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

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

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As the Institute focuses primarily on issues pertaining to the North American Free Trade Agreement and the pending Free Trade Area of the Americas, and the broader economic, political, legal, and social integration processes underway in the Western Hemisphere, Law and Business Review of the Americas is one of the International Law Review Association of SMU. Other parties of the journal are the Cox School of Business, the SMU Departments of Economics and Political Science, the London Forum, and the American Bar Association Section of International Law and Practice.

* 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
THANK YOU, Mr. Chairman. Chairman Salmon, Ranking Member Sires, members of the committee, it is a privilege to join you today. I appreciate the invitation. I have had the pleasure of working with many of you in the past and I look forward to getting to know the concerns and perspectives of the new members of the committee. I am grateful for this subcommittee’s abiding support for the Administration’s efforts. I would like to focus my remarks on the opportunities we see in the Western Hemisphere.

In pursuit of our national interests abroad, foreign policy is as much about seizing opportunities as it is about as countering threats. We are fortunate in the Western Hemisphere to have far more opportunities than threats. Opportunities to achieve energy self-sufficiency and to address climate change. To improve education. To increase trade and create jobs. To consolidate the democratic gains of the last 30 years. We are working hard to take advantage of these opportunities.

U.S. relations with our hemispheric neighbors are on a positive trajectory. We have fulfilled President Obama’s commitment at the 2009 Summit of the Americas by pursuing flexible, balanced partnerships. We focus on four areas: promoting inclusive economic growth; increasing citizen security; promoting clean energy; and strengthening democracy.

In the past 15 years, 56 million households in the region joined the middle class. Over 40 percent of U.S. exports go to the Western Hemisphere, more than to any other region. During the past three years, U.S. exports to the Americas increased by more than $250 billion, to nearly $700 billion in 2011. U.S.-Mexico bilateral trade alone supports nearly six million U.S. jobs. We are working to increase those numbers through trade promotion agreements with Colombia and Panama. Last summer, Canada and Mexico joined Chile and Peru in the Trans-Pacific Partnership negotiations, which we hope to conclude expeditiously.

These developments and trends all translate into more jobs, better and cheaper goods and services, and rising prosperity on Main Streets across the United States. That is good news.

Admittedly, not all of the news is good. In some countries, policy reforms are needed to accelerate economic expansion, regional integration, and greater opportunity for prosperity to be more widely shared. Many countries and people in the region remain under pressure from criminal gangs and violence. In response, we expanded and linked our four citizen security programs: the Merida Initiative, the Central American Regional Security Initiative, the Caribbean Basin Security Initiative, and the Colombia Strategic Development Initiative. Through a whole-of-government approach we are focusing on institution and capacity building while encouraging economic development for those most at-risk.

U.S. assistance has helped bring a dramatically improved security situation in Colombia, where the Santos administration is engaged in well-designed discussions on peace with the FARC that could result in the end of the longest running insurgency in the region and the FARC giving up drug trafficking. In Mexico, our partnership with President Peña Nieto’s administration is off to a strong start with both sides committed to addressing crime and violence through durable, long-term cooperation on institution building and social development. We are partnering with Colombia, Mexico, and others to help Central America address its security challenges.

I am focused on the challenges and opportunities of three key issues: energy, education, and the defense of human rights and democracy.

The Western Hemisphere is increasingly a global supplier of energy. Companies and entrepreneurs who never focused on the region are waking up to its enormous potential.

At the 2012 Summit of the Americas, the United States and Colombia launched Connecting the Americas 2022, a hemispheric initiative to provide universal access to affordable electricity within a decade. This complements President Obama’s Energy and Climate Partnership of the Americas (ECPA), in which we and 33 partners promote efficiency, encourage renewable energy, reduce the carbon footprint of heavy oils, and put Latin American cities on a more sustainable path. ECPA promotes adaptation and mitigation to climate change, in particular in the Andean Amazon and the Caribbean, where we are working to reduce net deforestation and greenhouse gas emissions without inhibiting economic growth and development.

Education underpins our other goals in the Americas. We can expand the momentous economic gains of the past decade only if we improve education. That’s why President Obama launched “100,000 Strong in the Americas,” to increase educational exchanges between the United States and Latin America and the Caribbean to 100,000 in each direction each year.

To meet that goal, we must double the current flow of students at a time when our own budget constrains us, so we are partnering with academic organizations and the private sector.
Our push on education complements our interest in promoting greater social inclusion. Expanding educational opportunity is crucial to ensuring all citizens share in the region’s recent prosperity.

Our commitment to true partnership and shared responsibility calls for an honest re-examination of areas where this hemisphere once led, but now falters.

In some countries, populist leaders who are impatient with or even disrespectful of democracy’s processes are closing down or subjugating independent media, and seeking to control courts and legislatures. We understand the aversion to unwarranted interventionism. That said, this hemisphere has been a global leader in setting standards of what democracy looks like. The leaders of many of today’s democracies in the Americas were fighting for these rights in their own countries not so long ago.

 Attacks on freedom of expression require a principled response. We are working through the Organization of American States and its Special Rapporteur for Freedom of Expression to protect these rights. We will continue to speak out to defend strong, independent institutions of democracy, including by using the March 22 OAS special General Assembly on the hemispheric human rights system to voice strong support for the continued independence of the Inter-American Commission on Human Rights.

In sum, our policy of partnership and shared responsibility has produced real progress. Though positive stories rarely make the news, they abound in the Americas, where inclusive economic growth is transforming the region and several of our partners are emerging as players on the global stage. There is of course still more to do to foster the peaceful, prosperous and democratic hemisphere we all want to see.

Again, thank you Mr. Chairman. I look forward to working with you and other members of this committee to advance U.S. interests in the hemisphere.
Articles
Speed Bumps, Potholes, and Roadblocks on the North American Superhighway

Robert A. Pastor*

Twenty years ago, President George H. W. Bush, Canadian Prime Minister Brian Mulroney, and Mexican President Carlos Salinas initialed the North American Free Trade Agreement (NAFTA), creating the largest free trade area in the world.¹ Leaders had the vision to replace nearly two centuries of distant relations and high trade and investment barriers with the promise of a continental market.

Despite fears in each of the three countries, by 2001 NAFTA achieved astonishing success with regard to its trade and investment objectives. From 1994, the onset of NAFTA, to 2001, trade had tripled among the three countries and foreign direct investment had quintupled.² Integration—trade within the region as a percentage of the three countries’ trade with the world—accelerated from 36 percent in 1988, before the U.S.-Canadian Free Trade Agreement, to 46 percent in 2001. This signified that the three economies were making products together and integrating their markets.

While Ross Perot had warned Americans that NAFTA would lead to job loss, the United States during those first years of trade expansion actually generated more jobs—22 million—than in any comparable period in its history. The region also became a formidable engine of growth, increasing its share of world production from 30 to 36 percent.

Unfortunately, North America peaked in 2001. Since then, the rate of trade growth among the three North American countries declined by two-thirds, and the rate of growth of foreign investment declined by half. The North American share of world production and the magnitude of regional integration both returned to the points that they were at before NAFTA.

* Robert A. Pastor is Professor and Director of the Center for North American Studies at American University. He is the author of The North American Idea: A Vision of a Continental Future (Oxford University Press 2011), from which this article was adapted.
What accounts for the “peaking” of North America in 2001? First, China emerged as a trade powerhouse and surpassed both Mexico and Canada as the main source of U.S. imports. Second, despite the increase in trade and the fact that 80 percent went overland, none of the countries planned or invested in transportation or infrastructure to connect the new market. Third, the three governments reverted to dual-bilateralism—separate talks with each country—rather than work together and build on the promise of North America.

There are other reasons why North America “peaked,” but the timing was not a coincidence. In fact, the most important reason was the attack of September 11, 2001. Perhaps, if the “North American Idea”—the spirit of working as a community of nations to improve the lives of everyone on the continent—had been inculcated in the leadership or the people, the three governments would have responded as one after 9/11. But that is not what happened. After the attack, the United States built new barriers to trade, commerce, travel, and communication with its neighbors that proved to be even more formidable than the ones that had been dismantled by NAFTA.

This essay is about those barriers, the feeble response by the three governments to create a seamless continental market for goods and services, and a community of three states and peoples. In the final part of the essay, I shall outline both a vision and a blueprint for what the United States should do to transform the new barriers into an opportunity to deepen and strengthen North America.

I. INEVITABLE AND IRREVERSIBLE, BUT THAT COULD CHANGE

“Economic integration within North America is not only inevitable; it is also irreversible,” insisted Thomas D’Aquino, one of Canada’s most effective and relentless advocates for trade and investment in North America. The truth, however, is that interdependence is neither inevitable nor irreversible; indeed, it stalled mainly because of 9/11 and has been declining since. On that day, the U.S. government ordered officials at all 300 land, sea, and air ports-of-entry in the United States to a “level one threat status,” which meant complete examination of everything approaching the border. Within one hour, the two borders virtually shut down.

The United States did not need to inform Canada and Mexico what happened because the whole world saw the attack on television, but

4. Stated in a meeting in early 2005 for the Council on Foreign Relations Task Force on the Future of North America, of which he and I were both co-vice chairs.
Canadians and Mexicans would have appreciated being consulted or even just informed of the decision to close the borders. Both countries immediately felt the consequences. The impact of shutting the two borders was equivalent to damming two huge, raging rivers.

Within two days, the lines of trucks waiting to cross Ambassador Bridge into Detroit stretched for twenty miles. By then, Ford, which used its Windsor location to supply parts for eight of its fifteen U.S. plants, was forced to shut down five of its assembly lines and one other plant. Chrysler shut all of its plants. Toyota cancelled shifts in its Kentucky plants. In San Diego, traffic stalled for eight hours. President Fox later described the economic aftermath in Mexico as “cataclysmic.”

When governments cannot locate a policy to respond to a crisis of the magnitude of 9/11, they tend to choose one of two “default options:” they go to war or reorganize the government. The Bush administration did both. Bush went to war against the Taliban in Afghanistan, and soon overthrew the regime. Establishing a stable government to replace the Taliban proved to be a lot harder than either.

The job of reorganizing the U.S. government seemed more mundane, but, in the long term, it might prove even more consequential. The President signed into law in November 2002 a law establishing the Department of Homeland Security (DHS). The bill did this by combining twenty-two existing agencies with 200,000 employees. It was the second largest government reorganization in American history, after the establishment of the Department of Defense (DOD) in 1947. As with the case of the DOD, the implications of the decision to set up the DHS will reverberate in the United States and the world for decades.

The mission of the new bureaucracy was simple and repeated as a mantra by every DHS official: “Close the door and stop terrorists!” In a politically correct age, targeting potential suspects is viewed as “profiling,” and to avoid being “politically incorrect,” DHS targeted everyone. It discarded the welcome mat and harassed everyone trying to enter the country legally.

Canada and Mexico were just gearing up to partner with the United States to create “the most efficient border in the world” when they realized that they had been transformed from policy makers to policy takers. Border efficiency had been replaced by border security, and Canada and Mexico were on the other side of a new fortified border.

