due to the limited scope of the enabling laws, the decrees largely consisted of banking reform, the sale of the national airline, and unpopular taxes.\textsuperscript{122} Of significant importance, however, was that the Legislature, in granting these enabling laws, narrowly permitted the Executives to create criminal sanctions for disobeying the decrees.\textsuperscript{123} The 1993 and 1994 enabling laws were the only instances under the 1961 Constitution where the Legislature granted the Executive power to modify the nation’s criminal code through decrees.\textsuperscript{124}

Although DDA was relatively common in the pre-Chávez era, the enabling laws were limited in several important respects. Professor Brian Crisp notes four important aspects of Venezuela’s pre-Chávez DDA.\textsuperscript{125} First, “the [1961 Venezuelan] Constitution restrict[ed DDA] to economic and financial matters.”\textsuperscript{126} Second, the time for which the authority had been granted was limited to a maximum of twelve months.\textsuperscript{127} Third, legislatively provided instructions regarding the scope of DDA became more and more detailed over time, as was seen in the 1974, 1984, 1993, and 1994 DDAs.\textsuperscript{128} Finally, “the provisions for [legislative] oversight [were] fairly rigorous.”\textsuperscript{129} Thus, although the Executive was granted the power to enact decrees with the force of law for upwards of a year, the Executive’s ability to enact far-sweeping changes was restricted by the Legislatur-

\textsuperscript{117} Crisp, \textit{supra} note 3, at 149-51.
\textsuperscript{118} \textit{Id.}
\textsuperscript{119} \textit{Id.}
\textsuperscript{120} \textit{Id.} at 149-50.
\textsuperscript{121} \textit{Id.} at 150-51.
\textsuperscript{122} \textit{Id.} at 149-51.
\textsuperscript{123} \textit{Id.} at 150.
\textsuperscript{124} \textit{Id.} at 149-50.
\textsuperscript{125} \textit{Id.} at 154.
\textsuperscript{126} \textit{Id.}
\textsuperscript{127} \textit{Id.}
\textsuperscript{128} \textit{Id.}
\textsuperscript{129} \textit{Id.}
ture. Moreover, we see that the Executive-Legislative interplay was balanced in favor of the Legislature during this time-period.

Despite the trend of providing more legislative oversight over the Executive decrees, one problematic aspect that developed was when the 1993 and 1994 enabling laws permitted the Executive to decree changes to the nation’s criminal code. These enabling laws created a dangerous precedent, making it appropriate for Venezuela’s Legislature to grant the authority to change the country’s criminal law to the Executive through DDA.

2. Chávez Era

Hugo Chávez has been granted DDA powers three times since he became President in February 1999. The first enabling law occurred under the framework of the 1961 Constitution, while the other two grants occurred under the 1999 Constitution. Because the constitutional framework between these two eras is different, the following section will first address the DDA grant under the 1961 Constitution and will then address the DDA grants under the 1999 Constitution.

a. DDA Grant Under the 1961 Constitution

Venezuela’s Legislature first granted Chávez DDA powers on April 26, 1999, to issue decrees in economic and financial matters for six months. While this time length and scope of the grant of DDA was not unusual in itself, the process by which Chávez obtained this grant is worth noting.

Shortly after Chávez became President in February 1999, he demanded a six-month enabling law to address the country’s economic crisis due to decreased oil prices. Congress, in response to Chávez’ request, drafted and approved an enabling law. Chávez, however, rejected Congress’ first version of the enabling law, arguing that it did not provide him broad enough powers to properly face the economic situation. Chávez then threatened to declare a state of emergency and rule by decree if Con-
gress, also facing the threat of being dissolved by the Constituent Assembly referendum, did not approve his own version of the enabling law.137 Congress balked under Chávez’ threats, sending Chávez a much broader version of the enabling law on April 22, 1999.138 Congress, however, did not grant Chávez the authority to issue decrees regarding the country’s Hydrocarbons Law, which controlled the nation’s oil reserves.139 Even without the Hydrocarbons law, Chávez accepted the second version and backed away from his threat to declare a state of emergency.140

Under the 1999 enabling law, Chávez enacted fifty-four decrees that were limited to economic and financial matters.141 Many of the decrees were innocuous. Those decrees included restructuring the country’s tax system to decrease the federal government’s dependency on oil income,142 cutting the nation’s short-term debt, and reforming the nation’s public administration to promote government efficiency.143 At the same time Chávez cut back on government programs, however, he increased government salaries by twenty percent.144 While the enabling law specifically authorized Chávez to raise government salaries by twenty percent, such a grant was likely crafted by Chávez to promote a clientelistic relationship between he and the public sector.

Furthermore, Chávez modified the nation’s Natural Gas Law, in what appears to be the complete opposite of his later economic ideology, to encourage $10 billion of foreign investment in Venezuela’s natural gas sector.145 The decree established a new pricing system to ensure returns on investment and set the general income tax on natural gas profits to thirty-four percent, subject to tax credits for new investments.146

While Chávez’ decrees enacted under the enabling law were consistent with those of his predecessors, the 1999 grant of DDA reveals a change in control over the DDA grant from the Legislature to the Executive.

137. Id.
139. Govt. Excludes Oil Bill From Enabling Law, supra note 138.
144. President Raises Public Sector Wages, Sends Two Tax Laws To Congress, BBC SUMMARY OF WORLD BROADCASTS (May 4, 1999).
146. Id.
fact that Chávez held the Legislature hostage and demanded that Congress enact the broader enabling law that he drafted himself reveals that Venezuela’s Legislature no longer controlled the DDA grant. Instead, by placing such control in the Executive’s hands, the 1999 enabling law created a dangerous precedent whereby the Executive-Legislative interplay became far more limited and one-sided in favor of the Executive.

b. DDA Grants Under the 1999 Constitution

Since the 1999 Constitution, Chávez has been granted DDA powers two times. The first time occurred in 2000, shortly after the passing of the 1999 Constitution.\(^{147}\) The second time was in 2007, while Chávez was, once again, attempting to re-write Venezuela’s Constitution.\(^{148}\)

i. 2000 Enabling Law

In November 2000, Venezuela’s Legislature granted Chávez an enabling law for one year in a broad range of areas, including: (1) finance; (2) the economy and society; (3) infrastructure; (4) personal and legal security; (5) science and technology; and (6) civil service.\(^{149}\) Although the time length of the enabling law was no longer than previous enabling laws, the scope was far broader than the prior constitutional limitations of economic and financial matters. As such, Chávez could effectively control all aspects of the nation through these six designated areas. Finally, a Commission was created to monitor and receive Chávez’ decrees.\(^{150}\)

Chávez enacted forty-nine decrees under the 2000 enabling law to support his “Plan Bolivar.”\(^{151}\) The majority of the decrees were uncontroversial: many involved modernizing industries,\(^{152}\) declaring sovereignty and providing better security over Venezuela’s natural resources, and promoting investment in science and technology.\(^{153}\) Chávez additionally enacted several decrees providing greater consumer protections by holding businesses and individuals accountable for fraudulent or unethical behavior.\(^{154}\)

\(^{147}\) Democracy and Human Rights in Venezuela, supra note 131.

\(^{148}\) Id. ¶ 326.

\(^{149}\) Id. ¶ 325.

\(^{150}\) The Commission was argued to be useless considering the majority support Chávez maintained in Congress and the Commission. National Assembly Passes Enabling Law Granting President Chávez Special Powers, BBC SUMMARY OF WORLD BROADCASTS (Nov. 9, 2000).


\(^{154}\) See, e.g., Decreto No. 1.204, Capitulo VIII, de 10 de Febrero de 2001, GACETA OFICIAL DE LA REPUBLICA BOLIVARIANA DE VENEZUELA, No. 37.148, de 28 de
Several of Chávez’ decrees, however, were extremely controversial, including: the Land Law, the Hydrocarbons Law, and the Fishery Law. Chávez’ Land Law, promulgated with the goal of ending “el latifundio,”155 permitted the government to expropriate land that was deemed to be underutilized or idle.156 The law applied only to plots of land that exceeded 5,000 hectares.157 After deemed idle and confiscated, the land would be redistributed to landless families.158 Despite a later Supreme Court decision finding the law unconstitutional, Chávez has expropriated land from large foreign companies under the legal framework of the Land Law.159

Chávez also decreed a new Hydrocarbons Law, which greatly increased the state’s presence in the country’s oil industry.160 The Hydrocarbons Law required that the state control at least fifty percent of all new oil developments and increased government royalties on oil profits from 16.7% to thirty percent.161

Chávez’ other controversial decree was the Fishery Law, which increased taxes on industrial fishing companies by 740 percent.162 Because the law defined industrial fishing companies to be those that used mechanized systems that are technologically or capital intensive, the law was viewed as an attack on the commercial and international fishers who made up roughly twenty-five percent of the nation’s fishing industry.163 Chávez alternately argued that the decree was enacted to protect artisanal fishers, who made up the remaining seventy-five percent of the


156. See Gregory Wilpert, Land for People Not for Profit in Venezuela, LAND RESEARCH ACTION NETWORK, Sept. 20, 2005, http://www.landaction.org/display.php?article=334 (compensation was only required if the land was expropriated for redistribution); see also Land Reforms Averted Food Crisis in Venezuela: Chavez, THAINDIAN NEWS, Jan. 22, 2008, http://www.thaindian.com/newsportal/world-news/land-reforms-averted-food-crisis-in-venezuela-chavez_10062953.html (land was deemed idle if 80% of the property was not being used).

157. Wilpert, supra note 156.

158. See id.


161. Id. arts. 22, 44; Rentner, supra note 87, at 361-62.


fishing industry.\textsuperscript{164} Thus, while the law was a direct attack on large foreign and domestic commercial interests, it must be noted that the law provided greater protections for the Venezuelan fishing population, whose interests were likely being hurt by their larger competitors.

One decree that was more ideologically than practically controversial was one that promoted the development of cooperative associations.\textsuperscript{165} The decree provided for economic, educational, and public support for cooperative associations to promote a participatory society.\textsuperscript{166} On paper, it seemed to support the inclusion of more sectors of society into the political process, but Chávez' opposition saw this as an attempt by Chávez to create clientelistic organizations, thereby allowing him to garner more political support.\textsuperscript{167} Moreover, the opposition perceived this decree as a move towards Socialism through its encouragement of socialist organizations.\textsuperscript{168}

But, the overwhelming majority of Chávez' decrees from the 2000 enabling law were uncontroversial—many benefited Venezuelan society in that they provided greater consumer protections, promoted economic development, and declared sovereignty over Venezuela's natural resources.\textsuperscript{169} At the same time, several of Chávez' decrees actively attacked the interests of large domestic and international corporations.\textsuperscript{170} As a result, these industries pushed back, vilifying Chávez as being a socialist and anti-democratic.\textsuperscript{171} While those complaints may later ring true, the level of criticism at that point in Chávez' career was not entirely justified.

\textit{ii. 2007 Enabling Law}

In February 2007, Venezuela's Legislature passed an enabling law prior to the 2007 constitutional referendum, granting Chávez DDA for eighteen months—six months longer than any previous enabling law.\textsuperscript{172} The enabling law also provided Chávez a much broader scope of authority than had ever been granted before, permitting him to enact decrees in eleven areas, including: (1) energy; (2) infrastructure, transport, and ser-

\begin{footnotesize}
\begin{enumerate}
\item See Malapanis & Catalan, supra note 162.
\item Id.
\item See generally Id.
\item See, e.g., supra notes 153-54.
\item See, e.g., Suggett, supra note 163.
\end{enumerate}
\end{footnotesize}
vices; (3) transformation of the state; (4) economic and social affairs; (5) finances and taxation; (6) grassroots participation; (7) the exercise of public office; (8) citizen and judicial security; (9) territorial order; (10) security and defense; and (11) science and technology.173 Similar to the 2000 version, the enabling law created a legislative commission to oversee Chávez’ decree authority.174 Once again, the commission lacked any true power as it was controlled by Chávez’ supporters.175

In total, Chávez enacted sixty-seven decrees.176 Similar to the 2000 enabling law, many of Chávez decrees under the 2007 enabling law were uncontroversial. For example, Chávez issued several decrees promoting development and investment in underdeveloped regions,177 protecting the natural environment,178 and seeking to ensure Venezuela’s sovereignty over its aquatic space and any oil interests that may be included within that territory.179 Moreover, Chávez enacted several decrees providing Venezuelan citizens better housing opportunities,180 ensuring them access to basic necessities and public resources,181 and protecting consumers from dangerous, black-market, and adulterated products.182

Unlike the 2000 enabling law, however, the number of controversial decrees enacted under the 2007 enabling law was proportionately higher. Although Chávez’ 2007 constitutional referendum failed, Chávez used the enabling law to push several of the proposed reforms through as law.183 Twenty-six of Chávez’ sixty-seven decrees, including more than a dozen that were similar to amendments of the failed 2007 constitutional

173. Id.
175. See Brewer-Carias, supra note 174, at 73.
176. Suggett, supra note 163.
183. Jose Orozco & Sara M. Llana, Venezuela’s Chavez Riles Critics With New Decree, CHRISTIAN SCI. MONITOR, Aug. 12, 2008, http://www.csmonitor.com/World/Americas/2008/0812/p04s01-womn.html (as Maryclen Stelling said, “Chavez had a Plan A and a Plan B. Approving the Constitutional reforms through a vote—the revolu-
reform, were enacted immediately before the enabling law expired in August 2008. The Venezuelan government, additionally, did not release the full text of the decrees until nearly a week after they were promulgated.185 Chávez’ opposition claimed that Chávez’ promulgation of these decrees was in direct conflict with the 2007 constitutional referendum and the will of the people.186 Chávez brushed aside such complaints, arguing that the decrees were lawfully promulgated under the Constitution, and that none of the decrees unlawfully modified any constitutional amendments.187

The decrees that were the most published, and possibly the most controversial, were Chávez’ decrees nationalizing industries. Under the enabling law, Chávez nationalized: (1) the iron and steel industries in the region of Guayana;188 (2) all private oil companies in the oil-rich Orinoco region;189 and (3) all large, private cement companies.190 The decrees required that these privately-owned companies become mixed public-private companies with the state owning, at a minimum, sixty percent of the company.191 Chávez also issued several decrees that provided the framework for future nationalizations in the energy, railroad, and banking industries.192 Currently, however, it is unclear whether Chávez will have to

185. Romero, supra note 184.
186. Id.
wait for another enabling law to nationalize such industries, or if he can use the “gray” area of his constitutional decree authority to nationalize them when he sees fit.

Chávez additionally issued several decrees increasing the Executive’s military strength. In his Law of the Bolivarian National Army, Chávez created the Bolivarian National Militia, which exists in addition to Venezuela’s Army, Navy, Air Force, and National Guard. Like the other arms of the military, the National Militia is under the control of the President. The National Militia’s duties are similar to the other armed forces in that the National Militia fights during a time of war, preserves internal peace, and assists in a time of emergency. The biggest difference between the National Militia and the other military branches, however, is that the militia consists of all citizens who voluntarily organize to help defend the nation. Because this definition was left intentionally broad, several questions arise regarding the National Militia. For example, are Chávez’ supporters who, acting in the name of Chávez and Venezuela, engage in violence against opposition forces provided protection since they may be acting under the guise of “national defense?” These questions remain to be answered, but it appears that the militia’s role in controlling the Venezuelan population may be increasing.

Although Chávez enacted decrees that provided consumers with greater protection, those same decrees undermined the rights of workers and business owners. For example, the decrees that ensured Venezuelan citizens access to basic services, food supplies, and goods also criminalized many actions that were once legal. Following the precedent established in the 1993 and 1994 enabling laws, these decrees created new felonies for individuals who boycott, or refuse to sell or produce, or impede—directly or indirectly—the production and transportation of goods
that are deemed “basic” or under price controls. Violations of these decrees may result in fines, seizure of goods or companies, temporary closings, or imprisonment for up to ten years.

These decrees are problematic for several reasons. First, the decrees appear to be an attack on Chávez’ labor opposition. By criminalizing actions that impede the production and transportation of necessary goods, the decrees essentially deny organized labor its right to strike. Moreover, the decrees undermine the property rights of business owners because unprofitable businesses would still have to operate at a loss or face confiscation and/or prison. Thus, while these decrees benefit consumers, they come at the cost of rights for other groups.

Another controversial decree was Chávez’ “Law of Public Administration.” The law created regional political leaders, directly appointed by the President, who possess national budgets separate from those given to regional governments. Through this law, Chávez can create alternative governments in regions where Chávez’ opposition is in control. Moreover, because the budget of these regional leaders is left intentionally vague, Chávez can pump oil-cash into these regional leaders who can distribute the money to ensure political patronage.

Additionally, Chávez enacted several decrees that were viewed as controversial because they further cemented “21st Century Socialism” in Venezuela. For example, Chávez created the National Institute for Socialist Education and Training, issued a decree providing barter as an official alternative payment system to currency, and promulgated the “Law for the Creation and Development of the Popular Economy” which created production, distribution, and consumption “brigades” to encourage the “socio-productive” economy. While these decrees may not have much impact in the overall function of society, the decrees’ emphasis on socialism is controversial as they help transform Chávez’ ideal of socialism into the nation’s status quo, which can only be changed through future action by opposition leaders.

200. Id.
201. See Context Paper: Laws Approved Via the Enabling Law, supra note 187 (a strike is cited as an example of activity that would be in violation of the law).
204. Suggett, supra note 163.
It is important to note that not all of Chávez’ controversial decrees were successful. In May 2008, Chávez issued an extremely controversial decree modifying the “National Intelligence and Counterintelligence Law.”\textsuperscript{207} The law, described as a tool to protect the country from a U.S. invasion, required that all citizens cooperate with police investigations or be subject to jail time.\textsuperscript{208} The law also authorized warrantless searches when they were done in the interest of national security, and created neighborhood leaders who actively sought to find incriminating information about their neighbors.\textsuperscript{209} Both Chávez’ supporters and opponents challenged the law, arguing that Chávez was creating a police state similar to that in Cuba.\textsuperscript{210} Due to the unpopularity of the decree, Chávez revised the law in June 2008 to remove the most controversial aspects of it.\textsuperscript{211}

Studying 2007’s enabling law, we can see that Chávez’ decrees were far more controversial than many of the decrees in prior enabling laws. First, Chávez nationalized many of the nation’s key industries and created the framework for the future nationalization of other industries. Second, Chavez issued decrees that greatly changed the legal obligations of many individuals within society, particularly union workers and business owners. Finally, and most importantly, Chávez used the 2007 enabling law to further consolidate power around the Executive. By creating the National Militia, Chávez has equipped himself with the manpower to quell opposition protests. Furthermore, by establishing alternative regional political leaders, Chávez has provided himself a legal framework to undermine opposition leaders.

iii. Comparing The Two Eras

In comparing the two eras above, it is clear that Venezuelan DDA, under the enabling law, has been used much more frequently under Chávez than during any previous presidency. From 1961 to 1998, the enabling law was granted five times.\textsuperscript{212} During Chávez’ presidency, however, the enabling law has been granted three times. It is also apparent that the balance of the Executive-Legislative interplay has switched from the Legislature to the Executive, with Chávez controlling both the scope and length of any enabling law. Moreover, Venezuela’s Legislature no longer provides specific details regarding their DDA grants. Instead, the details have been left intentionally vague to provide Chávez the most generous

\textsuperscript{208} Kraul, supra note 207, at 2.
\textsuperscript{209} Id.
\textsuperscript{210} Id.
\textsuperscript{211} Id. at 1; Decreto No. 6.156, GACETA OFICIAL DE LA REPUBLICA BOLIVARIANA DE VENEZUELA, No. 38.949, de 10 de Junio de 2008, available at http://www.tsj.gov.ve/gaceta/junio/100608/100608-38949-23.html.
\textsuperscript{212} Crisp, supra note 3, at 146.
amount of deference. Finally, the system of oversight by the Legislature is no longer rigorous. The fact that Chávez refused for a week to give the exact language of his twenty-six last-minute decrees in 2008 reveals that there is little, if any, Legislative oversight of the Chávez’ DDA power.

Chávez, however, has followed precedent established in one area of the 1993 and 1994 enabling laws by using the enabling laws to change the country’s criminal code. The difference between the two eras, however, is that Chávez has gone far beyond precedent by modifying the criminal code to include a broad range of criminal offenses that could have long-lasting effects on the nation’s labor laws, property laws, and economic rights of individuals.

Figure 3, below, provides a visual comparison of all of the enabling laws granted since Venezuela’s 1961 Constitution. I use four criteria in comparing the two eras: (1) length of DDA grant; (2) scope of the grant; (3) number of decrees issued during the grant; and (4) the number of controversial decrees. The analysis of controversial decrees is largely a subjective one, however it is not used to determine whether the decrees are good or bad and merely applies to decrees that were controversial in nature or substantially altered the pre-existing economic, social, or legal conditions of Venezuela.
<table>
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<th>Year</th>
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<th>Scope of Enabling Law</th>
<th>Num. Decrees Enacted</th>
<th>Num. of Controversial Decrees</th>
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<tr>
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<td>1</td>
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<td>Finance, Economy and Society, Infrastructure, Personal and Legal Security, Science and Technology, Civil Service</td>
<td>49219</td>
<td>4</td>
</tr>
</tbody>
</table>

**Time-Length of the Enabling Law:** The data shows that Chávez has lengthened the time-length of DDA in Venezuela from twelve months to eighteen month—a quarter of Chávez’ current term. Moreover, the data shows that Chávez has enjoyed DDA powers for three of the ten years he has been president—over one-fourth of his presidency. Alternatively, in the thirty-eight years prior to Chávez, the Executives enjoyed DDA powers for a combined total of three years, five months.

214. Id. at 16.
215. Thirty-six of the seventy-one decrees were used for the purpose of selling government bonds to refinance the public debt. Crisp, supra note 3, at 149.
216. Id. at 150.
217. Id. at 151.
218. Id.
Scope of the Enabling Law: The data shows that the scope of enabling laws has dramatically increased under the Chávez presidency. Although Chávez’ last two enabling laws contained a much larger scope than the prior six enabling laws, it is necessary to note that the first six enabling laws were constitutionally limited to economic and financial matters. As a result, Venezuela’s Legislature could not extend DDA powers in areas outside of economic and financial matters. Nonetheless, Chávez has obtained continuously broader enabling laws since the 1999 Constitution. In fact, Chávez 2007 enabling law doubled the 2000 enabling law in the amount of areas permitted. Even though the overall scope of the 2000 and 2007 enabling laws might be the same, the mere fact that the 2007 enabling law contained twelve distinct areas signifies that Chávez had the authority to enact decrees in any possible area, thereby making it much more difficult to challenge Chávez’ decree authority.

Number of Decrees Issued: When compared to any one grant of the enabling law, Chávez has not issued the largest number of decrees.221 Even though Chávez did not issue the most decrees during any one enabling law, the total number of decrees Chávez issued during his presidency is more than the total number of decrees issued by his predecessors combined. Whereas Chávez’ has issued 170 decrees under enabling laws, Chávez’ predecessors issued only 156 decrees combined.222 Based on these numbers, it is clear that not only has Chávez been more prolific in obtaining DDA powers, but he has also been prolific in issuing decrees under his DDA powers. Moreover, considering Chávez has enjoyed DDA powers five months less than all prior Executives, Chávez’ decree rate is substantially higher than those of his predecessors.

Furthermore, through the use of DDA, Chávez has become the nation’s leading legislator. During the 2007 and 2008 enabling law, Chávez issued sixty-seven decrees into law.223 At the same time, Venezuela’s Legislature approved only twenty-five laws.224 Thus, seventy-three percent of all laws passed during the 2007 enabling law were drafted by Chávez.

Number of Controversial Decrees: As previously mentioned, this criterion is a subjective element measuring the content of the decrees. Thus, the following figures apply to those decrees that were controversial in nature or substantially altered the pre-existing economic, social, or legal conditions of Venezuela. Examples of such decrees include the nationalizing or privatizing of industries, the changing of the criminal code, and the altering of legal rights and obligations of the nation’s citizens. Moreover, this criterion also applies to decrees that altered the federal government to consolidate power within the Executive branch or undermine the

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221. It is, however, important to note that during the 1984 enabling law, thirty-six of the seventy-one decrees were for the sole purpose of selling government bonds to restructure the country’s public debt. Crisp, supra note 3, at 149.
222. See fig. 3.
224. Id.
power of opposition parties. Finally, this criterion applies to ideological changes made through decrees. Although these decrees may not have a practical impact, the ideological make-up of the federal government is an essential component of the government’s overall policy and shapes the nation’s status quo.

Based on the subjective analysis, it is clear that Chávez, unlike his predecessors, has used the enabling law in a much more controversial manner. In the 1961, 1984, 1994, and 1999 enabling laws, the Executives did not promulgate any controversial decrees. Under the 1974 enabling law, the Executive issued one controversial decree, which nationalized the country’s iron ore industry. Moreover, the 1993 enabling law had one controversial decree when he privatized the national airline.

Since the 1999 Constitution, Chávez issued four controversial decrees under the 2000 enabling law and eighteen controversial decrees under the 2007 enabling law. What is important to note about this trend is that Chávez used his DDA powers to parallel, or even substitute constitutional change. Because Chávez’ 2007 Constitutional Referendum failed, Chávez used his DDA powers to make several broad changes that had previously been denied under the referendum. Essentially, Chávez used his DDA powers as a “back-up” plan to the failed referendum, thereby ensuring that he was going to bring these controversial changes regardless of the national vote. Furthermore, it appears that Chávez enacted decrees designed to protect himself and his movement from future political, economic, and social unrest by allowing him to take immediate action against any opposition challenging his authority.

Overall, the figures show that Chávez’ use of DDA powers has increased dramatically when compared to his predecessors. Chávez has lengthened the time-grant of the enabling law, enjoyed DDA powers more than any prior president, issued more decrees than all prior presidents combined, enjoyed a substantially broader scope of DDA authority, and issued far more controversial decrees than any prior president. Based on this trend of obtaining continuously broader grants of DDA, it seems clear that Chávez will continue to obtain powers under the enabling law and seek to further broaden those powers to include a longer time-length and even broader, if possible, scope of powers.

B. ECUADOR

As was previously discussed, Ecuador provides its Executive post-ap-

225. Crisp, supra note 3, at 147.
226. While some may argue that privatizing national industries is not as controversial as nationalizing industries, the effects are significant and both cases must be included in the analysis. See Crisp, supra note 3, at 149-51.
228. The following information on Ecuador is accurate as of Oct. 15, 2010. I must note that the accuracy of the data is limited to the accuracy of the data available on
Ecuador’s post-approval DDA is limited, however, as the Executive can only send one proyecto urgente at a time, and the scope of the proyectos urgentes are limited to economic matters. Moreover, since the Legislature has up to thirty days to act upon the proyecto urgente, the amount of proyecto urgentes an Executive can send in one year is effectively limited to twelve. Consequently, the use of DDA in Ecuador is inherently less than is seen in Venezuela.

The following analysis of the Executives’ use of post-approval powers in Ecuador focuses on the differences between the pre-Rafael Correa era and the Correa era. This section will determine if, and to what extent, Correa’s use of post-approval has differed from his predecessors Gustavo Noboa, Lucio Gutierrez, and Alfred Palacio.

I. Pre-Correa Era

a. Gustavo Noboa Presidency

Gustavo Noboa’s presidency lasted from January 20, 2000 to January 15, 2003. During this period, Noboa sent twelve proyectos urgentes to the Ecuador’s National Assembly. The proyectos urgentes created a “petroleum fund” to help pay off state debt and increase investment in the oil sector, restructured the financial system, provided tax credits, and increased foreign investment in the oil industry. Noboa also sent several proyectos urgentes that merely renewed prior laws that were on the verge of expiring. None of Noboa’s proyectos urgentes were controversial in nature.

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230. Id.
231. Id.
232. Although an analysis of the entire period after the 1998 Constitution would have been optimal, information regarding proyectos urgentes before 2000 is not readily available. Accordingly, the analysis includes only 2000 to the present.
234. See Registro Oficial, supra note 228.
Noboa did not face much resistance from the National Assembly regarding his proyectos urgentes as the National Assembly rejected only one of them. The National Assembly rejected Noboa’s proyecto urgente involving the income of public employees. Rather than face the issue through a proyecto urgente, the National Assembly wanted the law to be sent through ordinary means by incoming President Lucio Gutierrez.

b. Lucio Gutierrez Presidency

Lucio Gutierrez’ presidency lasted from January 2003 to April 2005. Gutierrez sent ten proyectos urgentes during his presidency. Gutierrez’ proyectos urgentes restructured the public sector to reduce nepotism, created a unified public employment income standard, and increased government efficiency. Gutierrez also sent a proyecto urgente increasing taxes on cigarettes and liquor to help pay for pensions. Moreover, shortly before the end of his presidency, Gutierrez sent a broad proyecto urgente intended to reform many aspects of the country’s economic sector. This proyecto urgente sought to modernize the nation’s economy by increasing foreign investment in the oil sector, lowering energy costs, and improving the operation of Social Security. While Gutierrez’ proyectos urgentes may have been broad in nature, none of those mentioned above were controversial. Instead, they were viewed as measures necessary to address issues that prior administrations had ignored.

Although the National Assembly approved many of Gutierrez’ proyectos urgentes, it rejected, perhaps, two of Gutierrez’ most important

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239. While it would have been best to have looked at how drastically the National Assembly modified individual proyectos urgentes, such data is not readily available. Thus, the most that could be considered was whether the National Assembly rejected or accepted the Executives’ proyectos urgentes.
241. Id.
243. See Registro Oficial, supra note 228.
247. Id.
ones. First, the National Assembly rejected Gutierrez’ *proyecto urgente* restructuring of the oil industry. It sought to encourage foreign investment in the oil industry by reducing the percentage PetroEcuador, Ecuador’s national oil company, would take from profits of new oil extractions to thirty-five percent. In essence, this *proyecto urgente* was an attempt by Gutierrez to force the National Assembly to deal with the inefficiencies of PetroEcuador and the oil industry—something the National Assembly had refused to do. Second, the National Assembly rejected Gutierrez’ *proyecto urgente* that would have issued government bonds to invest in a new generation of hydro-electric energy. Once again, this *proyecto urgente* sought to encourage private investment in the energy sector by prioritizing payment to private companies over state companies. The National Assembly thought it unpopular and rejected it.

c. Alfredo Palacio Presidency

Alfredo Palacio was President of Ecuador from April 2005 to January 2007. During his fifteen-month presidency, he sent eight *proyectos urgentes* to the National Assembly. Palacio’s *proyectos urgentes* created a uniform credit verification system, redistributed the funds of the Stabilization, Social Investment, and Reduction of Public Debt Fund, re-approved tax credits, and enabled the Central Bank to obtain loans to pay the country’s balance of payment problems. The remainder of Palacio’s *proyectos urgentes* involved the country’s energy sector. Palacio sent *proyectos urgentes* recognizing the inefficiency of the country’s energy companies and the need to invest in infrastructure to reduce future losses, calling for contract renegotiations.

251. Id.
with foreign companies,\textsuperscript{257} and creating a fund for investment into the energy sector.\textsuperscript{258} Unlike his predecessors, Palacio’s \textit{proyectos urgentes} were not rejected by the National Assembly.

d. Characteristics of the Pre-Correa Era

The pre-Correa era has several characteristics regarding the use of the country’s post-approval DDA powers. First, the use of post-approval DDA powers was quite limited. None of the Executives attempted to inundate the National Assembly with \textit{proyectos urgentes}. Noboa sent only twelve \textit{proyectos} in thirty-six months, Gutierrez sent ten \textit{proyectos} in twenty-seven months, and Palacio sent eight \textit{proyectos} in fifteen months. Second, Noboa, Gutierrez, and Palacio’s \textit{proyectos urgentes}, constitutionally limited to economic and financial areas, focused largely on increasing foreign investment and reducing costs of the nation’s public oil and energy sectors. Finally, the National Assembly did not hesitate to reject the Executives’ \textit{proyectos urgentes}. Although they rejected only a small percentage of the \textit{proyectos urgentes}—one during the Noboa administration and two during the Gutierrez administration—the rejections show that the Executive-Legislative interplay was quite active and balanced, and that the Legislature limited the amount of change an Executive could undertake in any one \textit{proyecto urgente}.

2. Correa Era

Rafael Correa became Ecuador’s president on January 15, 2007.\textsuperscript{259} Prior to the 2008 Constitution, Correa sent four \textit{proyectos urgentes} to the National Assembly. Those \textit{proyectos urgentes} increased taxes to improve Quito’s transportation infrastructure,\textsuperscript{260} financed $220 million for education,\textsuperscript{261} and limited the maximum interest rate on consumer credit.\textsuperscript{262}


\textsuperscript{259} Ecuador Politics: Crisis Overcome, Risks Linger, Economist Intelligence Unit, Oct. 1, 2010, http://www.eiu.com/index.asp?layout=VWArticleVW3&article_id=397476624&region_id=&country_id=179000179&refm=vwCtry&page_title=Latest-analysis&is=true. Even though Correa sent \textit{proyectos urgentes} to the National Assembly before and after the 2008 Constitution, it is not necessary to formally distinguish the two areas since the 2008 Constitution did not substantially change Ecuador’s DDA. Id.


Correa also sent a proyecto urgente modifying the country’s Hydrocarbons Law. It sought to combat the black-market sale of oil and its by-products.\textsuperscript{263} This proyecto urgente is significant in that it proposed altering the criminal code to increase criminal sanctions, including fines and jail time for individuals who violate the law.\textsuperscript{264} This appears to have been the first instance an Executive sent a proyecto urgente involving criminal measures.

Since the 2008 Constitutional Referendum, Correa has sent six additional proyectos urgentes to the National Assembly to push through his “Citizens’ Revolution.” Several of these proyectos urgentes were largely uncontroversial and included placing a one percent tax on currency leaving the country to combat capital flight,\textsuperscript{265} suspending fines for Haitian tourists whose visas had expired due to Haiti’s January 2010 earthquake,\textsuperscript{266} revaluing the country’s retirement pension system,\textsuperscript{267} and promulgating a new public finance law to increase the government’s access to debt-financing.\textsuperscript{268}

Since 2009, Correa has faced stiff resistance from his opposition in the National Assembly. A unifying opposition has denied Correa and his party, Alianza País (AP), the majority needed to pass key pieces of legislation through normal legislative channels.\textsuperscript{269} As a result, several of Correa’s key pieces of legislation that were intended to coordinate with the constitutional reform have been stalled or substantially changed by a deadlocked National Assembly.\textsuperscript{270} Due to Correa’s inability to pass leg-


\textsuperscript{264} Id.


\textsuperscript{270} Id.
islation through normal channels, Correa has begun to use proyectos urgentes as a means to bypass the deadlocked Legislature and push through legislation without opposition approval.\textsuperscript{271} For instance, in April 2009, Correa sent a proyecto urgente that required each employer to give 8.33\% of an employee’s salary to the Social Security Fund.\textsuperscript{272} Correa used political gamesmanship and sent the proyecto urgente on April 6, knowing that the National Assembly was going to be in recess from April 13 to April 27 due to national elections on April 26.\textsuperscript{273} As a result of this timing, the National Assembly’s thirty-day review period was essentially cut in half, as the thirty-day time period is not tolled during national elections or congressional recess.\textsuperscript{274} Notwithstanding the drama that surrounded the timing of Correa’s proyecto urgente, the National Assembly approved it.

Moreover, on June 25, 2010, Correa sent the National Assembly a proyecto urgente modifying the nation’s Hydrocarbons Law.\textsuperscript{275} The law requires foreign corporations to sign service contracts or face expropriation.\textsuperscript{276} Such service contracts require the state to pay the companies to pump oil, with the state owning all oil pumped within Ecuadorian territory.\textsuperscript{277} Recognizing that neither the AP nor the opposition had enough votes to modify, approve, or deny the proyecto, Correa and his allies merely delayed any discussion of the proyecto for the thirty-day time-period.\textsuperscript{278} As a result, Correa’s proyecto urgente became law without any legislative debate including the opposition.\textsuperscript{279}

Due to Correa’s inability to pass key pieces of legislation through normal channels, there is some concern that Correa will dissolve the National Assembly and rule by decree until national elections are held.\textsuperscript{280} It is unclear, however, whether the recent coup attempt has emboldened Correa to do so, or if he will seek to work with his opposition to build a


\textsuperscript{273} \textit{id.} at 4. I define “political gamesmanship” to be the use of tactical methods to increase one’s chances of succeeding in their desired objective. While political gamesmanship does not involve illegal tactics, it often involves unethical tactics.

\textsuperscript{274} See Report on the Legislative and Oversight Commission Ecuador, supra note 272.

\textsuperscript{275} Ecuador Industry: Taking Control of Oil, supra note 271.


\textsuperscript{277} Ecuador Industry: Risky Hydrocarbons Reform, supra note 276.

\textsuperscript{278} Ecuador Politics: Setbacks for Correa, supra note 269; Alvaro, supra note 276.

\textsuperscript{279} Ecuador Politics: Setbacks for Correa, supra note 269.

\textsuperscript{280} Ecuador Politics: Crisis Overcome, Risks Linger, supra note 259.
consensus of pieces of legislation.\textsuperscript{281}

Overall, during the Correa era we see a decrease in the use of post-approval DDA. Nonetheless, there appears to have been a recent uptick in Correa’s DDA use due to his inability to pass legislation through normal channels. As such, Correa and his allies in the National Assembly have been able to push through \textit{proyectos urgentes} without permitting open legislative discussion. Thus, while DDA may not have been Correa’s first method of choice in seeking legislative change, it appears that he is more willing to issue \textit{proyectos urgentes} in an attempt to bypass his opposition and push through legislation.