In an interview with Joseph Misenhelter, the Director of Homeland Security in San Diego, in October 2008, he acknowledged that, since 9/11, DHS officers on California’s border had not arrested a single person coming from Mexico for being suspected of terrorism. This was not for want of trying, and it also wasn’t because few people cross the border. Since 9/11, the California border has been legally crossed from the south more than 500 million times—on average, about eighty-five million per

6. Id. at 42.
This was also true of the Canadian border. There, DHS officers were more evasive in answering the question how many people have been arrested at the border for suspicion of terrorism, usually mentioning “that a terrorist incident” had occurred.

When one asks for specifics, they refer to the “millennium” bomber, but he was arrested by a border guard in Washington State in 1999—nearly two years before 9/11.

The costs and consequences of creating a mountain of restrictions since 9/11 have been exorbitant for the hundreds of millions of people who cross the Mexican and Canadian borders each year, but because most of these costs are not widely known, we suffer them quietly.

The problem is that within North America, businesses are not just selling products, they are increasingly making products together. These joint efforts need a “flat” terrain. Security restrictions are like speed bumps; they disrupt traffic and add to the cost of doing business. No one would question their utility if they stopped terrorists, but there is little evidence of that. This is not to suggest that we should open the borders and let everyone pass, but we should raise questions as to the effectiveness of the post-9/11 strategy and open our minds to the possibility of alternatives.

We have created problems on our borders and in our relationships with our neighbors since 9/11, but the more serious problem is what we have not done. When trade tripled, we should have built more highways to connect the North American market, but at that very moment, a movement emerged in the United States to stop construction on a mythical twelve-lane superhighway from Mexico to Canada. The groups, which include a resurgent John Birch Society, identify themselves as opponents of the North American Union—also an illusory target. They fear that the highway aims to undermine the sovereignty of the United States and facilitate migration. The fact that no such highway is either being built or even contemplated has not deterred these groups; indeed, their hysterical videos seem to grow in number and intensity.

While their fears of a highway are surreal, their concerns about illegal migration are shared by a broader constituency. Indeed, when Congress reviewed the immigration issue in 2006, the only part of a very complicated bill that was approved was to construct a wall. Instead of eliminating the speed bumps and filling in the potholes or approving comprehensive immigration reform, the United States Congress funded a wall across 670 miles of its border with Mexico. The declared purpose was to stop terrorists, undocumented workers, and drug traffickers.

Of course, a wall will not stop all illegal transactions. About 40 percent of undocumented workers—including the 9/11 terrorists—enter the United States legally with visas, and then overstay. Drug traffickers are very adept at finding new routes. A wall can reduce illegal migration and crime, but usually only at a few places on the border. The problem with the wall was that it sent a message to Mexico and to Mexicans in the United States that we view them as the problem. On the northern border, the added restrictions are an annoyance, a serious cost to commerce, and a signal that the United States really does not trust Canadians to look after shared security concerns.

North America’s problems are speed bumps (the new 9/11 restrictions), potholes (the failure to maintain or build roads and infrastructure), roadblocks (policies that prevent trucks from transiting the border or picking up return shipments), and hidden tolls (concealed taxes that encourage inefficiency and the lack of harmonized regulations). Together, these problems have hobbled North America, insulted our neighbors, and been so costly as to have turned the North American advantage into a disadvantage.

II. SPEED BUMPS

In the millennium year 2000, inspectors at all U.S. ports of entry counted 534 million people entering the United States. Of those, 437 million entered the United States overland legally from Mexico and Canada. After September 11, 2001, the numbers declined each year until they reached 250 million people in 2009. This was not due to economic recession; the numbers declined even when the economy improved. It was not due to a problem in Mexico; the numbers declined from Canada even more. It was not due to global restrictions; the numbers arriving by sea and air remained steady. It was due to a “thickening” of both borders.

Almost all of the people who entered came for short periods. Many commuted across the border, whether branch managers living in Arizona or nurses from Windsor crossing to work in hospitals in Detroit. Roughly one million a year came as permanent residents with the intent of immigrating to the United States.

Leaving aside the guns, drugs, and commerce, the U.S. government’s main preoccupation on the border is people. The legal entries each year have ranged from 240 to 437 million people each year, but the real focus are those who enter the United States without documents or remain after their visas expire.

In a press conference on October 23, 2008, DHS Secretary Michael Chertoff cited estimates by the Pew Research Center that more than 800,000 illegal migrants entered the country each year from 2000 to 2005, but he then noted the reduction to 550,000 in the following two years and saw this as a sign that enforcement “at the border has begun to turn the tide on illegal migration.” Of course, allowing the illegal entry of a half of a million people each year is not exactly a success story. During the
Bush years, the total illegal population in the United States increased 40 percent, from 8.4 million in 2000 to 11.6 million in 2008. In 2009, because of the recession and more enforcement, the number fell to 11.1 million, where it has remained through 2012.9

The two land borders have not moved or grown longer since 450 officers patrolled them in the 1920s. But from 1986 to 2001, the number of customs agents on the southern border tripled to nearly 9,000. In comparison, there were only 300 border officials and 1,500 customs agents on the 5,525 mile Canadian border. After 9/11, President Bush doubled the number of border agents on the southern border again, and the overall numbers grew to over 20,000 in 2009.10

The expansion in personnel coincided with a proliferation of programs — each with its own acronym. It wasn’t long before the bureaucrats had enough acronyms to design a new game of North American Scrabble. Citizens traveling frequently across the U.S.-Canada border need as many as five separate credentials: (1) NEXUS, a biometric, photo ID card, to allow fast travel across the border; (2) FAST for their commercial vehicle; (3) TWIC for transportation workers; (4) a passport; and (5) PASS, an e-passport in order to be compliant with the Western Hemisphere Travel Initiative (WHTI). Each requires a lengthy and expensive application process, and if someone also wanted to cross the U.S.-Mexico border, they would need an equal number but different set of cards, each with different acronyms.11

Part of the frustration of people who cross the border regularly is that they spend substantial money and time to acquire NEXUS or SENTRI, and then they discover that those lanes may be slower than the others. The requirements for truckers are even more complicated, expensive, and duplicative. Louise Yako, vice president of the British Columbia Trucking Association, complained about restrictions, duplication, and rising costs, and feared that many of the small trucking companies would go out of business. “They,” she said, referring to the Department of Homeland Security, “promised to consolidate the various programs and make them

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easier, but the requirements have multiplied and are far more costly.”12 Yako’s fears that the fees would drive small truckers out of business proved true.

One study commissioned by the Canadian government estimated that the total border costs and fees paid by the trucking industry was about $10 billion.13 Numerous studies since 9/11 have assessed the length and cause of delays and the cost to commerce and the nations, and they all point in the same negative direction. John Taylor and Douglas Robideaux of Grand Valley State University, with George C. Jackson of Wayne State University, calculated that the border management system was costing both the United States and Canadian economies about $10.3 billion per year.14 This was equivalent to about 2.7 percent of merchandise trade in 2001,15 which is higher than the average U.S. tariff before NAFTA.16 This is a tax, however concealed. If the tax made us more secure, it would be worth it, but there is no evidence that this is the case.

There are fewer studies on the U.S.-Mexico border, but their conclusions are consistent with those on the northern border. The most comprehensive report was done by El Colegio de la Frontera Norte in Tijuana, based on an extensive survey. The study computed total costs of delays of $436 million per year. In addition, they estimated the cost to the local community of delays, added pollution, and job loss, and concluded that they suffered $7.5 billion in lost production, nearly 300,000 jobs lost, and $1.4 billion in lost salaries.17

The evidence, in brief, is substantial and incontrovertible. Delays have increased by about 20 percent for Canadians going south and 12 percent for Americans going north to Canada according to one of the best non-government analyses.18 The direct cost to the taxpayer also soared. From 2001 to 2009, the U.S. Border Patrol budget alone tripled from $1.1 bil-

15. Id.
lion to $3.5 billion,\textsuperscript{19} while the entire budget of Customs and Border Protection (CBP) grew from $3 billion to $10 billion.\textsuperscript{20}

Canada and Mexico were initially sympathetic to the U.S. need to create a more secure border, but they were also wary of new barriers to trade. Canadians repackaged many of the initiatives that had been broached over the years into a “smart borders” agreement in December 2001 that increased border security without unduly harming commerce. The Mexican Foreign Minister tried to convince Canada to negotiate the agreement trilaterally, but Canada rejected that approach, and so Mexico replicated it with a similar agreement in March 2002. Despite those agreements, intrusive restrictions proliferated.

Canadians and Mexicans resented the restrictions, as well as the way that the U.S. government imposed them. The U.S. decision to fortify its borders has reduced trade, investment, tourism, and jobs; all while irritating or angering its neighbors. The investment in border security was substantial, but there is no evidence that it has provided more security.

III. POTHOLES

If trucks and pedestrians only had to drive over several speed bumps, they could manage, but in the next stage of their journey to the heart of North America, the highway is ravaged with potholes, some so deep that they would immobilize any vehicle. These potholes come in many forms. Some are the old-fashioned kind caused by governments that do not maintain roads, bridges, railroads, ports, communications, and border facilities. In those cases, vehicles break down, and there are more accidents.

Other potholes have strange names, “drayage” and “cabotage.” Both raise the cost of trade by protecting markets rather than promoting competition. “Drayage” literally means “the cost of carrying wagon,” but it actually means that many trucks are needed to do a job that one truck could do if there were free trade. “Cabotage” restricts foreign trucks, planes, trains, and ships from carrying shipments between cities within a foreign country. After Canadian trucks, for example, deliver their load in Chicago, cabotage prevents them from picking up other shipments to deliver to another U.S. city, and often they have to return to Canada empty, thereby doubling the transportation cost for consumers.

NAFTA was supposed to permit Mexican trucks to cross the border by 1995, but the U.S. prevented it. Only after the World Trade Organization authorized Mexico to raise tariffs in response to the U.S. failure to imple-


ment this agreement did the President, in 2011, finally allow a few trucks to cross the border. For most of the commerce going north, at least three trucks are still used to transport produce when only one is needed. The Mexican government estimated that the additional “border transfer” cost of drayage was about 15 percent of the volume of trade—or about $616 million for 2008.

The Jones Act of 1920 is one of the oldest examples of cabotage in the United States. Its purpose is to protect and maintain the U.S. maritime industry by preventing foreign ships from picking up cargo in the United States and delivering it to another city in the country. The U.S. International Trade Commission estimated that the cost to the U.S. economy of the “concealed tax” of the Jones Act was $656 million in 1999.21

If the trucks are ever able to cross the continent, they will find real potholes—not just the political-bureaucratic kinds—in the roads, bridges, and infrastructure. In a report to the Canadian-U.S. Inter-Parliamentary Group, Val Meredith, a member of Parliament, wrote: “While continental trade has skyrocketed, the physical infrastructure enabling the movement of these goods has not.”22

There were other signs. On August 14, 2003, a few trees fell on power lines in Ohio, and, within hours, a power outage affected fifty million people, including one-third of the population of Canada. Bill Richardson, who had been secretary of energy, said the essence of the problem was that the United States was “a superpower with a third world electricity grid.” Three years later, a bridge near Montreal collapsed, killing five people.