3. \textit{Comparing The Two Eras}

Because the use of post-approval DDA is different from that of pre-approval DDA, the qualitative factors for measuring post-approval DDA are different. Under this analysis we will look at the number of \textit{proyectos urgentes} sent to the National Assembly. To ensure that the number of \textit{proyectos urgentes} is not skewed by the length of a presidency, this number will be compared to the time length of each presidency. The analysis additionally looks at the number of times the National Assembly has rejected a \textit{proyecto urgente}.\textsuperscript{282} Finally, the analysis includes a subjective element to determine whether any of the \textit{proyectos urgentes} were controversial in nature or whether they substantially altered pre-existing legal, political, or economic rights of the nation’s citizens. Figure 4 below provides a visual comparison on the use of post-approval DDA during the previously discussed eras.

Figure 4: Ecuadoran DDA

<table>
<thead>
<tr>
<th>President</th>
<th>Number of Proyectos Urgentes</th>
<th>Average Rate of Proyectos Sent (# divided by months as president)</th>
<th>Number of Proyectos Rejected by the National Assembly</th>
<th>Number of Controversial Proyectos</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gustavo Noboa</td>
<td>12</td>
<td>1.3</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Lucio Gutierrez</td>
<td>10</td>
<td>1.27</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Alfred Palacio</td>
<td>8</td>
<td>1.19</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Rafael Correa\textsuperscript{283}</td>
<td>10</td>
<td>1.46</td>
<td>0</td>
<td>3</td>
</tr>
</tbody>
</table>

\textit{Number of Proyectos Urgentes}: Comparing the two eras, there does not appear to be much of a difference between Correa and his predecessors regarding the total number of \textit{proyectos urgentes} sent to the Legislature. Whereas Correa’s predecessors each sent twelve, ten, and eight

\textsuperscript{282} While it would have been useful to determine how much the National Assembly has modified the particular \textit{proyectos urgentes}, such information is not available.
\textsuperscript{283} Note that these figures are accurate as of October 15, 2010.
proyectos urgentes, respectively, Correa has sent ten proyectos urgentes to the National Assembly.

Frequency of Proyectos Urgentes: While the numbers of proyectos urgentes sent to the National Assembly appear relatively similar, the frequency of proyectos urgentes has decreased significantly under Correa. For instance, on average Noboa sent one proyecto urgente every three months, Gutierrez sent a proyecto urgente every 2.7 months, and Palacio sent one proyecto urgente every 1.9 months. Although the frequency of proyectos urgentes increased over time, no Executive tried to inundate the Legislature with a continuous stream of them.

The trend of increased frequency of proyectos urgentes has been dramatically reversed under the Correa era. During Correa’s presidency, he has sent, on average, one proyecto urgente every 4.6 months.\textsuperscript{284} It is important to note, however, that Correa’s figure of sending ten proyectos urgentes during his now three-year presidency may be skewed due to the country’s Constituent Assembly and subsequent six-month dissolution of the National Assembly in 2007.\textsuperscript{285} While the National Assembly was dissolved, Correa could not send proyectos urgentes to the legislature since no Assembly existed to receive them. It is important to note, however, that the frequency of Correa’s post-approval DDA may be increasing as Correa has recently begun to send proyectos urgentes to the National Assembly much more frequently.

Number of Proyectos Urgentes Rejected: The evidence also shows that Ecuador’s National Assembly has only rejected three proyectos urgentes since January 2000. In fact, the National Assembly has not rejected any proyectos urgentes since the Palacio presidency, which began in April 2005. This trend can be due to several possibilities. One is that the Executives have become wiser in sending certain pieces of legislation through proyectos urgentes. That is, when a proyecto urgente contains complex issues, the Executives may believe that it is more appropriate to send the proposed legislation through ordinary means instead of through DDA. Another possibility is that the National Assembly has become more adept at modifying the Executives’ proyectos urgentes and no longer needs to completely reject a proyecto urgente. Finally, the Executives may simply enjoy majority support within the Legislature, thereby making rejection unlikely.

Number of Controversial Proyectos Urgentes: Substantively, only one proyecto urgente during both eras can be considered controversial—Correa’s proyecto modifying the Hydrocarbons Law. Even though the proyecto gives Ecuador control over all of its native resources, it does provide for the potential nationalization of the oil industry. Thus, it is

\textsuperscript{284} Even if the number reflected the six-month dissolution of the National Assembly, the frequency would be one proyecto for every four months.

necessary to see what future effect this *proyecto* will have on private companies in Ecuador’s oil industry.

Moreover, we see that Correa has used post-approval DDA powers three times in a manner that must be considered controversial. Unlike his predecessors, Correa has used political gamesmanship when sending a *proyecto urgente* to give the National Assembly a shorter time-frame to react. Moreover, we see that Correa extended the scope of his post-approval DDA by modifying the criminal code through his *proyecto urgente* combating the illegal sale of oil. Finally, Correa has taken advantage of the National Assembly’s legislative deadlock to push through *proyectos urgentes*. Since Correa’s allies are the largest political block in the Assembly, Correa has been able to use *proyectos urgentes* and the opposition’s inability to override the AP to prevent his political opposition from having a political discussion over the *proyectos*.

VI. IS DDA CURRENTLY THREATENING THE RULE OF LAW IN VENEZUELA AND ECUADOR?

As previously discussed, both pre-approval and post-approval DDA pose threats to the rule of law. The following analysis seeks to determine whether Chávez and Correa’s use of DDA has threatened the rule of law in their countries. Because two of these leaders—Chávez and Correa—have several years remaining in their current presidential terms, it is necessary to determine whether their use of DDA currently poses a threat to the rule of law. If Chávez or Correa’s use of DDA currently poses a threat to the rule of law, any future DDA use by the two leaders will further threaten the rule of law.

A. VENEZUELA

It is clear that Chávez has threatened, and continues to threaten, the rule of law through his use of pre-approval DDA. As the scope of Chávez’ DDA powers have increased, so has DDA’s threat to the rule of law in Venezuela. Since 1999, Chávez’ scope of DDA powers have extended from economic and financial matters to twelve different areas under the 2007 enabling law. Based on the broad scope of DDA powers, Chávez has used his DDA powers to enact laws in every area of Venezuelan society.

Furthermore, DDA has allowed Chávez to become the nation’s leading legislator. During the 2007 enabling law, Chávez issued sixty-seven decrees into law, totaling seventy-three percent of all laws passed.\(^\text{286}\) Essentially, Chávez, through the enabling law, has consolidated both Executive and Legislative powers within the Executive branch.

Accordingly, Chávez’ use of DDA threatens the rule of law as it fails to satisfy the requirement of “formal equality” in several regards. First, Chávez’ initial grant of the DDA powers under an enabling law no longer

satisfies formal equality. In fact, Chávez has undermined Legislature’s control over the enabling law, thereby disrupting the Executive-Legislative interplay that is key to DDA. As such, Chávez has negated the Legislature’s, let alone the opposition’s, voice regarding the content of the enabling laws. Consequently, the initial grant of pre-approval DDA powers does not follow “carefully dictated procedures” as the Legislature is nominally involved in determining the scope of Chávez’ DDA powers.287

Moreover, Chávez’ promulgation of decrees under the enabling law fails to satisfy the formal equality requirement as Chávez does not involve the Legislature regarding the content of the decrees. For example, Chávez issued twenty-six decrees on the last day of this 2007 DDA grant.288 Chávez, however, did not release the actual text of the decrees until a week later.289 Thus, Chávez changed Venezuela’s status quo without any legislative involvement and without providing the text of the decrees at the time they were promulgated. Accordingly, Chávez explicitly excluded Venezuela’s Legislature, and his political opposition, from any discussion regarding the content of these decrees. As such, Chávez’ use of DDA did not follow the “carefully dictated procedures” that are required in the lawmaking process.

Furthermore, Chávez’ DDA powers fail to satisfy the “formal equality” requirement by changing Venezuela’s criminal code through decrees. When a law or decree substantially changes the rights and obligations of a nation’s citizens, it is imperative that carefully dictated procedures be followed to ensure that the decrees were not made with invidious motives. Here, no such procedures were followed. Instead, Chávez altered the nation’s criminal code without providing any public dialogue. Since no public dialogue occurred, Chávez effectively denied any individuals whose rights would be affected by the new criminal standards a chance to challenge the laws before they were promulgated. Even though these individuals may challenge these decrees in court, the decrees enjoy the force of law until they are found to be unconstitutional. Because it often takes months, if not years, before a law is struck down by Venezuela’s Supreme Court, Chávez will have a substantial amount of time to confiscate goods and send individuals to prison under these decrees. Thus, although these individuals may be able to repeal the decrees in the future, there is nothing they can do in the short-term to protect themselves from any invidious actions taken by Chávez.

Chávez’ DDA use has additionally nullified horizontal accountability by making the content of his decrees virtually untouchable. Even though the 2000 and 2007 enabling laws had commissions monitoring Chávez’ DDA use, those commissions were filled with Chávez’ cronies who readily acquiesced to Chávez’ demands.290 Additionally, as Chávez has ac-

287. See Section V.A.2.a, supra.
288. See Romero, supra note 184
289. Id.
290. See Brewer-Carias, supra note 174, at 73.
quired more power over the grant of the enabling law, Chávez has positioned himself to be the only individual who can challenge his DDA powers. Thus, because Chávez sculpted the enabling laws with decreased involvement by the Legislature, he has become the ultimate authority as to the Legislature’s intent over whether he is acting outside the boundaries established under any enabling law. As such, Chávez’ political opposition, or the Legislature itself, has little recourse to reprimand Chávez for acting outside of those boundaries.

Overall, the use of DDA during the Chávez era has progressively become a larger threat to the rule of law in Venezuela. Considering Chávez has several years left under his current term and is not limited by any term limits, it seems evident that Chávez will continue to obtain longer and broader grants of DDA. If Chávez succeeds in obtaining broader and longer grants of the enabling law, DDA’s threat to the rule of law will continue to increase until the rule of law no longer exists in Venezuela.

B. ECUADOR

Correa’s use of post-approval DDA in Ecuador presents a growing threat to the rule of law. Although Correa, overall, has used his DDA powers less frequently than his predecessors, he has recently shown a penchant of using proyectos urgentes in a controversial manner. Nonetheless, Correa’s threat to the rule of law is limited by Ecuador’s 2008 Constitution.

Ecuadoran DDA’s threat is limited due to the 2008 Constitution’s limit of one proyecto urgente at a time and the thirty-day time-period the National Assembly has to respond. Because of these procedural safeguards, laws based on proyectos urgentes follow the requirement of “formal equality” since they are enacted under carefully dictated procedures. “Formal equality” is also generally satisfied as opposition groups can voice their opinions about the content of the proyectos urgentes before they are decreed into law.

While the 2008 Constitution provides procedural safeguards to guarantee formal equality, Correa and his allies in the National Assembly have been able to take advantage of the Assembly’s legislative deadlock to push through proyectos without much opposition involvement. In fact, little, if any, opposition involvement occurred when Correa sent the controversial Hydrocarbon proyecto to the National Assembly. Moreover, Correa’s use of political gamesmanship by sending proyectos urgentes to the Legislature, knowing that it would be in recess for half of the constitutionally guaranteed thirty day time period, is problematic. By cutting the time period for Legislative involvement in half, Correa effectively limits some of the “carefully dictated procedures” that ensure opposition participation in the legislative process.

Furthermore, it is questionable whether horizontal accountability continues to exist within Ecuador under the Correa era based on the National Assembly’s legislative deadlock. Since neither Correa’s allies nor his opposition currently maintain enough votes to challenge Correa’s proyectos urgentes, it remains unclear whether the National Assembly would reject one of Correa’s proyectos for being outside the scope of his authority. Accordingly, it appears that the Executive-Legislative interplay that is at the core of DDA currently is lacking in Ecuador considering the small likelihood of legislative action checking Correa’s Executive decrees.

An additional concern is that Correa, unlike his predecessors, has used a proyecto urgente to change the nation’s criminal code. This issue is not as problematic as it would be under pre-approval DDA since Ecuador’s Legislature still maintains the chance to discuss and approve, modify, or reject the changes. Nonetheless, the use of proyectos urgentes to change the criminal code is problematic in that Correa has actively tried to broaden the scope of his DDA powers to include non-economic matters. Moreover, Correa’s attempt to change the criminal code through proyectos urgentes creates a dangerous precedent, whereby Correa and future presidents will be able to use proyectos urgentes to modify the nation’s criminal code.

Overall, Correa’s use of DDA has posed a nominal threat to the rule of law within Ecuador, which is largely due to the constitutional protections provided for in Ecuador’s 1998 and 2008 Constitutions. Correa, however, has shown a trend towards using DDA in a manner that undermines the Executive-Legislative interplay and limits his opposition’s ability to voice their opinion over the proyecto urgente’s content. Accordingly, it will be necessary to see how Correa uses proyectos urgentes in the future to determine whether Correa’s use of post-approval DDA becomes an increased threat to the rule of law.

C. COMPARISON OF THE COUNTRIES

Of the countries studied in this article, only Venezuela’s DDA under Chávez presents a legitimate threat to the rule of law. Chávez’ use of DDA through the enabling law has threatened the rule of law in Venezuela by denying formal equality and horizontal accountability. Moreover, Chávez’ use of DDA has substantially consolidated lawmaking power within the Executive branch. Unless Venezuela rewrites its constitution to limit the Executive’s pre-approval DDA powers, future Venezuelan Executives will continue to obtain longer and broader DDA powers, which, in turn, will continue to threaten the rule of law in Venezuela.

At the same time Chávez has increased his DDA powers, Correa in Ecuador has restrained his DDA use. Although Correa has recently shown some tendencies towards using Ecuador’s post-approval DDA in a way that could threaten the rule of law, Correa’s DDA use does not present nearly as larger of a threat to the rule of law due to the limited use of
proyectos urgentes. Furthermore, we see that because of the constitutional limits that are inherent in post-approval DDA, the potential for abuse is must less than that is seen in pre-approval DDA. However, if Correa continues to use political gamesmanship to limit his opposition’s opportunities to voice their opinion regarding any proyecto urgente, DDA’s threat to the rule of law could increase. Nonetheless, at this moment, Correa’s use of DDA is not comparable to that of Chávez, and it is not appropriate to categorize Correa with Chávez regarding their DDA use.

Overall, it appears that Chávez is a unique instance where a leader has used DDA to consolidate lawmaking power within the Executive branch and threaten the rule of law. For instance, we see that when an Executive possesses an immense amount of political power, that Executive can use pre-approval DDA in a manner that undermines the rule of law—i.e., Chávez. At the same time, however, we see that not every popular leader uses pre-approval DDA in a way that threatens the rule of law—i.e., Correa. Moreover, even though post-approval DDA does not generally present as large of a threat to the rule of law due to constitutional limits that are in place, a leader—i.e., Correa—may use his DDA powers in such a way as to manipulate the legislative system and present a threat to the rule of law. Thus, it is important to recognize that each unique form of DDA offers its own unique threat to the rule of law. As such, I recommend that future studies further explore the relationship between different forms of DDA and their threat to the rule of law so as to better understand what DDA characteristics, in practice, threaten the rule of law.

D. Prescriptive Safeguards on DDA to Protect The Rule of Law

Even though it remains unanswered as to what specific DDA characteristics present the greatest threat the to the rule of law, I believe that every South American country offering DDA should have several safeguards in place so as to limit DDA’s threat to the rule of law. In regards to pre-approval DDA, the constitution must limit the scope of DDA powers to specific areas. Although the DDA powers need not be limited to solely economic or financial matters, it is important that the powers not extend to criminal or individual rights, which can be used by an Executive to attack the political opposition. Moreover, the constitution should contain temporal limits on the length of the DDA grant. A nation’s Legislature should function as the country’s lawmaking body and limit any
particular grant of DDA to six or less months to ensure that lawmaking authority is not being completely usurped by the Executive.

Furthermore, when drafting a grant of pre-approval DDA, a nation’s Legislature must remain active in the drafting process. The Legislature must provide specific details as to the substantive scope of the Executive’s decrees. Such guidelines need not provide a checklist of everything that must be included within any one decree. These guidelines, however, should provide enough detail to indicate that the Legislature thought through its DDA grant and intended to limit the Executive’s DDA powers to specific areas and criteria. Moreover, pre-approval DDA should also provide for a monitoring system to ensure that the Executive-Legislative interplay is healthy and active. Although the Executive may choose to ignore the opposition, the monitoring system is symbolically important in that it provides the political opposition a voice, albeit a small one, in the legislative process.

In post-approval DDA, a nation’s constitution should contain several safeguards to provide the Legislature adequate opportunity to respond to any Executive decree and to prevent the Executive from inundating the Legislature with decrees. Accordingly, the constitution should provide a Legislature the absolute authority to modify, amend, or deny any post-approval decree. Furthermore, the Legislature must be given adequate time—i.e., a minimum of thirty days—to respond to any such decree. Finally, the constitution should limit the Executive to one post-approval decree at a time, so that the Legislature is not forced to address numerous post-approval decrees at any given moment.

While these safeguards are not perfect, they do help limit DDA’s threat to the rule of law. These safeguards help ensure that “formal equality” exists by providing weaker political figures a voice, albeit a small one, in the drafting and enforcement of pre-approval DDA grants. Moreover, they allow minority voices the opportunity to openly discuss post-approval DDA decrees through legislative dialogue. These safeguards also help provide “horizontal accountability” in that the Legislature can annul any decrees that are outside of the Executive’s DDA powers, thereby ensuring that the lawmaking authority remains within the Legislature and not the Executive.

VII. CONCLUSION

DDA is prevalent throughout South America and is used by leaders of all political ideologies. Although both pre-approval and post-approval DDA pose their own unique threats to the rule of law, the threat can be limited through careful constitutional drafting and legislative oversight. Constitutional text can limit the scope and time-length of pre-approval DDA and the amount of post-approval decrees an Executive can send at any one time. Moreover, a country’s Legislature can monitor an Executive’s DDA use to ensure that the Executive does not consolidate law-making power within the Executive branch.
Of the countries and leaders studied under this article, only Hugo Chávez in Venezuela poses a legitimate threat to the rule of law through his DDA use. On the other hand, Rafael Correa in Ecuador poses a smaller, but increasing, threat to the rule of law. Although Correa has recently shown some tendencies to use DDA in a manner that potentially threatens the rule of law, Correa has not used DDA enough to present a real threat to the rule of law. It is important, however, that we continue to monitor DDA use in these countries to ensure that Chávez and Correa do not continue to consolidate Legislative powers within the Executive branch to further threaten the rule of law, and to prevent future Executives from using their DDA powers in ways that may increase DDA’s threat to the rule of law.
OVER-THE-COUNTER DERIVATIVES: A NEW ERA OF FINANCIAL REGULATION

Seema G. Sharma*

ABSTRACT

On July 21, 2010, President Barack H. Obama signed into law financial reform legislation titled the “Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010,” also known as the “Dodd-Frank Act of 2010,” (the “Dodd-Frank Act”). After almost two years of intensely contentious legislative process, the U.S. Congress passed this new legislation in response to the financial crisis of 2008. The Dodd-Frank Act is the most sweeping legislation affecting the nation’s financial regulations since the Depression-era laws and is intended to restore confidence in U.S. financial markets and stimulate growth in the economy. The new law puts U.S. banks and financial markets under tighter government control by expanding the regulatory reach of the major federal agencies. It also sets new international standards for transparency in the financial markets and lays the foundation to build a stronger global financial infrastructure. Of the sixteen distinct Titles of the Dodd-Frank Act on a variety of topics, this paper will provide analysis and critique of Title VII of the Dodd-Frank Act. Title VII is referred to as the Wall Street Transparency and Accountability Act of 2010 (referred to herein as the “the Act”), and provides a comprehensive framework for the regulation of OTC derivatives.

* Associate Executive Director and Research Fellow at the SMU Institute of International Banking and Finance. Portions of this article are related to Ms. Sharma’s ongoing research on derivatives. Special thanks to Professor Joseph J. Norton of SMU Dedman School of Law for helpful comments on earlier drafts of this article. At the time of writing this article, December 31, 2010, the Commodity Futures Trading Commission (CFTC), and Securities and Exchange Commission (SEC) are busy formulating comprehensive regulations as to Title VII.


6. The Wall Street Transparency and Accountability Act of 2010, CLIENT PUBLICATION (Shearman & Sterling LLP), (Apr., 23, 2010), http://www.shearman.com/files/Publication/212cd5f0-44f4-45c9-9f97-51cde55cb59/Presentation/PublicationAt-
goal of Title VII is to bring transparency and accountability to the derivatives market by mandating centralized clearing of OTC derivatives and their trading on or through designated contract markets, national securities exchanges, or swap execution facilities.\textsuperscript{7} Needless to say, the provisions of the Act will change the style of derivatives trading in the United States forever.\textsuperscript{8} With New York being the major financial center in the Western hemisphere, the Americas will not be able to escape the impact of the new law, as the requirements of the Act will also apply to foreign entities dealing with the U.S. market participants or executing or clearing their swap transactions through a U.S. facility.\textsuperscript{9} Hence, a serious consideration of the provisions of Title VII is critical to fully comprehend its implications. Though at this point it is hard to predict the full scope of the Act, there is no doubt that the effects of the reform process will be profound. After examining the role of derivatives in the financial crisis and a detailed analysis of the aforementioned and other key provisions of Title VII, the paper concludes that the transparency in the derivatives markets that will result from the use of clearinghouses, exchange trading, and public reporting of trades, will make the U.S. financial markets stronger than ever.

1. INTRODUCTION

The U.S. economy experienced the worst economic nightmare since the Great Depression of the 1930s, derivatives\textsuperscript{10} were targeted for increasing systemic risk\textsuperscript{11} in the financial system.\textsuperscript{12} Credit Default Swaps (CDS), a type of the over-the-counter derivative (OTC derivative), was at the forefront, and was blamed for being the lead financial product that “contributed to the overall tightening in the credit markets following the bankruptcy of Lehman Brothers and the near-collapse of American Insurance Group (AIG), which was a major CDS

\textsuperscript{7} Id.
\textsuperscript{8} See id.
\textsuperscript{9} Id.
\textsuperscript{10} Derivatives include exchange-traded and over-the-counter (OTC) contracts. Kristina Zucchi, Derivatives 101, INVESTOPEDIA.COM, http://www.investopedia.com/articles/optioninvestor/10/derivatives-101.asp (last visited Jan. 16, 2011). Standardized derivatives are typically traded on exchanges which publicly display prices and customized derivatives products are traded off-exchange or over-the-counter where prices remain private. Id.
\textsuperscript{11} Systemic risk is the risk that failure of a firm or disruptions in a market will extend to other firms or in other market segments and destabilize the financial system as whole. Systematic Risk, INVESTOPEDIA.COM, http://www.investopedia.com/terms/s/systematicrisk.asp (last visited Jan. 16, 2011).
The call for greater transparency and reform of the derivatives market sparked the debate for comprehensive supervision and regulation of the OTC derivatives markets. Responding to the call, the Obama Administration released its proposal in June 2009. Following the Administration’s Proposal, the 111th Congress considered several legislative proposals to reform the regulation of financial markets and financial institutions. The goal for the new financial regulatory reform legislation was, among other things, to bring order and stability to the U.S. financial system. For the derivatives world, it meant sweeping changes to the OTC derivatives market and industry. The process for reform of the financial system that began in the summer of 2008 culminated on July 21, 2010, with the enactment of the “Dodd-Frank Wall Street Reform and Consumer Protection Act” (the “Dodd-Frank Act”). Title VII of the Dodd-Frank Act, entitled “Wall Street Transparency and Accountability Act of 2010,” (the “Act”), deals with the regulation of derivatives market and industry. Under the new regime, the world of OTC derivatives has

15. See generally id.
17. Comizio, supra note 2, at 101.
been divided into “swaps,”21 “security-based swaps,”22 and “mixed swaps.”23 The Commodity Futures Trading Commission (CFTC), and Securities and Exchange Commission (SEC) have been given regulatory authority to regulate “swaps” and “security-based swaps,” respectively.24 “Mixed swaps” will be regulated by both of the Commissions.25 The two Commissions have also been assigned the task of extensive rulemaking for the implementation of the provisions of the Act.26 Additionally, they will also be conducting a number of studies to assess the impact of certain regulations and to bring about international harmonization of derivatives markets.27 It is important to note that the Act allows an over-the-counter market in non-standardized swaps to continue.28

The Dodd-Frank Act has significance not just for U.S. entities, but also for non-U.S. entities, given the extraterritorial reach of its provisions.29 Because of the importance of New York as the major financial center in the Western hemisphere, a large number of entities from this side of the hemisphere participate in the U.S. financial markets. Hence, it is critical that they understand the implication of the new law on their businesses. Title VII of the Dodd-Frank Act will have a substantial impact on non-U.S. entities that engage in OTC derivatives transactions in the U.S. derivatives markets.30 Under § 715 of the Act, the CFTC and SEC, in consultation with the Treasury, have the authority to prohibit a non-resident

21. The Act defines “swap” very broadly as any agreement, contract, or transaction that is an option for the purchase or sale, or is based on the value, of an underlying financial or economic interest or property, or that provides for any purchase, sale, payment, or delivery that is dependent on the occurrence, non-occurrence, or the extent of the occurrence of an event associated with a potential financial, economic, or commercial consequence. Dodd-Frank Act § 721 The definition of “swap” includes interest rate, currency, foreign exchange, credit, equity, commodity, weather, energy, metal, agricultural, and index swaps. Id. Excluded from the definition are: “security-based swaps,” exchange-traded futures, contracts for the sale of commodities for future delivery (or options thereon), physically settled forwards (and options thereon), and exchange-traded options on currencies and certain securities contracts. Id.

22. A security-based swap is a “swap” based on a narrow-based security index (including an interest therein or on the value thereof), a single security or loan (including an interest therein or on the value thereof), or the occurrence, nonoccurrence, or the extent of the occurrence of an event relating to a single issuer or narrow group of issuers in a narrow-based security-index, provided that such event directly affects the financials of the issuer. Options, forwards, and credit default swaps referencing corporate bonds and loans are included. Id.

23. A “mixed swap” has the characteristics of both “swap” and “security-based swap,” such as a total return swap on a single security that also incorporates an FX hedge. The CFTC and SEC, in consultation with the Federal Reserve, will have joint rulemaking authority over mixed swaps. Id.


25. Dodd-Frank Act § 712(a)(8).

26. Id. § 712(d)(2).

27. Id. §§ 712(f)(2), 752.


company from participating in swap activities in the United States if they determine that the regulation of swaps in the company’s country undermines the stability of the U.S. financial system.\textsuperscript{31} Further, new swap laws:

\textquote{[s]hall not apply to swap activities taking place outside the United States unless those activities (1) have a direct and significant connection with activities in, or effect on, commerce of the United States, or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent evasion of . . . the Dodd-Frank Act.}\textsuperscript{32}

Most importantly, the Act does not provide any express exemptions for non-U.S. entities from the requirements applicable to swap dealers or major swap participants.\textsuperscript{33} Hence, depending upon the level of their activity in the United States, non-U.S. entities might be subject to regulation as swap dealers or major swap participants.\textsuperscript{34} The implication of this for such entities is significant, thus it is in their interest to comply with the law. Additionally, until such time that the Commissions promulgate final rules, these entities should apply caution while conducting their derivatives activities to avoid potential violation of the new legislation.

This article examines derivatives, their role in the financial crisis, and discusses key provisions of the new regulatory regime established under the Act in order to evaluate its impact on the OTC derivatives and their markets. Part II provides a brief description of derivatives financial instruments and the structure of the markets in which they are traded. Part III examines the role of derivatives in the financial crisis of 2008. Part IV discusses key provisions of Title VII of the Dodd-Frank Act and their impact on the OTC derivatives market and its participants. The article, in Part V, concludes that while regulation of OTC derivatives will bring transparency and efficiency to the market, there remains work to be done to harmonize the rules on an international scale to prevent migration of business overseas. Centralized clearing, exchange trading, reporting of uncleared swaps to swap repositories, and heightened business conduct requirements will ensure success of the objectives of the legislation and make our financial markets stronger than ever.

II. DERIVATIVES AND THEIR MARKET STRUCTURE

A. DERIVATIVES GENERALLY

Derivatives, such as futures, options, and swaps, are financial instruments whose value is based on or derived from other assets or variables.\textsuperscript{35} The underlying asset may be anything from stock and bonds, to commodities, interest rates, currency rates, or an index of a leading stock mar-

\begin{footnotesize}
\begin{itemize}
\item 31. Dodd-Frank Act § 715.
\item 32. Id. § 722(d).
\item 33. See Kroener, supra note 20.
\item 34. See id.
\item 35. See Zucchi, supra note 10.
\end{itemize}
\end{footnotesize}
Hence, these contracts are of no value by themselves, but, “rather, receive their value from movements in interest rates, the outcome of specific events, or the price of underlying assets like debt or equities.” Derivatives contracts have also been defined as “a form of price guarantee: an agreement between a future buyer and a future seller for something at some designated point in time.” An interesting aspect of derivatives is that although they are primarily used as invaluable tools of risk-management, they are also used for speculation, i.e. placing bets on the value of the underlying asset based on the investors’ assessment of the market-movement, without ever owning tangible assets in that market. Derivatives transactions “allow market participants, including commodity producers, processors, and end-users, as well as corporations, banks and governmental entities, to manage financial risks caused by fluctuating interest rates, currencies, commodity prices and securities prices.” To manage their risks effectively and efficiently, market participants use standard and customized derivatives contracts. Standardized derivatives contracts are liquid contracts that are traded on exchanges. Futures and Options are good examples of the exchange-traded financial derivatives, however, the more popular derivatives are the ones that are not traded on an exchange, but those traded off the exchange, known as “over-the-counter” (OTC) derivatives. These OTC derivatives contracts are customized contracts that are tailored to the specific needs of the counterparties, and include negotiated terms, such as amounts, payment timing, and interest or currency rates. Because OTC contracts are customized and tailored to meet the requirement of the trading parties, liquidity in the OTC markets can be low considering the costs involved in finding trading partners willing to take the other side of a desired transaction. Additionally, it is extremely difficult to exit positions in the over-the-counter contracts before the prescribed termination date. But, the customized aspect of OTC contracts is one of the reasons for its popularity, for it allows users achieve their precise risk-management needs through hedging, thereby facilitating innovation and variation in the products and making OTC derivatives valuable to business enti-

36. See id.
39. Id.
41. See Zucchi, supra note 10.
42. Id.
43. Id.
44. ROBERT W. KOLB & JAMES A. OVERDAHL, FINANCIAL DERIVATIVES 17 (3d. ed. 2003).
45. Id.
ties. The other reason for their popularity is that reporting, standardization and margin requirements that apply to exchange-traded derivatives, do not apply to them. As a result, OTC derivatives are considered cost-effective and the least burdensome, and thus are highly attractive to the parties involved. The OTC derivatives market consists of many variations on the basic derivative contracts of forwards, options, and swaps and “is divided into five major categories: foreign currency exchange contracts, interest rate contracts, equity-linked contracts, commodity contracts, and credit derivatives,” of which credit default swaps is the most popular product and is the one that brought the spotlight on derivatives during the recent financial crisis.

Dealers and End Users make OTC derivatives markets. Dealers—usually large banks, securities firms, insurance companies, or their affiliates—are intermediaries; they act as principals who take sides in transactions and earn spreads if and when they find others to take the opposite sides. A dealer’s basic role is to facilitate the transaction in exchange for financial gain in the form of a fee for executing the transaction. Firms that use derivatives to manage (hedge) their financial risks or to speculate are called end users, as they are the “final buyers and sellers of risk.” Sophisticated investors, such as institutional investors, government entities, corporate and hedge funds, are also end users of derivatives that hold large pools of intangible financial assets (loans, bonds, shares) whose value they wish to protect, in the same way that the rest of the world protects their buildings, their houses, their manufactures, their oil, their other tangible possessions, and also hope to make a profit out of them.

With the help of derivatives, the end users are able to protect the value of their assets and also make profit out of them.

B. Market Structure of Financial Derivatives

Derivatives are traded in two kinds of markets: exchanges and OTC markets. Exchanges are centralized markets that are subject to regulation by a federal agency, such as the CFTC for futures contracts or the

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46. Id.
47. Id.
48. See Lynch, supra note 38, at 1376.
50. Id.
52. Feder, supra note 49, at 717.
54. See Zucchi, supra note 10.
SEC for stock options. As a centralized facility, exchanges play a critical role in consolidating the bid (buy) and offer (sell) quotes and making it available to all market participants so that they can buy as low or sell as high as anyone else. OTC markets, on the other hand, are for privately negotiated bilateral contracts between the buyer and seller, which are not traded on any exchange; hence, these markets are not regulated by any agency. Although participants in the OTC markets, such as banks or bank holding company subsidiaries, are subject to regulation; state and federal bank regulators regulate banks and the Federal Reserve regulates bank holding companies. The SEC oversees a derivatives dealer who is also a securities dealer. Hence, limited regulation in the OTC derivatives markets along with the benefits that the OTC products offer, resulted in the phenomenal growth of these markets in the past two decades. Today, these markets are central to the trading of derivatives; treasury bills and bonds, foreign exchange, corporate bonds, and common stocks all trade over-the-counter.

In derivatives markets, billions of contracts change hands making it extremely hard to assess the creditworthiness of a counterparty. As a result, such contracts contain significant potential credit risk. Derivatives exchanges, such as the Chicago Mercantile Exchange (CME), the Chicago Board of Trade (CBOT), or the Chicago Board of Exchange (CBOE), deal with the issue of credit risk by employing a clearinghouse, which clears and handles post trade processing. The presence of a clearinghouse in the transaction ensures payment and settlement to both the parties. Typically, the transactions require posting of collateral or margin by counterparties to help the clearinghouse manage the credit risk. The margin accounts of the counterparties are marked-to-market on a daily basis and the clearinghouse collects additional margin from traders for any price movement. Furthermore, clearing members are also subject to capital requirements of the clearinghouse. The purpose of these requirements is to protect a counterparty from potential losses.