The U.S. Department of Transportation reported that one-fourth of America’s nearly 600,000 bridges needed significant repairs. The Federal Highway Administration reported that one-third of the country’s major roads were in substandard condition, and that this was a “significant factor” in 43,000 traffic fatalities each year.

The debt crisis of the mid-1980s compelled the Mexican government to reduce its spending for infrastructure—from about 8 percent of GDP in 1981, to less than 2 percent in 2002. By the latter date, the World Bank estimated that Mexico had a ten-year infrastructure deficit of $20 billion per year.23 Canada, like Mexico, reduced its investments in infrastructure significantly in order to close its fiscal deficit. By 2005, the Western Transport Ministers reported that total government spending for infrastructure as a proportion of GDP dropped by more than half—from 2.9 percent in 1991 to 1.4 percent in 2002–03.24

21. See Juan Carlos Villa, supra note 13 at 32.
22. Id.
After the financial crisis, all three governments diverted some funds to infrastructure, but each tended to use local plans, rather than develop national or continental plans. One area did witness some breakthroughs in North American transportation—railroads—and that was mostly because the governments cleared the way to allow the private sector to integrate the system. In the mid-1990s, several of the largest American railroad companies merged. At about the same time, the Canadian and Mexican governments privatized their railroads. Two U.S. railroads bought Mexican railroads, and the newly privatized Canadian National acquired assets in the United States. The result was that the railroads became more continental.

Instead of planning for a North American highway, the United States invested in expensive walls to separate the countries. Congress moved with unusual speed to appropriate $2.1 billion for a 670-mile wall on the southern border.

IV. HIDDEN TOLLS

North America’s prosperity has been stunted not just by speed bumps, potholes, roadblocks, and walls at its borders, but also by tolls that are concealed in the higher prices consumers have to pay for North American products. Unlike “drayage,” which protects trucking firms, no one benefits from these concealed taxes. They are simply the unnecessary costs of doing business within the continent. These additional tolls fall into three categories: (1) “rules of origin,” which impose unnecessary costs at the border in identifying the part of the product that is made in North America; (2) trivial differences in regulations that compel exporters to adapt their products to three different sets of regulations; and (3) taxes that encourage inefficiency.

Michael Hart, a Canadian trade negotiator and one of the foremost authorities of regulatory divergence in North America, defines these inefficiency taxes as “the sum of duplicative regulations, border administration delays, and other regulatory impediments.” The duplication occurs when truckers (and indirectly, consumers) have to pay for multiple credentials from at least two governments to cross the border in a theoretically expedited lane and fill out slightly different customs forms on both sides of both borders.

NAFTA eliminated tariffs among the three countries, but it allowed each country to set its own external tariff to the rest of the world. In order to prevent China from using one country’s relatively lower tariff as an entry point to swamp the other two markets, the three North American governments instituted “rules of origin” provisions. These procedures require every exporter to fill out a certificate describing the origin of each part in a product. The complicated administrative procedures and cumbersome paperwork cost, according to Danielle Goldfarb of the
C.D. Howe Institute in Canada, as much as $31 billion annually.²⁵

Another study suggested Mexico could save as much as 2 percent of the value of its exports to the United States, which, in 2008, would amount to $4.7 billion.²⁶ Using a general equilibrium analysis and examining the deeper effects of the procedures on the three economies, Alex Appiah estimated that the total cost of the “rules of origin” procedures amounted to about 2 to 3 percent of North America’s GDP. With a GDP of $17 trillion in 2008, 2.5 percent would amount to $425 billion.²⁷ This constitutes a colossal tax that consumers and producers unknowingly pay in North America. A common external tariff would eliminate this tax.

A second area where North Americans are paying taxes without getting benefits is the result of different rules. “Regulatory divergence” represents the next generation of issues that the three governments need to negotiate in order to improve market competitiveness. The logic of harmonization is clear-cut. All three governments have laws to protect the environment, ensure that food is safe, and guarantee good labor conditions. In those cases where the laws are very different, harmonization is not an option, but in many cases, the differences in the laws and regulations are trivial—say, on the size of a label. These increase the costs of production without benefit to society. In these cases, the three governments should negotiate a common standard.

These issues have become more important for three reasons. First, in a free trade area, the administration of regulations has replaced the collection of customs duties as one of the main responsibilities of border administration, and it adds considerably to the time needed to inspect commercial shipments. Secondly, in the last two decades, most countries have seen regulations multiply and extend to the full gamut of public concerns: food and car safety, environmental protection, labor rights, market failure, and so on.

Soon after NAFTA came into effect, the three governments set to work to harmonize standards on the weight and length of trucks. So the administrations convened a group—the NAFTA Land Transport Standards Subcommittee—to harmonize the sixty-four different standards. In 1997, the Subcommittee gave up, saying “there is no prospect of developing a complete consensus within North America on a common set of truck weight and dimension limits.”

The OECD estimated that divergent standards add 2 to 10 percent to

overall costs of production. The NAFTA governments have been groping since 2005 for a formula to harmonize standards, but they have not found it. Despite the high priority given to it by Presidents Bush and Calderon and Prime Minister Harper, the governments failed even to agree on jelly-bean regulations—an interest of Harper’s—and cereal—an interest of then-Secretary of Commerce Carlos Gutierrez, a former CEO of Kellogg.

V. THE VISION AND THE BLUEPRINT

NAFTA promoted competition transformed three national markets into a continental market, but in the absence of measures to govern the continental space, it failed to solve problems like harmonizing truck standards or unifying regulations on candy. It also did not share the gains of trade, and thus income disparities widened.

The changes within and between the three countries are still not widely understood. Mexico, the poorest and most stratified, experienced the most profound modernization and democratization. While Mexico’s middle class grew the fastest, those who were better off and in the north benefited more. Canada kept its fiscal house in order and thus experienced a positive economic jolt, but 9/11 confounded their manufacturing strategy and, together with the speed bumps and potholes, the country found its entire economic trajectory at risk. Canada’s dependence on the U.S. market deepened, but the United States treated the convergence of the two economies as if it had not happened.

The groups in the United States that opposed NAFTA initially blamed it for the decline of manufacturing and the rise of immigration. The drug-related violence in Mexico that exploded during the Felipe Calderon administration led to a higher degree of collaboration between Mexico and the United States on security issues, but at the same time, it harmed the perception of Mexico and diverted the governments from an agenda of economic cooperation.

Obama sought to warm the two bilateral relationships, but his agenda was so full—with two wars, a deep recession, and health insurance—that he could not devote the time or political capital to refashion the North American relationship. This is the political context that explains why the three governments failed to take any steps to flatten the speed bumps, fill the potholes, eliminate the roadblocks, tear down the walls, and stop extracting tolls in the absence of roads. Real integration stalled and went into reverse. The costs of doing business among the NAFTA countries increased.

With the election of a young and vigorous President in Mexico, and the re-election of Barack Obama in the United States, the two governments

have another chance to restore the promise of North America. Obama and Peña Nieto should join with Prime Minister Stephen Harper to propose a “North American Community” that would invigorate the three economies, improve competitiveness vis-à-vis Asia and Europe, enhance continental and public security, address more effectively the new transnational agenda, and design 21st century, lean but effective tri-national institutions.

The vision that undergirds this proposal is based on a principle of interdependence—if one country suffers a setback, all are hurt, but a success in one helps the others. The principle is simple, and often voiced by leaders, but they rarely act on those principles. If the United States actually accepted its “shared responsibility” for the drug problem, it would not permit the 7,500 gun shops on the U.S. side of the border to sell assault weapons to the drug cartels. If all three countries actually incorporated a sense of Community, they would advertise “Buy North American” instead of respective national products.

The word “Community” refers to a group in which the members feel an affinity and desire to cooperate. It is not a Union, and the NAFTA countries’ relationship would differ from Europe’s, though it should try to learn from EU experiences in order to avoid mistakes and adapt successes. A “Community” should be flexible, allowing for the three countries to define the new relationship that they would seek.

In December 2011, the United States and Canada presented “Action Plans” on the border and regulatory convergence. The United States and Mexico repeated the same exercise. The three countries restated the goal on borders that they did a decade before in the two “Smart Borders’ Agreement”—to make the border efficient and secure. And they affirmed the need to harmonize regulations just as they did in 2005 when they established the Security and Prosperity Partnership—to avoid “the tyranny of small differences in regulations” that serve only to protect companies rather than consumers. Instead of taking actions, the Plans actually proposed studies and pilot projects. The leaders called the plans “game-changers,” but anyone who bothered to read them knew they were playing the same games.

It is clear that the only way to move forward on the agenda is for the leaders to give North America a high priority and organize their governments to accomplish their goals. They will also need tri-national institutions, because the three governments are not designed to think continentally. They should start with a North American Advisory Commission to do research and prepare continental options for all three leaders to consider and choose at annual summits. They should encourage the two bilateral legislative committees to merge into a single North American Parliamentary Committee.

The three leaders of the nations should call for a North American Plan for Transportation and Infrastructure, and establish a North American Investment Fund that would connect the poorest southern regions of
Mexico with the richer North American market. Such a Fund would create the infrastructure in the south of Mexico that would attract investment and jobs and thus reduce migration to the border and the United States.

To create a seamless market, the three countries should negotiate a Common External Tariff. This would eliminate the excessive “rules of origin” tax of about $500 billion per year, and the common tariff would yield about $45 billion per year, which could be placed in the North American Investment Fund to build continental corridors. With a sense of Community, the three governments could then eliminate unnecessary border restrictions, expand educational opportunities across the continent, harmonize and lift environmental and labor standards, and train trinational teams of customs officers. These steps would begin to invigorate the sleeping giant of North America.

In November 2011, President Barack Obama toured Asia and committed the United States to negotiating a “Trans-Pacific Partnership” (TPP) in order to harness Asian dynamism for the benefit of the U.S. economy. This seems like a good idea, but is actually a strategic mistake because it diverts scarce U.S. attention from a project that would have a more profound and positive effect on the U.S. economy and society—deepening economic integration in North America.

It is unrealistic to expect these ideas to become policy in a short time. Big ideas take time for the body politic to absorb. When American women convened a meeting in Seneca Falls, New York in 1848 to seek the right to vote, no one would have thought it would take seventy-one years to succeed.

Still, this does not mean we should give up or slow our efforts. Representatives from the border regions could generate support for the “North American Idea.” The three leaders could begin by articulating a vision and announce a merging of the two sets of working groups on borders and regulations into a single North American group. They could ask their Ministers of Transportation to develop a North American Plan. They could allocate just $15 million for scholarships and support for Research Centers for North America.

None of the many proposals that have been advanced for the region can be achieved without such a vision. Americans and Canadians will not provide funds to a North American Investment Fund to narrow the development gap with Mexico without a convincing vision of how Mexico’s growth will benefit their countries. There is little prospect of reaching an agreement on labor mobility, on harmonizing environmental standards, on forging a transportation plan, or any proposal that would cost money or change the status quo unless there is a vision of a wider Community that could attract the support of the people and their legislatures.