56. Id.
57. Id. at 8.
58. See Lynch, supra note 38, at 1380.
59. See generally id.
61. See Lynch, supra note 38, at 1380.
63. Id.
64. Id.
65. RENA S. MILLER, KEY ISSUES IN DERIVATIVE REFORM, Congressional Research Service R40965, at 3 (2009).
66. Preliminary Staff Report: Overview on Derivatives, supra note 55, at 8.
that might result from the other party’s nonpayment.\textsuperscript{67} Most importantly, these requirements also prevent build up of large paper loss that could damage the clearinghouse in case of default.\textsuperscript{68}

By contrast, “In the OTC market...there is a network of dealers rather than a centralized market place.”\textsuperscript{69} Firms that act as dealers stand ready to take either long or short positions, and make money on spreads and fees.\textsuperscript{70} There is no clearinghouse to interpose itself between the dealer and the end user: “The dealer absorbs the credit risk of customer default, while the customer faces the risk of dealer default.”\textsuperscript{71} While there is no central counterparty involved in OTC transactions, OTC derivatives contracts require collateral or margin, for protection from the risk of counterparty default.\textsuperscript{72} As long as the requirements of margin and collateral posting are fulfilled, the operations run smoothly, however, there is a potential for large uncollateralized losses to build up in the OTC market as collateral or margin requirements are not mandatory.\textsuperscript{73} A case in point is AIG, “which wrote about $1.8 trillion worth of credit default swaps guaranteeing payment if certain mortgage-backed securities defaulted or experienced other ‘credit events,’ ” such as bankruptcy, obligation acceleration, obligation default, failure to pay, repudiation or moratorium, and restructuring—the six credit events provided under International Swaps and Derivatives Association (ISDA) definitions.\textsuperscript{74} Not only did AIG fail to post collateral when the credit quality of the underlying securities (or AIG’s own credit ratings) deteriorated, but the firm was also able to avoid posting initial margin because of its triple-A rating.\textsuperscript{75} AIG could sidestep the collateral and margin requirements because the structure of the OTC derivatives market allowed it. Given the size of AIG’s OTC derivatives position, there was grave danger to the stability of the U.S. financial markets from the failure of the insurance giant and, fearing the domino effect of AIG’s bankruptcy, “the Federal Reserve and the Treasury put tens of billions of dollars into AIG, the bulk of which went to its derivatives counterparties” and contained the spillover.\textsuperscript{76} Although derivatives were not the main cause of the crisis, flaws in their market structure allowed for the buildup of systemic risk in the economy.

\begin{flushleft}
\textsuperscript{67} Id.
\textsuperscript{68} Miller, supra note 65, at 3.
\textsuperscript{69} Id.
\textsuperscript{70} “In this kind of market, one would expect the dealers to be the most solid and creditworthy financial institutions, and in fact the OTC market that has emerged is dominated by two or three dozen firms—very large institutions like JP Morgan Chase, Goldman Sachs, Citigroup, and their foreign counterparts.” Id.
\textsuperscript{71} Id.
\textsuperscript{72} Id.
\textsuperscript{73} Id. at 4.
\textsuperscript{74} Id. ISDA’s Master Agreement is a standard contract commonly used by derivatives parties to document OTC derivative transactions.
\textsuperscript{75} Miller, supra note 65, at 4.
\textsuperscript{76} Id.
\end{flushleft}
III. ROLE OF DERIVATIVES IN THE RECENT FINANCIAL CRISIS

A. The Buildup to the Financial Crisis of 2008

There was no single factor that caused the financial crisis. To understand the role played by derivatives in the crisis, it is important to comprehend the regulatory environment that contributed to the popularity of derivatives and fostered the rapid growth of their markets. Although derivatives markets in the United States date back to 1865, derivatives markets for financial instruments appeared in the 1970s.\textsuperscript{77} The regulation of derivatives began with the Grain Futures Act of 1921 (GFA), which regulated grain futures contracts that were traded on exchanges.\textsuperscript{78} The current federal law governing derivatives and derivatives markets is the Commodity Exchange Act (CEA), which was passed by the Congress in 1936 to prevent price manipulation, fraudulent activities of bucket shops,\textsuperscript{79} and other trading abuses in the futures market.\textsuperscript{80} In 1971, the Bretton Woods system (a system of fixed exchange rate between currencies) collapsed and it fuelled the growth of the derivatives industry.\textsuperscript{81} Futures contracts on financial instruments were introduced to manage the currency risk. As futures markets evolved and were dominated by futures based on financial products, there was a change in the composition of market participants—farmers and commodity users were joined by large financial institutions and the transactions became more complex.\textsuperscript{82} An over-the-counter market for derivatives grew rapidly in 1980s, but despite the exponential growth, there was still no legal definition of the term “futures contract”—the CEA did not define it, nor did the numerous amendments to it.\textsuperscript{83} The lack of a definition created uncertainty for swaps and other OTC derivatives contracts that were similar to exchange-traded futures in their economic function but were privately negotiated between counterparties outside organized exchanges.\textsuperscript{84} There was a potential legal risk that they might be considered invalid and unenforceable, as these contracts, if determined to be futures contracts, were violating the CEA’s requirement that futures be traded on an organized ex-

\textsuperscript{78} This Act was held unconstitutional by the Supreme Court. Hill v. Wallace, 259 U.S. 44 (1922).
\textsuperscript{80} Id. at 5.
\textsuperscript{81} Preliminary Staff Report: Overview on Derivatives, supra note 55, at 19.
\textsuperscript{82} GAO Report CEA, supra note 79, at 5.
\textsuperscript{83} Id.
\textsuperscript{84} Id.
change.\textsuperscript{85} In 1999, the President’s Working Group on Financial Markets (PWG) made recommendations to the Congress to resolve legal uncertainties concerning OTC derivatives.\textsuperscript{86} The group’s recommendation was to exclude from oversight certain bilateral transactions between sophisticated counterparties and to eliminate impediments to clearing OTC derivatives, which Congress accepted and implemented in the Commodity Futures Modernization Act of 2000 (CFMA), signed into law by President Clinton on December 21, 2000.\textsuperscript{87} The legislative purpose for enacting the CFMA was

\cite{Pannell2011}

\begin{quote}
[to] promote innovation for futures and derivatives and to reduce systemic risk by enhancing legal certainty in the markets for certain futures and derivatives transactions; to reduce systemic risk and provide greater stability to markets during times of market disorder by allowing the clearing of transactions in over-the-counter derivatives through appropriately regulated clearing organizations; and to enhance the competitive position of [U.S.] financial institutions and financial markets.\textsuperscript{88}
\end{quote}

The CFMA removed OTC derivatives transactions from the requirements of exchange-trading and clearing under the CEA as long as the counterparties to the swaps were “eligible contract participants,” \textit{i.e.}, had in excess of $10 million in total assets.\textsuperscript{89} As a result, OTC derivatives were exempt from the CEA’s requirement for capital adequacy, clearing, reporting, and disclosure or any other requirement that would have the effect of regulating the market.\textsuperscript{90} The reasoning behind keeping the market out of the reach of any regulation was that a vast majority of OTC transactions were between sophisticated parties who were subject to oversight by their appropriate regulators.\textsuperscript{91} Additionally, it was felt that the self-discipline of the private counterparties would be sufficient to keep a check on the market and prevent systemic risk from building in the financial system.\textsuperscript{92} The CFMA was successful in providing certainty to the OTC derivatives and marked the beginning of the phenomenal growth of OTC derivative markets as a result of the blanket exemptions.\textsuperscript{93} Another interesting outcome of the new exemptions was that

\begin{thebibliography}{99}
\bibitem{Longer-term} See generally Long-Term Capital Management: Regulators Need to Focus Greater Attention on Systemic Risk, GAO/GGD-00-3, U.S. GEN. ACCOUNTING OFFICE, (1997), http://www.gao.gov/products/GGD-00-3. The Secretary of the Treasury chairs the working group, and other members include the chairs of CFTC, the Federal Reserve System, and the Securities and Exchange Commission. \textit{Id.}
\bibitem{Lynch} Lynch, \textit{supra} note 38, at 1378.
\bibitem{Id} \textit{Id.} at 1378-79.
\bibitem{Ibid} \textit{Id.} at 1379.
\bibitem{Id2} \textit{Id.} at 1380.
\bibitem{Id3} \textit{Id.}
\bibitem{Id4} The derivatives markets were transformed from simple commodity exchanges to multi-trillion dollar markets. \textit{Id.} at 1382.
\end{thebibliography}
they facilitated strong interconnectedness among the financial institutions and in the following years a handful of financial institutions rose to become major dealers who controlled the trading of derivatives.94 These financial institutions transacted heavily with each other trading OTC financial derivatives to hedge the risks from their customer trades and also to trade for their own account, and had strong interconnection as counterparties to derivatives transactions.95

The financial crisis exposed the interconnectedness of these OTC derivative counterparties and the potential such interconnection had for causing serious damage to the financial system through a domino effect, wherein the failure of a single counterparty could lead to the failure of all counterparties.96

B. THE FINANCIAL CRISIS OF 2008

The near-collapse of Bear Stearns in March 2008, followed by the bankruptcy of Lehman Brothers on September 15, 2008, and the bailout of American International Group (AIG) on September 16, 2008, put derivatives at the center of the crisis.97 While the leading proximate causes of the financial crisis were the unsound practices of the U.S. mortgage lending industry in the early 2000s and excessive foreclosures resulting from the housing market bubble burst, OTC derivatives, particularly credit default swaps (CDS) and collateralized debt obligations (CDO), were blamed for exacerbating the condition of the financial markets.98 CDOs are asset-backed debt securities derived from various underlying assets, such as loans and bonds.99 CDOs derived from mortgage bonds are known as collateralized mortgage obligations (CMO) and their value depends on the value of the mortgages, which, in turn, depends on how many of them are being paid off.100 CDOs, in general, were extremely popular as an investment product up to 2007 and their popularity stemmed from the fact that they provided high yields and were structured in a way that they could withstand adverse events.101 Credit Default Swaps, on the other hand, are bilateral swap contracts that insure against losses to financial institutions and corporate bondholders from credit risks—that is, provide protection in case of default, bankruptcy, or credit

94. Id.
96. Id. at 5-6.
97. Id. at 5.
98. Id.
99. Though CDOs are derived from mortgage bonds, their being considered as derivatives or not is a matter of labeling. CDOs are not held under ISDA Master Swap Agreement. They are insured by credit default swaps (CDS). CDOs “are regulated under laws governing the issuance of debt securities.” Id. at 5.
100. Id.
ratings downgrade resulting in inability of the borrower of the loan to repay the loan.\textsuperscript{102} They are similar to insurance contracts, in which the seller of the protection promises the buyer of the protection a particular amount in case of a default, in exchange for payment of a periodic premium fee. The value of CDSs swings with the fiscal health of the transaction or asset it is written to cover.\textsuperscript{103} During the recent housing boom in the United States, CDS sellers sold protection to CDO investors against the default of mortgage-backed securities—as long as the housing prices were appreciating and mortgage borrowing was escalating, the CDO and CDS markets were also thriving.\textsuperscript{104} When the housing bubble deflated in 2007, the residential property prices plunged and the subprime borrowers began defaulting on their loans.\textsuperscript{105} The mortgage defaults reduced the value of mortgage-backed securities and, as a result, holders of these securities lost their payments and their investments.\textsuperscript{106} The CDO market was hit hard by mortgage defaults.\textsuperscript{107} The situation in the market was further aggravated by the fact that investors were too scared to touch housing-based investments, crashing any hope to save the market by raising new capital. The CDS market, wherein CDSs were sold as protection for CDOs backed by subprime mortgages, was in no better shape either.\textsuperscript{108} The CDS insurers came under tremendous pressure to compensate banks and other protected buyers for the loss of value in their CDO portfolios from mortgage defaults.\textsuperscript{109} But, they were not adequately capitalized to make good on their promises and the CDO and CDS markets were completely destroyed, which, in turn, shook the foundation of prominent Wall Street firms that were heavily invested in these markets.\textsuperscript{110}

Bear Stearns, the nation’s fifth largest investment banking firm, had made significant investments in mortgage-backed securities and was heavily exposed to the subprime mortgage market.\textsuperscript{111} Like other Wall Street firms, Bear was also actively engaged in packaging, underwriting, trading, and investing in mortgage-backed securities.\textsuperscript{112} It also operated a significant prime brokerage business, in which it served as a counterparty intermediary for a large volume of OTC derivatives transactions.\textsuperscript{113} With the meltdown of the subprime mortgage market, Bear

\begin{thebibliography}{99}
\bibitem{102} Duffie, supra note 95, at 5.
\bibitem{103} Karl S. Okamoto, \textit{After the Bailout: Regulating Systemic Moral Hazard}, 57 UCLA L. Rev. 183, 200 (2009).
\bibitem{105} Id.
\bibitem{106} Id.
\bibitem{107} Id.
\bibitem{108} Id.
\bibitem{109} Id.
\bibitem{110} Duffie, supra note 95, at 5.
\bibitem{111} Okamoto, supra note 103, at 197.
\bibitem{112} Id.
\bibitem{113} Prime brokerage business of an investment bank focuses on the trading activities of large professional traders like hedge funds. Id.
\end{thebibliography}
Stearns was forced to write-down losses in its trading portfolios comprised of mortgage-related securities. These portfolios were used as collateral to support its access to borrowed funds. Bear’s lenders asked for more collateral and the firm was left with no other option other than to sell its mortgage-related assets at sharply discounted prices to meet the collateral calls. The fire sale of the assets led to a further drop in their value, thus making the market nervous about Bear Stearns’ financial health and generally reluctant to lend funds to the firm through the interbank market. Around the same time, Bear’s prime brokerage clients also withdrew their accounts from the firm, causing panic in the already nervous market and leading derivatives counterparties to start making margin calls for additional collateral to protect themselves from potential losses in the event Bear Stearns fell into bankruptcy. Finally, it all resulted in creating enormous pressure on the already shrinking liquidity of the firm, causing a liquidity crunch, and Bear suffered a run on the bank. In an effort to avert the firm’s bankruptcy, stabilize the firm, and prevent a wider financial panic, the Federal Reserve intervened and Bear Stearns was sold off to J.P. Morgan on March 22, 2008.

Lehman’s story was not much different from that of Bear Stearns. Like Bear, Lehman had also made significant investments in mortgage-backed securities and was equally exposed to the subprime mortgage market. Lehman was a major player in the securitization and credit derivatives markets and it “actively sought to arbitrage the securitization and credit derivatives markets by investing in securitizations and subsequently divesting itself of the associated risk by means of CDS of CDO transactions.” The collapse of the housing market in 2007 significantly impacted Lehman’s multi-billion dollar portfolio of mortgage-related securities, and as its losses intensified, Lehman’s credit ratings began to sink leading to demands for the firm to post additional collateral, which it was unable to do, thus leading it to file for bankruptcy on September 15, 2008. Lehman’s bankruptcy created an environment of distrust, and

114. Id.
115. Id.
116. Id.
118. Okamoto, supra note 103, at 197.
119. Id.
121. Okamoto, supra note 103, at 197-98.
122. See Robbe, supra note 117, at 22. But, investigation has revealed that it was not CDS that led to the firm’s failure. Lehman’s bankruptcy examiner’s report states that the firm failed because of the poor business decisions of its management. In fact, Lehman’s derivative trades, which accounted for only 3.3% of its net assets, were more carefully monitored than other asset classes. See Anton R. Valukas, In re Lehman Bros. Holdings, Examiner’s Report 16-17 & 568-578, available at http://lehmanreport.jenner.com (last visited Apr. 15, 2010).
financial institutions that had open trading positions with Lehman became wary of lending to each other, fearing that open positions against Lehman might implicate the creditworthiness of their counterparties, leading to a credit freeze in the financial markets.124

Only two days after Lehman declared bankruptcy, the Federal Reserve bailed out the American International Group, Inc. (AIG), with an $85 billion revolving two-year credit facility from the Federal Reserve Bank of New York.125 Although AIG was an insurance company rather than an investment bank, it was heavily exposed in the credit derivatives market—it sold massive amount of CDSs through its Financial Products Group, headquartered in London, without having the financial resources necessary to cover potential payments.126 AIG “wrote about $1.8 trillion worth of credit default swaps guaranteeing payment if certain mortgage-backed securities defaulted or experienced other ‘credit events.’ ”127 Of this, $61.4 billion was written on CDOs with exposure to subprime mortgages.128 The collapse of the subprime housing market impacted the value of the CDOs that the company wrote CDSs on and AIG was forced to write-down massive losses in its CDS portfolio: $11.2 billion in 2007, and $19.9 billion for the first nine months of 2008.129 Additionally, AIG’s credit-rating downgrade required the firm to post $14.5 billion in collateral.130 Although AIG had assets to take care of the additional collateral requirement, there was not enough time for it to satisfy those demands promptly.131 There was a danger that the insurance giant would collapse, and with it, potentially all the banks that had purchased protection from it. Because OTC contracts are customized contracts with limited transparency in their markets, it was unclear which banks were exposed to AIG’s insolvency, and to what degree.132 This uncertainty caused the credit markets to freeze at the peak of the crisis, thereby forcing the government to step in to control the situation and bring stability to the markets—primarily though bailouts, of which AIG received a substantial amount to pay its counterparties.133

124. See Rosnati, supra note 117, at 22.
126. Okamoto, supra note 103, at 200.
127. Miller, supra note 65, at 4.
129. Id.
130. Karnitschnig et al., supra note 125.
131. Id.
132. Miller, supra note 65, at 4.
133. Karnitschnig et al., supra note 125.
The set-back to the economy because of these incidents generated increased concern about the state of the OTC markets. It was strongly felt that limited transparency of these markets and transactions therein let them grow to such enormity unchecked, which ultimately resulted in causing serious damage to the U.S. financial system. Additionally, the interconnectedness of the financial institutions only aggravated the matter further as the risk of CDS and other OTC derivatives remained concentrated among a handful of such institutions. The old debates concerning the regulation of OTC derivatives took the forefront and with great vigor this time around. Finally, after two years of contentious legislative process, the Dodd-Frank Act was signed into law on July 21, 2010.

IV. KEY PROVISIONS OF TITLE VII OF THE DODD-FRANK ACT

Title VII of the Dodd-Frank Act, the “Wall Street Transparency and Accountability Act,” essentially alters the trading of swaps and other OTC derivatives in the United States with its repeal of the exemptions that OTC derivatives enjoyed under the provisions of the CFMA and by subjecting the OTC derivatives market to an extensive regulatory framework. Unless otherwise provided, the provisions of Title VII become effective on the later of (1) July 16, 2011, which is 360 days from the enactment date of the Dodd-Frank Act, and (2) in case of provisions of the Act that require a rulemaking, sixty days after the publication of such rule or regulation implementing that provision. Under the new regime, derivatives market, its participants, and trading activity will be subject to comprehensive regulation and supervision. The Act provides the CFTC and SEC with the authority to regulate swaps, their dealers, and markets while maintaining the jurisdictional separation between the two agencies reached under the Shad-Johnson Accord. Whereas the CFTC will have substantial regulatory authority over swaps, swap dealers, and major swap participants, the SEC will have the same authority over security-based swaps, security-based swap dealers, and major security-based swap participants. It is noteworthy though that according to recent estimates, the majority of outstanding OTC derivatives will fall

134. Duffle, supra note 95, at 11.
139. Id.
140. Id. at 1-2
under the jurisdiction of the CFTC. The CFTC, once described as a “sleepy little agency” by its then-chairwoman Mary Schapiro, post-Dodd-Frank Act, is the top cop for the U.S. derivatives market. The Act further requires the aforementioned two agencies to issue in joint rules with respect to a small number of definitions for the implementation of the legislation. In doing so, they are required to consult with each other and with federal banking regulators of banking institutions engaged in swap activities. Hence, it is critical that the regulators cooperate with each other for the successful completion of the extensive rulemakings.

The objective of the new legislation is to bring about transparency and efficiency in the market, promote competition, reduce the potential for counterparty and systemic risk, and also tackle the issue of interconnection in the financial markets. This objective will be achieved by having a regulatory system that requires: (1) all swaps, subject to limited exceptions, be centrally cleared and traded on exchanges or comparable trading facilities; (2) swap dealers and major market participants be subjected to capital and margin requirements, and heightened business conduct requirements; and (3) public reporting of transaction and pricing data on both cleared and un-cleared swaps. In this article, the focus is to discuss the key provisions of Title VII and analyze their impact on dealers and end users of swaps.

A. Regulation of Markets and Market Participants

1. Registration of Swap dealers and Major Swap Participants

The Act requires swap dealers, including security-based swap dealers, and major swap participants, including major security-based swap participants, to register with the CFTC or SEC, depending on if their business involves swaps or security-based swaps, not later than one year after the enactment date, i.e. July 16, 2011. Upon registration, these swap dealers and MSPs will be subject to additional scrutiny and regulation—they will submit reports of their trading activity, terms and conditions of their swaps, and their financial integrity protection to the CFTC or SEC, as applicable. An entity can be designated a swap dealer (or security-based swap dealer) or a major swap participant (or major security-based

143. Dodd-Frank Act § 712(d).
144. Id.
145. See generally Dodd-Frank Act.
146. Dodd-Frank Act § 731 (to be codified at 7 U.S.C. 4s(b)(5)).
147. § 731 (to be codified at 7 U.S.C. 4s(j)).
swap participant) for a single type, class, or category of swap (security-based swap) or for multiple classes of swaps.\textsuperscript{148} The Act grants authority to the Commission to determine the form and manner of the registration process for swap dealers and major swap participants.\textsuperscript{149} The terms “swap dealer”\textsuperscript{150} and “security-based swap dealer”\textsuperscript{151} are similarly defined and refer to a dealer in swaps or security-based swaps respectively. The only difference between the two definitions is substitution of “security-based swap” in place of “swap.” In this article, the term “swap dealer” is used to refer to both. A swap dealer is defined as any person who:

(i) holds itself out as a dealer in swaps; (ii) makes a market in swaps; (iii) regularly enters into swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing the person to be commonly known in the trade as a dealer or market maker in swaps.\textsuperscript{152}

Under this definition banks, dealers, and other financial institutions that are active in derivatives markets will be considered “swap dealers” unless (a) an insured depository institution “offers to enter into a swap with a customer in connection with originating a loan with that customer;”\textsuperscript{153} (b) an entity buys or sells swaps “for such person’s own account, either individually or in a fiduciary capacity;”\textsuperscript{154} and not as “part of a regular business;”\textsuperscript{155} and (c) “an entity that engages in a ‘de minimis quantity’\textsuperscript{156} of swap dealing in connection with transactions with or on behalf of its customers.”\textsuperscript{157} Like swap dealers, major swap participants will also be subjected to extensive supervision and scrutiny.\textsuperscript{158} The terms “Major Swap Participant”\textsuperscript{159} and “Major Security-Based Swap Participant”\textsuperscript{160} are also similarly defined and refer to a participant in swaps or security-based swaps respectively. Again, the difference between the two terms is substitution of “security-based swap” in place of “swap.” For the purpose of this article, the term “MSP” will be used to refer to both. A MSP is any entity that is not a swap dealer and that fulfills any one of the following criteria:

It “maintains a ‘substantial position’ in swaps for any of the major swap categories as determined by” the CFTC or SEC, excluding “po-

\begin{itemize}
  \item \textsuperscript{148} § 721(to be codified at 7 U.S.C. 1a), 761(to be codified at 15 U.S.C. 78c(a)(71)).
  \item \textsuperscript{149} § 731 (to be codified at 7 U.S.C. 4a(b)).
  \item \textsuperscript{150} § 721(to be codified at 7 U.S.C. 1a).
  \item \textsuperscript{151} § 761 (to be codified at 15 U.S.C. 78c(a)(71)).
  \item \textsuperscript{152} § 721 (to be codified at 7 U.S.C. 1a(49)(A)).
  \item \textsuperscript{153} Id. No such exception for depository institutions from the definition of “security-based swap dealer.” § 761 (to be codified at 15 U.S.C. 78c(a)(71)).
  \item \textsuperscript{154} § 721 (to be codified at 7 U.S.C. 1a(49)(C)).
  \item \textsuperscript{155} Id. (to be codified at 7 U.S.C. 1a(49)(C)) (referencing end users).
  \item \textsuperscript{156} What constitutes “de minimis quantity,” will be determined through the CFTC and SEC rulemaking process.
  \item \textsuperscript{157} Dodd-Frank Act §721 (to be codified at 7 U.S.C. 1a(49)(C)).
  \item \textsuperscript{158} Id. (to be codified at 7 U.S.C. 1a(33))
  \item \textsuperscript{159} Id.
  \item \textsuperscript{160} § 761 (to be codified at 15 U.S.C. 78c(a)).
\end{itemize}
sitions held for hedging or mitigating commercial risk” and positions held by employee benefit plans for hedging or mitigating its risks.\footnote{161} Its “outstanding swaps create ‘substantial counterparty exposure’ that could have serious adverse effects on the financial stability of the United States banking system or financial market”\footnote{162}; or It “is a financial entity that is highly leveraged relative to the amount of capital it holds and that is not subject to capital requirements established by an appropriate Federal banking agency,” and it “maintains a substantial position in outstanding swap” transactions in CFTC or SEC determined major swap categories.\footnote{163}

The definition of MSP excludes from its purview finance subsidiaries, \textit{i.e.} entities “whose primary business is providing financing, and uses derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures.”\footnote{164} These finance subsidiaries facilitate the purchase or lease of products which are manufactured by the parent company or another subsidiary of the parent company. It is worth noting that the definition of MSP is critical for the end user exemption extended to the corporate users of derivatives under the provisions of the Act. If an entity does not fall within the criteria specified for a MSP and is not a swap dealer, it can avail the benefits of the end users exemption—in which case the entity will not be subject to clearing requirements as long as the entity engages in OTC derivatives to hedge commercial risk of its business.\footnote{165}

2. \textit{Capital and Margin Requirements}

Swap dealers and major swap participants, pursuant to registration, will be required to satisfy minimum capital requirements, and with respect to uncleared swaps, margin requirements (initial and variation).\footnote{166} The capital and margin requirements will be determined by the CFTC or SEC for nonbank swap dealers and nonbank major swap participants.\footnote{167} For banks that are swap dealers, the appropriate federal banking regulator, in consultation with the Commissions, will establish these requirements, not later than one year after the enactment date.\footnote{168} With respect to cleared swaps, the requirements of DCO or the clearing agency, as applicable, will apply.\footnote{169} In determining the capital and margin requirements for uncleared swaps, the regulatory bodies must take into account the risks as-

\footnotesize
161. § 721 (to be codified at 7 U.S.C. 1a(33)(A)(i)). Under the requirements of the Act, the CFTC or SEC will define the term “substantial position,” which shall be at a level prudent for monitoring of such entities that are systemically important. \textit{Id.}
162. \textit{Id.} (to be codified at 7 U.S.C. 1a(33)(A)(ii)). The term “substantial counterparty exposure” will be addressed in the rulemaking process by the CFTC and SEC.
163. Dodd-Frank Act § 721 (to be codified at 7 U.S.C. 1a(33)(A)(iii)).
164. \textit{Id.} (to be codified at 7 U.S.C. 1a(33)(D)).
165. \textit{Id.}
166. § 731 (to be codified at 7 U.S.C. 4s(c)), 764 (to be codified at 15 U.S.C. 78a).
167. \textit{Id.} (to be codified at 7 U.S.C. 4s(e)).
168. \textit{Id.}
169. \textit{Id.}
associated with all swaps and other activities of the swap dealer or MSP, and not just the risks related to the types, classes, or categories of swaps that made such entity eligible to qualify as a swap dealer or MSP.\textsuperscript{170} The prudential regulator and the Commissions also have the authority to allow the use of noncash collateral to meet margin requirements as long as it is consistent with the financial integrity of the swap markets and preserving the integrity of the U.S. financial system.\textsuperscript{171} At this point, it will not be unreasonable to assume that the capital and margin requirements for uncleared swaps will be significantly higher than the requirements imposed in connection with cleared swaps. The intent of the legislation is to “offset the greater risk to the swap dealer or major swap participant and the financial system arising from the use of swaps that are not cleared,” and that the requirements shall “(i) help ensure the safety and soundness of the swap dealer or major swap participant; and (ii) be appropriate for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant.”\textsuperscript{172} It is worth highlighting that the higher capital and margin requirements for uncleared swaps will translate into higher cost of transaction for counterparties. The increased costs along with low liquidity for uncleared swaps might deter business entities from entering into customized bilateral transactions. Further, despite Congress’s intention to exclude end users from the margin requirement, there is no express exemption for end users under the Act similar to the exemption from the clearing requirement for such end users. Unless there is clarity on the issue of exemption from margin for existing swaps or end user swaps, the situation will remain unclear.\textsuperscript{173}

3. Recordkeeping and Business Conduct Requirements

The Act mandates that swap dealers and major swap participants provide reports to the CFTC or SEC, as applicable, regarding the transactions they enter into, the positions they take, and their overall financial

\textsuperscript{170} Id.
\textsuperscript{171} Id.
\textsuperscript{172} Id.; see also § 764 (to be codified at 15 U.S.C. 78a).
\textsuperscript{173} There is no provision in the Act authorizing regulators to retroactively impose margin and capital requirements to existing swaps. But, while addressing mandatory central clearing of swaps, the Act provides that a financing affiliate, subsidiary or a wholly-owned entity of a person that qualifies for the non-financial entity exemption to the mandatory clearing requirement, will be exempt from margin requirements for the first two years after the date of enactment of the Act. Senators Dodd and Lincoln wrote a letter, dated June 30, 2010, to Representatives Frank and Peterson to offer clarification on this issue. The letter states in clear terms that the legislation “does not authorize the regulators to impose margin on end users.” Further, the letter also states that the Congressional intent is to provide certainty to existing contracts and avoid any disruptions to them “for the sake of the economy and the financial system.” Letter from Chairman Christopher Dodd, Senate Comm. on Banking, Hous., & Urban Affairs and Chairman Blanche Lincoln, Senate Comm. on Agric., Nutrition, & Forestry, to Chairman Barney Frank, House Fin. Services Comm. and Chairman Colin Peterson, House Comm. on Agric. (June 30, 2010), available at http://www.schiffhardin.com/PDFs/dodd-lincoln-letter070110.pdf [hereinafter Dodd-Lincoln Letter].
condition.\textsuperscript{174} Under the provisions of the Act, swap dealers and major
swap participants will maintain daily trading records along with “rec-
corded communications,” including e-mails, instant messages, and rec-
corded telephone calls per the requirements of the Commissions.\textsuperscript{175} They
will also be required to maintain books and records of all their swap ac-
tivities in the form and manner that the Commissions prescribe.\textsuperscript{176} Swap
dealers will further be required to “maintain a complete audit trail for
conducting comprehensive and accurate trade reconstructions.”\textsuperscript{177}

Under the new regime, swap dealers and major swap participants will
be subjected to “business conduct” rules adopted by the Commissions.\textsuperscript{178}
The Commissions will establish duties for swap dealers and major swap
participants to verify their counterparties’ status as eligible contract par-
ticipants, to disclose material risks and characteristics of transactions, to
disclose any “material incentives or conflicts of interest” they may have
with respect to a transaction, and to communicate with their counterpar-
ties “in a fair and balanced manner based on principles of fair dealing and
good faith.”\textsuperscript{179} Furthermore, the Commissions have broad authority to
enact additional rules relating to fraud prevention and to curtail other
manipulative and abusive practices that have the potential to impact
adversely.\textsuperscript{180}

4. \textit{Duties with Respect to Special Entities}

Swap dealers and major swap participants will be required to take extra
care when dealing with “special entities,” which include: a Federal
agency; a State, State agency, city, county, municipality, or other political
subdivision of a State; an employee benefit plan; any governmental plan;
or an endowment.\textsuperscript{181} As an advisor to such a special entity, swap dealers
and MSPs are prohibited from employing any device or scheme to de-
clude a special entity or engaging in any transaction or course of business
that is basically fraudulent, deceptive or manipulative, or operates as a
fraud or deceit on any special entity.\textsuperscript{182} A swap dealer or MSP also has
“a duty to act in the best interests of the Special Entity”\textsuperscript{183} and make
reasonable efforts to obtain information that is helpful in determining
that a recommended swap is in the best interest of the special entity.\textsuperscript{184}

As a counterparty to a special entity in a swap transaction, a swap
dealer or a major participant must have a reasonable basis to believe that
the special entity has an independent representative that (i) will act in the

\textsuperscript{174} Dodd-Frank Act § 731 (to be codified at 7 U.S.C. 4s(f)(1)(A)).
\textsuperscript{175} Id. (to be codified at 7 U.S.C. 4s(g)(1)).
\textsuperscript{176} Id. (to be codified at 7 U.S.C. 4s(f)(1)(B)).
\textsuperscript{177} Id. (to be codified at 7 U.S.C. 4s(g)(4)).
\textsuperscript{178} Id. (to be codified at 7 U.S.C. 4s(h)(1)).
\textsuperscript{179} Id. (to be codified at 7 U.S.C. 4s(h)(3)(A)–(C)).
\textsuperscript{180} § 763(g) (to be codified at 15 U.S.C. 78i(j)).
\textsuperscript{181} § 731 (to be codified at 7 U.S.C. 4s(h)(2)).
\textsuperscript{182} Id. (to be codified at 7 U.S.C. 4s(h)(4)(A)).
\textsuperscript{183} Id. (to be codified at 7 U.S.C. 4s(h)(4)(B)).
\textsuperscript{184} Id. (to be codified at 7 U.S.C. 4s(h)(4)(C)).
best interest of the entity; (ii) has no connection with the swap dealer or major swap participant; (iii) is knowledgeable to evaluate the risks involved in the transaction and provide written representations to the special entity regarding fair pricing and the appropriateness of the transaction; and (iv) in the case of employee benefit plans, is a fiduciary. Before entering into a swap transaction with a special entity, a swap dealer or a MSP must also provide written disclosure to the special entity of the capacity in which they are acting. It is important to note that these heightened requirements do not apply to transactions initiated by a special entity and executed on an exchange or swap execution facility where the identity of a counterparty is not known.

B. Central Clearing, Trading, and Reporting

1. Central Clearing

OTC derivatives contracts are privately negotiated bilateral contracts. Because these contracts are not traded on organized exchanges with central clearinghouses, the credit risk in these contracts is borne by the individual counterparties. To eliminate the credit risk, the Act mandates central clearing for derivatives that can be cleared. The use of central counterparties (CCPs) in OTC derivatives markets will help mitigate counterparty risk—the risk associated with the failure of a party to fulfill its obligations to the other in a bilateral transaction. A CCP is an independent legal entity that interposes itself between the buyer and the seller of a derivative security. The presence of this third party in the bilateral OTC derivatives contracts “ensure[s] that every buyer has a guaranteed seller and every seller has a guaranteed buyer, thus minimizing the risk that one counterparty’s default will cause a systemic ripple through the markets.”

The Act requires that all swaps be subject to mandatory clearing provided the CFTC or the SEC has determined that they are cleared and they are acceptable for clearing to a “derivatives clearing organization” (DCO) (in the case of a swap) or a clearing agency (in the case of a security-based swap). A DCO or clearing agency must submit to the CFTC or SEC, as applicable, for their approval any group, category, type, or class of swaps that it intends to clear, and provide notice of the submis-

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185. Id. (to be codified at 7 U.S.C. 4s(h)(5)(A)(i)(I), (III)-(IV), (VII)).
186. Id. (to be codified at 7 U.S.C. 4s(h)(5)(A)(ii)).
187. Id.
189. Dodd-Frank Act § 723(a)(3) (to be codified at 7 U.S.C. 2 (h)).
190. See Cecchetti et al., supra note 188, at 45.
191. Id.
193. Dodd-Frank Act § 723(a)(3) (to be codified at 7 U.S.C. 2(h)(1)(A)).
sion to its members. It is the responsibility of the CFTC or SEC, as applicable, to make the submissions available to the public, make its determination as to whether clearing is required for the derivative, and provide at least a thirty day public comment period regarding its determination. The CFTC or SEC has ninety days from the day of receipt of submission to make a determination. In addition to the submissions made by clearing organizations, the CFTC or SEC may itself initiate review of any group, category, type or class of swap to determine whether mandatory clearing should apply. In determining which swaps need to be cleared, the regulators should consider the following factors: (i) existence of notional exposures, trading liquidity and pricing data; (ii) the availability of operational expertise and relevant infrastructure for clearing; (iii) the effect on mitigation of systemic risk and on competition; and (iv) the existence of reasonable legal certainty in the treatment of customer and swap counterparty positions, funds and property in the event of insolvency of the clearinghouse.

Clearinghouses do not have their own funds to deal with the defaults of their participants and absorb losses resulting from them. Instead, they depend on a system of margin or collateral. Traders are required to deposit an initial margin payment with the clearinghouse before the trade.

194. Id. (to be codified at 7 U.S.C. 2(h)(2)(B)(i)). The Act requires clearing organizations to register with the CFTC in order to clear swaps and with the SEC in order to clear security-based swaps. To be able to register or maintain its registration with the applicable agency, a DCO must meet an extensive set of criteria, with the most important criteria being: (1) each DCO must have adequate financial, operational and managerial resources, as determined by the CFTC or SEC, respectively; (2) each DCO must possess financial resources that, at a minimum, exceed the total amount that would (a) enable the DCO to meet its financial obligations to its members and participants, notwithstanding a default by the member or participant creating the largest financial exposure for the DCO in “extreme but plausible market conditions;” and (b) enable the DCO to cover the costs of the DCO for a one-year period; (3) each DCO must establish and implement procedures to verify the compliance of each participation and membership requirement of the DCO on an ongoing basis; (4) each DCO must (a) not less than once during each business day, measure the credit exposures of the DCO to each member and participant of the DCO, and (b) monitor each such exposure periodically during the business day of the DCO; (5) each DCO, through margin requirements and other risk control measures, must limit its exposure to potential losses from default by its members and participants; (6) each DCO must have rules and procedures designed to allow for the efficient, fair, and safe management of events in the event of a member or participant’s insolvency or default on their obligations to the DCO. Id. § 725 (to be codified at 7 U.S.C. 7a-1(c)(2)).

195. § 723(a)(3) (to be codified at 7 U.S.C. 2(h)(2)). The Commissions are required to establish, within one year of enactment, rules for the submission and review of derivatives accepted by clearinghouses for clearing. Id. (to be codified at 7 U.S.C. 2(h)(2)(E)).

196. Id. (to be codified at 7 U.S.C. 2(h)(2)(C)). The ninety-day review period may be extended up to ninety days or longer by the reviewing agency on application of counterparty or on its own initiative. Id.

197. Id. (to be codified at 7 U.S.C. 2(h)(2)(A)(i)).

198. Id. (to be codified at 7 U.S.C. 2(h)(2)(D(i)).

199. See Miller, supra note 65, at 2.

200. See id.
to cover any future potential losses.201 “Then at the end of each trading
day, all contracts are repriced, or “marked to market,” and all those who
have lost money (because prices moved against them) must respond to
the margin call and post additional margin (called variation or mainte-
nance margin) to cover those losses before the next trading session.”202
Under the provisions of the Act, swap counterparties of cleared transac-
tions that are not cleared by a registered DCO will be required to post
initial and variation margins.203 Posting margins would result into re-
duced liquidity and potential increased costs for the counterparties—ac-
cording to the International Monetary Fund’s (IMF) report, upfront costs
to dealers from posting of the initial margin and contributions to CCPs’
guarantee fund would be up to $150 billion.204 Further, dealers will not
be able to re-use (by lending, pledging, investing, or rehypothecating) the
funds and securities posted as collateral at the CCP and will suffer a loss
on the potential interest income.205 Though margins are not required
from end users, there is a possibility that end users might get impacted
indirectly from increased costs resulting from posting of margins if those
costs are passed through to them from the dealers.206 The increased costs
of transactions might deter counterparties from entering into derivatives
transactions, but the good news is that the industry recognizes the value
of clearinghouses as a means of reducing risk and has already cleared
over $200 trillion of interest rate swaps despite these costs.207 As clear-
inghouses further develop their ability to clear a variety of products with
more firms and make OTC derivatives markets safe for trading, they will
be able to attract more dealers to clear their trades through them, even
with all costs attached as the benefits of clearing outweigh these costs.