A vision can inspire the three nations to rethink and renew North America.
Geo-Political Insignificance, Information Sharing, and Economic Survival: An Unofficial Perspective from Within the Caribbean Region

Dr. Christopher Malcolm*

“Dearly beloved we are gathered here today to think about this thing called . . . life.” PRINCE AND THE REVOLUTION, LET’S GO CRAZY (Purple Rain 1984)

I. INTRODUCTION

His perspective is personal and reflects individual thoughts, including some that have been shared in public fora, which have occupied my mind at one time or another over the last several years. While the ideas here included are not novel and could also be reflective of what can be read elsewhere, the narrow geographic focus of this perspective is the Commonwealth Caribbean region.

The introduction to the song “Let’s Go Crazy,” which has been referenced above, could, without more, appear out of sync. But, the sentiment is indeed well placed, and this perspective will seek to highlight, even if it does not flesh out, some of the things called life considerations that should be borne in mind when new approaches or mechanisms are being implemented elsewhere in the hemisphere, with implications for the Commonwealth Caribbean.

II. CONTEXT

The Commonwealth Caribbean comprises several jurisdictions that are not homogenous in their stages of development, economic dependence models, financial and regulatory systems, population sizes, or governance mechanisms. The region includes, for example, the member states of

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CARICOM, which, but for Montserrat, are independent states, as well as the Overseas Territories (OTs), including Montserrat, which are still, in substance, colonies of the United Kingdom, albeit called by another name. The GDP of Trinidad and Tobago relies most significantly on oil and natural gas, the Bahamas most significantly on tourism, and the Virgin Islands depends mostly on revenue derived from the financial services sector.

Notwithstanding that the region is not homogenous, without inward foreign investment in one shape or form every economy here would crumble. To this extent, homogeneity can be inferred. This also means that exogenous factors, in particular those affecting how money flows and those relating to the financial regulatory mechanisms that apply elsewhere, have significant implications for the region. Furthermore, over time there has been an established reliance on the fortunes of the U.S. economy, which speaks to another level at which homogeneity can be inferred. For example, notwithstanding that the Virgin Islands is a British OT, its legal tender is the U.S. dollar and its established trading and associated economic relations with the United States are more significant than they are with the United Kingdom.

Insofar as Trinidad and Tobago is concerned, investment in its oil and gas economy, as well as its external market for output, is United States centered. Where tourism is most important, such as in the Bahamas and Barbados, arrivals from the United States dominate, and the product being offered is usually driven by U.S. market conditions. Insofar as cultural industries are concerned, the primary external, and often most lucrative, target market for regional singers and musicians is the United States. And those who target and even become more successful in Europe and elsewhere tend to break internationally through the U.S. market.

Against this background, it may be considered well established that the lives and livelihoods of the peoples of the Commonwealth Caribbean are intricately bound to the United States. Accordingly, as we consider this thing called life in the western hemisphere, it is important to bear in mind that the leadership and active support of the United States are critical to the economies of the region.

Since the beginning of the global financial crises in 2007, there has been a growing tendency, or so it appears, to find fault in business models that enable homeland nationals to include offshore legal arrangements in their development plans. Whether financial planning options are included or

\*1. The member states of CARICOM are Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Lucia, St. Kitts and Nevis, St. Vincent and the Grenadines, Suriname, and Trinidad and Tobago. **CARICOM Member States, CARIBBEAN COMMUNITY (CARICOM) SECRETARIAT,** http://www.caricom.org/jsp/community/member_states.jsp?menu=community (last visited Mar. 1, 2013).

\*2. The OTs in the Commonwealth Caribbean are Anguilla, the Virgin Islands, the Cayman Islands, Montserrat, and the Turks and Caicos Islands. See id.
not, these legal arrangements represent the essence of capitalism, and related offshore corporations enable investor-determined best arrangements for capital formation, market penetration, and risk allocation. At the core, offshore corporations highlight the principle of separate legal personality, and those who undermine these structures and the flexibility they offer are inflicting what could become fatal wounds to the concept of globalization, as well as the lure of the market economy.

While the principle of separate legal personality has evolved over time, as applied in the Commonwealth Caribbean this legal fiction still affirms that individual members of a corporation do not bear joint and several responsibility for its authorized acts or omissions. The principle is well established under company law statutes and has been judicially confirmed since 1897, per Salomon v. Salomon.3

In Salomon, the court had to determine, in particular, whether the creditors of an insolvent company could recover outstanding debts from its shareholders. At first instance, in the High Court, Vaughan Williams, J. gave judgment for the claimant, Mr. Broderip,4 after having determined that the company was Mr. Salomon in another form and that against him there was a right of indemnity. The Court of Appeal confirmed the judgment of Williams, J., albeit on the ground that Mr. Salomon had abused the privileges of incorporation and of limited liability, which Parliament had intended for bona fide shareholders unlike Mr. Salomon, who was a mere puppet. In substance, the Court of Appeal found that the company was a myth and a mere scheme that enabled Mr. Salomon to carry on as before but with limited liability.5

The House of Lords, now the U.K. Supreme Court, unanimously overturned the decision of the Court of Appeal, and, in so doing, rejected the argument that the company had been Mr. Salomon’s agent. The House of Lords also found that the company was duly constituted and that it was not the function of judges to read into the statute limitations which they considered expedient. In substance, they confirmed that the company was a separate legal person from its shareholders/members.6

Since this House of Lords decision, there have been various exceptions to the principle confirmed therein. Courts have, for example, disregarded a company’s separate legal personality or lifted the corporate veil where the company has been used as an instrument of fraud or to commit crimes. Nevertheless, Salomon is still considered by many to be the most important and time-honored decision in English company law. Furthermore, its core principle has since been a significant facilitative component of the market economy, without which, capitalism, as we now know it, could not exist.

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6. Id.
Unfortunately, in recent years there has been a sustained ‘global’ push towards greater ‘transparency,’ which, if unchecked, will put to death the legal personality framework of a statutory limited liability company in the several jurisdictions of the Commonwealth Caribbean. This march of death could also mark the beginning of the end of capital formation and risk allocation under a corporate vehicle as we now know it. If not certain death, the current push will certainly cause an irreversible, and as yet unquantifiable, undermining of the modern company, especially in its appeal to non-national members; and the important market economy function that it has served could be stymied if not lost.

Although it is quite proper to examine the fundamentals of any company, and to then determine whether it is being properly operated in accordance with its governing articles and the relevant laws under which it was established, there will be cause for concern where it appears that there is a more sinister motive at play. In this context, it is instructive that the period of sustained chipping away of the protective layers of the company has corresponded with a period of sustained layering of ‘global regulatory requirements’ to protect against the possibility of money laundering and terrorism financing.

In principle, money laundering and terrorism financing cannot be supported. As always, however, the devil is in the details, and it goes without saying that the concepts of money laundering and terrorist financing are not always understood in the same way by all persons. Beyond this philosophical debate, it may appear from a cursory glance at the international media, and even some articles that purport to be written from an academic perspective, that these phenomena are, in substance, problems of the developing world and that their continued negative implications are being actively supported by international financial centers. In reality, this perception, where held, is as far from the truth as distance could possibly measure.

In fact, the real statistics would likely show, for example, that more ‘dirty money’ passes through London and New York each day than through all other international financial centers combined. It is important to recall, for example, that at the time of the BCCI scandal, one of the ‘culprits’ openly questioned why he was a target. He argued that he had done nothing that is not done in every major international bank every day. His fault, he could have concluded, was to breach the eleventh commandment – thou shall not get caught.

It can be said, without fear of contradiction, that major financial transactions anywhere in the developing world are directed from or supported by mechanisms in the developed world. Therefore, as with arms control, effective policing of money laundering or terrorism financing must be controlled from the developed world. It follows also that any impression given, express or implied, that the developing world, and in particular international financial centers, is the real culprit in the fight against
money laundering and terrorist financing should be rejected without the possibility of serious opposing argument.

On their face, ‘global regulatory requirements’ do not discriminate against any jurisdiction in preference of others. But it is not easy to justify that such requirements are in fact global in their design, and experience has shown that their implementation and related cost implications are more unfavorable to small jurisdictions and those jurisdictions’ small financial institutions. Furthermore, it could appear to an innocent bystander that the ‘standards’ setting process is unduly influenced by a select group of major jurisdictions, and that their transgressions, even if improperly labeled that way, are more easily forgiven or simply overlooked.

There is no apparent end in sight to the constant layering of Organisation for Economic Co-operation and Development (OECD) influenced regulatory requirements. Worse, no real performance audit of these requirements has ever been conducted. While strong arguments are made by flag-bearers to justify ongoing review and supporting implementation of these requirements, no credible empirical data has ever been presented in their defense. In addition, no analysis has ever been presented to show that the regulations that are being implemented will ever prevent the ills that they have been designed to cure. In fact, the need for constant change is the surest indicator that the process is hit or miss, with miss having been the more common result.

III. GEOPOLITICAL INSIGNIFICANCE

While the Cold War was being ‘fought,’ the United States was the acknowledged super power in the West and the Soviet Union (USSR) was the acknowledged super power in the so-called Eastern Bloc. Each super power then sought to maintain strategic outposts in the ‘backyard’ of the other or, at the very least, to ensure that its backyard did not fall prey to the outpost ambitions of the other. Given its geographic location, the Caribbean region was of strategic importance to both super powers. On the one hand, the United States would have considered real or perceived control within the region by the USSR to be interference in its zone of influence and an imminent danger that could not be tolerated. On the other hand, the USSR would have considered having significant socio-economic, political, and military influence in the backyard of the United States as a desirable objective.

For the United States, the risk of danger was exacerbated as Cuba, which had before then been subject to significant direct or indirect U.S. influence, was now ideologically and otherwise aligned to the USSR. To add insult to injury, Cuba was promoting communism and closer association with the Eastern Bloc, some have argued as a surrogate for the USSR, than to the Caribbean region and Latin America more generally. Even if this was not clearly articulated, there was also a period during the Cold War when Caribbean states were required to be either with or
against the United States. If not with the United States, the offending states were considered, by their nationals, to be tending towards communism. This perception, and the fear it induced, was often the subject of intense media debate or scrutiny and even a dint of socialism was often considered to be evidence of communism.

The stakes appear to have been higher than they are today, and this was reflected in the extent to which the super powers were intimately involved in the socio-economic affairs of the region. It does appear, from a cursory examination, that the USSR, through their surrogate Cuba where necessary, gifted more major infrastructure to the region than did the United States.7 But it also appears that the trading relations that developed between the United States and the Caribbean, except with Cuba, against which a U.S. trade embargo is still in force, were better sustained over the long term. During the Cold War there was perceived, even if not real, possibility for trade-offs between the USSR and the United States. Now, with the Cold War at an end, the geographic and strategic citing of the Caribbean is not as critical. Consequently, the erstwhile perceived capacity to influence external resource allocation, by reference to geography, has crystallized to naught.

In any event, the era of fundamental socio-political divide on ideological bases has also apparently come to an end. Radical communism is now as good as dead; and rabid capitalism has been tempered over time by elements of socialism. Even corporations, which are at the core of capitalism, have allowed the concept of corporate social responsibility to take root in recent years. It has been shown, for example, that corporations that implement and adhere to corporate social responsibility best practices are generally more appealing to consumers. They also benefit from greater workforce satisfaction, productivity uplifts, and enhanced resilience in tough times.

As the tendency towards ideological neutrality became more prominent so did the relative geopolitical insignificance of the Caribbean region. It is worth noting, for example, that during the last U.S. presidential election campaign the socio-economic wellbeing of the Commonwealth Caribbean appeared to have been of little or no significance to either the now re-elected President Barack Obama or his then challenger Mitt Romney. Furthermore, over the last several years, when the Caribbean has figured in a high-level debate or a significant media blitz, the usual context has been when arguing that the international financial centers within the region have an undermining effect on U.S. tax revenue and on its economy more generally.

Invariably, the arguments supporting death for international financial centers do not sufficiently consider that these centers have, over time, enabled, and still enable, efficient capital formation, offshore market penetration, and risk allocation for the continuing benefit of Western econo-

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7. This infrastructure has included an international airport in Grenada and several schools, including the Jose Marti Technical High School in Jamaica.
In a sense, it is like arguing against reparations for slavery without ascribing net present value to the once thriving slave economy or acknowledging that there is wealth now being enjoyed by some that would not have materialized without the benefit of slavery.

While the reference to slavery is clearly tangential, it nevertheless brings into focus that what was once important can, if vigilance is not observed and genuine concern exhibited, be revised out of importance. Furthermore, when examined in the context of current approaches to the Commonwealth Caribbean more generally, and in relation to their international financial centers in particular, it appears that ongoing significance is but a measure of how well the arrangement in question now serves the needs of those who require or once have it. Memories are often short, and historical value, though important, is usually trumped by knee-jerk or even well-considered responses favoring the here and now.

While the undermining of globalization of financial and related services, insofar as such globalization relies on international financial centers, is being actively promoted in a supposed attempt to protect the economies of developed states, it is instructive that the undermining impact of globalization of sugar and banana production has not been considered as important at the head table. Furthermore, the phasing out of trade and related preferences to the manifest detriment of small Caribbean economies has been met with what appears to be an ‘accept and get on with it’ attitude from the head table. While this paper will not seek to justify trade preferences, the historical import and what must be considered to have been a conscience-centered mechanism to justify avoidance of reparations cannot be overlooked. In any event, the circumstances under which such preferences were agreed to be phased out, and which effectively hammered the final nail in the sugar and banana coffin, indicate that affected jurisdictions in the Commonwealth Caribbean had very little influence at the head table where the burial order was signed.

In short, the Commonwealth Caribbean is now what it has always been—several dots on a map with limited capacity to influence decision-making, including in relation to decisions that affect the lives and livelihoods of their nationals. Where once there might have been Cold War enhanced capacity to affect external resource allocation, that era has ended. Accordingly, until there is a major shift in global power dynamics, without overly supportive U.S. policies towards the Commonwealth Caribbean, including in relation to how the international financial centers are treated, regional capacity for sustainable development could be frozen at naught or, at best, next to naught.

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IV. INFORMATION SHARING AND ECONOMIC SURVIVAL

The business of banking and financial services has always thrived on data capture. In an era where banks and other financial institutions were smaller and more community-oriented, data capture was easy and often driven by personal knowledge. Accordingly, there was no need for sophisticated underlying systems to capture and manage data. But, as institutions became larger and more global in their outlook, as well as in their operations, reliance on personal knowledge for data capture could no longer suffice. Over time, banks and other financial institutions became multinational and had to implement an intricate web of underlying data-driven support systems for effective management and control.

In this new dispensation, there is an inherent risk of cross-jurisdictional contagion from systemic failure in one jurisdiction. In addition, the interconnected operational mechanisms across jurisdictions now make it easier to transfer funds, including illicit gains, from one place to another. In short, the information age has matured, or at the very least tended to mature, the financial sector, and with maturity it has become even more important for gate-keepers to act responsibly and to, where necessary, implement robust management and related systems for data capture and control. Unfortunately, robust could have the appearance of heavy-handedness and worse could, if vigilance is not observed, be discriminatory in substance and effect.

The most well developed systems for data capture and control in the financial sector require that institutions know their customers as well as their customers’ customers. KYC, as the industry knows it, and related requirements to profile customers and, where necessary, report upon their ‘suspicious’ transactions is costly and often generates more data than the supporting underlying analysis systems can manage.

At the industry level, the approach to KYC, and in particular the reporting requirements, cannot be standardized. Even though there may be standard requirements at the jurisdictional level, there are requirement variations across jurisdictions. Implementation relies upon subjective input, which will vary across, and even within, institutions as well as across implementation regimes more generally.

The KYC shortcomings notwithstanding, there is general agreement that data capture, verification of such data, and subsequent analysis is necessary for functional efficiency as well as to assure, more generally, that the financial system is properly serving its intended intermediation purpose. The concern will ordinarily focus on whether what is required is in fact fit for the purpose, and if, in a cost-benefit analysis, such requirements are justified. In this latter regard, much has been said to support the reporting requirement, but little has been done that would, flowing from a credible performance audit, justify that the several additional layers of information that are required from time to time do in fact serve a laudable purpose.
If it is indeed the case, for example, that much of what is provided is incapable of credible analysis, and merely results in information overload, then it could be cynically concluded that the real purpose being served is the creation of jobs for data capture and related service providers. For example, when prohibition of illicit drugs was introduced in the United States during the 1930s it was indicated that prohibition would undermine that industry and cure related social ills within a generation. Since then, the industry has grown and related social ills have multiplied. In the same breath, several feeder or beneficiary industries, such as the illegal arms trade, the cutting agent business, legal support services, and addiction counseling services, have burgeoned in circumstances where the purpose of prohibition has not been and may never be met.

In its role as a ‘global standards setting agency,’ the Financial Action Task Forum has been involved in an ever-expanding program that often requires urgent, time-consuming, and expensive implementation of anti-money laundering and counter-terrorism measures at a national level. Insofar as the Commonwealth Caribbean is concerned, effective implementation is monitored through the Caribbean Financial Action Task Force (CFATF). The CFATF program generally requires enactment of new domestic legislation, and each jurisdiction is subject to ongoing peer review to assure compliance. Where deficiencies are identified, urgent corrective measures are required, and there is an ultimate threat of black listing for ‘recalcitrant’ jurisdictions.

Experience has shown that there is unevenness in the peer review mechanism, and, in any event, the threat, and even the action, of black listing is more detrimental to some jurisdictions than it is to others. When measuring the likely impact of black listing, for example, it must surely be concluded that its substantive effect on the United States, which has the reserve currency that most international financial transactions must be settled in and is the world’s largest economy, has to be less than it would be for the Virgin Islands, which does not have its own currency but instead uses the U.S. dollar. The Virgin Islands also has a domestic economy that relies primarily on revenue derived from the financial services sector.

From an implementation perspective, it is also clear that the playing field cannot be level. It must always be kept in mind that the essential functions of government are the same in large as well as small jurisdictions. Even the core cost implications related to the implementation of any measure will likely be the same across jurisdictions. Where there are large government bureaucracies, specialization can be developed and there are more hands on deck to undertake critical research and to get the job completed. Insofar as the Commonwealth Caribbean is concerned, while the size of governments could, in some instances, be considered large relative to population size, the institutional frameworks cannot and do not in fact sustain large numbers of specialists, including legislative drafters.
It is not unusual for a government drafting unit in the Commonwealth Caribbean to include just a single legislative drafter, and, in many instances, drafters are available only under externally funded consultancies. Notwithstanding this lacuna, the business of government must continue. At the same time, scarce resources must also be spent to continuously update laws that secure the CFATF and other requirements in circumstances where the real substantive value may simply be to avoid blacklisting and its negative implications.

In 2009, the United States enacted the Foreign Accounts Tax Compliance Act (FATCA). This law will have extra territorial reach, and, when operational, will require that offshore financial institutions holding accounts for U.S. nationals, whether such accounts are held by individuals or through companies, with balances above a prescribed limit, will have to make specified disclosure to the U.S. authorities. The information provided will then be analyzed for U.S. tax collection purposes. If disclosures are not made in the manner prescribed, or otherwise agreed, the United States retains the right to take such action as they deem appropriate to secure or at least assure that required tax payments have been made. In each case offshore financial institutions will be required to drill down as necessary to ensure that corporations, trusts, and other such devices are not used to avoid U.S. tax liability.

FATCA is now scheduled to become operational by 2014. In the interim, financial institutions will have to undertake a cumbersome, time-consuming, and very expensive system and training overhaul to secure their readiness for compliance. There is a heavy financial burden for implementation, which will, based on Ernst & Young estimates, cost each institution approximately $30mm. Furthermore, deliberate or even inadvertent failure to provide the required information could cause a recalcitrant financial institution to suffer corporate liability. The cost and related implications could get worse as the United Kingdom is expected to follow with its own version of FATCA, and continental Europe could follow soon thereafter.

Notwithstanding the obvious burden of compliance and that the substantive value to regional jurisdictions may not be easily justified, the ongoing legislative adjustments that are required under ‘global regulations’ must be implemented. Even where implementation could, for example, offend constitutional provisions and accordingly require fundamental change, the general attitude from outside nations underscores that such impediments are problems of the jurisdiction under review to be addressed without unnecessary delay. The question often asked from within, even if not clearly or forcefully articulated, is: would a similar and perhaps equally heavy-handed approach be applied to every jurisdiction?

In essence, while there is much that could be complained about, this business of life is about survival. Where, as in the case of the Commonwealth Caribbean, there are limited options for sustainable development,
less-than-ideal could appear, and will often be considered, a most viable, in the circumstances, option. As is, staying in the game requires information sharing, which may or may not be on desirable bases. Against this background, whatever steps are necessary, however onerous and unjustified they may be or appear to be, are usually implemented in the interest of economic survival.

V. CLOSING COMMENTS

This thing called life in the Commonwealth Caribbean is an ongoing struggle for survival. The region cannot sustain itself and, in real terms, is at the mercy of exogenous factors, over which it has little or no control. Insofar as the hemispheric balance of power is concerned, it is often said, and experience has shown, that if the United States coughs the region catches a cold.

Given this background, it can be concluded that the economic and related wellbeing of the Commonwealth Caribbean is fragile. Furthermore, given the trading balance of power that the United States wields in this hemisphere and beyond, it is also clear that sustained development here depends, in large measure, on ongoing and concerned U.S. support for the region. Accordingly, as the United States contemplates, implements, or supports any measure, if the best interest of the Commonwealth Caribbean is spared a thought, it will vigilantly advocate on behalf of its hemispheric ‘dependents’ in the region.
**Constitutional Challenges of the Mexican Insolvency Law (Ley de Concursos Mercantiles)**

Luis Manuel C. Méjan*

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ECENTLY, one major case, Vitro SAB, has brought to the arena a strong discussion about whether the Insolvency Law in Mexico duly performs the concept of due process of law granted by the Constitution of Mexico. One could look to constitutional concepts in other jurisdictions, but the constitutionality of Mexican law has to be weighed according to the concepts, texts, and decisions rendered in the Mexican system of law. This paper looks to those sources as it gathers all the issues about constitutionality that have been raised since the bankruptcy law, Ley de Concursos Mercantiles (LCM), was enacted.