Additionally, the changed scenario will see market participants as
members of several DCOs or clearing agencies. It is not clear, though, if
their membership of multiple DCOs and/or clearing agencies would allow
them to enjoy the advantages of netting and margin posted, not just
across products, but also across clearing platforms.208 While there is no
express prohibition on clearing organizations to provide such a benefit to
the members, under the provisions of the Act, the clearing organizations
cannot be compelled to accept the counterparty credit risk of another
clearing organization if there is risk to its financial integrity.209

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201. Id.
202. Id.
203. Dodd-Frank Act § 731(a)(3) (to be codified at 7 U.S.C. 4s(e)(2)(B)(ii)).
204. INT’L MONETARY FUND, GLOBAL FINANCIAL STABILITY REPORT: MEETING NEW
CHALLENGES TO STABILITY AND BUILDING A SAFER SYSTEM 101 (2010), available
205. Id.
206. As noted above, the issue of exemption from margin for end users requires clarifi-
cation as the Act does not expressly exempt end users from such requirement.
207. Letter from Conrad Voldstad, CEO, Int’l Swaps & Derivatives Ass’n, to Interna-
209. Id. (to be codified at 7 U.S.C. 2(b)(4)(C)).
Commercial End User Exemption to Clearing: Corporations use derivatives for hedging or mitigating business risks, but under the new law such end users of derivatives have been exempted from the mandatory clearing requirement.\textsuperscript{210} Consequently, end users will also enjoy exemption from exchange trading and possibly margin requirements. Under the provisions of the Act, there is an optional exemption from the clearing requirement to a swap counterparty that (i) is not a “financial entity,” (ii) is using the swap to hedge or mitigate commercial risk, and (iii) notifies the CFTC or SEC, as applicable, how it generally meets its financial obligations associated with entering into uncleared swaps.\textsuperscript{211} An exempted counterparty has the option to clear swap contracts with a clearinghouse if such counterparty chooses to do so; the counterparty also can choose the clearinghouse it wishes to use for the purpose.\textsuperscript{212} For the purposes of this exemption, it is important to understand what the term “financial entity” stands for because the exemption has been granted to counterparties that are not “financial entities.” The Act defines a “financial entity” as a swap dealer or a major swap participant as defined in the Act, a commodity pool as defined in the CEA, a private fund as defined in section 202(a) of the Investment Advisers Act of 1940, an employee benefit plan as defined under ERISA, or a person predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature.\textsuperscript{213} This exemption is strictly for corporate end users engaged in hedging transactions and will not be extended to entities like hedge funds, irrespective of their status as major swap participants or not.\textsuperscript{214} But the definition expressly excludes certain captive finance companies whose primary business is providing financing, and which use derivatives for the purpose of hedging underlying commercial risks related to interest rate and foreign currency exposures, ninety percent or more of which arise from financing that facilitates the purchase or lease of products, ninety percent or more of which are manufactured by the parent company or another subsidiary of the parent company.\textsuperscript{215} In plain language, captive finance companies, i.e. those affiliate companies that are wholly owned by a parent company and whose primary business is to provide financing for customers purchasing or leasing the parent company’s products – will be exempt from clearing requirements for swaps entered to mitigate risk related to interest rate and foreign exposures. Further, the Act leaves it to the discretion of the CFTC and SEC to exempt small banks, savings associations, farm credit system institutions, and credit unions with total assets not exceeding $10 billion from the definition of a “financial entity”.\textsuperscript{216} Whether these institutions will be ex-

\textsuperscript{210} Id. (to be codified at 7 U.S.C. 2(h)(7)(A)).
\textsuperscript{211} Id.
\textsuperscript{212} Id. (to be codified at 7 U.S.C. 2(h)(7)(B)).
\textsuperscript{213} Id. (to be codified at 7 U.S.C. 2(h)(7)(C)).
\textsuperscript{214} Id.
\textsuperscript{215} Id.
\textsuperscript{216} Id.
cluded or not from the definition will become clear only after the completion of the rulemaking process of the Commissions.

Effect on Existing Trades: Swaps entered into before the date of the enactment of the Act are exempt from the clearing requirements as long as they are reported to a swap data repository or to the Commissions no later than 180 days of such date.217 Additionally, swaps entered into before the clearing mandate is effective are exempt if reported to a swap repository or the Commissions within ninety days after the Effective date or at such other time as the applicable Commission may prescribe.218

2. Trading

OTC derivatives are not exchange-traded, however, to improve transparency, promote efficiency, and reduce systemic risk in the OTC derivatives market, the Act requires all cleared swaps to be traded on a designated contract market,219 or a registered swap execution facility (in the case of a swap), or a national securities exchange, or a security-based swap execution facility (in the case of a security-based swap).220 A “swap execution facility” is a facility “in which multiple participants have the ability to execute or trade swaps by accepting bids and offers” made by other participants in the facility, through any means of interstate commerce.221 The trading requirement of the Act will not apply in the case of uncleared swaps of counterparties opting to exercise the commercial end user exemption for clearing.222 Exchange trading will bring price transparency to OTC derivatives trading, as the prices of the trades will be published, and will become easily accessible to the public.223 Exchanges have improved the functioning of the existing securities and futures markets by producing better price information and a more liquid market, and, hopefully, will be able to do the same for OTC markets.224

3. Reporting and Publication of Transaction Data

In order to improve market transparency and provide regulators tools for monitoring derivatives trading activity, the new regulatory regime requires collection and publication of data through clearinghouses or swap repositories.225 Swaps not accepted for clearing by a clearing organiza-

217. Id. (to be codified at 7 U.S.C. 2(h)(5)).
218. Id.
219. A swap contract with a party that is not an “eligible contract participant” must be entered into on a designated contract market. An “eligible contract participant” includes, subject to limitations, financial institutions, insurance companies, investment companies, commodity pools, employee benefit plans, government entities, brokers, dealers, high net worth individuals, and others. 7 U.S.C. § 1a (2011).
220. Dodd-Frank Act § 723(a)(3) (to be codified at 7 U.S.C. 2(h)(7)(A)).
221. § 723(a)(21) (to be codified at 7 U.S.C. 1a).
222. § 723(a)(3) (to be codified at 7 U.S.C. 2(h)(7)(A)).
224. Id.
225. Dodd-Frank Act § 727 (to be codified at 7 U.S.C. 2(a)(13)).
tion must be reported to a registered swap repository or a “registered securities-based swap repository,” as applicable.\textsuperscript{226} In case a swap repository does not accept the report or there is no swap repository to report to, the data should be reported to the CFTC or SEC.\textsuperscript{227} The Act defines a “swap data repository” as “any person that collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps.”\textsuperscript{228} Swap data repositories are required to register with the CFTC or SEC.\textsuperscript{229} They are also required to make available on a confidential basis all data obtained by such repositories to (a) each appropriate prudential regulator; (b) the Financial Stability Oversight Council; (c) the SEC; (d) the Department of Justice; and (e) any other person that the CFTC or SEC determines to be appropriate, including foreign financial supervisors, central banks, and ministries.\textsuperscript{230} The swap data repositories shall also “establish and maintain emergency procedures, backup facilities, and a plan for disaster recovery that allows for the timely recovery and resumption of operations and the fulfillment of the responsibilities and obligations of the organization.”\textsuperscript{231}

The responsibility for reporting uncleared swaps, for the most part, lies with swap intermediaries and not end users.\textsuperscript{232} For example, if one of the parties to the contract is a swap dealer or a major swap participant, the responsibility lies with the swap participant or major swap participant.\textsuperscript{233} In a contract between a swap dealer and a major swap participant, the swap dealer has the responsibility to report.\textsuperscript{234} But, where neither party is a swap dealer or a major swap participant, or where both parties are either swap dealers or major swap participants, then it is the responsibility of the counterparties to decide which party will report.\textsuperscript{235} The Act leaves it to the discretion of the CFTC or SEC to promulgate rules concerning the timing and content of the reports.\textsuperscript{236} Further, the Act mandates that the CFTC or SEC promulgate rules and regulation for the “real-time public reporting” of swap transaction and pricing data to enhance price discovery.\textsuperscript{237} “Real-time public reporting” is defined as public dissemination of data, including price and volume, “as soon as technologically practicable after the time at which swap transaction has been executed.”\textsuperscript{238}

\begin{itemize}
  \item \textsuperscript{226} Id. (to be codified at 7 U.S.C. 2(a)(13)(C)).
  \item \textsuperscript{227} § 729 (to be codified at 7 U.S.C. 60-1(4r)(a)(1)(B)).
  \item \textsuperscript{228} § 721(a)(21) (to be codified at 7 U.S.C. 1a).
  \item \textsuperscript{229} § 728 (to be codified at 7 U.S.C. 24(21)(g)).
  \item \textsuperscript{230} Id. (to be codified at 7 U.S.C. 24(21)(c)(7)).
  \item \textsuperscript{231} Id. (to be codified at 7 U.S.C. 24(21)(c)(8)).
  \item \textsuperscript{232} Dodd-Frank Act § 729 (to be codified at 7 U.S.C. 60-1(4r)(a)(3)).
  \item \textsuperscript{233} Id.
  \item \textsuperscript{234} Id.
  \item \textsuperscript{235} Id.
  \item \textsuperscript{236} Id. (to be codified at 7 U.S.C. 60-1(4r)(a)(1)(B)).
  \item \textsuperscript{237} § 727 (to be codified at 7 U.S.C. 2(a)(13)(E)).
  \item \textsuperscript{238} Id. (to be codified at 7 U.S.C. 2(a)(13)(A)).
\end{itemize}
are subject to the mandatory clearing requirement, including those that
are exempt from the clearing requirement pursuant to end users exemption,
and swaps that are not subject to mandatory clearing, but are ac-
cepted by a registered DCO or clearing agency.\textsuperscript{239} For transactions that
are not cleared but are reported to a swap data repository or the Com-
misions, as applicable, the Act requires the CFTC or SEC to promulgate
rules that ensure the details of the business transactions or market posi-
tions of any person are not disclosed and the parties are not identified.\textsuperscript{240}
The concern that real-time price reporting of trades will come in the way
of execution of block trades has been addressed under the Act and the
Commissions have been authorized to specify criteria for determining
what constitutes a block trade for particular markets in order to institute
appropriate time delays of the reporting of such transactions.\textsuperscript{241} In
promulgating these rules and regulations, the CFTC or SEC is required
to take into account whether public disclosure would materially reduce
market liquidity.\textsuperscript{242} Finally, the CFTC or SEC will issue semiannual or
annual reports on the trading and clearing of major swap categories and
the market participants and development of new products.\textsuperscript{243}

C. The Swaps Push-Out Rule\textsuperscript{244}

The controversial “push-out” provision, originally proposed by Senator
Blanche Lincoln to the Senate Agriculture Committee, was modified and
a substantially moderated version of the provision is included in the
Act.\textsuperscript{245} Under § 716 of the Act, commonly known as “swaps push-out
rule”, no federal assistance will be provided to registered swap dealers
and major swap participants “with respect to any swap, security-based
swap, or other activity of the swaps entity.”\textsuperscript{246} The Act defines “Federal
assistance” as:

the use of any advances from any Federal Reserve credit facility or
discount window that is not part of a program or facility with broad-
based eligibility under section 13(3)(A) of the Federal Reserve Act,
Federal Deposit Insurance Corporation insurance or guarantees for
the purpose of:

(A) Making any loan to, or purchasing any stock, equity interest,
or debt obligation of, any swaps entity;

\begin{itemize}
\item \textsuperscript{239} Id. (to be codified at 7 U.S.C. 2(a)(13)(C)).
\item \textsuperscript{240} Id. (to be codified at 7 U.S.C. 2(a)(13)(E)).
\item \textsuperscript{241} Id.
\item \textsuperscript{242} Id.
\item \textsuperscript{243} Id. (to be codified at 7 U.S.C. 2(a)(14)(A)).
\item \textsuperscript{244} § 716.
\item \textsuperscript{245} See generally Matthew Leising, New Democrats Seek Swaps Trading Change, Op-
nessweek.com/news/2010-06-16/new-democrats-seek-swaps-trading-change-
oppose-lincoln-plan.html; Phil Mattingly, House Democrats Target Senator Lin-
www.businessweek.com/news/2010-05-25/house-democrats-target-senator-lincoln-s-
waps-desk-proposal.html.
\item \textsuperscript{246} Dodd-Frank Act § 716(a).\
\end{itemize}
(B) Purchasing the assets of any swaps entity;
(C) Guaranteeing any loan or debt issuance of any swaps entity; or entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity; or
(D) Entering into any assistance arrangement (including tax breaks), loss sharing, or profit sharing with any swaps entity.247

Furthermore, a “swap entity” for the purposes of federal assistance prohibition includes any swap dealer, security-based swap dealer, major swap participant or major-security-based swap participant registered with the CFTC or SEC, except insured depository institutions that are major swap participants.248 An insured depository institution acting as swap dealers, though, will be considered a “swap entity” under the provisions of the Act. These insured depository institutions acting as swap dealers are exempted from the prohibition on federal assistance under the Push-Out Rule, as long as they engage in the following expressly permitted swap activities:

(1) Hedging and other similar risk mitigating activities directly related to the insured depository institution’s activities;
(2) Acting as a swaps entity for swaps or security-based swaps involving rates or reference assets that are permissible for investment by a national bank under the paragraph designated as “Seventh” of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), other than as described in paragraph (3)249 and acting as a swaps entity for credit default swaps that are cleared by a derivatives clearing organization or a clearing agency.250

Hence, these depository institutions would be required to limit their swap activities to only those that are specifically permitted under the Act and push out all other kinds of swaps that are based on reference assets, not permissible for investment by national banks, such as most commodities and equity securities, as well as uncleared CDS, unless they enter into these transactions for hedging purposes. In simple words, banks or other entities that have access to Federal Reserve credit or FDIC assistance, and that currently deal with swaps and wish to continue their business as

247. § 716(b)(1).
248. § 716(b)(2)(A).
249. While national banks can invest in a wide array of assets, including loans, notes, other extensions of credit, foreign currency, gold and other precious metals, U.S. government and agency securities, investment grade commercial or residential mortgage-related securities, marketable investment-grade asset-backed securities, and other similar obligations, they are expressly prohibited to deal in equity securities. § 716(l).
250. Id. There is a possibility that these permitted activities may be banned in the future if the Financial Stability Oversight Council, established under the Dodd-Frank Act, makes such determination. Such determinations will be institution-specific and will require affirmative vote of two-thirds of its members, including the chairperson. § 121.
swap dealers or as major swap participants would lose their eligibility for federal assistance unless they spin off their swap businesses which deal with activities outside of permitted swap activities under the Act, to another entity, or divest or cease to engage in that business. An insured depository institution may establish or maintain an affiliate that is a swaps entity (registered dealer or MSP) provided the following conditions are satisfied: (1) the insured depository institution is part of a bank holding company that is supervised by the Federal Reserve, and (2) such swaps entity affiliate satisfy the requirements of Sections 23A and 23B of the Federal Reserve Act that govern transactions with the affiliated bank and any other requirements as prescribed by the Federal Reserve, the CFTC or SEC.\textsuperscript{251}

The Swaps Push-Out Rule will be effective two years following the effective date of the Act, which will be approximately three years after enactment of the Act.\textsuperscript{252} If the insured depository institution which qualifies as a “swaps entity” is interested in retaining its eligibility for Federal assistance, then the appropriate Federal bank regulatory agency will allow them an additional twenty-four month transition period, plus a year’s extension.\textsuperscript{253} The one-year extension is discretionary and would be allowed by the Federal bank regulatory agency only after consultation with the CFTC and the SEC.\textsuperscript{254} During the transition period, such insured depository institutions will be required to cease the activities that require registration as a swaps entity by allowing them to push out their swap business into an affiliate of the bank holding company or to another entity.\textsuperscript{255} Any swaps entered into by these institutions before the expiration of the transition period will remain unaffected by the prohibitions of § 716.\textsuperscript{256}

The discussion on the “Swap Push-Out” provision cannot be complete without the mention of the restrictions imposed by new Section 13 of the Bank Holding Company Act, which is commonly referred to as the “Volcker Rule,”\textsuperscript{257} first proposed by Paul Volcker, former chairman of the Board of Governors of the Federal Reserve System and the current head of the President’s Economic Recovery Advisory Board.\textsuperscript{258} Although the Volcker Rule is included under Title VI of the Dodd-Frank Act, its mention here is important because the Lincoln Provision mandates insured depository institution’s compliance with the limitations on proprietary trading of the Volcker Rule.\textsuperscript{259} The “Volcker Rule,” prohib-

\begin{itemize}
  \item \textsuperscript{251} § 716(c).
  \item \textsuperscript{252} § 716(f).
  \item \textsuperscript{253} Id.
  \item \textsuperscript{254} Id.
  \item \textsuperscript{255} Id.
  \item \textsuperscript{256} § 716(c).
  \item \textsuperscript{257} § 619 (to be codified at 12 U.S.C. § 1851(13)).
  \item \textsuperscript{258} Chairman Paul A. Volcker, \textit{White House}, http://www.whitehouse.gov/administration/eop/perab/members/volcker (last visted Feb. 9, 2011).
  \item \textsuperscript{259} Under the Dodd-Frank Act, a new Section 13 has been added to the Bank Holding Company Act of 1956 and provides that a banking entity shall not engage in pro-
its insured banks and other “banking entities” from making speculative
bets for their own account, known as proprietary trading, subject to lim-
ited exceptions. Proprietary trading has been defined as engaging as a
principal for the “trading account” of a banking entity in any transac-
tion to purchase or sell, or otherwise acquire or dispose of, (1) any security,
derivative, or contract of sale of a commodity for future delivery, (2) any
option on any such security, derivative, or contract, or (3) other security
or financial instrument that the appropriate Federal banking agencies, the
CFTC or SEC (the “regulators”), may determine. The “trading ac-
count” of a banking entity is defined as (1) any account used to acquire or
take positions in securities or financial instruments principally for the
purpose of selling in the near term or otherwise with the intent to resell in
order to profit from short-term price movements, and (2) any other ac-
counts as the applicable regulators may determine.

The prohibition on proprietary trading, however, excludes (a) under-
writing and market-making activities to the extent such activities are de-
dsigned not to exceed the reasonably-expected near term demands of
clients, customers, or counterparties; (b) risk-mitigating hedging activities
that are designed to reduce specific risks to the banking entity in con-
nection with and related to individual or aggregated positions, contracts, or
other holdings; (c) customer-driven investments; (d) investments in gov-
ernment and government-related obligations; and certain other permitted
activities. These permitted activities will remain permitted as long as
they do not involve or result in a potential conflict of interest between the
banking entity and its clients, customers, or counterparties, or would pose
a threat to the safety and soundness of the banking entity or to the finan-
cial stability of the United States.

Though it was strongly felt by Paul Volcker, Treasury Secretary
Timothy Geithner, FDIC Chairman Sheila Bair, and others in the govern-
ment and the derivatives industry that the Volcker Rule effectively ad-
dresses risks and potential conflicts posed by banking organization’s
proprietary trading in derivatives, Senator Lincoln believed that the Rule
does not go far enough to address the issue of risk in the nation’s banking
sector and pushed hard for her amendment. Together, the two provi-
sions will achieve the result desired for this legislation, which is to sub-
stantly limit the derivatives activities of insured depository insti-

260. Any insured depository institution or thrift, any company that controls an insured
depository institution or thrift, any company that is treated as a bank holding com-
pany under Section 8 of the International Banking Act of 1978, and any affiliate or
261. Dodd-Frank Act § 619 (to be codified at 12 U.S.C. § 1841(13)(h)(4)).
262. Id. (to be codified at 12 U.S.C. § 1841(13)(h)(6)).
263. Id. (to be codified at 12 U.S.C. § 1841(13)(d)(1)).
264. Id. (to be codified at 12 U.S.C. § 1841(13)(d)(2)(A)).
265. Edward Wyatt, In Tough Stance, Democrat Finds Few Allies, N.Y. TIMES, May 15,

and their affiliates. Hence, a spun-off entity that is an affiliate of an insured depository institution as well as any insured depository institution that continues to engage in swap business (limited to permitted swaps) would be equally subject to the Volcker Rule, and as a result, engage in only limited swap activities. Further, in addition to satisfying the requirements set forth in the Act for swap dealers, the spun-off entity would also be required to be independently capitalized so as to qualify as a participant in a clearing organization and to obtain credit rating that would give confidence to counterparties to enter into transactions with the entity. There is no doubt that losing the advantage of housing OTC derivatives within the lead bank and “moving positions to a different subsidiary can have material franchise, operational and, possibly, capital implications for U.S. dealers.” The insured depository institutions providing capital to spun-off entities would, in turn, find themselves in a tough situation, as it would limit their ability to extend credit. In addition, in their effort to find a cost-efficient solution to the situation, U.S. dealers might consider moving their business to London-based regulated broker-dealer subsidiaries, which would not only take business away from the United States but would also make it difficult and complex to unwind positions, thus potentially increasing systemic risk. To avoid such a situation, it is important that serious work be done simultaneously to accomplish international harmonization of rules and regulations concerning OTC derivatives.

D. Implications of Title VII for Financial Institutions, Hedge Funds, and End Users

1. Financial Institutions

Financial institutions that qualify as swap dealers, under the definition of the Act, will have to register with the CFTC as swap dealers and with the SEC as security-based swap dealers, within a year of the enactment of the Act. As a swap dealer or security-based swap dealer, they will be subject to minimum capital and margin requirements. They will also be subject to reporting and recordkeeping requirements, and business conduct standards in dealing with their counterparties and customers, and “special entities”. Needless to say that as a result of the provisions of the Act, the cost of using derivatives will increase. The provisions of the new law are likely to impact liquidity in the market as capital will be reserved and financial institutions will have to post initial and variation margins for their trade positions. But the major change for financial institutions, that are also insured depository institutions, would come from

267. Id. at 2.
268. Dodd-Frank Act § 731 (to be codified at 7 U.S.C. 1 §§ (4s)(a)(1), (c)(1)).
269. Id. (to be codified at 7 U.S.C. 1 (4s)(c)(1)(A)).
270. Id. (to be codified at 7 U.S.C. 1 (4s)(f)).
the “swap push-out” provision, which prohibits “federal assistance” to registered swap dealer and major swap participants.\textsuperscript{271} These institutions are allowed to continue as swap dealers to hedge their own activities and enter into interest rate swaps as well as swaps referencing assets permitted for investment by a national bank, and still remain eligible for “federal assistance.”\textsuperscript{272} But for all other swap activity, these institutions will have to push-out their derivatives desk to a separately capitalized entity (which may be an affiliate controlled by the same bank holding company) that will be responsible for satisfying requirements for a swap dealer.\textsuperscript{273} In addition, the derivatives activities of financial institutions will be further restricted under the Volcker Rule, which bans proprietary trading in derivatives by “banking entities.”\textsuperscript{274}

2. Hedge Funds

Hedge funds may qualify as “major swap participants,” if their outstanding swaps give rise to substantial counterparty exposure that has the potential to adversely affect the financial stability of the U.S. banking system or financial markets.\textsuperscript{275} If classified as a “major swap participant,” they will be required to register with the appropriate agency, the CFTC or the SEC, and be subject to capital and margin rules, reporting and recordkeeping requirements, and business conduct standards, expected of such entities under the Act.\textsuperscript{276} Additionally, even if hedge funds fail to meet the above noted criteria for MSPs, their swap transactions will still be required to be cleared and executed on an exchange or a swap execution facility, if they are a highly leveraged financial entity and maintain a substantial position in outstanding swaps in a major category.\textsuperscript{277} Further, there is a possibility that funds entering into swaps may be treated as commodity pools and their managers and advisors be subjected to regulations as commodity pool operators and commodity trading advisors.\textsuperscript{278} If they fall under either of these classifications, they will be required to register as a “commodity pool operator” (CPO) or “commodity trading advisor (CTA),” and subjected to disclosure, periodic reporting, audit, and other requirements under the Act.\textsuperscript{279} Until the applicable rules and regulations are promulgated, there will not be any clarity as to how each hedge fund will be categorized. There is no problem for those hedge funds that engage in large-scale derivatives trading for they already have an understanding as to how they will be categorized. For that matter, hedge funds with very small swap portfolio need

\textsuperscript{271} Section 716(a).

\textsuperscript{272} Section 716(d)(1)-(2).

\textsuperscript{273} See Sections 716, 731.

\textsuperscript{274} Section 619 (to be codified at 12 U.S.C. § 1851(13)).


\textsuperscript{276} Dodd-Frank Act § 731 (to be codified at 7 U.S.C. 1 §§(4S)(a)(2), (e), (f)).


\textsuperscript{278} § 1a(10)(A)(i).

\textsuperscript{279} 7 U.S.C. § 6m(3)(A).
not worry either. The dilemma is only for those who fall in the middle. They are the ones who need to know how broad the new rules will be and under the new rules, which category will they fall under. Going by the tone of the legislation, it will probably be in their best interest to be prepared for compliance with the new law.

3. Corporate End Users

Corporate end users, under the Act, are exempted from having to register as a “major swap participant,” and are thereby relieved from the clearing, exchange trading, and possibly margin requirements, as long as they enter into swap transactions to hedge their business risks. But, the Act does provide them with the option to submit their trades for clearing. If they choose not to opt for clearing of their trade, then the Act does not provide any guidance as to whether they will be required to post margin, even if noncash, in connection with such trade. It is important to note that margin is required for all uncleared swaps and the Act fails to provide explicit exemption from margin for business end users. To address the growing concern about this issue, Senators Christopher Dodd and Blanche Lincoln offered clarification in a letter dated June 30, 2010. In their letter, they emphasized that “[t]he legislation does not authorize regulators to impose margin on end users, those exempt entities that use swaps to hedge or mitigate commercial risk.” The letter obviously is not legally binding and how much of an impact it will have on the future rulemaking remains to be seen.

Another area of concern for end users is the possibility that the risk-mitigating swaps of large corporate end users might put them in the category of “major swap participants,” as the terms “substantial position,” “substantial counterparty exposure,” and “highly leveraged,” used in the definition of “major swap participants,” have been left either unexplained or to be defined by the Commissions. Hence, until such time that the Commissions provide guidance on this issue through detailed definitions, end users, particularly highly leveraged financial entities not subject to regulatory capital requirements and holding substantial position in outstanding swaps in any major swap category, will be better off if they could avoid holding large positions in outstanding swaps in any major swap category. End users should also consider monitoring their status on a regular basis so that they understand where they stand as far as their being classified as a “major swap participant” goes. Further, it is important for

280. Dodd-Frank Act § 763 (to be codified at 15 U.S.C. § 78a (3c)(g)(1)).
281. Id. (to be codified at 15 U.S.C. § 78a(3c)(g)(2)).
283. Id.
end users to appreciate that because of the divided jurisdictions between the CFTC and the SEC, entities who hold positions in both swaps and security-based swaps, might find themselves being regulated by the two Commissions as a “major swap participant” and a “major security-based swap participant.”

V. CONCLUSION

The financial crisis exposed weaknesses in the U.S. financial system and led to the enactment of the Dodd-Frank Act to fix the flaws in the weak system. The new legislation makes fundamental changes to the regulatory landscape to bring stability to the financial system and the economy. Most of the provisions of Title VII will be effective by July 16, 2011 (the “Effective Date”), which is 360 days after July 21, 2010, the date of the enactment of the Act (the “Enactment Date”). Other provisions that require additional rulemaking by different federal agencies will become effective not less than 60 days after publication of the final rule or regulation implementing such provision. This means that the derivatives market and industry will not experience drastic changes overnight. But the legislation will definitely get them thinking as to what their future course of action is going to be now that the Act has been enacted. The Act requires swap dealers and security-based swap dealers to register with the CFTC and the SEC, respectively. Pursuant to registration, swap dealers and major swap participants will be subject to increased capital and margin requirements, and heightened business conduct requirements. The capital and margin requirements will not only increase transactions costs, but will also affect liquidity in the market as the traders post initial margin and variation margin to keep up with changes in the values of positions. Most importantly, insured depository institutions that are part of bank holding companies and are swap dealers will have to push-out their swap trading desks to affiliates that are swap entities in order to remain eligible for “federal assistance.” Additionally, they will also be prohibited from engaging in proprietary trading for their own accounts. These key aspects of the derivatives legislation will influence the decision-making of the derivatives participants to determine if they wish to continue with their derivatives business and in what form.

Even though enactment of the Act has cleared some air and provided some level of certainty, the full scope of the legislation will be known only after the completion of rulemaking process and adoption of additional rules and regulations to implement the legislation. In fact, it would not be farfetched to say that the success of this legislation will largely depend on the rules to be written by the CFTC and the SEC. It is being speculated that if the Commissions write stringent rules that end up creating a rigorous regulatory environment for the United States-based dealers then it is possible that these dealers might move their OTC derivatives

286. §731(to be codified at 7 U.S.C. (4s)(c)).
But in the case of the two Acts is that the Dodd-Frank Act not only prohibits financial institutions from engaging in proprietary trading on their own accounts, but also requires them to push-out their swap trading desks to an affiliate. In this scenario, these institutions have to find a home for their derivatives business and when looking for it they might be tempted to take it to a place where the regulatory environment is comparatively less severe. No doubt that migration of business to foreign markets would take these institutions out of the reach of the U.S. regulators and will also affect U.S. competitiveness in the global markets adversely. But such an outcome can be avoided if the United States is successful in bringing about international harmonization of rules impacting derivatives markets worldwide and remove any opportunities for regulatory arbitrage. Given the global nature of the OTC derivatives market and the cross-border impacts of the recent market problems faced worldwide, achieving this would not be hard. Already the Group of Twenty (G-20), the Financial Stability Board (FSB), and international standard setting bodies, such as International Organization of Securities Commissions (IOSCO), are pushing for global OTC

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287. The Group of Twenty (G-20) Finance Ministers and Central Bank Governors was established in 1999 to bring together systemically important industrialized and developing economies to discuss key issues in the global economy. About G-20, G-20, http://www.g20.org/about_what_is_g20.aspx (last visited Feb. 9, 2011).  
288. The FSB was established to coordinate the work of national financial authorities and international standard setting bodies to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of international financial stability. The FSB is chaired by Mario Draghi, Governor of the Bank of Italy. Its Secretariat is located in Basel, Switzerland, and is hosted by the Bank for International Settlements. The FSB met in Seoul on October 20, 2010, ahead of the G-20 summit and approved a report containing recommendations to promote consistent implementation of the G-20 commitments concerning: increasing the proportion of the market that is standardized; moving to central clearing of OTC derivatives by (i) implementing mandatory clearing requirements, (ii) strengthening oversight and regulation of central counterparties (CCPs) and (iii) introducing robust risk management requirements for the remaining non-centrally cleared markets; trading on exchanges or electronic platforms, where appropriate, by asking IOSCO to complete an analysis by the end of January 2011; and ensuring that OTC derivatives transactions are reported to trade repositories. About the FSB: Overview, FIN. STABILITY Bd., http://www.financialstabilityboard.org/about/overview.htm (last visited Dec. 31, 2010); Financial Stability Board Agree Tighter Watch Over Gib Financial Firms Ahead of the G20 Summit in Seoul, ASYMPOTIX, Oct. 20, 2010, http://www.asymptotix.eu/content/financial-stability-board-agree-tighter-watch-over-big-financial-firms-ahead-g20-summit-seoul.  
289. IOSCO is recognized as the leading international policy forum for securities regulators. It has formed a Task Force on OTC Derivatives Regulation (Task Force) in order to coordinate securities and futures regulators’ efforts to work together in the development of supervisory and oversight structures related to OTC derivatives markets. The purpose of the Task Force is to seek to develop consistent international standards related to OTC derivatives regulation in the areas of
derivatives reform by bringing consistency in international financial regulatory standards. Most major financial jurisdictions have expressed their intent to align their efforts for reforms in their financial markets with the reforms proposed under the Dodd-Frank Act. The European Commission’s legislative proposal for a Regulation on OTC derivatives, central counterparties and trade repositories, introduced on September 15, 2010, is fairly close to the provisions of the Dodd-Frank Act. Likewise, amendments were made to the Japanese Financial Instruments and Exchange Act (FIEA) in May 2010. The amended FIEA mirrors the Dodd-Frank Act in many respects. With similar laws in place, major financial markets overseas will not be a lucrative option for United States-based dealers contemplating migration of their businesses.

Finally, there is no denying that OTC derivatives contracts serve a useful function in helping businesses mitigate their risk and making capital markets more efficient. Congress recognized that the elimination of the OTC markets would cause more harm than good and did not ban use of OTC derivatives. The Commissions, when crafting rules, should also keep in mind that these markets are critical for financial innovation and that the new rules should not have the effect of restricting innovation in financial markets as it spurs economic growth. Though the Dodd-Frank Act is a tough law, it is a constructive step in the right direction, and the success of the financial reform process that has begun with the enactment of the Dodd-Frank Act will be reflected in a safe and sound financial system that fosters innovation.

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293. In fact, many important financial products, such as interest-rate swaps originated in the OTC markets and “if mid-twentieth century regulation had precluded the over-the-counter trading of derivatives, many important financial products would not have developed.” Duffie, _supra_ note 95.
Comment and Casenotes
BOLIVIA, BATTERIES, AND BUREAUCRACY

Alexander S. Farr*

I. BACKGROUND ON BOLIVIA AND LITHIUM

little over seventy years ago, Saudi Arabia was a poor, undeveloped nation without an international presence or any significant influence.1 After discovering it was sitting on over one quarter of the world’s total oil reserves, the nation vaulted to a wealthy and powerful position that earned it substantial control and influence over international oil policy.2 Looking halfway across the world to the small landlocked nation of Bolivia, it is difficult to see a relevant comparison, much less to suggest that Bolivia could be the next Saudi Arabia.3 The comparison is appropriate, however, as Bolivia possesses the world’s largest supply of lithium reserves beneath the crust of its Salar de Uyuni salt flats—an estimated 5.4 million tons of the eleven million known tons of lithium in the world.4

This paper focuses first on what makes lithium such a potentially valuable resource, considers the challenges Bolivia faces as it positions itself to reap the most out of its strategic resource, and looks at how the nation’s history of resource exploitation at the hands of imperialist nations and transnational corporations could color its development. It will then assess Bolivia’s history of nationalization through the lens of the most recent 2006 nationalization of its hydrocarbon industry and how Bolivia advances redefined resource ownership and indigenous rights under its new constitution. Finally, the paper will consider the developmental successes and societal pitfalls that Saudi Arabia experienced while developing its oil reserves in order to develop suggestions and warnings for how Bolivia should proceed with exploiting its newfound wealth.

Three main conclusions arise from this analysis. First, in order to succeed as a major producer of lithium, Bolivia requires outside investment

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2. See id.

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by foreign transnational corporations. To entice such corporations to make significant investments, the Bolivian government must distance itself from the recent trend of nationalization. Bolivia can still ensure that it has a place at the table in controlling the industry and reaping profits from it through a system of participation (gradual repurchase of lithium production assets), much like Saudi Arabia did with Saudi Aramco. Second, Bolivia would also be well-served to protect the lithium market by establishing a joint organization with other lithium producers, similar to OPEC. Finally, to avoid the problems stemming from a welfare state, rather than allowing profits from the lithium industry to accrue in government coffers before being redistributed to citizens in the form of handouts, Bolivia should allow all profits to be directly distributed to its citizens and then rely on normal taxation for its own monetary needs. By taking these steps, Bolivia has the potential to succeed much like Saudi Arabia while avoiding some of the pitfalls that remain in Saudi Arabian society today.

A. What is the Potential Importance of Lithium?

Today, almost every laptop, cell phone, GPS, iPod, or other modern electronic device utilizes a lithium-ion battery. In fact, the “United States Geological Survey (USGS) [said that] one quarter of the lithium mined last year was used solely for lithium ion (LiIon) batteries, which operate portable electronic devices.” The reason that the lightweight metal is preferred for such technology is that “at an elemental level, lithium’s atomic radius is smaller, and in turn metallic lithium is more electro-negative, and boils at a lower temperature than any other metal,” all of which makes for batteries that “weigh less, take up less space, and last longer than alkaline batteries.” In fact, the primary reason lithium-ion batteries “are considered revolutionary [is] because . . . [they] can hold a charge for eight times longer than alkaline versions.” But application in consumer-electronics is only the start, for those in the automotive industry have their eye on the metal for the future of electric car technology because “it weighs less than nickel, which is also used in batteries, [which] would allow electric cars to store more energy and be driven longer distances.” With such advantages in mind, the U.S. govern-

ernment has been actively pushing for research and development in the sector—[w]hile on the campaign trail, President Obama promised that by 2015, there would be one million plug-in hybrids and electric vehicles on U.S. roads, and, once in office, he allocated billions of economic stimulus package dollars toward battery technology and manufacturing.”

If such potential advances in the application of lithium technology were to become a reality, it would “undoubtedly increase the demand for electric vehicles which [would] require a large amount of lithium in the next few years” whereby those with lithium reserves would stand to benefit significantly, not unlike Saudi Arabia whose wealth can be indirectly attributed to the prevalence of the internal combustion engine over the past century. With an eye on the future, Bolivia “is currently working to assess, produce, and manufacture lithium products that correspond with the rising global demand for clean energy vehicles.” But there are detractors who argue that to extract “enough lithium to meet even ten percent of global automotive demand would cause irreversible and widespread [environmental] damage,” and that “Lilon propulsion is incompatible with the notion of the ‘Green Car.’”

Other promising developments in the uses of the metal include updating the national energy grid utilizing technology currently being researched by IBM, who “recently announced an ambitious project to develop lithium-air batteries, which hold considerably more charge than their lithium-ion cohorts, both for transportation and for powering the national energy grid.” While standard lithium-ion batteries can produce around 585 watt-hours of output, lithium-air batteries are significantly more powerful with the potential to produce up to 5,000 watt-hours. Such projects and expectations suggest that lithium truly will become a crucial material for the future of global energy use and storage and that the lithium market will undoubtedly continue to grow. In order to reap the benefits of its abundance of the material, Bolivia will have to take a hard look at its policies and development strategy.