B. ENACTMENT OF MEXICAN INSOLVENCY LAW

The Mexican Insolvency Law: Ley de Concursos Mercantiles, or LCM, was enacted in Mexico, replacing the former insolvency law, as a result of several factors arising during the last decade of the twentieth century. The most important of these was a major financial crisis that took the interest rates, the currency exchange, and inflation to levels above the resources and possibilities of many of the enterprises and natural persons, resulting in defaults and a very close call for the banking industry, such that a rescue program of the banks and the deposits representing the savings of the country had to be implemented.

2. Id. at 124 (stating that “it did not find that a jury trial is absolutely necessary in order to have a fair and impartial verdict”).
3. Ley de Concursos Mercantiles [LCM] [Bankruptcy Law], as amended, Diario Oficial de la Federacion [DO], 27 de Diciembre de 2007 (Mex.).
4. Ley de Quebras y Suspensión de Pagos [LQ] [Bankruptcy and Suspension of Payments Law], as amended, Diario Oficial de la Federacion [DO], 12 de Abril de 1943 (Mex.) was, during its time, a modern statute, but after forty years of being applied with only one amendment, it needed major change.
6. Id. at 81.
Important measures in the structure of the country’s legal system were also required. Along with the inception of electronic commerce and digital signatures, credit bureaus were established and regulated to foster trust in credit markets, a new system of bank deposit insurance was put in place, a financial services consumer protection system was instituted, and, of course, a new bankruptcy law had to be considered.7

C. The Constitutionality Issue

In 1999, when the LCM was being drafted, the document was presented to several consultants, among them were several former justices—in Mexico, the Supreme Court of Justice covers the function of a constitutional tribunal, meaning that the former justices were experts in constitutional matters—to ensure that the prospected provisions of the new statute abided by the Constitution.8 As a matter of fact, the leading senator filing the proposed act was himself a former justice.

Through all the years that the LCM has been in operation, several challenges to its constitutionality have been raised, matters that have been different than those that the law drafters were expecting. For instance, everybody was expecting that the exclusive federal jurisdiction provision would be challenged. As a prophylactic measure, the then Director General of the recently created insolvency regulator, El Instituto Federal de Especialistas de Concursos Mercantiles (IFECOM), wrote and published an essay on the matter,9 but the issue has never been raised.

The purpose of this paper is to discuss those matters in the LCM for which the constitutionality has been addressed by the constitutional tribunals in Mexico.10

D. Constitutional Review in Mexico

The judicial power in Mexico, for dealing with constitutional matters, is composed of district judges, the so-called Tribunales Colegiados (a panel of three magistrates), and the Supreme Court of Justice.11 The Supreme Court of Justice works either in small chambers (Salas) formed by five justices, or in a plenary group (with the members of the two Salas plus the

7. Id.
10. In order to provide the sources presented in this paper, the relevant LCM provisions are inserted each time they are mentioned. The constitutional provisions and the decisions made by constitutional tribunals will be inserted in footnotes. To understand mentions made to constitutional tribunal decisions, it is important to note that each reference contains both the data necessary to locate the decision, and a secondary reference to the specific case(s) based on which the decision was rendered.
Chief Justice, which means eleven justices).\textsuperscript{12}

The constitutionality of an act performed by an authority is judged through the so-called amparo, which is the action that can be filed by those whose constitutional human rights were infringed upon. Such constitutional review can also be triggered when some high government officials or entities request that the Supreme Court rule on the constitutionality of specific acts described in the law. Finally, the Supreme Court of Justice can decide an issue that has been resolved in a contradictory way by two or more of the Tribunales Colegiados.

Precedents established by constitutional tribunals become, in some cases, binding upon lower courts. This is usually the case when the same criteria have been consistently applied in a number of cases.\textsuperscript{13} When a high enough number of cases has not been reached, precedents only serve as a reference, albeit a strong one.\textsuperscript{14}

E. Binding Precedents

So far, more than twelve years after the implementation of the LCM, constitutional tribunals (the Supreme Court of Justice and the Tribunales Colegiados), have issued nine decisions that are now binding upon future cases. Two of them are related to the authority invested in the IFECOM to issue regulations covering technical and operative measures. The Court ruled that such authority does not usurp the authority of Congress, nor does it contradict the text of the Constitution.\textsuperscript{15} Three other cases do not refer to any constitutional grounds related to human rights but are instead related to procedural issues.\textsuperscript{16} Two other cases refer to the pro-


\textsuperscript{13} M. C. Mirow, Marbury in Mexico: Judicial Review’s Precocious Southern Migration, 35 HASTINGS CONST. L.Q. 41, 57-58 (2007).

\textsuperscript{14} Id.

\textsuperscript{15} Instituto Federal de Especialistas de Conursos Mercantiles. La facultad que le confiere el artículo 311, fracción XIII de la ley relativa, para dictar las reglas técnicas-operativas de observancia general, no constituye un acto delegatorio del Congreso de la Unión. Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XXIII, Enero de 2006, Tesis 1a./J. 172/2005, Página 393 (Mex.) (Registro No. 176,271) (The power under article 311, section XIII of the law relative to dictate the technical and operational rules of a general is not an act delegatory of Congress’ authority); Instituto Federal de Especialistas de Conursos Mercantiles. El Artículo 311, Fracción XIII, de la ley relativa, que lo faculta para dictar reglas técnica-operativas de observancia general, no viola el artículo 100 de la Constitución Federal, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XXIII, Enero de 2006, Tesis 1a./J. 173/2005, Página 368 (Mex.) (Registro No. 176,272) (under article 311, Section XIII, entitling it to make operational rules does not violate article 100 of the Federal Constitution).

\textsuperscript{16} Concurso Mercantil. Momento en el que los acreedores genéricos del concursado pueden intervenir en el procedimiento respectivo, Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XXV, Marzo de 2007, Tesis 1o.C. J/35, Página 1508 (Mex.) (Registro No. 173075) (Insolvency. Time at which the creditors of the bankruptcy can intervene in the dispute resolution process.); Concurso Mercantil.
tected regime of labor rights, providing employees with assistance in the way they file their requests to the court.\footnote{17}

The last two cases refer precisely to the matters discussed in this paper because they define the constitutionality of some of the law’s provisions, and because they validate the general intent of the LCM, as provided by its own text, to be of public interest, criterion supported by the Supreme Court of Justice.\footnote{18} These two decisions will form part of the next chapter.

\section*{F. Non-Binding Precedents}

Out of the total number of decisions rendered by the constitutional tribunals, those referring precisely to challenges to the constitutionality of the Law will also be addressed in the next chapter.

\section*{II. CHAPTER 2 – CONSTITUTIONAL ISSUES IN THE MEXICAN BANKRUPTCY LAW}

\subsection*{A. Due Process of Law in Mexican Proceedings}

\subsubsection*{1. Guaranty of the Auditor’s (Visitador) Fees - Article 24}

The LCM provides for the obligation, for one who files a request or demand for an insolvency proceeding, to grant a guarantee to cover the fees of the first of the specialists involved in the proceeding, meaning the \textit{Visitador} (Auditor) who is the insolvency professional in charge of running an “insolvency test” to determine whether or not the debtor meets the requirements to be declared subject to an insolvency proceeding. Ar-

\begin{footnotesize}

\footnote{La resolución que decide en definitiva un incidente de acción separatoria constituye una sentencia definitiva, por lo que es impugnable a través del juicio de amparo directo, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo IV, Enero de 2012, Tesis 1a./J. 31/2011 (9a.), Página 2207 (Mex.) (Registro No. 160435) (The resolution ultimately decides incident separatoria action constitutes a final judgment, and it is open to be challenged through the direct amparo); Concursos mercantiles. La admisión en ambos efectos del recurso de apelación en contra de la sentencia de quiebra no puede extenderse a hipótesis distintas a la prevista legalmente, Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo VIII, Mayo de 2012, Tesis I.4o.C. 1/32 (9a.), Página 1579 (Mex.) (Registro No. 160,135) (Admission to both effects of the appeal against the judgment of bankruptcy cannot be extended to different scenarios provided by law).

\footnote{17. Suplicación de la queja. Procede en favor de los trabajadores, aun en un concurso mercantil, porque sus derechos se encuentran protegidos por la constitución y los tratados, Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Court], Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo VIII, Mayo de 2012, Tesis I.7o.C. 3/1 (10a.), Página 1740 (Mex.) (Registro No. 2009911) (Replacement of the complaint is appropriate for workers, even in bankruptcy because their rights are protected by the constitution and treaties); Suplicación de queja. En tratándose de concurso mercantil y en favor de trabajadores, debe ser absoluta, Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Court], Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo VIII, Mayo de 2012, Tesis I.7o.C. 3/1 (10a.), Página 1741 (Mex.) (Registro No. 2009911) (Replacement of complaint. In the case of insolvency and for workers, must be absolute).

\footnote{18. Ley de Concursos Mercantiles [LCM] [Bankruptcy Law], as amended, art. 1o, Diario Oficial de la Federación [DO], 27 de Diciembre de 2007 (Mex.).}
article 20 provides that “[a]ny Merchant who believes that he has generally defaulted his obligations in the terms of either of the two events listed in Article 10 of this Act, may file a petition for business reorganization declaration . . . ”19 It further provides that, if the petition is admitted, the offer granting the guarantee, referred to in article 24, must be attached to the petition.20 The petition must be processed pursuant to article 23(II) that provides that “[a]ny demand filed by a creditor must be accompanied by: . . . [t]he offer of granting the guarantee referred to in the following article, in case the demand is admitted . . . .”21

The purpose of such rule is not exactly to guarantee the Visitador’s fee; rather, it is a security requirement to ensure the seriousness of the request or demand. Proof of this is that once the work of the auditor is done, if the court declares the debtor in bankruptcy, the amount of the guarantee must be returned to the party that sponsored the trial.22 The LCM adds a penalty for those who do not meet this requirement: the admission of the bankruptcy proceeding is cancelled. Under article 24:

If the judge finds no reason to declare improper or any defect in petition or demand for business reorganization, or if the deficiencies ordered in the warning issued by the judge are cured, will accept the petition or demand. The decree admitting the petition or demand shall cease to be in effect if the plaintiff does not guarantee payment of the inspector’s fees at the rate of 1500 days the minimum daily wages in the Federal District, within three days following the date on which the decree admitting the petition or demand for processing is notified to him. Such guaranty will be returned to the plaintiff if the judge rejects the petition or demand or issues a judgment declaring the business reorganization.

If the District Attorney files the demand for reorganization, the guaranty referred to in this Article shall not be necessary.23

On several occasions, the constitutionality of the obligation to secure the Visitador’s fees and the resulting annulment of the determination of insolvency due to a failure to secure the fees have been challenged. The First Chamber of the Supreme Court of Justice has addressed the issue twice, rendering conflicting decisions. In its first decision, the Supreme Court did not find that article 24 was unconstitutional because the obligation was that of the creditor who filed the Concurso and not of the debtor; therefore, the debtor was not entitled to challenge the constitutionality of the article that establishes the obligation to offer the guarantee.24 In its second decision, the Court further analyzed the matter and

19. Id. art. 20.
20. Id. art. 20(IV).
21. Id. art. 23(II).
22. See id. art. 24.
23. Id.
24. Concursos mercantiles. El articulo 24 de la ley relativa no causa al demandado agravio personal y directo, por lo que es improcedente el amparo en el que
found that annulling a determination of insolvency is unconstitutional because it denies the right of free access to the justice administration—which must be free of any charges under the Constitution—and because it is not possible to establish such a condition on the judiciary’s ability to act.  

None of those criteria set forth in those two decisions are binding yet; rather, they are only precedents.

2. Producing Evidence - Articles 26 and 27

It is necessary to understand that, in the Mexican legal procedural system, evidence is constrained to witnesses, but there is a large variety of ways to produce evidence. Article 26 refers to the chances of the defendant debtor to produce evidence while answering the summons and gives a new chance to the plaintiff to add some evidence in light of what the defendant has answered, whereas article 27 only refers to, as means of evidence, documents and expert opinions. Under article 26:

Once a demand for business reorganization has been admitted, the judge will summon the Merchant and will grant him a nine-day term to file his answer to the complaint. The Merchant must offer, in his answer, such evidence as may be authorized by this Act.

. . .

The day following the date on which the judge receives the answer, he will submit a copy thereof to the plaintiff so that, within three days, the plaintiff make such statements as may benefit his rights and, if proper, make additions to his offer of evidence with such other evidence related to the exceptions opposed by the Merchant.

According to article 27:

the answer to the demand the documentary evidence and any expert opinions filed in writing shall be admitted. Whoever files an expert opinion must accompany to such opinion the information and documents that establish the expertise and technical knowhow of the corresponding expert. Under no circumstances will the experts be summoned for questioning.

With his answer to the demand, the Merchant may offer, in addition to the evidence to which the preceding paragraph refers, any evidence that may directly disprove the event mentioned in Article 10 of this Act, and the judge may order . . .

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reclama la inconstitucionalidad de ese precepto, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Seminario Judicial de la Federación y su Gaceta, Novena Época, tomo XX, Julio de 2004, Tesis 1a. XCI/2004, Página 189 (Mex.) (Registro No. 181179).


27. Id. art. 27.
Some defendants challenged the constitutionality of the provision, arguing that, if LCM allows only two kinds of evidence and, additionally, the plaintiff has two chances of offering evidence while the defendant only has one, it violates the right to be heard under articles 14 and 16 of the Constitution.  

The constitutional tribunal (the First Chamber of the Supreme Court of Justice) found, on three different occasions, that provisions in LCM’s article 26 are not contrary to the spirit of the Constitution; rather, giving to the plaintiff two chances to present evidence contributes to equity because this enables both parties to argue and present evidence in response to what the other party is alleging. The Court also found that even if only two kinds of evidences are referenced in the first paragraph of the article, the second one allows producing any other evidence suitable to what is being alleged.

3. Restraining - (Arraigo) - Article 47

The LCM provides that the debtor, or the principals if the debtor is a legal entity, should be held in confinement during the Concurso proceeding, that is, they cannot leave the city where they live unless they appoint a representative who will have the authority to act in the business and affairs of the debtor.

Article 47. The judgment will bring about the Merchant’s restraint and, in the case of legal entities, of the parties charged with the administration of such legal entities, only to prevent them from leaving the place of the Domicile without leaving behind any attorney in fact appointed by means of a power of attorney, with sufficient instructions and money to meet expenses. Once the party who has been made subject to a restraining order proves that he complied with the aforesaid requirements, the judge will cancel the restraining order.

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28. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 14, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.) (stating “No law shall be given retroactive effect to the detriment of any person whatsoever. No person shall be deprived of life, liberty, property, possessions, or rights without a trial by a duly created court in which the essential formalities of procedure are observed and in accordance with laws issued prior to the act.”); Id. art. 16 (stating “No one shall be molested in his person, family, domicile, papers, or possessions except by virtue of a written order of the competent authority stating the legal grounds and justification for the action taken.”).

29. Concursos Mercantiles. El artículo 26 de la ley relativo no viola el principio de equidad procesal, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XXIII, Enero de 2006, Tesis 1a. CLI/2005, Página 715 (Mex.) (Registro No. 176359) (Article 26 of the LCM does not violate the principle of procedural fairness); Concursos Mercantiles. Los artículos 26 y 27 de la ley relativa, no violan las garantías de legalidad y audiencia, pues no limitan el ofrecimiento de pruebas en ese tipo de juicios, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XX, Julio de 2004, Tesis 1a. XCI/2004, Página 192 (Mex.) (Registro No. 181175) (Articles 26 and 27 of the Act do not violate the guarantees of legality and audience, because they do not restrict the presentation of evidence in such trials).
The restraint set forth in the previous paragraph shall not be applicable in those cases in which the business reorganization had been requested directly by the Merchant.30

This provision has been challenged on the grounds that it represents a violation to the freedom of transit.31 The Tribunal has ruled that there is no such violation to the freedom of transit because the law itself allows the administrator to appoint a representative to act on his or her behalf.32 In another decision it was provided that the order of restraint or confinement cannot be stayed during the amparo challenging the constitutionality of article 47 because LCM is a public interest law and its provisions must be accomplished as they are.33 In this way, the administrators of a debtor can be legally restrained to move and abandon the city where they live, even if there is a challenge against such order.

4. Right to Appeal - Article 49

LCM establishes that the filing creditors are allowed to appeal the judgment ordering or denying the business reorganization. Other creditors do not have that possibility because they have not appeared yet in the proceeding.

Article 49. An appeal may be filed against the judgment denying the business reorganization. Such appeal shall stay the business reorganization process. An appeal may be filed against the judgment granting the business reorganization. Such appeal shall not stay the reorganization proceeding unless it is declared valid.

30. LCM art. 47.
31. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 11, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.) (stating “Everyone has the right to enter and leave the Republic, to travel through its territory and to change his residence without necessity of a letter of security, passport, safe-conduct or any other similar requirement. The exercise of this right shall be subordinated to the powers of the judiciary, in cases of civil or criminal liability, and to those of the administrative authorities insofar as concerns the limitations imposed by the laws regarding emigration, immigration and public health of the country, or in regard to foreigners residing in the country.”).
32. Arraigo. El decretado a los administradores de una sociedad declarada en estado de concurso mercantil o quiebra, no vulnera las garantías de libre tránsito y residencia ni en modo alguno es limitativo de los intereses económicos del comerciante, Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Courts], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XIX, Enero de 2004, Tesis 1.6o.C.291 C, Página 1453 (Mex.) (Registro No. 182482) (The decreed restraint to directors of a company declared to be in state of insolvency or bankruptcy, does not violate the guarantees of free movement and residence or in any way is a threat to the economic interests of merchant).
33. Arraigo Previsto por el articulo 47 de la Ley de Concursos Mercantiles. No procede conceder la suspension provisional contra la resolución que lo decreta, pues de otorgarse se afectarian disposiciones de orden público e interés social, Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Courts], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XX, Agosto de 2004, Tesis IV.3o.C.25 C, Página 1552 (Mex.) (Registro No. 180955) (Restraint is provided by article 47 of the bankruptcy law. It is not possible to grant a stay of the order of restraint because the public policy provisions and interest protected by the law would be affected).
The Merchant, the inspector, the plaintiff creditors and the plaintiff District Attorney may file the appeal.\textsuperscript{34}

In one case, one of those non-plaintiff creditors asked to declare the provision as unconstitutional because it violates the principle of equal treatment under law, a right granted by the Constitution.

Article 1 - In the United Mexican States, every individual will enjoy the guarantees that this Constitution grants, which shall not be restricted or suspended except in the cases and with the conditions under which the same is established.\textsuperscript{35}

The Supreme Court, on two different occasions, found that such provisions were not unconstitutional because the position of those creditors is different from the creditors that filed the \textit{concurso}, so they should be treated differently.\textsuperscript{36} Additionally, they will have all their rights as creditors during the commencing trial (including filing a proof of claim, for instance).\textsuperscript{37}

As a result, it is clear that the judgment granting the “\textit{concurso mercantil}” is the one that starts the proceeding, and all creditors will be treated equally from that point on.

5. \textit{Objections Made to the Definitive List during the Proof of Claim Proceeding - Articles 127 and 130}

In the proof of claim stage, creditors might file a petition to the conciliator to include their claim in a provisional list. This provisional list is offered to everyone, so each has the opportunity to make objections. Afterwards, the conciliator has to prepare what is called “the definitive list,” which will be presented to the Court in order to prepare and issue the Proof of Claim Order.

\textsuperscript{34} LCM art. 49.
\textsuperscript{35} Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 1, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.).
\textsuperscript{36} Conursos Mercantiles. El artículo 49 de la ley de la materia no viola la garantía de igualdad al legitimar a los acreedores demandantes para interponer recurso de apelación en contra de la sentencia que declara o niega el concurso, y no así a los acreedores no demandantes, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XX, Julio de 2004, Tesis 1a. XCVI/2004, Página 190 (Mex.) (Registro No. 181177) (Article 49 of the relevant law does not violate the guarantee of fairness when it authorizes the defendant creditors to file an appeal against the order that declares or denies the insolvency and does not authorize the non-plaintiff creditors).
\textsuperscript{37} Conursos Mercantiles. El artículo 49 de la ley de la materia no viola la garantía de audiencia al no legitimar a los acreedores no demandantes para interponer recurso de apelación en contra de la sentencia que declara o niega el concurso, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XX, Julio de 2004, Tesis 1a. XCVII/2004, Página 190 (Mex.) (Registro No. 181178) (Article 49 of the relevant law does not violate the guarantee of hearing when it does not authorize the non-plaintiff creditors to file an appeal against the order that declares or denies the insolvency).
Article 127. If in a different proceeding a final and conclusive judgment, labor-related award, standing administrative resolution or arbitration award has been issued prior to the retroactivity date, pursuant to which the existence is declared of a right to collect against the Merchant, the creditor involved must file a certified copy of said resolution with the judge and the conciliator.

The judge must recognize the credit in the terms of said resolutions, by including it in the credit recognition, ranking and preference judgment.38

Article 130. The conciliator shall have a non-extendable ten-day term following the date on which the term to which the preceding Article refers expires, in order to draw up and file with the judge the final credit recognition list which shall prepare based on the provisional credit recognition list as well as the objections that in any case might be filed against it and whereby shall be included, in the approved terms in the Res judicata judgment, the credits with regard to it is known the existence of firm and final judgment, including the tax liabilities and labor-related credits, which up to then may have been reported to the Merchant, attending in addition all the applications, if any, filed after the provisional credit list was prepared.

If the conciliator fails to file the final list at the end of the term to which the preceding paragraph refers, the judge will issue such coercive actions as he may deem necessary in that respect and, if the conciliator does not file it within five more days, the judge will ask the Institute to appoint a new conciliator.39

On one occasion, some creditors complained that, because those provisions do not grant the possibility to make objections to the definitive list, the referred articles should be deemed unconstitutional as a denial of due process of law.40

The Supreme Court of Justice did not agree with that argument because creditors will have the chance to oppose the judgment rendered by the court based on that list, so they are not defenseless nor denied the opportunity to oppose and argue.41

With this decision, the procedures outlined by the statute are considered regular and in accordance with the Constitution.