B. Bolivia’s Lithium Reserves

Despite its natural resource wealth, Bolivia remains one of the poorest nations in South America, lacking even the “basics like adequate health care and extensive infrastructure.” This deficiency proves problematic.
for the nation whose lithium reserves are located deep in the remotest part of the country thereby requiring it “to drastically strengthen [its] industrial and transportation infrastructure in order to fully take advantage of the country’s lithium reserves [and] in order to meet the recent demands for eco-friendly cars.” Furthermore, Bolivian President Evo Morales is determined to avoid a repeat of the historic exploitation of the nation’s resources by outside forces and is therefore looking for ways to keep control of the extraction, processing, and production of lithium products on Bolivian soil. The former Mining Minister Mariobo Moreno cautioned in an interview that the Bolivian government “must resist globalizing ‘instruments like transnational corporations and economic and international political pressure.’” In fact, “in the 1990s, proposals to sell the lithium reserves to the American Lithium Corporation were dropped after massive protests decried the benefits given to the company.”

But if President Morales wants to develop the infrastructure necessary to begin processing lithium on a large scale, he does not have the luxury of choosing many alternatives outside private sector financing and investment. With his predicament in mind, he is seeking collaboration from transnational corporate investors who will help Bolivia develop a full-scale lithium production process, starting with a small pilot plant out in the Salar de Uyuni. The pilot project is crucial to the development of a more extensive industry since “[p]roducing lithium carbonate, even on a relatively small scale, would lend more credibility to the government’s grand plans for Bolivia to become a global supplier of lithium.” The goal is for the project to evolve into a large-scale plant capable of producing twenty to thirty thousand metric tons of lithium carbonate a year (about one-third of the current world supply being produced) and also refine the extracted resource into batteries to profit from a fully integrated process. Such an outcome now seems attainable given the recent announcement by COMIBOL (the national mining company) that Bolivian scientists discovered a “formula for producing high-quality lithium carbonate” thereby allowing the nation to produce lithium without outside expertise.

If Bolivia truly intends to break into the market as a major global supplier and compete with those who already supply the world’s lithium, it has to act fast—currently Chile, Argentina, and Tibet supply the majority

21. See Del-Colle, supra note 5.
23. Salt of the Earth, supra note 8.
25. See id.
27. Id.
28. See Salt of the Earth, supra note 8.
of lithium to the market with the United States now importing predominantly from the South American nations. Furthermore, Mexico recently uncovered its own significant deposit of the metal; thus Bolivia is under pressure to get its own industrialized processes running. If and when Bolivia begins to catch up to its neighbors in the trade, it might even consider entering into an agreement similar to OPEC with the other lithium producing nations in order to protect supply and pricing of the material. The bulk of the responsibility lies with President Morales for “[o]nly if he can quickly find the right balance between his people’s needs and international demand will he successfully be able to recover his country’s economy.”

II. THE MOTIVES BEHIND NATIONALIZATION

As the potential lithium economy develops in Bolivia, outside investors are tepidly contemplating the idea of full-scale investment given the nation’s history of nationalizing the natural resources industry; “[T]o date, Bolivia has nationalized its natural resources four times including the 2006 nationalization, and of the four, three have involved the hydrocarbon sector.” To be precise, Bolivia nationalized the tin industry in 1952, oil in 1937 and 1969, and most recently it nationalized the full hydrocarbons sector in President Morales’ 2006 decree following his election. The reason that private investors are afraid is that “nationalization is generally defined as the transfer of private resources into the hands of the public through the expropriation [takeover] of the assets of private owners or investors.” Aside from pure governmental takeover, Bolivia’s history, particularly within the last twenty years, is rife with examples in which the Bolivian people protested so vociferously that they drove various private corporations out of the nation—in the 1990s, an American lithium mining company (Lithco) was ousted, in 2000, the Water Wars protesting privatization of the nation’s water supply ended up driving a subsidiary of Bechtel out, and in 2003, the Gas Wars led to violent protests which propagated the latest nationalization of the hydrocarbons

29. McAdams, supra note 6.
31. See McAdams, supra note 6.
32. See Del-Colle, supra note 5.
33. Hopper, supra note 4.
36. Jova, supra note 34, at 1.
A. Colonial Exploitation of Bolivia

The aggressive nationalization responses by the people and government of Bolivia can best be explained by the country’s “500-year history of exploitation” at the hands of outsiders. Boliva was once one of the greatest sources of silver and other minerals, with a mining industry that lined the pockets of imperialist Spain for 250 years beginning in 1545. The mining operations extracted some of “[t]he most important natural resources found in Bolivian soil . . . metals such as gold, silver, tin, cadmium, tungsten, iron, lead and antimony.” In fact, in addition to leaving mountains stripped of all their natural value, the extensive extraction of metals using mercury amalgamation left an environmental and health disaster behind. Over the course of the mining operations, “[a]round two billion ounces of silver were extracted from . . . [Potosi’s] Cerro Rico (Rich Mountain) during the Spanish colonial era.”

Scarcely any of the profits from the intensive Spanish silver mining ever remained in the city around the Cerro Rico site and as one Bolivian commentator put it, “[l]ike other colonized peoples, the indigenous and later mestizo peoples of the region saw the profits from their labor and land go to the first world, initially through monarchies, then through corporations that stole their natural resources, captured their governments, and created local mestizo elites to do their bidding.”

Furthermore, the social impact on the region was profound: “[t]he silver and tin mining city of Potosi, Bolivia—in the 1600s richer and larger than Paris—is now the capital of the poorest province in the poorest country in South America.” During the 250 years of Spanish colonial rule, “the Spanish crown organized a migration [system] of forced labour [sic] to the mines of Potosi which [had] . . . disruptive effects on the indigenous

39. Id.
42. Ogawa & Kobayashi, supra note 40.
44. See Chekuru, supra note 38.
46. Battle, supra note 7.
communities from which they were recruited.”

The labor system required that “every seven years, for a period of four months, all males between 18 and 50 were ordered to work in the mines.” Those forced laborers suffered under harsh conditions, rarely seeing the light of day, and as a result, “[e]ighty per cent of the male population of the 16 provinces . . . died in these conditions.”

The mining continues to this day in unsafe and environmentally hazardous conditions “with miners effectively signing away at least their health, if not their lives, as they enter the mines for income they desperately need.”

The desperation of those remaining in the region is profound: “[m]ost of the city’s population of around 120,000 are Quechua Indians, who live by scratching at what is left in the old mines . . . [without] access to modern technology . . . [or] social security protection.”

B. Transnational Corporations and Exploitation

After colonial imperialism came transnational corporations hoping to extract wealth from the natural resources of backwards and underdeveloped South American countries, including Bolivia. Such corporations were predominately engaged in extractive rather than developmental industries and they brought little benefit to the native populations: “Extractive industries are those economic activities that hinge around the withdrawal of a natural resource while making no effort to replace that resource: either because the resource is non-renewable (hard rock minerals, hydrocarbons etc.) or because the agent doing the extraction is simply uninterested in replacing the resource.”

Transnational corporations possess significant governance power (and the ability to abuse it) over the economies and people in poor, underdeveloped nations like Bolivia because they have the ability to “produce goods and services that can earn foreign exchange and create extra jobs.” Furthermore, such companies created a noticeable divide between the “haves” and “have-nots” in Bolivian society by rewarding those who advanced their cause (namely government officials) at the expense of the poor majority. In fact, such corporations have the advantage of sheer size, resources, and contacts with governing authorities that give them “the capacity to sponsor candidates in local and regional elec-

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49. Id.
50. McAdams, supra note 6.
51. Barron, supra note 43.
54. See Bebbington, supra note 52, at 7.
tions . . . to assume a dominant presence in the local media, and to . . . become a sort of puppeteer in a regional political economy.\textsuperscript{55\textsuperscript{55}}

Thus, the poor (constituting about 1.5 billion people in Africa, Asia, and Latin America) tend to have little say in how their country is run.\textsuperscript{56} Transnational corporations, whose goods and services typically are targeted at those with expendable purchasing power, indirectly increase the inequality within host countries because the poor are unable to express their needs in the marketplace and cannot even obtain the basics essential to their livelihood.\textsuperscript{57} Adding insult to injury is the fact that such corporations, particularly those involved in extraction of natural resources, are prone to flaunting environmental concerns and labor protections while employing the poor and indigenous who have little other choice than to pillage and lay waste to their own land in an attempt to maintain their impoverished existence.\textsuperscript{58}

External forces, however, are not the only ones to blame for inequality and general lack of development—“occupied” nations themselves tend to perpetuate their position by remaining dependent upon natural resource wealth and “rent seeking” (passive income) behavior instead of redistributing the wealth and investing it in development of other industries and human capital.\textsuperscript{59} In Bolivia, privatization of the main industries led the nation to “a loss of sovereignty,” which turned it into a “servant of big capital” thereby intensifying the “exploitation of [the country’s] national resources in order to increase corporate profits.”\textsuperscript{60}\textsuperscript{60} Because of a historic lack of transparency in contracts between the government and large corporations, it is easy for Bolivian citizens to assume they are being cheated out of their resources and to unapologetically protest and urge the government to overthrow its legal obligations.\textsuperscript{61}

Now, against the backdrop of centuries of exploitation, the Bolivian people are turning to their newfound wealth in lithium reserves with hope:

To many Bolivians, the potential of lithium wealth represents a symbolic remuneration for 500 years of natural resource looting by foreign corporations. Bolivian political analyst and former vice-minister of mining, Pedro Máriobo Moreno, calls for the “state monopoly of all the riches of the Salar of Uyuni . . . to avoid the third massive

\textsuperscript{55} Id.
\textsuperscript{56} MADELEY, supra note 53, at 6.
\textsuperscript{57} Id. at 9.
\textsuperscript{60} OSCAR OLIVERA, ¡COCHABAMBAL! WATER WAR IN BOLIVIA 14 (2004).
sacking of our natural resources, after silver and tin.”

In an interview with the New York Times, Saúl Villegas, head of a division in COMIBOL that oversees lithium extraction, dismissed privatization of lithium production, claiming: “The previous imperialist model of exploitation of our natural resources will never be repeated in Bolivia,” and regarding potential outside investment, he said: “[m]aybe there could be the possibility of foreigners accepted as minority partners, or better yet, as our clients.” Furthermore, Marcelo Castro, who is the engineer overseeing the construction of the small lithium plant in the Salar de Uyuni region, seemed guardedly hopeful for Bolivia’s future when he commented to National Public Radio that “the flow of natural resources out of Bolivia left us poor, backwards, underdeveloped, and dependent. Only the success of this plant can guarantee that profits will be reinvested in our country. If not, we’ll end up the same as before.” Therefore, it seems that Bolivia’s lithium industry could be the country’s prime opportunity to make up for years of lost time and economic advancement, but it also means that a significant burden rests on the shoulders of President Morales and his government to bring success to their country.

## III. NATIONALIZATION OF HYDROCARBONS AND BEYOND

### A. POLICIES BEHIND THE 2006 NATIONALIZATION

With an understanding of the context in which Bolivia has nationalized many of its resource sectors in the past, the 2006 nationalization of hydrocarbons under Supreme Decree No. 28701 is more readily appreciated. Specifically, the decree required the major oil companies operating in Bolivia (Petrobrás, Repsol, and Total) to relinquish control of their field operations to the country’s national oil company, YPFB, and to sustain an increase in taxes on their profits to a total of eighty-two percent or to leave the country. This action effectively turned the tables on the transnational corporations because policy decisions and profits now rested primarily in the hands of the Bolivian government. The strong assertion of authority over hydrocarbons is permeating to the new lithium sector as well; “Morales is committed to ensuring that his people reap the benefits of their natural resources. Nationalization of the lithium industry is one option which [he] is considering in order to reach his goal.”

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62. Salt of the Earth, supra note 8.
63. Romero, supra note 3.
64. Interview by Annie Murphy with Marcelo Castro, Engineer, in Salar de Uyuni desert, Bol, (May 11, 2009), available at http://marketplace.publicradio.org/display/web/2009/05/11/pm_bolivia_lithium/#.
66. Weintraub, supra note 35.
67. Hopper, supra note 4.
In fact, Morales has a rather ambitious agenda as he is determined to prevent foreign companies from extracting lithium and leaving with the profits. Instead, his aspirations include full-scale production of lithium-ion batteries and possibly even electric cars on Bolivian soil. His hope is that such an extensive industry (from extraction to production of finished products) could create numerous employment opportunities for the Bolivian people who would finally become the primary beneficiaries of their country’s resource wealth. There is typically a conflict between the extractive industries and the resource-rich country in which they operate and where such resources should be further processed; the multinational firms prefer to process minerals back in the industrialized West, while the developing countries prefer to expand local processing activities and reap the economic benefits of doing so. The primary motivators for multinationals to process minerals back home is the fact that they already possess the necessary refining installations there, the developing host country usually has poor infrastructure unable to support processing activities without a significant financial investment, and, in some cases, the enormous political, economic, and social risks involved with committing investment capital to the country outweigh the potential benefits.

Despite Morales’ agenda and his dedication to nationalization, the reality is that in order for him to develop his country’s infrastructure and technology required for a successful lithium industry, he must turn to private foreign corporate investors for help. Even given the completion of the small government-owned lithium plant currently under construction, for Bolivian production to reach profitable and influential levels, the country will require substantially more development and investment. Bolivian economist, Juan Carlos Zuleta, stated that, “[t]here has to be some private investment. Not only because we are a poor country, and we don’t have enough financial resources, but more important is that we don’t have the technology.” Although the large reserves have caught the attention and solicitations of large foreign companies and automakers like Japan’s Mitsubishi, many others may be hesitant for fear that after they commit a significant investment and provide infrastructural development Morales will simply nationalize the industry as he did with hydrocarbons and expropriate their assets.

68. Id.
69. McAdams, supra note 6.
70. Transnational Corporations and the exploitation of natural resources 94 (Bruce McKern & John H. Dunning, eds., 1993).
71. Id. at 100-101.
72. See McAdams, supra note 6.
73. See Romero, supra note 3.
75. Id.
76. See Hopper, supra note 4.
Foreign corporations have good reason to worry about investing in Bolivia; one of Morales’ motivations behind nationalizing the hydrocarbons sector in 2006 was the fact that “foreign investors received too much in gas-sale profits based on the hydrocarbons law in place at the time.”

Even if such corporations were to partner with the Bolivian government, they risk having the government take over their operations arbitrarily upon a determination that they are benefitting too much from the relationship. Such fears explain why so many “private sector experts agree that even the best-executed nationalization plans carry risks.” Among them, R. Fleischer of the Center for Strategic and International Studies in Washington believes that once a country begins a policy of nationalization, foreign investors are quickly scared off.

Carlos Alberto López, a former energy minister and consultant with Cambridge Energy Research Associates, shares his less enthusiastic sentiment about Bolivia’s potential in stating, “Foreign companies are afraid to deal with a government that confiscates assets and rips up contracts . . . Bolivia’s-ideological face does not square with business and commercial realities. I doubt lithium’s potential will be realized in the short or medium term.”

He further notes that following the nationalization of the oil and gas industry, “foreign investment evaporated, production fell, and the state-owned energy company, YPFB, became mired in corruption,” all of which he contends hurts Bolivia’s trustworthiness in the eyes of potential investors. Part of the problem stems from the fact that YPFB was a de-capitalized company (thus unable to finance its activities); in order to capitalize it to gain the resources necessary to take absolute control of the hydrocarbons industry, Bolivia had to de-capitalize foreign companies by increasing the appropriation of revenues from the hydrocarbons industry that go to the state. This capitalization, in turn, discouraged foreign investment in the nation.

One counterargument to the negative assertions above is the fact that Bolivia’s actions reflect an emerging if not prevalent regional attitude rather than an isolated choice by the country: “around the world, developing countries are throwing off colonial overlords and nationalizing in-

79. Id.
81. Id.
dustries to return some of the profits to the citizens." The systemic move to nationalize could leave foreign investors with little choice but to enter relationships with headstrong but resource-rich countries:

And this time, the leaders of these countries are not about to see their resources go straight into the hands of the Americans. Venezuela nationalized its oil, and other countries on the continent have been not-so-quietly expelling companies who exploited them through deals made with puppet dictators or through coercion.

Perhaps Bolivia’s turn to nationalization is less about “getting back” at foreign corporations than it is about asserting control over the country’s remaining natural resources in order to “promote much needed development” and economic growth. Bolivia could be taking these steps now when the country has the rare opportunity and ability to learn to stand on its own and claim its position at the league tables of powerful resource-rich nations by strengthening and protecting its national sovereignty through the “recuperation of a certain decision-making autonomy of the Bolivian state, which in the previous administrations was completely subordinated to outside interests and designs.”

Despite Bolivia’s Constitution claiming all hydrocarbons as property of the state, prior weaker administrations bent to the will of the International Monetary Fund (IMF) and granted various concessions to U.S. and European oil and gas corporations in the mid-1990s. Rather than help the country advance, such concessions failed to relieve the Bolivian people’s severe poverty, and thus Morales’ choice to nationalize reflects a growing awareness in the importance of corporate social responsibility—if the companies fail to take into account and mitigate the impact of their actions, they will be forcibly removed. At the very least, even if all positive reasons are discounted, “hydrocarbons are in high demand and this might help disguise or at least mitigate the severity of the negative message Bolivia has sent to foreign investors, and tempt new investment to test the waters.”

From President Morales’ perspective, not only were his actions intended to help his people, but they were necessary for political survival—his predecessors were pushed out of office over the issue of nationaliza-

84. Id.
86. Gutierrez & Mokrani, supra note 65.
87. Martinez, supra note 85.
88. Id.
89. Jova, supra note 34, at 17.
tion. Thus, in issuing Supreme Decree No. 28701, President Morales intended to annul the “transnational contracts that had been put into place under President Sanchez de Lozada’s capitalization process of the late 90s.” Furthermore, Morales, unlike prior administrations, actually has ambitious and specific plans for the use of his country’s resource profits, primarily 1) reinvesting in job creation to begin to raise the country out of extreme poverty and 2) educating his citizens to best position and strengthen them and future generations of Bolivians.

B. Legality of the 2006 Nationalization

In terms of the legality of Bolivia’s annulment of contracts, the 2006 nationalization was touted as “nationalization without expropriation,” meaning that the country was not depriving the foreign corporations of any actual property right and in fact left the corporations in place as operators of the facilities. This action falls squarely within one of three traditional theories of appropriation: 1) state monopoly and appropriation of all revenues through a state-owned company (i.e. Saudi Aramco); 2) coexistence between private companies (whose revenues are taxed by the state) and a state-owned company (like Bolivia’s 2006 nationalization); and 3) exploration and exploitation of the natural resources only by private companies but with hefty state-imposed taxes and royalties on their revenues (the U.S. method). Bolivia’s primary argument is that the foreign corporations never owned any property rights as to the hydrocarbons to begin with and therefore no purchase transaction was required to legally transfer assets from the corporations to the state:

It might seem incredible to many that national resources were . . . transferred from the public to the private sector without any type of sale, but this is exactly what happened. There was no sale, so now there is no expropriation. If one reviews the press and the laws passed during 1995 and 1996 in Bolivia it is clear that this was the peculiar mechanism of privatization devised in that country to transfer public wealth, national resources, and the state investment accumulated in the thirty years prior to 1990 directly to the private sector. [emphasis added]  

Aside from what appears to be a “lack of consideration” argument, the public refusal to honor government contracts also stems from a feeling of unfair dealing and fraud because the government, without the legally required approval from Congress, agreed to long-term fixed price capitalization contracts without stipulating how and when taxes were to be paid.

91. Jova, supra note 34, at 5.
92. OCHOA, supra note 41, at 91-92.
95. Gutierrez & Mokrani, supra note 65.
by foreign corporations. Bolivia settled on the option of nullifying contracts, saying they are against constitutional provisions that require prior congressional approval as an alternative to the more expensive option of buying out the foreign corporations under an eminent domain theory of taking their property for public use or the less certain option of closely scouring the contracts to find an unmet condition upon which to base a rescission. In addition to arguing that without congressional approval the privatization contracts were void, a third assertion is that such contracts, even if approved, directly contradicted the language of article 139 of the constitution, stating that hydrocarbons are the property of the state, and therefore could not be legally privatized.

Given the multitude of historic, social, and legal reasons for nationalizing, what remains clear is the fact that Bolivia is determined to take a stand and make up for centuries of abuse and repression at the hands of internal and external forces. This mentality has already colored the discussions surrounding lithium extraction and development, but it also seems likely that the Bolivian people are cautiously willing to accept foreign partners so long as their due share is secured. Without the support of the Bolivian people, foreign corporations will lose their potential to develop one of the greatest sources of lithium for the future, and without the trust and investment of foreign corporations, the Bolivian people will remain underdeveloped and poverty-stricken.

IV. THE NEW BOLIVIAN CONSTITUTION

A. THE INDIGENOUS POPULATION GETS ITS DUE

The election of President Evo Morales is significant not only because of his unprecedented dedication to walking a hard line internationally, but because of his unique status of being the first indigenous president in Bolivia’s history. One of the primary campaign promises that vaulted him to the position was a promise to reform the country’s constitution in order to bring greater social and political rights to the country’s indigenous majority. And reform he did: “Morales staged an historic referendum in February 2009 that called for land redistribution of the holdings of the country’s powerful European-descended minority in favor of its indigenous majority.” The most crucial aspect of this reform is that it grants control over natural resources existing within indigenous territories to the people living there. The significance of such control is that it allows indigenous populations to govern the types of concessions they

96. See Jova, supra note 34, at 12.
97. See Albuquerque, supra note 82, at 27-29.
98. Jova, supra note 34, at 12.
99. Freyman, supra note 83.
101. Lucky Bolivia, supra note 20.
will give for resource extraction, if at all. While such changes did not earn Morales the hearts of the country’s largely European elite, his intentions were to compensate the indigenous majority for the various encroachments and injustices they suffered over the country’s history. Those encroachments by transnational corporations and the country’s elites left the indigenous population displaced and impoverished. In recognition of the country’s diverse population, the new constitution declares Bolivia as “pluri-national” in order to acknowledge the presence of over thirty different indigenous nations. In addition to such recognition, the constitution goes further by creating a new Congress that specifically reserves a number of seats for the indigenous groups thereby giving them unprecedented official representation and say in the government. Such changes, while drastic for the non-indigenous population, are not surprising given that “Bolivia’s campesino, indigenous and original peoples (pueblos originarios) make up 60 percent of the country’s 8.8 million population.” Furthermore, recognizing indigenous rights within the country parallels a global trend.

The Bolivian Constitution cements some of the rights outlined in the 2007 U.N. Declaration on the Rights of Indigenous Peoples, which supports indigenous self-government and self-determination. Article 289 of the constitution stipulates, “Rural indigenous autonomy consists of self-government and the exercise of self-determination for rural indigenous nations and native peoples who share territory, culture, history, language, and unique forms of juridical, political, social, and economic organization.”

The new provisions even allow the indigenous groups to create their own statutes for their autonomous territories (provided they comport with the other laws of the state and other constitutional provisions) and to govern their own development by managing their natural resources and by levying and re-distributing taxes. Inclusion of indigenous representation even extends to the judicial system since the constitution provides for a “new indigenous judicial system, at the same level of ordinary justice, along with a new Plurinational Constitutional Court which will have to elect new members for both systems.” Most important to the present analysis are the provisions regarding natural resources; in some

103. Romero, supra note 3.
104. See Freymann, supra note 83.
105. Romer, supra note 45.
109. Van Schaick, supra note 106.
110. Id.
111. Nagel, supra note 107.
cases the indigenous population is granted full control over any such resources in their territories and in others they are at least guaranteed the right to be consulted about the nature of extraction and entitlement to share in the economic benefits of that extraction.\textsuperscript{112}

While the constitutional changes appear drastic, the creation of increased indigenous authority may have been viewed as a way to repair former grants of rights that have gone largely unfulfilled—by placing control in the hands of the indigenous groups and allowing them representation in the government, they will be better able to police and enforce their own rights. A 2007 U.N. Special Report on human rights and freedoms of indigenous peoples highlighted the fact that, despite provisions in the constitutions of many countries that provide for inalienable rights to and titling procedures for gaining ownership of land, the process has been slow and largely ignored, especially in Bolivia. “[By] 2005, the indigenous Aymara people in Bolivia—which make up sixty to eighty percent of the total population—had filed land claims covering 143,000 square miles, but due to the slow, under-funded titling process, only 19,300 miles had been granted by the end of 2006.”\textsuperscript{113}

Even more discouraging is that in many countries, despite specific demarcation of indigenous lands, resource extraction and encroachment by transnational industries has gone largely unchecked, particularly in the mining and logging industries.\textsuperscript{114} The U.N. has noted the significance of such abuses because of the fact that “the majority of the world’s remaining natural resources—minerals, freshwater, potential energy sources and more—are found within indigenous peoples’ territories.”\textsuperscript{115} In an effort to combat flagrant disregard for indigenous rights, the new Bolivian Constitution puts the power in the hands of those most affected, and thus transnational corporations in Bolivia can expect increased scrutiny over current and potential operations within the country.

B. REAFFIRMATION OF NATIONAL OWNERSHIP OF NATURAL RESOURCES

In addition to improving the rights of the indigenous population, the new constitution also reasserts Bolivia’s right to the full benefit of its natural resources under article 349. “Natural resources are the inalienable and indivisible property and direct dominion of the Bolivian people and will be administrated, in the collective interest, by the State.”\textsuperscript{116} It further specifies that the state oil and gas company, YPFB, is in charge of


\textsuperscript{114} Aylwin, \textit{supra} note 112.

\textsuperscript{115} Indigenous Peoples, \textit{supra} note 113.

\textsuperscript{116} Van Schaick, \textit{supra} note 106.
the entire productive chain with authority to enter contracts with private companies to engage in oil and gas production as well.\textsuperscript{117} Apart from specific contracts with private organizations, all remaining profits from natural resources are considered property of the state.\textsuperscript{118} Article 359 is more specific, discussing hydrocarbons in particular, and reaffirming that they “are the inalienable and imprescriptible property of Bolivians” and that, on behalf of its citizens, the government “exercises the property rights over all hydrocarbon production in the country and only it is authorized to carry out its marketing.”\textsuperscript{119}

It is interesting to note that the constitution specifically stipulates control over hydrocarbons, but fails to mention lithium resources. Perhaps Morales and the Bolivian government assumed control over lithium would fall under the more general article 349 provisions governing natural resources as a whole. Alternatively, the specific provisions of article 359 could simply be a result of the relatively volatile history of hydrocarbon management as a way of ensuring Bolivian control for the future. A third (and the most likely) possibility is that Morales did not want to foreclose all opportunities for gaining foreign investment in developing the lithium industry and therefore did not specifically target it in the constitution so as to avoid the appearance of an overbearing government, unwilling to yield benefits to private actors.

Asserting control over natural resources is crucial to Morales’ developmental goals for his country.\textsuperscript{120} By capitalizing on Bolivia’s natural wealth, Morales can presumably increase living standards for his people while gaining international recognition as a major resource supplier, the benefits of which are already accruing even without a developed lithium industry. “Bolivia’s mining industry was producing significant gains for the country, leading to a 9.4 [percent] increase in its GDP, as reported in early 2008.”\textsuperscript{121} Such positive indicators could signal the start of a much-needed reversal in the fortunes of a country that, until recently, did not have the political strength to overcome its instability. “Bolivia is typical of the world’s poorest countries, where the management of resources essential to sustain economic development has suffered serious neglect.”\textsuperscript{122}

The fortified strength of the government under the new constitution should drastically improve control over the natural resources that are a key aspect of internal development “especially for indigenous and peasant groups that cannot easily benefit from the international economic system.”\textsuperscript{123} Opponents of nationalization frequently criticize the system for

\textsuperscript{117} Id.
\textsuperscript{118} Nagel, supra note 107.
\textsuperscript{119} Id.
\textsuperscript{121} Lucky Bolivia, supra note 20.
\textsuperscript{122} World Bank Indep. Evaluation Group, supra note 120.
\textsuperscript{123} OCHOA, supra note 41, at 93.
failing to allow the capitalist system to run its course by allowing strong-armed governments to manipulate and control markets, however:

If things were left purely to the momentum of economic forces—the so-called logic of the market that is nothing more than the logic of the transnationals—the result would be a type of integration that would continue producing marginalization and poverty in every country and accentuating the inequalities between rich countries and poor countries.\(^{124}\)

The increased control of the government is not solely a power-grab by the elite politicians either; much of the impetus and support for the new constitutional provisions came from the Bolivian people themselves, and as Francisco Quisbert (leader of a group of salt gatherers in the Salar de Uyuni, known as Fructas) said in an interview with the New York Times: “We know that Bolivia can become the Saudi Arabia of lithium . . . we are poor, but we are not stupid peasants. The lithium may be Bolivia’s, but it is also our property.”\(^{125}\)

The alignment of sentiments between the national government and the Bolivian people will most likely color the execution of future plans for the country’s lithium resources, but before jumping into a full-scale development project, they would be best-served to learn from the rise to economic and resource prowess of an unlikely, but surprisingly similarly situated nation, Saudi Arabia.

V. AN UNLIKELY ROLE MODEL: SAUDI ARABIA

A. AN ALTERNATIVE TO NATIONALIZATION: PARTICIPATION AGREEMENTS

Bolivia’s dilemma, that it possesses vast reserves of valuable lithium without the capital or infrastructure to properly extract it, is similar to the one Saudi Arabia, the country that possesses the world’s largest oil reserves, faced during the 1930s.\(^{126}\) The development of the now-booming oil industry in Saudi Arabia was a direct result of significant foreign investment. In the 1930s, when Standard Oil of California (SOCAL) discovered oil in the nation after winning concessions from the government, the country was capital-poor and undeveloped, thus unable to provide the necessary investment to create an oil industry to exploit the valuable resource.\(^{127}\) In fact, “prior to World War II, [Saudi Arabia] was one of the poorest [countries] on earth.”\(^{128}\) Foreign investment in Saudi Arabia was particularly important for its oil industry since “the problems of oil production . . . have always been the high sums of money needed for investment, the need for using the latest technology and the high risk and

124. Zibechi, supra note 90.
125. Romero, supra note 3.
127. Lucky Bolivia, supra note 20.
uncertainty involved mainly in the exploration phase.”

The extent of oil production operations in Saudi Arabia quickly grew as SOCAL gave way to a series of other cross-company partnerships (later known as the Arabian American Oil Company—ARAMCO) when it sold part of its interest to Texaco in 1936, which was then joined by today’s Exxon-Mobil in 1946 “to gain investment capital and marketing outlets for the large reserves being discovered in Saudi Arabia.”

The initial ownership of ARAMCO was divided wholly between those four companies with Mobil taking ten percent and the remaining three each owning thirty percent. Through significant foresight, the Saudi government managed to secure its future place at the helm of the oil industry by negotiating a gradual buyout process for ARAMCO known as “participation.” The Saudi government recognized that without maintaining involvement of the oil companies (if it chose to implement a traditional nationalization), the oil-producing countries would engage in pricing battles that could collapse the global market. In 1950, Saudi Arabia negotiated a fifty-fifty profit sharing agreement whereby the government would tax each barrel of oil produced by ARAMCO, which led to a significant increase in the country’s tax revenues. In 1972, under what was termed the “General Agreement,” Saudi Arabia continued to incrementally nationalize ARAMCO through participation purchases, initially beginning with a twenty-five percent share in the company with a five percent annual increase until a fifty-one percent holding by 1983; this would prevent “a precipitous nationalization” while laying “the groundwork for cooperation between the American and Saudi owners based on common business interests, such as maintaining stable markets and supply.” The agreement was modified periodically and by the end of the 1980s, Saudi Arabia had officially repurchased all of ARAMCO’s (now renamed Saudi Aramco) assets and was the oil conglomerate’s sole owner.

The importance of this repurchase process in the context of Bolivia is that Saudi Arabia started out in a similar situation of possessing a vast wealth of natural resources that the country could not afford to develop into a profitable economic sector on its own—much as Bolivia is unable to get its lithium industry on a global production level without significant

133. Id.
134. Metz, supra note 130.
136. Id. at 39.
outside aid. Saudi Arabia provides an excellent example for Bolivia because it obtained the necessary investment to get oil production off the ground, but managed to resist selling out its entire national resource wealth to foreigners by devising a clever method of regaining control of its assets over time. For a country like Bolivia, whose history is plagued with exploitation by such outside investors, taking a close look at how the Saudi government structured such a deal is crucial to ensuring the successful and profitable development of its lithium resources.

In order to effectively develop lithium production into a profitable, high-volume industry while maintaining a beneficial stake in the profits, it seems Bolivia should take steps to encourage outside investment and partnerships with a similar “participation” plan as Saudi Arabia executed during its fledgling years. The Bolivian government should also consider downplaying its nationalistic tendencies and realize that there are equally viable options that will bring wealth and improved standards of living to its people without polarizing foreign investors. The Saudi government carefully avoided a bare nationalization of ARAMCO after it realized the crucial role that foreign oil companies played in keeping the oil market stable and profitable. The Bolivian government needs to recognize the substantially similar position it is in and quell its population’s rancorous language concerning nationalization and the dissolution of contracts with private corporations. Without the aid of such corporations, it seems highly unlikely that Bolivian lithium production will be relevant, if it succeeds at all.

The best plan is for the government to draft an agreement as a precursor to allowing any external aid in which the government specifies how it will maintain an ownership stake in any joint venture with foreign multinational companies and that it will retain options or rights to repurchase the remaining shares over time. To encourage investment, the government should specify limits on its ability to repurchase all of the outstanding assets—either that it would be unable to do so before a specified date or before its foreign partners had recouped their initial investments or booked a specified profit. Furthermore, the Bolivian government will have to devise a reasonable share repurchase rate because unlike Saudi Arabia, Bolivia has a history of breaching contracts and misappropriating foreign companies, and thus it will have to tread lightly to encourage transnational corporations to trust the government and will be unable to engage in as aggressive a share repurchase process as Saudi Arabia conducted. With such a “participation” agreement, Bolivia could ensure its involvement in its lithium production industry despite the country’s need for foreign-sourced capital and infrastructural development.

137. See Lucky Bolivia, supra note 20.
B. **Should Bolivia Create Its Own OPEC?**

Another factor that greatly aided Saudi Arabia’s development and the success of the oil market as a whole for oil-producing nations was the creation of the Organization of the Petroleum Exporting Countries (OPEC) in 1960 between Saudi Arabia, Iran, Iraq, Kuwait, and Venezuela. This structure is another that, if successfully mimicked by Bolivia and other lithium-producing nations, could lead to a stable and profitable market for the metal. OPEC was a necessary response by oil-producing nations to check the pricing pressures of transnational oil companies (those same companies that provided the necessary initial investment to get the industry off the ground) and other threats to the producing nations’ welfares. OPEC represents the collective interests of oil-producing nations (much like a labor union, but for countries) and has four primary defining characteristics:

1) OPEC is an intergovernmental organization restricted exclusively to countries heavily dependent on oil exports for foreign exchange and economic development; 2) membership is in practice limited to developing countries; 3) decisions are reached by a ministerial conference, require a unanimous vote, and are subject to approval of all member governments; 4) political matters are at least formally outside the scope and purview of the organization.

Surprisingly, it did not take long for the organization to have a beneficial impact for member countries: “at the moment of its inception, OPEC managed to halt additional attempts to reduce oil’s posted price.”

Article 2 of OPEC’s guiding statute sets forth that its main purpose is to unify and stabilize oil prices between member countries, to ensure a stable income from oil production to those countries, and to ensure a regular supply of oil to consuming countries. The most interesting provision, however, is in article 2(c), which states that one of the functions of the organization is to give “due regard . . . to . . . a fair return on their capital to those investing in the petroleum industry.” While awkwardly phrased, this provision essentially declares that not only will OPEC protect member-nations, but it will also operate to ensure that those participating in the oil industry (the foreign oil companies) will receive a “fair return” on investment. This provision was probably included to reduce the threat that OPEC posed to the multinational oil companies—while other provisions set boundaries to protect the interests of OPEC members, this provision specifically extends an olive branch in asserting that

138. **Johany, supra** note 126, at 50.
140. *Id.* at 206.
143. *Id.*
non-member investors can expect fair treatment and thus encourages continued partnership and investment in the oil industry.

Despite unification under OPEC, a number of differences continue to cause tension between member countries mainly due to unequal allocation of natural resources and correspondingly varied policy interests. For example, while Saudi Arabia is interested in maintaining moderate price levels to ensure the long-term value of its vast reserves, a country with a smaller endowment of oil would want higher prices to maximize its return over its shorter production horizon.144 A further area of disunity is the proper role for national oil enterprises in member countries—whether they are to become proper transnational companies or remain agents of the national governments focused primarily on domestic development.145 Even with their assorted differences, however, the OPEC members continue in their joint relationship, realizing that “unless they remain together on the oil-pricing issue, they may well fail separately, and that their protagonists, the industrial powers and major companies, will regain the power they had over the oil industry until recently.”146

Article 3 of the OPEC statute reflects the desire for members to cooperate despite differences by providing that “[t]he Organization shall be guided by the principle of the sovereign equality of its Member Countries . . . [who] shall fulfill, in good faith, [their] obligations . . . in accordance with this Statute [emphasis added].”147 This article means that despite inequalities in distribution of oil resources and wealth, each member of OPEC is considered an equal of the others thus mitigating the threat of the more powerful members (Saudi Arabia) from setting the agenda and policies of the organization over the protests of weaker members (Venezuela). In addition, the language of “good faith” in the second clause of the article also addresses the guarantee of a fair return for non-member investors under the above-mentioned provisions of article 2. It effectively prohibits a member nation from breaching the guarantee by taking a drastic step contrary to an investor’s interests, such as nationalization, which is unlikely to classify as a “good faith” action under the statute.

The OPEC statute does not specifically provide for sanctions against a member country if it should breach any of the statutory provisions, however, the power to impose sanctions seems to be indirectly proposed under article 4. Article 4 provides: “If, as a result of the application of any decision of the Organization, sanctions are employed, directly or indirectly, by any interested company or companies against one or more Member Countries . . . [emphasis added].”148 The language of the provision suggests that the OPEC members cannot themselves enforce sanctions, but may issue a decision leading a non-member corporation to

144. Mikdashi, supra note 139, at 209.
145. Id.
146. Id. at 210.
147. OPEC Statute art. 3.
148. Id. art. 4.
impose sanctions on its own accord. The remainder of the provision clarifies that it is not actually meant as a grant of sanctioning power, but as a guard against the potential contradiction of a decision by the members as a result of a corporation imposing sanctions against one member for the benefit of another:

[N]o other Member shall accept any offer of a beneficial treatment, whether in the form of an increase in oil exports or in an improvement in prices, which may be made to it by such interested company or companies with the intention of discouraging the application of the decision of the Organization. 149

Thus, rather than providing for some inherent sanction power, the statute instead establishes that in the event a non-member imposes sanctions against a member, no other member may profit from those sanctions or go against the collective interest of the organization. This stipulation seems to further address the general policy of cohesion and cooperation between members, recognizing that allowing members to profit from the misfortunes of another would be divisive and undermine the unified interests that the organization seeks to protect.

A final interesting aspect of the organization is the quasi-democratic nature of its structure despite the fact that most member countries do not themselves embrace any form of democracy in their own respective governments. The organization is divided into three main components: a Conference, a Board of Governors, and a Secretariat. 150 The Conference is essentially the legislative body of the organization whose primary role is to set the general policies and methods for implementing them, to adopt the budget, to amend the statute, and to conduct other common policymaking functions. 151 The Board of Governors, on the other hand, plays an executive oversight function (more along the lines of a board of directors in a corporation) directing the management of the affairs of the organization, implementing decisions by the Conference, and making recommendations to the Conference regarding policies and drawing up the budget for the organization. 152 Finally, in addition to the Board of Governors, the Secretariat is also charged with an executive role that is subordinate to the board, but contains the legally authorized representative of the organization, the Secretary General (like the CEO of a corporation), who is appointed from one of the member countries for a three-year term. 153 The structure of OPEC seems like it is intended to establish a distribution of powers and division of labor, which also supports the ever-important cooperative bond between the member countries and prevents any one member from exercising too much control or authority over the others.

149. Id.
150. Id. art. 9.
151. Id. art. 15.
152. Id. art. 20.
153. Id. arts. 25-27.
After garnering foreign corporate investment to help get its lithium industry to become a regular supplier to the market, it seems that Bolivia would greatly benefit from taking a page out of the Saudi Arabian playbook by creating an organization similar to OPEC (perhaps the Organization of the Lithium Exporting Countries—OLEC) jointly with Tibet, Mexico, and the other South American lithium producers. The goals of creating such a joint venture with the other lithium producers would be similar to those that instigated the creation of OPEC in the 1960s, namely a need for a unified front against pricing pressures and for a self-regulated production and supply schedule to stabilize prices and ensure regular income to each member. Structurally, an organization between lithium producing countries would be best served to adopt a similar division of powers that exists under the OPEC Statute. A separation of powers is important to ensure no single member becomes too powerful or abusive of the policies.

While it is unlikely that Bolivia could currently exert enough influence to instigate the creation of such an organization, after a few years of producing and supplying the market with its lithium, being the country with the largest known reserves, it would be best suited to lead the charge towards protecting the market for its valuable resource. Furthermore, if Bolivia could somehow currently convince the other lithium producing countries to join such an organization and to adopt a statute containing provisions similar to the OPEC Statute that protect outside investor corporations participating in the industry, Bolivia could potentially solve its issues with convincing transnational companies to invest in lithium extraction and production infrastructure within the country. Those companies would be statutorily protected for a “reasonable return on their investments” and, should Bolivia violate those terms, the corporations could impose sanctions against its production.

To add further assurances to convince foreign corporations to invest despite Bolivia’s recent trend toward nationalization, the organization should include its own provisions for censuring member countries that breach the statutory language and provide sanctioning power by one of the arms of the organization. In order to effectively hear grievances by non-member corporations and render decisions when issues arise over the conduct of a member nation, Bolivia and its peers should also consider adding a pseudo-judicial arm or tribunal that could more effectively interpret and apply the statutory language governing their organization. Such a tribunal could be composed of a rotating group of representatives from member nations to ensure a fair representation of each individual’s interests and interpretation of the statute.

A strong statutory structure and protections like those proposed above would hopefully overshadow Bolivia’s history and recent reprise of nationalistic tendencies that chill foreign investment. With stronger protections for foreign corporations, they would be more inclined to feel confident that they could profitably invest in Bolivia’s lithium production infrastructure without facing a sudden seizure of assets in a governmental
nationalization. Clearly, Bolivia would benefit from such protective provisions as well because outside foreign investment is crucial to the country’s ability to become a major member of the lithium production market. Therefore, a central organization of lithium producers governed by a strong statute seems like an excellent option for Bolivia and its peers to consider as the lithium market grows. Aside from helping countries like Bolivia obtain the necessary initial investment and eventual negotiated repurchase agreements with transnational lithium extracting companies, such an organization would add a further level of protection for Bolivia and fellow member countries by regulating the prices and supply of lithium on the market to avoid misalignment of supply or demand.

C. AVOIDING THE PITFALLS OF A RENTIER STATE

Before Bolivia proceeds to mimic Saudi Arabia in the hopes of becoming as wealthy and powerful, the country should take heed of the indirect negative effects of a government suddenly becoming the collector and redistributor of natural resource wealth. During the oil boom, Saudi Arabia transformed into what is commonly termed a “rentier state,” the government collected economic “rents” from the profits of the extractive oil industry and then became a “source of wealth domestically as one of its primary functions [became] that of distributor . . . [a] patron of both the economy and of society.”154 Rentier states are defined by the fact that their primary income is based purely on the extraction of natural resources rather than from some actual capital-producing function, and that without such rents, the state would be a deficit economy.155 Furthermore, in their extraction of natural resources, rentier states employ a small percentage of the indigenous population because “the technology required for the profitable extraction of the natural resources is predominantly in the hands of foreigners.”156 With all rents concentrated in the hands of the government, the state becomes a distributor of economic benefits, which it uses as a continuing source of legitimacy to advance other agendas as it no longer depends on taxation and thus has no political accountability.157

As a financially independent entity not dependent on taxation, the Saudi Arabian rentier-state gave rise to a controlling elite bureaucratic business class based on family connections, favoritism, and excessive wastage with the ability to “buy off” any potential opposition.158 The various social provisions (medical care, education, food subsidies) making Saudi Arabia a “welfare state” have evolved into a “social contract” whereby the state provides and the people bite their tongues against its

154. CHAMPION, supra note 1, at 9.
156. Id.
158. CHAMPION, supra note 1, at 81.
frequent abuses of power. Distribution is not an entirely effective tool for silencing the masses, however, for the inequitable distribution of wealth is cause for dissent because “the prosperity of private citizens is dependent upon . . . access to contracts, information, jobs in the public sector or infrastructure governed by family relations, friendship, religious branch, and regional affiliation.”

When the government plays a central role in distributing economic rents, it is independent of its untaxed citizens who benefit from the welfare of the state and thus who “have little incentive and no effective mechanism by which to hold the government accountable.” While there are a number of proposed methods of mitigating this disconnect between governments and their people, the most effective solution would be direct distribution of revenues or interest from the extraction of natural resources to the people themselves. Although distribution to all citizens poses some logistical challenges, especially for developing countries, it is not impossible and has been done in Bolivia previously with direct distribution of pension returns from private enterprise to senior citizens—the advantage being that such a system prevents natural resource profits from passing through the hands of public officials prone to corruption and misappropriation.

Therefore, with the potential rise of a booming lithium industry that would bring much economic and social success to Bolivia, the government and its people should be wary of transforming into a welfare state or rentier-state whose primary function would become distribution of economic rents from its extractive industries to its people. While the population would certainly benefit from an improved standard of living, the lack of accountability that comes with a government running a constant budget surplus is risky to human rights and democracy, especially in a region where political corruption and improper influence is abundant.

Bolivia should strongly consider a system of direct distribution of the economic rents to its people to avoid exposing the country’s newfound wealth to misappropriation by political officials. The potential benefits of a direct distribution system would be threefold: 1) it would drastically improve the standard of living for each and every Bolivian; 2) with increased capital wealth, those citizens would have the ability to reinvest in the country’s economic development through various business pursuits; and 3) the government would remain accountable to its citizen body since it would still have to raise taxes in order to function. With foresight towards avoiding the pitfalls that have arisen in Saudi Arabia, Bolivia would maximize the beneficial effect of its lithium industry profits.

159. Id. at 82.
160. Okruhlik, supra note 157, at 297.
162. Id. at 86.
163. Id. at 86-87.
VI. CONCLUSIONS AND RECOMMENDATIONS

Lithium extraction, production, and development have strong potential to raise Bolivian society out of the economic and social rut that has plagued the nation since colonial times. While in recent history the Bolivian government has favored a policy of nationalization of various natural resource industries in an effort to keep some of the profitability and wealth within the country, the current leadership under Evo Morales should pursue an alternative strategy for the development of the country’s lithium industry. Threats of nationalization and misappropriation do not encourage transnational corporations and foreign investors to feel secure about helping the country develop the infrastructure necessary for a thriving lithium industry, but without such outside investment, Bolivia will be unable to exploit the full potential of its resource wealth and will run the risk of missing its window to join other lithium producing countries as a major supplier to the global market.

To fully realize the benefits of its wealth of lithium resources, Bolivia will have to make some important concessions at the start. By following the path Saudi Arabia took when developing its oil industry, Bolivia should initially allow foreign corporations to develop and begin lithium production under a collaborative central company and then use revenues from taxes on the profits of those corporations to gradually repurchase shares of that company under a participation plan to increase the state-owned share. This would allow Bolivia to benefit from outside help in getting the industry up and running as well as ensure it has a share in the process that could gradually revert to state control over time.

To protect the value and market for lithium, Bolivia should also encourage forming a lithium production organization like OPEC with its peers in the lithium industry. This would achieve dual goals of ensuring stable, regulated prices on the lithium market as well as further assure foreign corporations that investment in Bolivia is not too risky. With a proper statute and a judicial oversight arm to guide the conduct of member countries and provide for sanctions against those who breach the language, foreign corporations could be assured that their investment in infrastructure and expected profits would be guaranteed.

Finally, to avoid some of the societal pitfalls of a government distributing resource-wealth to its people, Bolivia should set up a system for directly distributing proceeds to Bolivian citizens to increase their standard of living, to encourage new investment in businesses and industries, and to keep the government accountable by forcing it to rely on a system of taxation for its budget.

With these policies and structures in place, Bolivia has great potential to become a valuable, resource-producing nation that will finally benefit from its own wealth and overcome centuries of abuse and mistreatment by external forces.
HE innovations and creations of individuals in a given society are a valuable and integral aspect of the society.\textsuperscript{1} In an effort to protect these innovations and creations, societies have either applied principles of common law or have statutorily implemented copyright, trademark, and patent protection.\textsuperscript{2} Because the main case in this note deals with copyright law, the focus of the note will be solely on copyright law. On an international scale, treaties like the World Intellectual Property Organization (WIPO) Copyright Treaty and the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement have been implemented to enforce copyright protections in an age where the Internet makes it easy to download works without paying royalties to the creators.\textsuperscript{3} In the 2004 case, Society of Composers, Authors & Music Publishers of Canada v. Canadian Association of Internet Providers, the Supreme Court of Canada considered who should pay royalties to musicians and composers when their copyrighted music is downloaded in Canada from an Internet server located outside the country.\textsuperscript{4} The Court held that Internet service providers (ISPs) are not users under Canada’s Copyright Act, and therefore, do not have to pay royalties for illegally downloaded music.\textsuperscript{5} While the Supreme Court of Canada made a valid attempt to

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5. Id. ¶¶ 131-32.
enforce copyright protection for the works of its citizens, the Court failed to carefully consider the WIPO Copyright Treaty and the TRIPS Agreement, both of which should be reconsidered by their respective organizations due to rapidly changing technology.

This article will analyze Society of Composers and will compare the ruling of the case with the provisions of two treaties to which Canada is a signatory, along with statutes and cases from other countries. The following section will contain a brief overview of the primary case and the issues that arose under it. Section II will discuss the legal and historical context for the case and how the case relates to treaties signed by Canada. Section III will analyze how the holding of this case fits into today’s legal context with a specific focus on the treaties. Finally, section IV will discuss the implications of the case and how the law has changed since the case was published.

I. THE PRIMARY CASE: SOCIETY OF COMPOSERS, AUTHORS & MUSIC PUBLISHERS OF CANADA V. CANADIAN ASSOCIATION OF INTERNET PROVIDERS

Advocates of strict copyright laws have gone so far as to blame ISPs for the continuous violations of copyright laws by their users. The Society of Composers, Authors, and Music Publishers of Canada (SOCAN) is one such advocate. As the appellants in Society of Composers, SOCAN argued that royalties should be imposed against ISPs who allow users to violate copyright laws. Applying section 2.4(1)(b) of Canada’s Copyright Act, the Supreme Court of Canada found that Internet intermediaries, also known as ISPs, are not “users” as defined under the act, and therefore, are not liable to pay royalties to the artists.

Before Society of Composers went to the Supreme Court of Canada, however, it started out as a proposal by SOCAN for a tariff that would have required a license and a royalty fee for musical works owned by SOCAN to be communicated to the public via telecommunication. The Copyright Board of Canada, an administrative body that has the authority to hold hearings without the presence of a legally trained member, heard SOCAN’s tariff proposal. While the Copyright Board usually deals with general application of copyright laws, the decisions of which cannot be appealed, where there are issues regarding questions of law, a Canadian court may have appellate jurisdiction.

SOCAN, which was formed under the Copyright Act to represent both Canadian and foreign music composers, authors, and publishers, brought

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6. Id. ¶ 14-15.
7. Id.
8. Id. ¶¶ 131-32.
9. Id. ¶ 12.
10. Id. ¶ 12, 49 (noting that while a legally trained member is not required, the Chair of the Board must be either a current or former judge).
11. Id. ¶ 49.
before the Copyright Board a proposal for the imposition of Tariff 22 on Internet telecommunications. In doing so, SOCAN referred to certain provisions of the Copyright Act to argue that licenses and royalties were due to the artists based on the provisions and definitions of the statute. Section 2.4(1) of the Copyright Act in part states that persons who communicate copyrighted works via telecommunication to the public are liable for their transmissions. “Public” refers partly to “persons who occupy apartments, hotel rooms or dwelling units situated in the same building.” “Communication to the public,” is defined under the statute as a work or subject matter meant to be received by those persons who comprise the public. But Justice Binnie, writing for the Supreme Court of Canada, defined communication in its ordinary sense, as “to impart or transmit.” Finally, section 2 of the Copyright Act defines “telecommunication” as “any transmission of signs, signals, writing, images or sounds or intelligence of any nature by wire, radio, visual, optical or other electromagnetic system.”

Opponents of Tariff 22 were Canadian ISPs who supplied Internet access to users who uploaded the copyrighted content and to end users who viewed the content. They argued that they were not communicating the protected music, as defined under the statute. Despite the fact that the ISPs may not have transmitted the entire work, the Copyright Board found that they did transmit some part of the work, and therefore, were found to have communicated under the statute.

To better understand the issues presented by the parties, one must first understand how the Internet facilitates communication between the content provider and the end user. Where ISPs are involved, content providers must pay a fee to store their files on a host server, provided by the ISP, from which content is transmitted to end users. Any musical work, for example, posted on a host server can then be accessed by an individual anywhere in the world so long as that individual has service from an ISP.

12. Id. ¶ 11-12.
13. Id. ¶ 12.
15. Id.
16. Id.
20. Id. ¶ 22; R.S.C., c. C-42 (Section 2.4(1) of the Copyright Act provides: “For the purposes of communication to the public by telecommunication . . . (b) a person whose only act in respect of the communication of a work or other subject-matter to the public consists of providing the means of telecommunication necessary for another person to so communicate the work or other subject-matter does not communicate that work or other subject-matter to the public . . . ”).
22. Id. ¶ 18.
23. Id.
Initially, SOCAN wanted to impose royalties against not only ISPs, but also against what the Court called “Backbone Service Providers,” or those companies that provide the infrastructure necessary to support Internet service such as fiber optic cable and telephone lines. But they later singled out ISPs because of the providers’ abilities to control the content of a particular website. SOCAN was particularly concerned with “caching” being conducted by the ISPs and argued the cache copies that had been retransmitted violated the Copyright Act. Caching is the process of making a temporary copy, or “cache copy,” of a website’s content when it is visited by an end user. The cache copy is then retained for the next user to view, ultimately enhancing the speed at which the subsequent end user receives the information and reducing the costs incurred by the ISP. Although cache copies are not permanent, the ISP has discretion in deciding when to terminate a particular cache.

After consideration of the issues before it, the Copyright Board held that ISPs, acting in their ordinary course of business rather than as content providers, could not be forced to pay a royalty under the Copyright Act because their activities did not constitute communications under the act, and thus did not violate copyright protections. But the Copyright Board also held that where the ISPs did provide content to be accessed by other users, such as music stored on servers located in Canada, those service providers would have to pay a royalty. The Copyright Board further held that mere knowledge of an infringement was not enough to impose a royalty on a service provider; rather, a royalty would be imposed on the provider if it granted a content provider permission to infringe a copyright. Finally, the Copyright Board found that caching was a practical necessity because it related to the quality of service provided by the ISP and reduced the provider’s costs.

Finding little satisfaction from the holding of the Copyright Board, SOCAN appealed the decision to the Canadian Federal Court of Appeals on the grounds that it involved legal questions. Upon review, the appellate court found that an application of the real and substantial connection test was proper to determine whether a certain communication had any real and substantial connection to Canada or the ISP. The real and substantial connection test is a type of balancing test that looks at weighing factors such as the locations of the ISPs, the content providers, the ultimate.

24. Id. ¶ 14-15.
25. Id. ¶ 19.
27. Id. ¶ 23.
28. Id.
29. Id.
30. Id. ¶ 28.
31. Id.
32. Id. ¶ 33.
33. Id. ¶ 38.
34. Id. ¶ 35.
35. Id. ¶ 36.
users of the content, and the host server.\textsuperscript{36}

Under Canada’s real and substantial connection test, the appellate court unanimously found that the Copyright Board erred as a matter of law when it failed to consider factors such as the locations of the end users, content providers, and host servers.\textsuperscript{37} Further, the court concluded that caching, even in the context of improving service, violated the Copyright Act and was not a practical necessity as the Copyright Board had found.\textsuperscript{38} The case was then appealed by the ISPs to the Supreme Court of Canada.

This issue of how to protect copyrighted works has become increasingly important in the purview of global economics, especially with advancements in technology and increasing globalization.\textsuperscript{39} And while solutions to upholding copyright owners’ rights abound, there is still the problem of how to enforce these rights on an international level.\textsuperscript{40} Treaties like the Berne Convention, the WIPO Copyright Treaty, and the TRIPS Agreement attempt to solve this issue.\textsuperscript{41} Yet these international agreements have failed to account for the rapidly enhancing technology and have left countries in a stalemate over copyright protection and enforcement.\textsuperscript{42} Society of Composers illustrates the need to amend existing treaties to take into account recent technological innovations and the increasingly globalized market.

For a better understanding of the issues in this case, consider the following hypothetical. John is a content provider who has purchased storage space on a host server that is operated by XYZ Co., an ISP with its principal place of business in the United States. As part of their agreement, John agrees not to post illegal content such as copyrighted materials for which he has not paid royalties, but he knows that XYZ Co. does not monitor the content that is posted. John subsequently posts a copyrighted song written and performed by Group X to his website and makes the song available for others to download without paying a fee. John lives in the United States, but people all over the world can access his website and download the song he has posted. Group X is a band that holds copyrights to all of its songs in several countries, including Canada and the United States. Assume now that Jane, a woman living in Canada and a fan of Group X, comes across John’s site and decides to download

\textsuperscript{36} Id. ¶ 60-61.
\textsuperscript{37} Id. ¶ 37.
\textsuperscript{38} Id. ¶ 38.
\textsuperscript{40} Id. at 215 (noting that jurisdiction and choice-of-law issues have hindered the United States’ efforts to combat copyright violations).
\textsuperscript{42} Nehila, supra note 39, at 216.
the posted song. Although the song is copyrighted in both countries, neither John nor Jane paid royalties to use the song. This situation is exactly why SOCAN wanted to impose a tariff against the ISPs—because it was easier for them to pursue royalties from a company than from individuals. But copyright laws vary between nations and sometimes countries do not even apply the minimum standards required by current treaties, as seen in Part III of this case note.43

II. LEGAL BACKGROUND: INTERNATIONAL COPYRIGHT TREATIES, PRECEDENT, AND THE SUPREME COURT OF CANADA

The English common law began recognizing copyrights shortly after the invention of the printing press.44 Since then, copyright laws have evolved with changing technology.45 But despite society’s best efforts to curb infringement of these rights, technology remains one step ahead, giving people access to copyrighted material and leaving the creators with little to no return for their work.46 In this age, sharing via the Internet is becoming more pervasive in societies with the infrastructure to support such a system.47 This proliferation of readily available technology and connection to the Internet has created myriad copyright issues for artists, companies, and countries attempting to regulate intellectual property rights both on domestic and international levels.48

The most recent international enactment of copyright protection is the WIPO Copyright Treaty, enacted in December 1996.49 The first convention to consider issues of copyright protection was the Berne Convention, to which Canada became a signatory in 1928.50 Since then, the Berne Convention has undergone several amendments and has been adapted into both the WIPO Copyright Treaty and the TRIPS Agreement.51 Canada is a signatory to both of these treaties, but has not enacted either of

43. Id.
44. WIPO, INTRODUCTION TO INTELLECTUAL PROPERTY THEORY AND PRACTICE 23 (1997).
45. Id. at 25.
46. See, e.g., Nehila, supra note 39, at 199-200 (discussing the impact of MP3 technology on copyright infringement in the digital music arena).
47. Soc’y of Composers, 2 S.C.R. 427, ¶ 129 (“The internet makes it possible for large numbers of people to rapidly copy protected materials worldwide . . . . [D]evelopments have led some to hypothesize that copyright law is dead because technology is so far ahead of the law that enforcement is impossible, and should not even be attempted.”) (quoting Matthew V. Pietsch, INTERNATIONAL COPYRIGHT INFRINGEMENT AND THE INTERNET: AN ANALYSIS OF THE EXISTING MEANS OF ENFORCEMENT, 24 HASTINGS COMM. & ENT. L.J. 273, 278 (2002)).
49. Id. at 201.
51. WIPO Copyright Treaty, supra note 41; TRIPS Agreement, supra note 41.
them. But the U.S. Congress, the Parliament of Canada has the ability to enact laws that can be enforced on citizens of foreign countries. But as the Court in Society of Composers notes, courts do not presume that Parliament writes laws in this way, especially where there is no provision giving extraterritorial effect. The fact that the court will not read extraterritorial effect into a statute, such as the Copyright Act, is significant to the outcome of Society of Composers. Further, “the real and substantial connection test” applied by the appeals court in this case was first adopted by the Supreme Court of Canada in its decision in Morguard Investments Ltd. v. De Savoye to rein in the extraterritorial jurisdiction. Morguard involved a mortgage default claim, in which one party resided in Alberta and the other had moved to British Columbia after defaulting. Although the case dealt with two parties in different provinces, the Court noted that it adapted its holding from a rule recognizing judgments in foreign countries where they concern Canadian citizens. More recent cases out of the Supreme Court of Canada have reaffirmed the “real and substantial connection test,” noting that the test reflects the realities of territorial limits and realizes respect for the laws of other nations.

The Court in Society of Composers held that the case should be remanded back to the Copyright Board to decide whether Tariff 22 should be enacted in accordance with the Court’s opinion. The Court found that an ISP is not liable for royalties to copyright holders as long as it is acting merely as a “conduit” for communications. Further, the Court extended the decision of the Copyright Board by holding that ISPs do not authorize their users to violate copyright laws even when they know that their users might commit such violations. Basing its holding on the legislative policy of the Copyright Act, the Court noted that an ISP cannot possibly monitor all of the content users post each day. Using the “real and substantial connection test,” the Court found that the test was more than sufficient to justify bringing claims against those providers outside the country, especially because Canada has a public interest in the infor-

54. Id.
55. Id. ¶ 57.
56. Id. ¶ 60.
58. Id. ¶ 22.
60. Id. ¶ 133.
61. Id. ¶ 101.
62. Id. ¶¶ 101, 103.
63. Id. ¶ 101 (the court cites evidence that one Internet service provider in general delivers “11 million transmissions a day.”).
mation that enters and exits the country.\textsuperscript{64} Finally, the Court held that caching is protected under the Copyright Act because the main purpose of caching is to streamline service, not to violate copyright.\textsuperscript{65}

Although the Court had plenty of its own authority on which to rely, a good deal of the Court’s analysis also considered the decisions of other countries regarding copyright law.\textsuperscript{66} Among the statutes cited by the Court were the E-Commerce Directive of the European Commission and the Australian Copyright Amendment (Digital Agenda) Act 2000.\textsuperscript{67} Notably, the Court cited the E-Commerce Directive for the proposition that either the country in which the transmission is received or the country from which the transmission is sent can take jurisdiction of the communication as long as there is a connection to its territory and the country, as a matter of national policy, chooses to take jurisdiction.\textsuperscript{68} Australia, also a signatory to the WIPO Copyright Treaty, permits Australian copyright holders to impose royalties on communications sent and received inside and outside Australia.\textsuperscript{69} The Court also made note of a case concerning copyright protection between the United States and France in which the United States refused to grant an injunction mandated by a French court that had ordered a U.S. company to block its French users from access to an auction because of the harm that would have been suffered in the place of reception, France.\textsuperscript{70} Although in that case, the U.S. federal court refused to grant the injunction based on the First Amendment of the U.S. Constitution, not on jurisdictional justifications.\textsuperscript{71}

The Supreme Court of Canada analyzed the laws of other countries to ensure that it could in fact claim jurisdiction over copyright conflicts originating both in Canada and in other countries.\textsuperscript{72} The Court found that several nations were willing to take jurisdiction outside their own countries and that Canada would also be justified in doing so.\textsuperscript{73} Surprisingly, the only treaty mentioned by Justice Binnie is the WIPO Copyright Treaty, to which he noted Canada is a signatory, but not a party.\textsuperscript{74} He cited the treaty for the proposition that multiple royalties cannot be imposed on one work in different countries that are parties to the treaty.\textsuperscript{75}

\begin{itemize}
\item \textsuperscript{64} Id. ¶¶ 60-62. Justice Binnie is careful to point out that while Canada can apply the Copyright Act to Internet transactions occurring on an international level, the country is still mindful of the laws of foreign countries also involved. Id. ¶ 60.
\item \textsuperscript{65} Id. ¶ 116.
\item \textsuperscript{66} Id. ¶¶ 64, 69, 70, 73, 75.
\item \textsuperscript{67} Id. ¶¶ 66, 63.
\item \textsuperscript{68} Id. ¶ 68.
\item \textsuperscript{69} Id. ¶¶ 73-74.
\item \textsuperscript{70} Id. ¶ 75 (citing Yahoo!, Inc. v. La Ligue Contre Le Racisme et L’Antisémitisme, 145 F. Supp. 2d 1168 (N.D. Cal. 2001)).
\item \textsuperscript{71} Id.
\item \textsuperscript{72} Id. ¶¶ 76-78.
\item \textsuperscript{73} Id. ¶ 76.
\item \textsuperscript{74} Id. ¶ 65; see also Contracting Parties to the WIPO Copyright Treaty, WIPO, http://www.wipo.int/treaties/en/ShowResults.jsp?lang=en&treaty_id=16 (last visited Nov. 6, 2010) (showing that Canada remains a signatory of the treaty but is currently not a party).
\item \textsuperscript{75} Soc’y of Composers, 2 S.C.R. 427, ¶ 65.
\end{itemize}
Nevertheless, the Supreme Court of Canada asserted its ability to take jurisdiction over foreign matters via the “real and substantial connection test” and Justice Binnie reemphasized that when Canada is the country where the communication is transmitted or received, the Court’s ability to claim jurisdiction is in accordance with international copyright guidelines.76

After ensuring that its legislation was in line with the predominant international legislation on copyright protection, the Supreme Court of Canada then turned to the specific language of the Copyright Act and the intent of Parliament in its enactment.77 The Court started with the actual language of the statute and found that the burden of proof was on the copyright holder seeking to assert his or her right against another who had communicated that right by telecommunication.78 On its appeal, SOCAN took issue with section 2.4(1)(b) of the Copyright Act and argued that the Act’s exemption for ISPs should be narrowly construed.79 But the Court disagreed and stated that ISPs would be shielded from liability as long as they did not participate in acts that dealt with the content of the communication.80 In a parliamentary report, a sub-committee expressed the need for the Copyright Act to incorporate a broader definition of telecommunication, which it later adopted as an amendment to the Act, reflected in section 3(1)(f).81 Along with this amendment, the sub-committee commented that ISPs who were merely intermediaries should not be held liable under the broadened definition.82 The comment served as a reminder to Canadian courts that the nature of the intermediaries’ actions would continue to be important in the copyright context.83

The Supreme Court of Canada also compared the wording of the Copyright Act to the statutes of other countries to determine that the language was consistent with and met the obligations of the WIPO Copyright Treaty.84 The Court again cited to the European E-Commerce Directive, which states that operating a network of communication is merely technical and passive, which implies the operator has neither knowledge nor control of the information being communicated.85 And, as the Court noted towards the end of its opinion, Parliament enacted the Copyright Act to distinguish those who infringe copyrights to avoid paying for works from those who merely provide the Internet infrastructure and, therefore, unavoidably impact the nation’s economics with contin-

76. Id. ¶ 63.
77. See generally id. ¶¶ 89-91.
78. Id. ¶ 83 (quoting R.S.C., c. C-42).
79. Id. ¶ 88.
80. Id. ¶ 92.
81. Id. ¶ 90.
82. Id.
83. Id.
84. Id. ¶ 97.
85. Id. ¶ 98.
ued expansion and development.  

In sharp contrast to the majority opinion is Justice LeBel’s dissent. He agreed with the Copyright Board that the legal standard required the host server to be located in Canada but that he would not have applied the real and substantial connection test.  

While Justice LeBel agreed that Canada does have the authority to give extraterritorial effect to legislation, he looked directly to the Copyright Act to find that it does not expressly or implicitly give extraterritoriality. To reinforce his position that the real and substantial connection test did not apply in this case, Justice LeBel distinguished cases like Morguard and relied on treaties to which Canada is a signatory. Although Canada is only a signatory to the WIPO Copyright Treaty and the TRIPS Agreement, Justice LeBel dispelled the notion of the majority that the treaties could not be considered as interpretive aids. After all, Canada has an interest in following international copyright practice. Justice LeBel’s further problems with the majority’s approach were that it could result in awarding more royalties than necessary and its possibility of invading the privacy of end users.

III. PRACTICAL ANALYSIS & IMPLICATION—REVISIONING COPYRIGHT LAW ON AN INTERNATIONAL LEVEL

Today, countries have the guidelines of the WIPO Copyright Treaty and the TRIPS Agreement on which to base their copyright laws. And while several nations have proven that they can adapt and apply treaty mandates to their own jurisprudence, there still remain several issues with copyright protection. The first issue is that copyright infringement is still being committed on an international level and possibly at a greater rate due to advancements in technology over the past decade. This is further exacerbated by the fact that worldwide Internet usage has risen from about ten percent of the world’s population in 2002 to more than a quarter in 2009.

86. Id. ¶ 131.
87. Id. ¶ 134.
88. Id. ¶¶ 143-44.
89. Id. ¶ 147-48.
90. Id. ¶ 149.
91. Id. (noting that treaties like the WIPO Copyright Treaty bring domestic copyright laws from different countries into harmonization with one another).
92. Id. at ¶¶ 152-53.
93. Overview: The TRIPS Agreement, supra note 2; Summary: WIPO Copyright Treaty (WCT) (1996), supra note 3.
95. Witt, supra note 3, at 377 (noting that initial copyright laws dealt with print media and have not been modified to a great enough extent to take into account new technologies, thereby creating copyright issues).
The second issue is enforcement. Copyright holders are no longer just worried about individuals illegally downloading files; they now also have to worry about whether certain countries are fulfilling the obligations imposed on them by treaties like the TRIPS Agreement.\textsuperscript{97} More recently, a panel of the World Trade Organization (WTO) was called to resolve a dispute over copyright laws brought by the United States against China.\textsuperscript{98} The United States argued that China’s copyright laws did not comply with the terms of the TRIPS Agreement because it denied copyright protection to works that China considered illegal.\textsuperscript{99} Although the panel recognized China’s right to prohibit certain works, it found that China’s denial of copyright protection for the works at issue was inconsistent with the Berne Convention, which was incorporated under the TRIPS Agreement.\textsuperscript{100} China was then asked to revise its copyright laws to conform to the provisions the country had agreed to under the TRIPS Agreement when it became a member.\textsuperscript{101}

The United States is particularly concerned with copyright protection for its artists, especially as copyright industries generated sales of $89 billion in 2002.\textsuperscript{102} In a document distributed by the U.S. Copyright Office, the United States makes light of the fact that there is no international copyright law, but rather that protection is given by individual nations’ laws.\textsuperscript{103} But the United States must also take the extra step of ensuring that the copyright protection it grants does not violate its own First Amendment.\textsuperscript{104}

In a recent decision out of the Tenth Circuit Court of Appeals, the court held that section 514 of the Copyright Act did not violate the First Amendment right to free speech.\textsuperscript{105} At issue in that case was whether works removed from the public domain to have their copyrights restored violated the First Amendment rights of a group of plaintiffs who relied on those once public works to make a living.\textsuperscript{106} The Tenth Circuit looked at congressional hearings and determined three things: (1) failing to restore the copyrights would put the United States in violation of the Berne Convention and TRIPS Agreement, (2) not restoring the copyrights would harm American artists’ copyrights abroad, and (3) other countries would

\begin{flushleft}
\textsuperscript{98} Id. at 17.
\textsuperscript{99} Id. at 16-17.
\textsuperscript{100} Id. at 32.
\textsuperscript{101} Id. at 133.
\textsuperscript{104} See Golan v. Holder, 609 F.3d 1076, 1080 (10th Cir. 2010).
\textsuperscript{105} Id. at 1095.
\textsuperscript{106} Id. at 1081-82.
\end{flushleft}
follow the United States’ lead in this area.\textsuperscript{107}

While Canada has established a legal test for determining when it will enforce its copyright laws, there is still substantial variation within the international community.\textsuperscript{108} Some countries, like Hungary and China, have implemented strict punishments for copyright infringement on both the criminal and civil levels.\textsuperscript{109} At the other extreme, other countries, like Australia and Greece, have been more lenient in both implementing and enforcing copyright infringement penalties.\textsuperscript{110} Yet all of these countries have something in common; they are all at least signatories, if not parties, to the TRIPS Agreement and the WIPO Copyright Treaty.\textsuperscript{111}

As previously mentioned, the respective intergovernmental organizations have procedures for ensuring that copyright laws are enforced according to the provisions of the treaties, which provide the minimum standards to be met.\textsuperscript{112} The majority in \textit{Society of Composers} mentions the WIPO Copyright Treaty, but does not fully analyze the treaty because of the fact that Canada is only a signatory.\textsuperscript{113} Further, the Court applies a domestic law with no extraterritorial effects to a situation that could have foreign consequences, which could be problematic for the country later.

So far, no challenges to the holding in \textit{Society of Composers} have come through the Canadian court system. But recent cases like \textit{Public Performance of Musical Works, Re} reaffirm the standard of correctness that the Court used in reviewing \textit{Society of Composers}.\textsuperscript{114} As a side note, Canada enacted proposed Tariff 22, but it was only effective until 2006 and only applied on an interim basis until 2007.\textsuperscript{115} The final language adopted in the tariff was consistent with the holding of \textit{Society of Composers} in that it did not single out liability for ISPs; rather, the tariff applied to online music services.\textsuperscript{116}

\section*{IV. CONCLUSION}

While courts around the world continue to attempt to protect copyrights, the simple fact is that technology has out-paced copyright law. Those who hold copyrights need to be aware of the issues they face in enforcing their rights, particularly when dealing with countries that do not effectively implement the treaties to which they are parties. In this

\textsuperscript{107} Id. at 1086-87.
\textsuperscript{108} See, e.g., Nehila, supra note 39, at 219-20.
\textsuperscript{109} Id. at 219.
\textsuperscript{110} Id. at 219-20.
\textsuperscript{111} \textit{Understanding the WTO: Members and Observers}, supra note 52.
\textsuperscript{112} See, e.g., Panel Report, supra note 97, at 12.
\textsuperscript{113} \textit{Soc’y of Composers}, 2 S.C.R. 427, ¶ 65.
\textsuperscript{114} \textit{Public Performance of Musical Works, Re}, [2010] F.C.R. 348, ¶ 8 (Can.).
\textsuperscript{116} Id. at 1-2.
digital age, copyright holders have to take the initiative and lobby for stronger protection of their rights on both national and international levels, or they risk losing royalties on property rights to which they are entitled. Furthermore, while countries like Canada have made policies that attempt to deal with copyright protection issues, these countries cannot go it alone. Society of Composers may benefit Canada, but as the dissent pointed out, treaties need to be followed even if they are used merely for interpretive purposes.
MEXICANA AIRLINES, ONE OF THE WORLD’S OLDEST AIRLINES, FILES FOR BANKRUPTCY PROTECTION IN MEXICO AND THE UNITED STATES AND SUSPENDS FLIGHTS UNTIL FURTHER NOTICE

Lina Forero-Niño*

IMAGINE traveling to Bogotá, Colombia for a summer family vacation. While on vacation, you receive an email from your airline carrier notifying you that it has filed for bankruptcy and is consolidating some of its flights. You are concerned about whether your return flight is in jeopardy so you immediately confirm your flight number against the information provided in the email and find that your flight does not appear to be affected.

When you arrive at the airport on the day of your flight, you are informed by an employee of the airline that you will not be able to fly out of Bogotá. The reason for this is because only one plane is permitted to fly per day and only the first 150 passengers that arrived at the airport had a seat on the plane. You were not within that group of 150. Unable to get more information about when you could expect to fly, you decide to leave the airport and return to a relative’s house. Fortunately, three days later, your airline honored your tickets and you were able to travel back to the United States on August 17, 2010. Only eleven days later on August 28, 2010, your airline suspended all of its flights until further notice.¹

In this case note, I will provide a history of Mexicana Airlines (Mexicana), explain the factors that led to the airline’s downfall, review Mexicana’s insolvency proceedings under Mexico’s Law of Commercial Bankruptcy and under Chapter 15 of the U.S. Bankruptcy Code, and predict whether the airline will be back in the air.

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¹ This scenario is based on the real life experiences of the author’s family. The story served as the primary inspiration for writing this case note and learning about bankruptcy law.
I. HISTORY OF MEXICANA AIRLINES

Mexicana Airlines was established in Mexico City on July 12, 1921 under the name Compañía Mexicana de Transportación Aérea (Mexican Company of Air Transportation). It began operations with four Lincoln Standard airplanes capable of carrying one passenger and fifty kilograms of cargo and mail while traveling at ninety-five kilometers per hour. The first services the airline provided were the shipment of mail and aerial photography. Americans piloted Mexicana’s first flights for passengers.

In 1924, the airline had new American owners and was formally known as Compañía Mexicana de Aviación S.A. (Mexican Aviation Company). Mexicana was the first airline in Mexico to receive the Mexican government’s permission to service a route from Mexico City to Tampico. In 1929, Pan American Airways purchased stock in Mexicana and Mexicana began to service international routes. The renowned American aviator, Charles A. Lindbergh, piloted Mexicana flights and participated in the restructuring of the airline. Mexicana was the first international airline to service a flight from Brownsville to Guatemala in 1930. During the 1930s, several other international routes were added, including a route to Los Angeles, California. During the 1940s and 1950s, the company experienced steady growth as it added national and international flights, and acquired more sophisticated aircraft for its fleet. Mexicana gained popularity as celebrities such as Marilyn Monroe took international flights onboard Mexicana planes. But fierce competition in the airline industry caused serious economic problems for Mexicana and in 1967 it was near bankruptcy. Mexicana was saved from bankruptcy by Crescencio Ballesteros and other businessmen who purchased Mexicana’s stock. In 1970, the airline flew more than three million passengers.

In 1982, economic turmoil in Mexico forced Ballesteros and the other

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3. Id.
4. Id.
7. Mexicana, una Historia de Rescates, supra note 5.
8. Una Historia con Mucha Turbulencia, supra note 6.
9. Mexicana, una Historia de Rescates, supra note 5.
10. Historia de Mexicana de Aviación, supra note 2.
11. Una Historia con Mucha Turbulencia, supra note 6.
12. Historia de Mexicana de Aviación, supra note 2.
13. See id.
15. Mexicana, una Historia de Rescates, supra note 5.
16. Historia de Mexicana de Aviación, supra note 2.
stockholders to sell Mexicana. The Mexican government purchased fifty-four percent of Mexicana’s stock. In 1990, a group of Mexican investors called the Grupo Falcon became the new owner of Mexicana, but the Mexican government continued to maintain a thirty percent share interest. Mexicana’s new owners initiated a campaign to improve the company’s image and to purchase new aero navigation equipment. But in 1993, Mexicana’s competitor, Aeroméxico, owned by private investors, purchased and operated Mexicana.

As a result of an economic crisis in Mexico in 1995, Aeroméxico and Mexicana were both taken over by the Mexican government. On May 23, 1995, the government created a company called CINTRA for the purpose of “operating, reforming, and selling the airlines.” In 2001, Mexicana added MexicanaClick as its low-fare domestic subsidiary. In 2005, the government sold Mexicana for $165.5 million to Grupo Posadas, a Mexican hotel company. In 2007, Mexicana received numerous awards including ‘World Travel Awards’ Best Airline Mexico and Central America for the eleventh year running, Best Business Class Latin America for the third year running, . . . and Best Airline in Mexico for two years running by Global Traveler magazine.” “Mexicana boarded 8.3 million passengers in 2008, with MexicanaClick carrying another 3.4 million.” In 2009, the airline industry was adversely affected by a “sharp decline of passengers” as a result of the economic recession and the H1N1 outbreak. Nevertheless, Mexicana was distinguished as the “the leading carrier in Mexico and Central America” and joined the Oneworld Alliance on November 10, 2009, which placed it alongside the “best and biggest names in the airline business,” including American Airlines, British Airways, and Iberia. Mexicana and its subsidiaries “serve[d] fourteen countries and sixty-seven destinations, thirty-seven of them in Mexico.” Mexicana flew to forty-one destinations in fourteen countries in North America, Central and South America, and Europe, made more than 200 departures a day, and employed 8,400 staff.

17. Mexicana, una Historia de Rescates, supra note 5.
18. Una Historia con Mucha Turbulencia, supra note 6.
19. Mexicana, una Historia de Rescates, supra note 5.
20. Historia de Mexicana de Aviación, supra note 2.
21. Mexicana, una Historia de Rescates, supra note 5.
22. Id.
24. Historia de Mexicana de Aviación, supra note 2.
25. Mexicana, una Historia de Rescates, supra note 5.
27. Id.
28. Mexicana, una Historia de Rescates, supra note 5.
30. Id.
31. Id.
“transported 11.1 million passengers in 2009.”

In May 2010, Mexicana reported two consecutive years of economic losses and asked the Mexican government for assistance. By August 2010, Mexicana reported its economic situation as critical and the Mexican government refused to bail out Mexicana. On August 2, 2010, “amid labor unrest and mounting financial woes,” Mexicana filed for bankruptcy protection in Mexico and the United States. The company suspended all ticket sales on August 4, 2010, and reduced its flights on August 8, 2010. A group of Mexican investors, Tenedor K., acquired ninety-five percent of Mexicana’s stock on August 21, 2010 to “save the debt ridden company,” while the pilots’ union held the remaining five percent of shares. On August 28, 2010, after eighty-nine years of continuous service, Mexicana suspended flights for all of its three airlines until further notice.

II. WHAT LED TO THE AIRLINE’S DOWNFALL?

Mexicana was able to overcome financial problems and a potential bankruptcy in the past, but this year, several factors combined to make the company unable to defeat its financial problems. According to court documents, the company reported four causes of its financial problems: “labor costs, high jet fuel prices, the swine flu outbreak in 2009, and the global economic recession.”

In a press release, the company stated that non-competitive labor costs were the primary cause of the company’s losses “to the extent that it is now financially non-viable.” Mexicana reported that even though it was successful in cutting back some of its operating costs, which produced savings in excess of $800 million, this was not sufficient to offset its labor costs. Mexicana’s operating costs, excluding labor costs for its pilots and flight attendants, were “30 [percent] lower than the average of legacy airlines in the U.S.” But Mexicana considered its labor costs non-com-

33. Id.
36. Olson, supra note 32.
38. Olson, supra note 32.
40. Id.
41. Id.
petitive because statistics showed that Mexicana’s pilots were paid “49 [percent] more than the average wage paid to pilots by airlines in the U.S. and 185 [percent] more than the average wage paid by other Mexican low-cost airlines.”\textsuperscript{43} Similarly, Mexicana’s flight attendants earned “32 [percent] more that the U.S. average and 165 [percent] more than flight attendants for other Mexican airlines.”\textsuperscript{44} The company stated “that if [its] collective contracts had been more competitive, instead of registering losses of $350 million from 2007 to date, the company would have posted profits of $350 million.”\textsuperscript{45}

Mexicana offered its pilots’ and flight attendants’ unions two alternatives with hopes of lowering its labor costs, securing Mexicana’s long-term financial viability, and ensuring its continued existence.\textsuperscript{46} The first option involved negotiating a new “collective contract” with terms requiring pilots and flight attendants to accept cuts in wages of forty-one percent and thirty-nine percent, respectively.\textsuperscript{47} In addition, cuts would be made to fringe benefits and the company would make a “40 percent reduction in employees.”\textsuperscript{48} The positive aspect about this option was that the company offered a “profit-sharing plan whereby the unions would get a percentage of any operating profits that exceed 5 [percent] of the company’s total revenues.”\textsuperscript{49} Mexicana’s stockholders realized that the unions had the power to reform the company’s financial situation. Therefore, as part of the second option, the stockholders offered to sell the company to the pilots’ and flight attendants’ unions for the “token sum of one Mexican peso,” which is equivalent to about eight U.S. cents.\textsuperscript{50}

Mexicana and the unions negotiated a new collective contract pursuant to the first option after the airline filed for bankruptcy protection in Mexico and the United States.\textsuperscript{51} But they were unable to reach an agreement that would allow the company to have long-term financial viability.\textsuperscript{52} Leaders of the unions rejected the proposal because “their members already agreed to cuts in 2006.”\textsuperscript{53} Thus, the company was forced to suspend flights until further notice.\textsuperscript{54} Mexicana’s financial woes worsened because it continued operations in the interests of its passengers despite the fact that it was forced to suspend ticket sales and thus did not receive

\textsuperscript{43} Id.
\textsuperscript{44} Id.
\textsuperscript{45} Id.
\textsuperscript{46} Id.
\textsuperscript{47} Olson, supra note 32.
\textsuperscript{48} Id.
\textsuperscript{49} Mexicana Airlines Informs, supra note 40.
\textsuperscript{50} Id.
\textsuperscript{52} Grupo Mexicana Suspends Flights Until Further Notice, supra note 38.
\textsuperscript{53} Olson, supra note 32.
\textsuperscript{54} Grupo Mexicana Suspends Flights Until Further Notice, supra note 38.
revenues.  

III. MEXICO’S COMMERCIAL INSOLVENCY PROCESS UNDER THE LAW OF COMMERCIAL BANKRUPTCY

The purpose of this section is to explain Mexico’s Concurso Mercantil process which is Mexico’s insolvency process regulated by the Law of Commercial Bankruptcy (hereinafter LCB). Mexico’s insolvency process is a type of bankruptcy protection “that grants companies a reasonable timeframe in which to reorganize themselves in an orderly manner while continuing to operate.”  
The LCB is the “Mexican equivalent of Chapter 11” of the U.S. Bankruptcy Code. Mexico’s Law of Commercial Bankruptcy was enacted in 2000 and governs the “insolvency process for merchants, both individuals and legal entities.” This law covers “cross-border insolvency cases’ and incorporates the United Nations Commission on International Trade Law’s Model Law on Cross-Border Insolvency.” Mexico’s insolvency process under the LCB:

[consists of two consecutive stages: (i) the conciliation stage, of which the main purpose is facilitating the reorganization of debtors’ debt in order to preserve their businesses as going concerns; and (ii) the liquidation stage, of which the main purpose is terminating merchants’ businesses, selling their assets, and, with the proceeds derived from the sales, paying as much as possible of debtor’s debt and equity.

A company in financial distress seeking protection under the LCB is required to petition a judge for a declaration that the company is in concurso mercantil, meaning a formal declaration that a company has commenced the insolvency process. The most notable legal consequences of a judge’s declaration of insolvency are the suspension of any garnishment actions taken by a creditor and the prohibition from seizing the debtor’s property.

Under the LCB, a district judge in the city where the company seeking commencement of the insolvency process is domiciled has jurisdiction

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57. Fitzgerald, supra note 35.
59. Id.
60. Id. at 20.
61. Ley de Concursos Mercantiles [L.C.M.] [Law of Commercial Bankruptcy], art. 20, Diario Oficial de la Federación [D.O.], 12 de Mayo de 2000 (Mex.) (translated from Spanish).
62. Id. art. 65.
over that company’s insolvency process. After accepting a company’s petition for insolvency, the judge first issues an order to the Instituto Federal de Especialistas de Concursos Mercantiles (Federal Institute of Specialists on Insolvency Proceedings, hereinafter Institute), which is a branch of the Consejo de la Judicatura (Federal Judiciary Council). The Institute was created through Article 331 of the LCB. The main purpose of the Institute is to appoint individuals who satisfy the requirements under the LCB to carry out the roles of visitador (investigator), conciliador (mediator), and sindico (receiver), who are collectively referred to as “intervening parties” to the insolvency process. Upon receiving the order from the judge, the Institute has five days to appoint an investigator to the insolvency process.

The main role of the investigator is to go to the company’s place of business to determine if the company satisfied the requirements to commence the insolvency process under the 2007 amended version of Article 10 of the LCB. Under Article 10, a company seeking an insolvency process must show that it defaulted on its debt obligations with two or more different creditors and satisfy other certain conditions. The investigator has authority to access the company’s accounting records and other documents which are material to his or her final determination. Upon completion of the investigation, the investigator must create a legal document stating his or her findings. This document must be signed by a representative of the company and two witnesses. Within fifteen days after the investigation is completed, the investigator must report to the judge whether the company should commence the insolvency process. The day after receiving the investigator’s judgment, the judge will provide the judgment to the company and the company’s creditors. The company and creditors will then have ten days to respond by presenting their written complaints. After receiving the complaints, the judge will have five days to determine whether the company should commence the insolvency process. Then, the judge will notify the following parties of his

63. Id. art. 17.
64. Id. arts. 17, 311.
65. Id. art. 311.
66. Id.
67. Id. art. 29.
68. Ley de Concursos Mercantiles [L.C.M.] [Law of Commercial Bankruptcy (amended)], as amended, art. 30, Diario Oficial de la Federación [D.O.], 27 de Diciembre de 2007 (Mex.).
69. Id. art. 10.
71. Id.; Law of Commercial Bankruptcy (amended), art. 36.
72. Mejia, supra note 70.
73. Law of Commercial Bankruptcy (amended), art. 40.
74. Id. art. 41.
75. Id.
76. Id. art. 42.
decision: the debtor, the Institute, the investigator, creditors, and other government entities.77

The parties officially enter the conciliation stage of the insolvency process on the day when the judge’s declaration that a company has entered the insolvency process is published in the Diario Oficial de la Federación (Official Reporter).78 The conciliation stage lasts for a period of 185 days.79 But the debtor and certain creditors can petition the judge for a ninety-day extension.80 Additional extensions may be granted, but the entire conciliation stage must not exceed 365 days.81 The Institute appoints a mediator five days after the judge declares that a company has entered the insolvency process.82 The mediator must give the judge a provisional list identifying the debtor’s creditors and the amount owed to each creditor.83 This list is created through the mediator’s review of the company’s accounting records and other relevant documents.84 The mediator also reviews filings by creditors requesting the judge’s formal recognition of their creditor status in the proceedings.85 After the list is submitted to the judge, the debtor and creditors have the opportunity to review the list and make objections.86 The mediator reviews the objections and submits the final list of creditors to the judge.87 The judge uses the mediator’s list to make a declaration formally recognizing the debtor’s creditors.88

The main role of the mediator is to assist the debtor and creditors in reaching restructuring agreements so as to prevent the insolvency process from reaching the liquidation stage wherein the debtor is declared bankrupt and the debtor’s company is sold to satisfy its debt obligations.89 To this end, the mediator presents to the judge and the parties recommendations on studies and evaluations that should be performed for the purpose of inducing an agreement.90 During the conciliation stage, the debtor’s company shall continue to be operated by the debtor.91 But the mediator has the authority to monitor the accounting and other operations of the debtor.92 The judge will formally terminate the insolvency process if the debtor and creditors reach an agreement approved by the judge.93

77. Id. art. 44.
78. Id. art. 145.
79. Id.
80. Id.
81. Id.
82. Id. art. 146.
83. Id. arts. 121, 123; Mejía, supra note 70, at 177-78.
84. Law of Commercial Bankruptcy (amended), arts. 121, 123.
85. Id.
86. Id. art. 129.
87. Id. art. 130.
88. Id. art. 132.
89. Id. art. 3; Mejia, supra note 70, at 173.
90. Law of Commercial Bankruptcy (amended), art. 151.
91. Id. art. 74.
92. Id. art. 75.
93. Id. art. 166.
The debtor will be declared *en quiebra*, or bankrupt, if one of the following occurs: 1) if the debtor requests to be declared bankrupt; 2) the debtor and creditors are unable to reach an agreement in the course of the conciliation stage; or 3) the mediator requests that the debtor be declared bankrupt.94 Once the company is declared bankrupt, the parties enter the liquidation stage of the insolvency process where the judge will order the Institute to either re-assign the mediator as a receiver for the bankrupt company or to appoint a receiver.95 One of the main roles of the receiver is to operate the bankrupt company.96 The receiver has the right to take possession of the bankrupt company’s assets.97 Upon taking possession of the company’s assets, the receiver shall take the necessary procedures to preserve the company’s business.98 The receiver has the duty to manage the bankrupt company as would a “diligent manager in his or her own business” and is responsible for any company losses resulting from the receiver’s negligence.99 The receiver must also give the judge various documents reporting on the company’s financial and accounting status.100 At the final step in the liquidation stage of the insolvency process, the receiver coordinates the sale of the bankrupt company to satisfy the company’s debt obligations.101

IV. THE STATUS OF MEXICANA’S INSOLVENCY PROCEEDINGS IN MEXICO AND THE UNITED STATES

Mexicana filed a petition for an insolvency process with a Mexico City District Court on August 2, 2010.102 The petition was admitted by a Mexican bankruptcy judge on August 4, 2010 and Mexicana was granted temporary injunctive relief “to prevent creditors from exercising their rights over [Mexicana’s] outstanding debt obligations.”103 The Institute appointed an investigator to the insolvency process.104 As required under the LCB, the investigator submitted to the judge a report on the financial status of Mexicana and whether it should be granted an insolvency

94. *Id.* art. 167.
95. *Id.* art. 170.
96. *Id.* art. 178.
97. *Id.* art. 180.
98. *Id.* art. 183.
99. *Id.* art. 189.
100. *Id.* art. 190; Mejia, *supra* note 70, at 174.
101. Law of Commercial Bankruptcy (amended), art. 3; Mejia, *supra* note 70, at 174.
process.105

On September 7, 2010, the judge officially declared that Mexicana commence the insolvency process because, according to the investigator’s report, Mexicana defaulted on its debt obligations with more than two creditors.106 With this declaration, the conciliation stage of the process began.107 According to the LCB, the Institute appoints a mediator to the case when the parties reach the conciliation stage.108 But in Mexicana’s case, the mediator was appointed by a Mexican government agency, the Communications and Transportation Ministry, because the Mexican federal government provided “public concessions” to Mexicana.109 The Ministry appointed a mediator and administrator for Mexicana.110 The primary role of the administrator is to restructure the costs for the company.111 In addition to the statutory duty of assisting the debtor and creditors in reaching an agreement, the mediator in this case also has the duty of supervising the administrator.112

A preliminary list of Mexicana’s creditors includes more than 20,000 creditors.113 This figure includes about 8,000 of the airline’s employees.114 In November 2010, while Mexicana’s insolvency process was in the 185th day conciliation stage wherein the mediator assists the parties in reaching a restructuring agreement, the mediator reviewed a business plan prepared by PC Capital, a private equity group interested in purchasing Mexicana.115 The mediator selected PC Capital’s business plan as the most promising option to enable Mexicana to resume operations.116 Mexico’s Communications and Labor ministries supported the business plan.117 Negotiations with PC Capital were so promising that Mexicana announced that it would resume operations in the beginning of 2011 with seven planes and then increase its fleet to forty planes by the

107. Id.
108. Law of Commercial Bankruptcy (amended), art. 146.
111. Id.
112. Id.
114. Id.
116. Id.
117. Id.
end of the year.\textsuperscript{118} By February 2011, Mexican government officials announced that Mexicana made a restructuring agreement with PC Capital whereby PC Capital “acquired a controlling stake in the airline’s holding company.”\textsuperscript{119} But on March 2, 2011, the Mexican government suspended the sale of Mexicana to PC Capital because PC Capital did not have sufficient funds to purchase the airline.\textsuperscript{120} Because the restructuring agreement failed, Mexicana continues to be in the conciliation stage of the insolvency process where it has until the end of March 2011 to reach an agreement with its creditors.\textsuperscript{121} But the LCB provides that the mediator may petition the court for a ninety-day extension.\textsuperscript{122}

V. THE STATUS OF MEXICANA’S INSOLVENCY PROCEEDINGS IN THE UNITED STATES

Concurrent with the petition in the Mexico City District Court on August 2, 2010, Mexicana filed a petition for bankruptcy protection in a New York Bankruptcy Court under Chapter 15 of the U.S. Bankruptcy Code.\textsuperscript{123} One of the purposes of Chapter 15 is to “assist foreign representatives to protect assets located in the United States that belong to a foreign debtor that has commenced insolvency proceedings in a foreign jurisdiction.”\textsuperscript{124} Mexicana’s foreign representative petitioned the court to recognize Mexicana’s insolvency proceeding commenced in Mexico as a “foreign ‘main’ proceeding” under Chapter 15 and to “provid[e] the protections and benefits identified in the Bankruptcy Code.”\textsuperscript{125} The petition listed more than $500 million in assets and $1 billion in debt\textsuperscript{126} and requested the court to grant injunctive relief by barring “U.S. creditors from seizing planes or canceling contracts.”\textsuperscript{127} The court issued a tempo-

\begin{itemize}
\item\textsuperscript{120} Id.
\item\textsuperscript{122} Id.
\item\textsuperscript{123} Compañía Mexicana de Aviación Files for Insolvency Proceedings, supra note 56.
\item\textsuperscript{124} Petition for Recognition of Foreign Main Proceeding and Request for Chapter 15 Relief, \textit{In re: Compañía Mexicana de Aviación, S.A. de C.V.}, Page 8, (No. 10-14182) (citing 11 U.S.C. § 1501(b)) (on file with author).
\item\textsuperscript{125} Id.
\end{itemize}
A temporary restraining order to protect Mexicana’s assets. A consortium comprised of nine major U.S. airports petitioned the court for permission to cancel contracts with Mexicana for terminal space. The temporary restraining order prohibited the consortium from taking legal action against Mexicana. But on November 4, 2010, the court allowed the consortium to terminate its contracts with Mexicana. On November 8, 2010, the court granted Mexicana’s request for Chapter 15 bankruptcy protection from U.S. creditors. This ruling stays collection actions by Mexicana’s U.S. creditors, allows Mexicana’s foreign representative to both operate Mexicana’s business and to serve as its trustee, and grants other protections under the Code.

VI. PREDICTIONS ON WHETHER THE AIRLINE WILL BE BACK IN THE AIR

After filing for bankruptcy protection and suspending its operations, Mexicana remained optimistic that it would “secure the company’s long-term viability” and thus resume operations. But there has been debate among experts as to whether Mexicana will be able to fly again. Analysts from the UBS bank believe that Mexicana’s suspension will be permanent. Even though the suspension “initially curb[ed] air traffic and hurt airport operators,” these issues were quickly addressed when other airlines offered their services to fill the void left by Mexicana. Therefore, it can be inferred that it will not be necessary for Mexicana to resume operations. On the other hand, Mexico’s Communications and Transportation minister remained optimistic that the suspension would not be permanent because of continued discussions with investors interested in restructuring the airline. Experts involved in the airline’s restructuring process contemplated the possibility of the airline resuming operations with a reduced fleet. An attorney and expert in Mexican

130. Id.
131. Id.
132. Id.
133. Kary, supra note 126.
134. Grupo Mexicana Suspends Flights Until Further Notice, supra note 38.
137. See Levin & Harrison supra note 135; see also Infosel, supra note 136.
138. Levin & Harrison, supra note 135.
139. Id.
insolvency proceedings suggested that Mexicana has a good chance of resuming operations because the Mexican government is involved in its insolvency process.\footnote{140}{Id.}

After the restructuring agreement between Mexicana and PC Capital was suspended, Mexicana remained optimistic that it would find a new investor and would be able to be back in the air by Easter.\footnote{141}{Dow Jones Newswires, \textit{Mexicana Airline Holds Out Hope for Return to Skies}, \textit{FOX Business}, Mar. 8, 2011, http://www.foxbusiness.com/industries/2011/03/08/mexicana-airline-holds-hope-return-skies/#ixzz1HSjZhZU4.} The mediator in Mexicana’s insolvency process said that Mexicana continues to negotiate with potential investors interested in providing the necessary capital for the airline to resume operations.\footnote{142}{Id.} Mexicana’s mediator recognized that the airline’s entrance into the market will be more difficult because of rising fuel prices.\footnote{143}{Id.} In expectation of getting back to business, Mexicana developed a business model that budgets for jet fuel prices at the current price.\footnote{144}{Id.} So rising fuel prices may not completely hinder the airline’s ability to operate. The business model also provides that the airline’s fleet will consist of forty-six planes and that the airline will “rehire around forty percent of its original workforce, focus on domestic and U.S. routes, and require a startup investment of around $250 million.”\footnote{145}{Id.} Mexicana does not plan to operate as a low-cost carrier.\footnote{146}{Id.}

Other experts believe that Mexicana’s restructuring approach is not sustainable. Currently Mexicana seeks investors to provide capital for the airline to continue to operate under its current management. According to experts, the more reasoned restructuring approach is for the airline to sell its business, specifically the Mexicana brand name, to another domestic or international airline.\footnote{147}{Id.} An airline purchasing Mexicana could operate Mexicana as a low cost carrier or it could use the Mexicana brand name to service new routes.\footnote{148}{Id.} In short, Mexicana would resume operations under the ownership and management of another airline.\footnote{149}{Id.} Experts suggest that the sale of the Mexicana brand is the most viable solution because the Mexicana brand and its routes are the airline’s most valuable assets and the acquisition of these assets could result in increased profits for the purchasing airline.\footnote{150}{Id.} Three airlines that could be interested in purchasing the Mexicana brand and possibly operating it as a low cost carrier include Aeroméxico, Interjet, and Volaris.\footnote{151}{Id.}
VII. CONCLUSION

At this point it is uncertain whether the airline will be back in the air. Currently the biggest hurdles for Mexicana are finding an investor with sufficient funds to purchase the airline and maintaining financial viability upon resuming operations. The most important issues that Mexicana should address to maintain financial viability are the following: First, rising jet fuel prices indicate that the airline’s management should ensure that the airline has adequate funding to purchase fuel in the long term. Second, the acquisition of routes formerly serviced by Mexicana by competing airlines means that Mexicana should have a plan specifying how it will reacquire those routes.152 Third, the cancellation of contracts for terminal space in major U.S. airports requires strategic efforts by Mexicana to renegotiate those contracts to ensure successful operations in the United States. Fourth, it should set wages for its pilots and flight attendants that are more in tune with the average paid in the airline industry. Fifth, to ensure that consumers will buy tickets, it should study how consumers view the airline after this crisis and develop its customer relations accordingly. It is more probable that Mexicana will be able to maintain financial viability in re-entering the market if it is purchased by another airline because the purchasing airline will be able to provide the logistical support to enable Mexicana to overcome its operational issues and will have the incentive to make Mexicana profitable.

152. Mexicana Airline Holds Out Hope for Return to Skies, supra note 141.
Updates
LATIN AMERICA UPDATE: THE ENHANCEMENT OF GOVERNMENTAL POWERS AND RESTRICTION OF FREEDOMS IN GUATEMALA AND VENEZUELA

Allen C. Unzelman*

I. GUATEMALA’S PUBLIC ORDER LAW AND THE TWO MONTH SIEGE OF ALTA VERAPAZ

GUATEMALA has a drug problem. The drug-related violence of Mexico has spilled over Mexico’s southern border into Guatemala’s northern regions. As the Mexican government increases pressure on drug cartels within its own borders, the cartels are fleeing south to Guatemala. At stake are valuable drug smuggling routes that connect South American drug sources to the United States. Among these cartels is Los Zetas, one of Mexico’s most feared drug cartels, who has already set up camps in the northern regions of Guatemala.

Following Mexican President Felipe Calderon’s aggressive crackdown on drug cartels, governments such as Guatemala’s are attempting to rid their jurisdictions of the cartels and are turning to the United States for assistance in doing so. Guatemalan President Alvoró Colom, for example, requested assistance from both the United States and Mexico in fending off cartels. The U.S. Drug Enforcement Agency has already commenced its support by cracking down on air trafficking of drugs throughout the region. Although this has helped to significantly reduce air trafficking of drugs into Guatemala, it has only increased the value of

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3. Id.
4. Id.
6. Id.
7. Id.
land trafficking routes through Guatemala.\textsuperscript{8}

Historically, Guatemala has served as a pivotal bridge for the transportation of drugs, primarily cocaine, from South America to the United States.\textsuperscript{9} After arriving from Ecuador and Colombia via the sea, drugs are transported north by land through Guatemala and Mexico en route to the consumer base in the United States.\textsuperscript{10} In the midst of a number of these drug routes exists Guatemala’s northern province of Alta Verapaz and its capital city of Cobán.\textsuperscript{11} The high importance of transportation routes and the desire to monopolize these northern bound arteries pits drug cartels against one another and fosters vicious and bloody turf wars.\textsuperscript{12} Currently, the Los Zetas cartel is in a fierce battle with Mexico’s Gulf drug cartel over precious transport routes.\textsuperscript{13} Recently, Los Zetas provided Guatemalans with a brutal reminder of the viciousness of these battles by leaving a number of decapitated human heads on the parliament steps.\textsuperscript{14}

In December 2010, President Colom and the Guatemalan government took dramatic steps to up the stakes in their resistance to these cartels. In order to combat the Los Zetas cartel, President Colom imposed martial law in the Alta Verapaz province and deployed the military to the region to regain control of the area in an attempt to root out the cartel.\textsuperscript{15} But as Guatemalans quickly discovered, ridding their territory of drug cartels through such policies will not come without significant costs to their freedoms.

A. THE TWO-MONTH SIEGE OF ALTA VERAPAZ

On December 19, 2010, President Colom declared martial law in the country’s Northern Province of Alta Verapaz after concluding that the presence of the Los Zetas drug cartel made the area “ungovernable and lawless.”\textsuperscript{16} President Colom’s effort to stabilize the region, which he claimed was authorized by Guatemala’s Law of Public Order, was approved in an emergency legislative session on December 22, 2010.\textsuperscript{17} On January 19, 2011 President Colom announced that the siege would be ex-

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{8} Id.
\item \textsuperscript{9} Id.; Griffin, supra note 2.
\item \textsuperscript{10} Griffin, supra note 2.
\item \textsuperscript{11} Booth & Miroff, supra note 1.
\item \textsuperscript{12} Griffin, supra note 2.
\item \textsuperscript{13} Id.; The Zetas have already forced at least one other drug cartel out of Guatemala. Id. The cartel is comprised of former military personnel were initially members of the Gulf Cartel but later split and formed an independent cartel. See Guatemala Ends ‘Siege’ In Drug-Plagued Province, \textit{Jakarta Post}, Feb. 19, 2010, http://www.thejakartapost.com/news/2011/02/19/guatemala-ends-039siege039-drug-plagued-province.html.
\item \textsuperscript{14} Griffin, supra note 2.
\item \textsuperscript{15} Booth & Miroff, supra note 1.
\item \textsuperscript{17} Id.
\end{itemize}
\end{footnotesize}
tended for thirty days, explaining that “more need[ed] to be done.”


20. Kearney, supra note 16.

21. Id.


24. Id.

25. Id. ch. I, art. 1.

26. See id.

27. Id. ch. IV, art. 15(2).

28. Id. ch. IV, art. 15(4).

29. Id. ch. IV, art. 15(5).

30. Id. ch. III, art. 13(1).

31. Id. ch V, art. 19(1).
government...”\textsuperscript{32}

President Colom’s action came as a response to the growing presence of Mexican drug cartels in northern regions of Guatemala.\textsuperscript{33} As a popular local saying emphasizes, “[o]ur neighbor is cleaning his house, and the cockroaches are fleeing here.”\textsuperscript{34} Guatemalan Defense Minister Abraham Valenzuela even referred to the cartels as “narcoterrorists.”\textsuperscript{35}

B. THE EFFECTS OF THE SIEGE ON LOCAL INHABITANTS

Many Guatemalans reacted skeptically to the heightened military powers by arguing that the siege was nothing more than a front for the government to achieve other ends, primarily to extinguish social reform efforts mounted by province’s relatively poor population.\textsuperscript{36} For example, some feared that the law was simply a method for the government to quash land reform efforts of the local residents.\textsuperscript{37} As evidence of this contention, two well-known land reform activists within the area were arrested after the siege was put in place.\textsuperscript{38}

Understanding the history of the relationship between the government and the inhabitants of this region helps place these fears in context.\textsuperscript{39} Many inhabitants of the region fled during the violent conflicts that took place during the 1970s.\textsuperscript{40} When they returned, however, their property had been transformed into a national park, which created tension between the displaced settlers and the Guatemalan government.\textsuperscript{41} The continued presence of this tension is evidenced by the over 300 agrarian disputes that currently exist in the region.\textsuperscript{42}

Such reservations about the heightened power were fueled by incidents such as the one that occurred on February 8, 2011, when a well-known local activist was “beaten in front of his family” by the military and “detained in a private residence...and did not resurface.”\textsuperscript{43} Although it was later discovered that the leader had been imprisoned, officials refused to acknowledge or provide information on his arrest.\textsuperscript{44} Prior to this incident, on January 10, 2011, troops entered another settlement without warning, discharged weapons in the air, destroyed crops, and stole livestock.\textsuperscript{45} One community member also accused a government official of

\begin{itemize}
\item \textsuperscript{32} Id. ch. V, art. 19(2)(a) (emphasis added).
\item \textsuperscript{34} Matalon, supra note 33.
\item \textsuperscript{35} Id.
\item \textsuperscript{36} See id.
\item \textsuperscript{37} Id.
\item \textsuperscript{38} Id.
\item \textsuperscript{39} See Granovsky-Larsen, supra note 22.
\item \textsuperscript{40} Id.
\item \textsuperscript{41} Id.
\item \textsuperscript{42} Id.
\item \textsuperscript{43} Id.
\item \textsuperscript{44} Id.
\item \textsuperscript{45} See Granovsky-Larsen, supra note 22.
\end{itemize}
accompanying the soldiers during an attempted rape.\textsuperscript{46} Suspicions of governmental foul play are fueled by the fact that this community is home to a large number of the land disputes cited above.\textsuperscript{47} Another community, Saquimo Setano, which was also involved in a land dispute with a large landowner, was the subject of an armed attack on January 20, 2011.\textsuperscript{48} Further, in the nearby town of Izabal, three activists were killed in February 2011.\textsuperscript{49} Following the implementation of the siege, the number of indigenous arrests also drastically increased.\textsuperscript{50} But, because the government restricted the ability of the media and the flow of information, it is not clear how many other incidents similar to these occurred during the two-month siege.\textsuperscript{51}

Another report alleges that the government may have implemented the siege in order to prevent the local groups from meeting in opposition to dam projects in the region.\textsuperscript{52} In the months prior to the siege, local communities began assembling in opposition to dams, which were planned “without the consent of [the] affected Qeqchi communities.”\textsuperscript{53} But the siege prohibited such meetings and assemblies, and hence, some are sceptical that the siege was enacted at least in part as a reaction to these meetings.\textsuperscript{54} According to one source, the construction of one of these dams would flood eighteen or more indigenous communities.\textsuperscript{55} Here again, painful memories create concern for members of these communities.\textsuperscript{56} Dam construction during the late 1970s and early 1980s involved military evictions that forced local inhabitants from their land.\textsuperscript{57} Those who demonstrated and opposed the dam project were met with violent resistance, leading to a number of deaths.\textsuperscript{58}

Others question why the government chose to single out Alta Verapaz for the siege but left other areas with similar problems unaltered.\textsuperscript{59} As Haroldo Shetemul, a journalist with the local Prensa Libre newspaper, explained “57.7 percent of the country’s murders in 2010 happened in the

\textsuperscript{48} Granovsky-Larsen, supra note 22.
\textsuperscript{50} See id.
\textsuperscript{51} See id.
\textsuperscript{52} See id.
\textsuperscript{53} See id.
\textsuperscript{54} See id.
\textsuperscript{55} See id.
\textsuperscript{56} See id.
\textsuperscript{57} See id.
\textsuperscript{58} See id.
region around Guatemala City, the capital.\textsuperscript{60} For Shetemul, this calls to question why Alta Verapaz was the only area chosen for the siege if the government’s objective was really to restore order and security.\textsuperscript{61}

Although it is still too early to gauge the success of the siege in removing drug cartels from the region, the results seem mixed. According to Interior Minister Carlos Manocal, the crime rate decreased by fifty percent during the period of martial law, the number of homicides declined drastically, and a number of planes and weapons of traffickers were seized.\textsuperscript{62} At the same time, however, others point to the lack of Los Zetas arrests and drug-related arrests as indicia of the siege’s failure to deter the cartels.\textsuperscript{63} Moreover, it took the government until February 2011 to arrest their first high ranking member of Los Zetas.\textsuperscript{64}

Corruption and bribery between Los Zetas, the military, and the Guatemalan government also makes it difficult to crack down on the cartel.\textsuperscript{65} In 2009, for example, weapons seized from the Los Zetas cartel were traced back to the Guatemalan army.\textsuperscript{66} In addition, Los Zetas actively recruits Guatemalan soldiers by offering higher wages than the government, a tactic that has proved successful in luring a number of soldiers into the cartel.\textsuperscript{67} Los Zetas has also infiltrated the police force of Alta Verapaz, leading one government official to conclude that police in the area were “totally infiltrated by the Zetas.”\textsuperscript{68}

C. Conclusion

Although the siege has been lifted, Guatemalans will face a difficult situation going forward. While the Guatemalan government will likely continue to take measures to resist the drug cartels, likely with funding and assistance from the United States and other foreign sources, the siege that lasted from December 2010 until February 2011 is indicative of the toll that such measures may take on the country’s population. The historic tension between the government and indigenous communities, coupled with corruptive nature of drug cartels such as Los Zetas, creates a situation ripe with distrust and suspicious motives. The end of the siege did not represent an end to either the land disputes of the Alta Verapaz region or of the presence of the Los Zetas cartel in the Guatemala. Hence, both the drug problem and the vulnerability of indigenous groups remain an issue in Guatemala and should be monitored going forward. Furthermore, it will be important for the international community to be

\textsuperscript{60} Id.
\textsuperscript{61} Id.
\textsuperscript{63} Granovskys-Larsen, supra note 22.
\textsuperscript{64} Id.
\textsuperscript{65} Id.
\textsuperscript{66} See Johnson, supra note 50.
\textsuperscript{67} Id.
\textsuperscript{68} Arsenault, supra note 59.
mindful not only of the drug problem present in Guatemala, but also to ensure that efforts to rid the country of such drug problems are not pursued at the cost of the livelihood of its inhabitants.

II. VENEZUELA’S CRACKDOWN ON DISSIDENTS AND RESTRICTION OF PRESS FREEDOMS

A. CHAVEZ’S CRACKDOWN ON DISSIDENTS

A wide variety of Venezuelans, ranging from journalists to political opponents of Venezuelan President Hugo Chavez, have been victims of the President’s recent crackdown on those who oppose or question his governance.69 The President has now taken action against at least twenty-four individuals who dissidents contend are being targeted as political prisoners.70 Other targets of Chavez have fled Venezuela and sought asylum in other countries.71

One of the dissidents who fled Venezuela was Manuel Rosales, who lost the presidential election to Chavez in 2006.72 Rosales, one of the President’s chief opponents, has sought asylum in Peru.73 Corruption charges against Rosales, which had previously been abandoned because of a lack of evidence, were reinstated during a subsequent election period.74 As President Chavez declared, “I am putting myself at the head of Operation ‘Imprison Manuel Rosales.’”75

Another target of Chavez is Judge Maria Lourdes Afiuni, who was detained in December 2009 after allowing the release of another political prisoner who had been detained without trial for nearly three years.76 The judge, who cited not only Venezuelan law but also a statement by the United Nations on the individual’s detainment when ordering his release, was jailed in harsh conditions.77 According to El Universal, Afiuni was also psychologically tortured while in jail.78

On another front, others fear that recent legislative measures passed by the Venezuelan government may further restrict the freedoms of the press in Venezuela.

70. Id.
71. Id.
73. Id.
74. Criminals or Dissidents, supra note 69.
75. Id.
76. Id.
77. Id.
B. NEW MEDIA LAWS FURTHER RESTRICT PRESS FREEDOMS

In December of 2010, the Venezuelan government passed legislation that will place further limitations on the media in a country where many contend the government has already overstepped its bounds in regulating the press.\(^7^9\) Two pieces of legislation alter Venezuela’s Organic Telecommunications Law and the Social Responsibility on Radio and Television Law.\(^8^0\) The changes make the “use of telecommunications networks. . . a public service,” perhaps to enhance the government’s ability to patrol such media.\(^8^1\) Expanding on limitations implemented in 2004, the changes bring internet content under the government’s scope of regulation and make “webpage managers ‘responsible for the information and content’ published on their websites” by requiring them to “now ‘establish mechanisms to restrict, without delay, the diffusion of messages. . . that are included in the ban.’”\(^8^2\) The law “prohibits messages and images that ‘disrespect public authorities,’ ‘incite or promote hatred’ or crimes, or could create ‘anxiety in the citizenry or alter public order.’”\(^8^3\)

Despite the government’s touted objective of ensuring social responsibility, a number of sources suspect that the law is aimed at curtailing the broadcasting reach of its critics, such as Globovision.\(^8^4\) Chavez’s recent actions have led some to conclude that the President has been looking for methods to silence his opposition, especially Globovision.\(^8^5\) Criminal charges were even filed against Globovision’s leader, who is currently seeking asylum in the United States.\(^8^6\) Prior to the passage of the latest restrictions, the government had already taken control of two companies that owned approximately twenty-five percent of Globovision’s shares.\(^8^7\) As explained by Carlos Lauria of the Committee to Protect Journalists, “[t]hese reforms, passed without any debate, are a clear attempt by the Venezuelan government to further its clampdown on critics and indepen-

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81. Id.
83. Toothaker, supra note 79.
84. See Controversial Media-Law Changes Approved in Venezuela, supra note 80; Toothaker, supra note 79; Venezuela Passes Media, Internet-Muzzling Law, supra note 82.
85. See Venezuela Passes Media, Internet-Muzzling Law, supra note 82.
86. Id.
Of particular concern is the broad and ambiguous phrasing of the new laws. Sources fear that the use of phrases such as “fomenting anxiety” and “altering public order” could enable the government to preclude the broadcast of almost any message critical to its objectives. Overly broad internet regulations also pose a danger to human rights groups and other groups who are opposed to the government’s position by making it exceedingly difficult to reach citizens through the internet and to organize human rights movements.

C. CONCLUSION

Although it is not clear to what degree the government will use these powers to quash the voices of its opposition, these latest changes represent yet another step in the Venezuelan government’s recent attempts to enhance control and regulation of the press in Venezuela. These changes, combined with the other attempts by the Venezuelan government and President Chavez to silence dissidents, will likely continue to garner international attention going forward.

90. Id.
91. Id.
Canada Update: Supreme Court Supports the PMPRB’s Ability to Control Prices of Patented Medicines Sold Abroad to Canadians

Soji John*

I. INTRODUCTION

In January, the Supreme Court of Canada bolstered the government’s ability to regulate the prices charged for patented medicines used by Canadians.1 In Celgene Corp. v. Attorney General of Canada, the court unanimously affirmed the Federal Court of Appeals decision and held that the Patented Medicine Price Review Board (PMPRB) has the ability to control the prices of Canadian patented medicines sold in foreign countries to Canadian consumers.2 Relying primarily upon the legislative intent of the Patent Act in creating the PMPRB, the court approved the Board’s interpretation of its authority over drugs sold by Celgene in the United States subsequently shipped to Canadian patients.3 In doing so, the court pronounced that the clear purpose of the enabling legislation would control the interpretation of what it understood to be a textual ambiguity regarding the Board’s jurisdiction.4 The court also indicated that it would apply a deferential standard of review when a tribunal is interpreting its enabling legislation.5

II. BACKGROUND

This case stemmed from the refusal of Celgene, a global pharmaceutical company, to submit sales records of its brand-name drug Thalomid as requested by the PMPRB.6 Celgene, formed in 1980 as a spinoff from the merger of the Celenese and Hoechst corporations, obtained approval from the U.S. Food and Drug Administration in 1998 to promote

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1. See generally Celgene Corp. v. Att’y Gen. of Can., 2011 SCC 1 (Can.).
2. Id. ¶¶ 32, 35.
3. Id. ¶ 1, 26.
4. See id. ¶¶ 25, 32, 35.
5. Id. ¶ 33.
Thalomid as a treatment for leprosy and related illnesses. Later, in 2006, Celgene obtained approval for Thalomid’s use in the treatment of multiple myeloma, a form of cancer. But Canada has generally banned the use of thalidomide, the primary active ingredient in Thalomid, since the early 1960s, when it was identified as causing birth defects in the children born to women taking the drug to combat nausea and sleep loss during pregnancy. Until recently, Thalomid was only available to Canadians through the Special Access Program (SAP).

Under the SAP, physicians are able to obtain drugs that are not approved for general use in Canada on behalf of specific patients “with serious or life-threatening conditions on a compassionate or emergency basis when conventional therapies have failed, are unsuitable, or are unavailable.” The Therapeutics Product Directorate in Health Canada reviews each application under the SAP, and allows the physician to prescribe and order the drug once it determines that the “need is legitimate” and that the physician is qualified. In its analysis, the Directorate will consider each application for the drug on an individual basis using factors such as urgency and condition of the patient. Even with approval, the SAP Program limits the amount of drug available per approval to a six-month supply and requires the sponsoring physicians to monitor and report adverse reactions to Health Canada.

9. Id.
10. See id.
11. Special Access Programme—Drugs, Health Canada, http://www.hc-sc.gc.ca/dhp-mpsa/alt_formats/hpfb-dgpsa/pdf/acces/sapfs_pasfd_2002-eng.pdf (last visited Feb. 17, 2011). In the typical process for drug development and approval, a pharmaceutical company obtains a Canadian patent for the new drug and conducts preclinical testing on tissue cultures and small animals. Drugs from Research Lab to Pharmacy Shelf, Canadian Pharmacists Ass’n, http://www.pharmacists.ca/content/hcp/resource_centre/drug_therapeutic_info/pdf/DrugApprovalProcess.pdf” (last visited Feb. 17, 2011). Once the drug is found to be promising, a formal application is made to Health Canada to start a clinical trial. Id. With approval, the company conducts several phases of clinical trials culminating in a review process by the Therapeutic Products Directorate within the Health Products and Food Branch. Id. With successful completion of the review process and upon authorization of the “new drug and its manufacturing process,” Health Canada provides a Notice of Compliance (NOC) and a Drug Identification Number allowing the company to manufacture, market, and sell the drug within Canada. Id.
14. Special Access Programme—Drugs, supra note 11. Since this case was originally brought, Thalomid has been made available through a new program called RevAid. Thalidomide Authorization For Sale in Canada, supra note 8. In the RevAid “controlled distribution program,” specially registered physicians are able to register patients. Id. This program essentially forgoes the individualized ap-
Celgene has made Thalomid available under the SAP since 1995. But until 2006, Celgene had not been issued a Canadian patent for its brand name drug. Celgene’s Canadian patents in this case involve methods for the formation of thalidomide and its use in combination with other drugs for the treatment in a variety of health problems. Once Celgene was granted its first patent, 2,166,315, in April of 2006, the PMPRB contacted the company and requested pricing information regarding Thalomid. This request was based upon section 80 of the Patent Act which allows the Board to obtain “information and documents … [regarding] the price at which medicine is being or has been sold in any market in Canada and elsewhere.” As a result, although Thalomid was already being sold under the SAP unregulated by the PMPRB, once Celgene obtained a patent and restricted others’ use of thalidomide in the Canadian market, the PMPRB sought information to appropriately regulate the price paid by Canadians for the drug.

In response to the PMPRB, Celgene provided pricing information for the period after it received its patent, April 5, 2006; however, the Board requested pricing information for all times after Celgene had made Thalomid available to the Canadian market after the publication of its patent application—January 12, 1995.

Celgene refused to provide this information and brought a jurisdictional challenge to the board’s ability to regulate the pricing of Thalomid, arguing that the Board could not regulate the price charged because the drug was sold under the SAP program rather than “general commercial marketing” and because commercial

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cial law defined the sale as occurring in the United States.\textsuperscript{22} The PMPRB's judicial arm rejected this challenge, and Celgene brought the matter before the Federal Court pursuing the argument that, per commercial law, the sale should be designated as occurring extra-territorially such that the Board lacked authority over the sale because the payment was made in U.S. dollars, in New Jersey, and the product was shipped free on board.\textsuperscript{23} Upon judicial review, the court accepted this argument and held that the Board lacked jurisdiction under § 80(1)(b) of the Patent Act to regulate prices when the sales occur outside of Canada.\textsuperscript{24} The Attorney General of Canada, representing the Board, appealed, and the Federal Court of Appeals reversed, relying primarily upon the legislative purpose of the PMPRB, and found that the Board could regulate prices of Canadian Patented medicines to Canadian consumers when sold from abroad into the Canadian market.\textsuperscript{25}

III. REGULATION OF CANADIAN MEDICINE PRICE AND THE PMPRB

Canadian health care is administered provincially through its Medicare plan, providing universal health care under "criteria set forth in the 1984 Canadian Health Care Act."\textsuperscript{26} Since the system is publicly financed, the government has a strong incentive to regulate the price charged for pharmaceuticals.\textsuperscript{27} In order to limit exorbitant pricing, Canada originally used compulsory licensing whereby generic drug manufacturers could forcibly take a license—a government enforced limitations of the right of exclusivity of the patent owner.\textsuperscript{28} The generic manufacturer would then be able to produce a drug and market it, typically for a lower price than the patent holder would charge.\textsuperscript{29} Because compulsory licensing tended to act as a disincentive to drug development, the government sought to catalyze innovation by allowing patent holders a right to completely exclude for a limited period of time and amended the Patent Act.\textsuperscript{30} But to control prices, in the amendment, the government also established the Patented Medicines Price Review Board with the ability to regulate prices based on a market median price in seven western industrialized

\begin{thebibliography}{99}


\bibitem{27} Michael B. Moore, "Open Wide" (Your Pocketbook That Is)—A Call for the Establishment in the United States of a Prescription Drug Price Regulatory Agency, 1 Sw. J. L. & Trade Am. 149, 162 (1994).

\bibitem{28} \textit{id.}

\bibitem{29} \textit{id.}

\bibitem{30} \textit{id.} at 163.

\end{thebibliography}
nations.31 For excessive prices, the PMPRB is able to “order the patentee to reduce the price and take measures to offset any excess revenues it may have received.”32

In order to determine whether a price is excessive, the PMPRB typically relies upon sales information that the company provides.33 Without direct information from the drug companies, the PMPRB could not effectively evaluate the prices charged for medicines; they would have to rely upon “highly subjective statistical data produced by the drug companies,” to determine whether “the drug companies [were obtaining] a fair return on their investment.”34 In addition to the sales data provided, the PMPRB also takes into account other factors such as comparing prices of drugs already on the Canadian market with similar therapeutic benefits and the amount invested by drug companies in development.35 The PMPRB indicates that in 2009, of the 1,003 patented drugs sold in Canada, 91.5% were sold at prices within the prescribed PMPRB guidelines.36 The PMPRB’s analysis also indicates that the prices spent by Canadians on these patented medicines is roughly twenty percent higher than that of the lowest of the seven comparative industrialized nations but seventy-one percent lower than the highest of the seven nations.37 Thus, the steps taken by the PMPRB have been effective in ensuring that Canadians have access to medicines at a reasonable price in a system that encourages new drug development.38

IV. THE SUPREME COURT OF CANADA PRIORITIZES CONSUMER PROTECTION

In finding on behalf of the PMPRB, the Supreme Court of Canada held that the overarching purpose for the implementation of the Board controlled over a commercial law contractual understanding regarding the sale of an item.39 The primary argument that Celgene proposed was that because the sale occurred in the United States, the Board lacked jurisdiction over the price charged for Thalomid.40 Celgene argued that its sale of Thalomid in a foreign country, albeit to Canadian citizens, does not implicate the Board’s powers to regulate the price because the jurisdic-
tion of the Board is limited to sales in Canada.41

But in conferring authority to the Board, the Patent Act states that a “patentee of an invention pertaining to a medicine shall . . . provide the Board with such information and documents . . . respecting . . . the price at which the medicine is being sold . . . in any market in Canada and elsewhere.”42 Moreover, Patent Act § 83(1) states that the Board’s remedial power applies to “a patentee of an invention pertaining to a medicine [that] is selling the medicine in any market in Canada.”43 Celgene argued that because the words of the statute are clear and unambiguous, they should have priority over any interpretation of the “overriding purpose of the statute.”44

For example, in Canada Trustco Mortgage Co. v. R., the Supreme Court of Canada had relied upon a textual reading of the relevant statute and the common interpretation of the term “cost” as the “price that the taxpayer gave up in order to get the asset” and would not stray to redefine “cost” as “money at risk.”45 Celgene argued that, in the same way, the court should rely on the common interpretation of a “sale” as understood in the commercial context.46 Celgene attempted to strengthen its position by providing evidence of the commercial meaning of the term “sale,” so that “sale in any market in Canada” per § 83(1) of the Patent Act limits the PMPRB’s regulatory authority to a commercial sale occurring in Canada.47 To define “sale,” Celgene relied upon Deputy Minister of National Revenue v. Mattel Canada, Inc. where the court analyzed in detail the vending process by a foreign entity for “export to Canada under [section] 48(4) of the Customs Act.”48 But the court found that while Mattel does discuss “sale,” it considered it from an import duty context, which was not relevant to the understanding of “sale” in the context of the PMPRB’s jurisdiction.49

The court, however, did not find the issue of the commercial meaning of “sale” to be determinative.50 The court also considered “sale” as it relates to patents.51 In Domco Industries Ltd. v. Mannington Mills Inc. the plaintiff’s claim of infringement failed because an alleged infringer

41. See id.
42. Patent Act, § 80(1).
43. Id. § 83(1).
44. See Celgene Corp., 2011 SCC 1, ¶ 21.
47. Id. ¶¶ 22-23.
50. See Celgene Corp., 2011 SCC 1, ¶¶ 24, 25.
did not sell the patented item within Canada. In Domco, the court stated that when delivery occurs outside of Canada and where the contract for sale of infringing goods are not proven to be within Canada, there is no vending of the goods locally to infringe the patent per the Patent Act § 46. This result is supported by the commonly accepted view that patent laws are territorial. Despite the fact that commercial laws and patent laws could define “sale” as having occurred abroad, the court felt the purpose of the statute—protecting Canadians from excessive drug prices—allowed the PMPRB to regulate drugs which relied on Canadian patents and avail the Canadian market. Moreover, the court considered that accepting a purely commercial law interpretation of “sale” as controlling would result in the PMPRB having authority over Canadian pharmaceuticals sold in Canada for export. Because the jurisdiction of the PMPRB should not extend to foreign consumers, the court felt justified in avoiding an outcome based purely on the commercial and patent law interpretation of “sale.”

The court concluded that the PMPRB was authorized to seek Celgene’s sales records to 1995 for two reasons. First the court gave deference to the PMPRB and used a reasonableness standard of review. In this regard, the court followed it prior holding from New Brunswick v. Dunsmuir where it stated that “[d]eference will usually result where a tribunal is interpreting its own statute or statutes closely connected to its function.” In this case, the PMPRB was interpreting its jurisdiction under the Patent Act, which created the Board, and thus the court would only set aside the Board’s decision if it were to fall outside a range of possible, acceptable outcomes which are defensible in respect of the facts and law.”

Second, because the court felt that the textual authority was unpersuasive, it turned to the purpose of the PMPRB for guidance and found consumer protection to be mandated by the legislative history. The PMPRB was formed with the amendment of the Patent Act, which, at the same time, limited the availability of compulsory licensing. The court noted that in introducing the Bill C-22 that created the PMPRB, the Hon. Harvie Andre stated that “[t]hese changes will also ensure consumer protection by creating a drug prices review board to monitor drug prices.”

54. See Neilson, Howell & Kozuka, supra note 20, at 337.
55. Celgene Corp., 2011 SCC 1, ¶ 32.
56. See id. ¶ 11.
57. Id.
58. See id. ¶¶ 33, 34.
59. Id. ¶ 34.
60. Dunsmuir v. N.B. Bd. of Mgmt., [2008] 1 S.C.R. 131, ¶ 54 (Can.).
63. Halser, supra note 26, at 553.
64. Celgene Corp., 2011 SCC 1, ¶ 26.
Moreover, with the later amendment of the Patent Act in 1993, the Hon. Pierre Blaise, “reiterated the Board’s consumer protection mandate.”65 As a result of the legislative history and with prior holdings, the court found support for the consumer protection mandate and the holding of the PMPRB.66

V. CONCLUSION

In summary, the Supreme Court of Canada has supported the PMPRB’s mandate in protecting Canadian consumers from excessive drug prices. The court determined that the PMPRB was justified in asking Celgene to provide the prices it charged for Thalomid even when sold extraterritorially and shipped under the SAP policy. For Celgene, the outcome may be of little practical concern as Thalomid has been recently approved for sale through the RevAid process, and the original volumes in the SAP process, though a significant percentage of total SAP sales, were inconsequential in terms of absolute numbers.67 This case demonstrates the court’s approval of regulation by the PMPRB and its increasing broadening of the PMPRB’s jurisdiction.68 As such, Celgene v. Attorney General of Canada is a case that drug manufacturers that pursue the Canadian marketplace should consider.69

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65. Id. ¶ 27.
66. See id. ¶¶ 26-30.
68. Mason, supra note 21.
NAFTA Update and Trade News Highlights from November 2010 through January 2011

Chad Bond*

I. JOINT STATEMENT FROM THE JANUARY 10, 2011 MEETING OF THE NAFTA FREE TRADE COMMISSION (FTC), IN MEXICO CITY, MEXICO

In January, the representatives of the NAFTA Member States—Bruno Ferrari (Mexico’s Secretary of Economy), the Honorable Peter Van Loan (Canada’s Minister of International Trade), and Ambassador Ron Kirk (U.S. Trade Representative)—released a joint statement detailing the results of the January 10, 2011, NAFTA Free Trade Commission (FTC) meeting in Mexico City, Mexico. Article 2001 of NAFTA provides for the purpose and activities of the FTC, which holds in relevant part:

2. The Commission shall:
   (a) supervise the implementation of this Agreement;
   (b) oversee its further elaboration;
   (c) resolve disputes that may arise regarding its interpretation or application;
   (d) supervise the work of all committees and working groups established under this Agreement, referred to in Annex 2001.2; and
   (e) consider any other matter that may affect the operation of this Agreement.

The FTC emphasized the benefits of NAFTA over the seventeen years of its implementation and noted that “[f]rom 1993 to 2009, trade among the NAFTA countries has more than doubled, from $288 billion to $701 billion. Each day the NAFTA countries conduct nearly $1.9 billion in

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trilateral trade.” Among the issues that the FTC addressed were the reduction of transaction costs, the elimination of barriers to trade, and increased regulatory cooperation. One statement that the FTC made is relevant to recent cases: “We tasked relevant NAFTA committees, including the Committees on Standards-Related Measures and Sanitary and Phytosanitary Measures, to continue their work in this area and identify additional areas for cooperation.” This statement was likely due in part to the United States’ September 2010 request that the FTC “establish a dispute settlement panel regarding Mexico’s decision not to move its ‘dolphin safe’ labeling dispute from the World Trade Organization (WTO) to the NAFTA.” Furthermore, the FTC noted that an update to, and simplification of, the rules of origin will allow more goods to qualify for duty-free treatment and reduced transactional costs when those rules of origin accurately reflect patterns in sourcing and production. The FTC also announced that “the Working Group on Rules of Origin (WGRO) has reached preliminary agreement on a fourth set of changes to the NAFTA rules of origin. Annually, these goods are valued at approximately $90 billion dollars.” Finally, the FTC emphasized the need to increase information available to small and medium-sized enterprises (SMEs) regarding export opportunities via publications such as Opportunities for Small-and Medium-Sized Enterprises in North America and via websites like SBDCGlobal.com, an information exchange site. In closing, the FTC said:

We are committed to the successful conclusion of the WTO Doha Development Agenda. We urge all WTO Members to demonstrate renewed energy and directly engage immediately with each other in across-the-board give-and-take negotiations to put the Doha Development Agenda on a path toward a balanced and ambitious overall outcome that opens new markets and creates new trade flows.

This aspirational statement was then followed the next month by a warning by the WTO Chief that time was running out for any breakthroughs in Doha talks and what was deemed to be “a disappointing round of talks Feb. 14-17 among senior officials from 11 key members representing the main Doha negotiating alliances—Argentina, Australia, Brazil, Canada, China, the European Union, India, Japan, Mauritius, and

4. Id.
5. Id.
8. Id.
9. Id.
10. Id.
II. COMMERCE PROPOSAL SEeks TO END THE PRACTICE OF ZEROING IN ADMINISTRATIVE REVIEWS IN ANTIDUMPING CASES

On December 28, 2010, the U.S. Department of Commerce (Commerce) requested comments on a proposal that would likely end zeroing in administrative reviews in most cases—something that has brought praise from critics of zeroing such as foreign manufacturers and U.S. lawmakers. Commerce has acknowledged that WTO dispute settlement reports have been overwhelmingly hostile to the practice as being inconsistent with the United States’ WTO obligations and states that “[i]n response to these reports, the Department proposes modification of its methodologies, including changes to certain provisions of the Department’s regulations.”

Commerce initially addressed the issue of zeroing in 2006, when it decided to implement the findings of WTO dispute settlement bodies by discontinuing its practice of zeroing in new and pending investigations. Thus, Commerce “will no longer make average-to-average comparisons . . . without providing offsets for non-dumped comparisons.” The public comments Commerce received in 2006 after it proposed eliminating zeroing in investigations provide a useful reference for the kind of public comments that are likely to be submitted in the current proposal to eliminate zeroing in administrative reviews:

Some commentors welcomed the Department’s proposal to permit offsets when making average-to-average comparisons, which would bring the Department’s methodology into conformity with U.S. international obligations . . . other commentors argue that the denial of offsets creates more accurate results, because it combats the phenomenon of masked dumping. According to these commentors, masked dumping occurs when import transactions which are sold at less than normal value are masked by those sold at prices greater than normal value. The U.S. Court of Appeals for the Federal Circuit, these commentors note, has upheld the denial of offsets on

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15. Id.
these grounds. These commentors argue that if the Department is to grant offsets, it should do so on the narrowest grounds possible.16

The elimination of zeroing in administrative reviews would result in a more uniform application of anti-dumping methodologies.17 The Consuming Industries Trade Action Coalition (CITAC) welcomed the change, “saying that Commerce has finally acted to remove a serious distortion from antidumping calculations” in most administrative reviews, though commentators have already noted that it is unclear “how frequently [Commerce] will invoke exceptions” and apply a zeroing methodology anyway.18

A group of twenty-two U.S. lawmakers, including Senators Sherrod Brown (D-Ohio) and Carl Levin (D-Mich.), ranking member of the House Ways and Means Committee, sent a letter to Commerce Secretary Gary Locke and U.S. Trade Representative Ron Kirk that expressed concerns with the proposed elimination of zeroing.19 The lawmakers argue that “[w]ith the zeroing decisions, the WTO’s Appellate Body overreached its mandate, jeopardizing U.S. interests and undermining confidence in the system.”20 Groups that have submitted comments opposing the elimination of zeroing include the Coalition for Fair Lumber Imports, Alliance for American Manufacturing, and Florida Tomato Exchange and Florida Tomato Growers Exchange, which have “urged Commerce to withhold any modification of U.S. law, regulation, or practice until the WTO Doha negotiations are completed to minimize disruption to administration of U.S. law.”21 In that regard, Commerce officials have indicated that the United States “would continue to push for its right to use the criticized practice of ‘zeroing’ when calculating duties on dumped goods during the ongoing Doha round of trade talks.”22 Furthermore, the same official delineated between the Doha talks and current efforts to comply with WTO rulings by stating that “[t]he U.S. proposal to come into compliance with the WTO rulings in no way signals a change in the U.S. position in the Doha Rules negotiations with regard to zeroing.”23 The Office of the U.S. Trade Representative reaffirmed this position when it indicated that it will negotiate for the reinstatement of the zeroing methodology in antidumping rules within the Doha round of trade talks, but as at least one commentator has noted, “with those talks having been stalled for some years and many other WTO members implacably

16. Id. at 77,223.
18. Id.
20. Id.
21. Id.
168909094.html?mod=googlenews-wsj.
23. Id.
opposed to zeroing, Washington is likely to face an uphill struggle.”

III. THE UNITED STATES SUCCESSFULLY DEFENDS ANOTHER NAFTA CHAPTER 11 CLAIM

A. OVERVIEW

On January 12, 2011, a NAFTA tribunal rejected a Chapter 11 claim brought against the United States by a Canadian corporation, Grand River Enterprises Six Nations, Ltd., and others. The claim alleged damages in excess of $600 million dollars because of measures—violating NAFTA investor protections—that were taken in response to the 1998 Master Settlement Agreement (MSA) between U.S. states and major tobacco companies. The NAFTA Articles allegedly violated were those concerning national treatment, most-favored-nation treatment, better of national or most-favored-nation treatment, minimum standard of treatment under international law, and expropriation.

B. DISPOSITION OF THE CASE

“The United States maintained that Grand River Enterprises Six Nations, Ltd., Jerry Montour and Kenneth Hill did not have an investment in the United States and did not qualify for NAFTA Chapter Eleven investment protections,” and that any measures enacted as a result of the MSA were legitimate and reasonable measures with the aim of protecting public health and not violations of NAFTA provisions. The tribunal agreed that “[t]he evidence did not establish that these Claimants had constituted an enterprise in the United States or engaged in other significant activities there satisfying the definition of investment in Article 1139 of NAFTA...[and necessary to] satisfy the jurisdictional requirements for a claim against another NAFTA party.” But, the Tribunal did find that the jurisdictional requirements were met for the remaining claimant, Arthur Montour, who “created and carried on a substantial business in the United States, importing cigarettes manufactured by Grand River and distributing them to wholesalers and retail outlets on Indian reservations in the United States.”

Regarding the expropriation claim, the Tribunal found that Arthur Montour’s claim of expropriation of his investment in a business importing and distributing Grand River’s cigarettes failed, because “[a]n act of expropriation must involve ‘the investment of an investor,’ not part of an

26. Id.
28. Id. ¶ 5.
29. Id. ¶ 6.
investment. This is particularly so in these circumstances, involving an investment that remains under the investor’s ownership and control and apparently prospered and grew throughout the period for which the Tribunal received evidence.”30 As to the claim concerning national or most-favored nation treatment, the Tribunal concluded that the measures in question did not prejudice Arthur Montour by subjecting him to “treatment less favorable than that accorded the appropriate domestic comparator.”31 Finally, the Tribunal considered the claim of violation of minimum standard of treatment under international law and recognized that “[t]he language of Article 1105 does not state or suggest a blanket prohibition on discrimination against alien investors’ investments, and one cannot assert such a rule under customary international law.”32 Furthermore, “[t]he customary international law minimum standard of treatment is just that, a minimum standard . . . [and] is not meant to vary from state to state or investor to investor.”33 From the foregoing, the Tribunal concluded that Arthur Montour’s treatment did not violate either NAFTA Article 1105 or customary international law.34

The dismissal of this case by the Tribunal means that there has yet to be a successful NAFTA Chapter 11 claim against the United States, although there are five cases pending, while foreign investors had won nine cases against Canada and Mexico for damages totaling $326.9 million as of November 2010.35

IV. LONDON COURT OF INTERNATIONAL ARBITRATION (LCIA) TRIBUNAL SIDES WITH THE UNITED STATES IN SOFTWOOD LUMBER DISPUTE

The Softwood Lumber Agreement (SLA), which became effective in 2006, “provides for binding arbitration to resolve disputes between the United States and Canada regarding interpretation and implementation of the Agreement. Under the SLA, arbitration is conducted under the rules of the LCIA, and there is no appeal from the decision of the tribunal.”36 Additionally, “[u]nder the SLA, Canada agreed to impose export measures, including volume restraints and export charges, on Canadian exports of softwood lumber products to the United States . . . [and] to not

30. Id. ¶ 155.
31. Id. ¶ 171.
32. Id. ¶ 208.
34. Id. ¶ 7.
take action to circumvent or offset the commitments made in the Agreement. The arbitration concerned British Columbia’s practice of selling timber at prices below that provided for in SLA’s pricing system. The United States contended that this circumvented export measures and provided benefits to softwood lumber producers in Canada to the detriment of those in the United States. One U.S. industry group, which applauded the initiation of arbitration proceedings, asserts that the selling of improperly classified lumber since 2007 by the British Columbia Government has resulted in an “enormous increase in the amount of [minimum priced] timber [saving] BC Interior lumber producers hundreds of millions of dollars in fiber costs, compared to what they would have paid under the timber pricing system that was in place when the U.S.-Canada Softwood Lumber Agreement was signed.” The Tribunal agreed with the United States that certain measures by Canada violated its obligations under the SLA and concluded that “Canada must impose, as an appropriate adjustment to compensate for the breach, additional charges on exports of softwood lumber to the United States originating in Quebec and Ontario.” These additional export taxes are expected to cost Canada $59.4 million, and, if Canada fails to comply, the United States is permitted to place additional import duties on softwood lumber from Canada.

Despite the ruling by the LCIA, Canada’s Federal Trade Minister Peter Van Loan continues to insist that the SLA is still good for Canada, because it brings stability and predictability to the industry during those periods when lumber prices are low by limiting exports. Additionally, Minister Van Loan noted that “the outcome could have been much worse. The United States was seeking nearly $2-billion in penalties, but the court ruled that only some of the targeted programs are illegal.” The Tribunal granted less compensation than that sought because it rejected the U.S. argument that the remedy amount should reflect the dollar-for-dollar benefits the provincial programs conferred to Canadian softwood lumber producers. Instead, [the Tribunal] sided with Canada and ruled that the remedy should only seek to undo the extent to

37. Id.
38. See id.
39. Id.
41. SLA Press Release, supra note 36.
42. Id.
44. Id.
which the programs circumvented the SLA’s export measures.\textsuperscript{45}

The president of the Quebec Forest Industry Council has stated that “[t]he Canadian government has indicated it intends to comply with the ruling and impose the additional export charges by the end of February [2011].”\textsuperscript{46}

\textsuperscript{45} U.S. Prevails in Lumber Dispute with Canada, But Falls Short on Remedy, 29 In-
\textsuperscript{46} Id.
CONCEPT DOCUMENT
PHASED U.S.-MEXICO CROSS-BORDER LONG HAUL TRUCKING PROPOSAL

PRE–OPERATIONS ELEMENTS

1. Application: Interested Mexican Carriers apply for long-haul operating
   a. Passenger and hazardous materials carriers will not be included in this program.
   b. Subject to negotiation with Mexico, the number of carrier and truck participants in first phase of program will be managed to ensure adequate oversight.

2. Vetting
   a. Applicant carriers’ information is vetted by DHS and DOJ.
   b. Driver specific information from applicant carriers is vetted by DHS and DOJ.

3. Pre-Authority Safety Audit (PASA)
   a. Review carrier’s safety management programs (vehicle maintenance, drug and alcohol testing programs, driver qualification files, etc.).
   b. Review driving records for only those drivers who would participate in cross-border long haul operations.
   c. Review the combined driving record of drivers who would participate in the program (U.S. driving history, Mexican Federal license history, and Mexican State license history).
   d. Inspection of each vehicle to be used in the phased in program.
   e. Check all participating vehicles for Federal Motor Vehicle Safety Standards (FMVSS) certification.
   f. Check all participating vehicles for EPA emissions standards.
   g. Conduct an English Language Proficiency and US Traffic Laws knowledge test of each driver participating in the program, conducted in English.
   h. Review of all convictions, crashes and inspections in Mexico in determining carrier’s safety record.

4. Document Mexican Commercial Driver’s License process to demonstrate comparability.

5. Insurance-If PASA is successfully completed, applicant must submit evidence of financial responsibility (insurance) to FMCSA.

OPERATIONS ELEMENTS

1. Monitoring
   a. Inspections
b. For an agreed upon period of time a carrier’s long-haul operations, vehicles and drivers would be inspected by FMCSA each time one of its vehicles crosses the northbound border.

c. Electronic Monitoring-The program will use available technology to provide redundant monitoring of program’s trucks, drivers and carriers.

d. Initial, phased in access.

2. Follow Up Review (1st Review)-Each Mexican trucking company would undergo a follow-up review to ensure continued safe operation. After the follow-up review, the company’s trucks would be subject to border inspections at FMCSA’s normal border inspection rate\(^1\) and subject to inspections in the interior of the U.S. at the same rate as U.S. companies. Additionally, the company must maintain a valid safety inspection sticker.

3. Compliance Review (2nd Review)-After successful completion of a compliance review and earning a Satisfactory Safety Rating, the participating carrier will be eligible for full operating authority.

4. FMCSA Reviews
   a. Insurance Monitoring—FMCSA monitors the participating carriers’ insurance filings to ensure there are no lapses in coverage.
   b. FMCSA conducts compliance reviews of drug and alcohol collection and testing facilities used by participating carriers.

TRANSPARENCY ELEMENTS

1. Federal Register Notices—FMCSA publishes a Federal Register notice describing the proposed program and docket appropriate analyses and seeks comment on the program.

2. Publically Accessible Web Site—FMCSA develops and maintains a public web site that provides information on participating carriers.

3. Federal Advisory Committee—DOT establishes a Federal Advisory Committee Act group with representation from a diverse group of stakeholders.

4. Periodic Reports to Congress—DOT is required by statute to submit annual reports to Congress.

5. Office of the Inspector General—DOT OIG is required by statute to submit reports to Congress.

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1. Note: Drivers’ licenses will still be checked at a fifty percent rate in accordance with requirements in section 350 of the Department of Transportation and Related Agencies Appropriations Act, 2002 (Pub. L. 107-87, Dec. 18, 2001).