38. LCM art. 127.
39. Id. art. 130.
40. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 14, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.) (stating that “[n]o law shall have retrospective effect to the detriment of anyone. Nobody may be deprived of life, liberty, or of his land, possessions or rights, except by means of judicial proceedings before previously established courts that comply with essential formalities of procedure, and conforming to laws made previously before the case.”).
41. Concursos Mercantiles. Los artículos 127 y 130 de la ley relativa no violan la garantía de audiencia. Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo XXXII, Noviembre de 2010, Tesis 1a. CXIX/2010, Página 55 (Mex.) (Registro No. 163493) (Articles 127 and 130 of the Act do not violate the right to a hearing).
6. Time Frame to File a Proof of Claim or to Express Objections to the Provisional List Made by the Conciliador - Article 129

During the proof of claim process, the conciliador is requested to present a provisional list of claims and creditors to the court and to the creditors. Under article 129, creditors have the possibility, for a period of five calendar days, to file a proof of claim\(^42\) and/or to express objections to the list filed by the conciliador,\(^43\) attaching to this request all the necessary documents to support the petition.

The general and default rule in the LCM is that all time frame periods should be considered in business days unless other ways are stated by the text of the statute. In this case, the term of calendar days was expressly mentioned.

The Supreme Court of Justice, through its First Chamber, ruled that this term is contrary to the right of “effective access to justice,” as safeguarded under Article 17 of the Constitution, because during non-business days it would be impossible to have access to the court’s docket, and difficult for the creditors to collect all the documents needed to support filing a proof of claim or to object to the way the conciliador is considering the claims in the provisional list.\(^44\)

This decision is not binding as it is only a precedent and further arguments might be raised in future cases sustaining that the LCM is very cautious with defining the time frame of the different stages of the proceeding. In one case, *Mexicana*, the judge ruled that all the periods of the reorganization should be taken as business days, despite the text of the law clearly referring to calendar days, arguing that the spirit of the law is in favor of trying to get a reorganization plan approved. The amparos filed against this decision should bring new light on this subject.

7. Right to Object to the Judgment Granting the Proof of Claim - Article 135

Once the credit recognition, ranking, and preference judgment is rendered, the creditors that consider that such order is against their interests

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42. “The creditors may request the recognition of their credits . . . [w]ithin the term granted to object to the provisional list referred to in Article 129 of this Act.”

43. *Id.* art. 129. Once the conciliador submits to the judge the provisional credit list, the judge will make it available to the Merchant and the creditor so that, within a non-extendable five-calendar-day period, they file in writing to the conciliador, through the judge, their objections together with any documents they may deem pertinent, which will be made available to the conciliador through the judge, the day after the judge receives them.

44. *Concursos Mercantiles*. El artículo 129 de la ley relativa, al establecer que el término para presentar objeciones a la lista provisional de créditos debe computarse en días naturales, viola el derecho de acceso Efetivo a la Justicia, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo libro VII, Abril de 2012, Tesis 1a. LXVIII/2012 (10a.), Página 860 (Mex.) (Registro No. 2,000,522) (Article 129 of the Law establishes that the term to file objections to provisional list of credits should be counted in calendar days, violates the right of effective access to justice).
are allowed to appeal such order, but this challenge of the decision will not stay the proceeding. Such is the text of article 135 in the LCM.

Article 135. The credit recognition, ranking and preference judgment may be appealed. Such appeal will be accepted only in such manner that it does not stay the reorganization proceeding.45

One creditor considered this provision unconstitutional because it denies the opportunity to be heard as stated in article 14 of the Mexican Constitution.46

The First Chamber of the Supreme Court denied this allegation considering that article 135 grants the creditor the possibility to object to the judge’s decision.47

8. Possibility to Extend the Length of the Reorganization Period - Article 145

The reorganization must be accomplished within the frame of 185 natural days. There are two possible reasons for an extension: (1) a ninety day extension can be requested by the insolvency professional (the conciliador) along with recognized creditors representing two-thirds of the aggregate amount of credits; (2) the law grants the debtor, plus the 90 percent of recognized creditors, the possibility to request an additional extension of ninety days to conclude a Reorganization Plan. Article 145 provides:

The conciliation stage will have a duration of 185 calendar days following the date on which the business reorganization judgment is last published on the Official Gazette of the Federation. The conciliator or the Recognized Creditors representing at least two thirds of the aggregate recognized credits, may ask the judge to approve an extension of up to ninety calendar days following the date on which the term mentioned in the preceding paragraph expires, if they believe that the execution of an agreement is about to take place.

45. LCM art. 135.
46. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 14, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.) (stating “No law shall have retroactive effect to the detriment of anyone. Nobody may be deprived of life, liberty, or of his land, possessions or rights, except by means of judicial proceedings before previously established courts that comply with essential formalities of procedure, and conforming to laws made previously before the case.”); id. art. 16 (stating that “[n]obody can be disturbed in his or her person, family, residence, papers, or possessions, except by virtue of a written order by a competent authority, that is founded in and motivated by legal procedural cause.”).
47. Concursos Mercantiles. El artículo 135 de la ley relativa, al prever un recurso para hacer valer el derecho al reconocimiento como acreedor, no viola la garantía de audiencia, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo libro XXX-III, Febrero de 2011, Tesis 1a. III/2011, Página 610 (Mex.) (Registro No. 162913) (When article 135 of the law provides a remedy to enforce the right to be recognized as a creditor, it does not violate the right to a hearing).
The Merchant and the Recognized Creditors that represent 90% of the total amount of whole credits may ask the judge for an extension of up to ninety calendar days in addition to the extension to which the preceding paragraph refers. Under no circumstances may the conciliation stage and its extension exceed 365 calendar days following the date on which the business reorganization judgment was last published on the Official Gazette of the Federation.48

The difference between the first and second extension (conciliador or two-thirds of credits in the first one and a debtor plus 90 percent of claims in the second one) was challenged as unconstitutional because it does not provide equal treatment to the debtor. One debtor questioned the provision on whether the debtor should be allowed to request both the first extension and the second one; and that this different treatment supposed a violation of the equal treatment that should be accorded to everybody under the first article of the Constitution.49

The First Chamber of the Supreme Court rejected the argument, considering that both extensions differ in scope and procedure. If the first extension were to be requested by the debtor it will be used without justification only for the purpose to lengthen the period of the automatic stay, thus frustrating the goals of the law, while the second extension can be requested only when it is very likely that a reorganization plan is to be reached.50

9. Appeal Against the Termination Order - Article 266

This article defines who is entitled to appeal the Termination Order, among them the recognized creditors.

Article 266. The business reorganization conclusion judgment may be appealed by the Merchant, any Recognized Creditor and the District Attorney as well as by the inspector, the conciliator or the receiver in the same terms that the business reorganization judgment may be appealed.51

The article was challenged on the grounds that, because creditors are not granted any participation in making a decision, to conclude the proceeding is denying them the right to justice from the courts as established

48. LCM art. 145.

49. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 1, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.) (stating “Article 1. In the United Mexican States, every individual will enjoy the guarantees that this Constitution grants, which shall not be restricted or suspended except in the cases and with the conditions under which the same is established.”).

50. Concursos Mercantiles. El artículo 145 de la ley relativa, segundo párrafo, de la ley relativa, no viola la garantía de igualdad, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo libro XXXII, Julio de 2010, Tesis 1a. LXXXIV/2010, Página 250 (Mex.) (Registro No. 164,367) (Article 145, second paragraph, of the Act does not violate the guarantee of equality).

51. LCM art. 266.
by article 17 of the Constitution.52

The First Chamber of the Supreme Court of Justice found that this provision provides creditors access to the legal system by allowing them the right to appeal. This right, the court reasoned, was enough to meet the threshold obligation of allowing creditors access to courts.53

10. Punitive Damages in Criminal Cases - Article 276

The criminal situations raised in an insolvency situation are to be judged and decided by a criminal court that usually awards damages to the victim of the crime. In the insolvency proceeding, LCM has determined that it is the Bankruptcy Court, not the Criminal Court, that is in charge of defining the amount and how punitive damages will be paid.

Article 276. In the cases of offenses while under business reorganization, the penal judge will not hear the relief of any damage, as such issue will be handled by the business reorganization judge.54

In one case, the victim of one of those criminal cases argued the unconstitutionality of such provision on the ground that he was being denied the possibility to request the relief in the manner that the Constitution allows to victims in article 20, section A, I and B, IV.55

52. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 17, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.) (stating that “[a]ll persons have the right to have justice by courts that will be able to give them justice in the time and terms that the laws set, and give them resolutions in a quick, complete, and impartial manner.”).

53. Concursos Mercantiles. El artículo 266 de la ley relativa, segundo párrafo, de la ley relativa, no viola la garantía de igualdad, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court]. Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo libro XXXIII, Febrero de 2011, Tesis 1a. II/2011, Página 611 (Mex.) (Registro No. 162,912) (Article 266 of the Law does not violate the guarantee of access to Justice).

54. LCM art. 276.

55. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 20, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.) (stating that “[i]n all criminal processes, the accused, victim, or person offended against by a crime will have the following guarantees:

A. Of the accused:

1. Immediately when he or she petitions for it, the judge should always grant provisional release under bail, except for crimes which, because of their seriousness, the law expressly prohibits this benefit. In the case of non-serious crimes, upon the application of the Public Ministry, the judge may deny bail, when the accused has been found guilty of a crime classified serious by the law before. The judge may also deny bail when the Public Ministry presents elements that establish that the accused poses, by his or her previous conduct or by the circumstances and characteristics of the crime committed, a risk to the person the crime was committed against, or to society.

The amount and form of bail shall be obtainable by the accused. In circumstances that the law determines, the judicial authority may modify the amount of the bail. To take into account the form and the amount of bail, the judge must take into account the nature, means, and circumstances of the crime, the characteristics of the accused and the possibility of the accused’s complying with his or her obligations resulting from the
The case was indeed more complicated because of a further issue: the debtor in the Concurso was a legal entity, and according to the Mexican system, only natural persons are subject to criminal charges, not legal entities. Thus, the perpetrator in this case was the administrator of the Debtor Enterprise. The judge rejected the request for damages. The court reasoned that article 267 of the LCM denied such authority. But, the bankruptcy court took a different view, reasoning that the court had authority over the debtor and not over the principal administrator of the debtor.

The Constitutional Court, then, solved on one hand that article 267 can only apply when the debtor and the criminal are one and the same person, and, in other cases, the regular criminal judge has to resolve the issue. The reason is that it is up to the Bankruptcy Court to decide how much and how all the debtor’s liabilities must be met.\(^{56}\)

B. Labor Credits

1. Preference of Labor Credits - Article 224, Section I and Article 225, Section I

Under the Mexican Constitution, the credits owed to the labor force as wages for the last year\(^ {57}\) have exceptional protection and a super preference in insolvency situations. The LCM increased this protection to wages covering the last two years. The sources of this protection are: (1) Mexican Constitution article 123 (XXIII). “Credits in favor to workers

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\(^{56}\) Delitos Concursales. El artículo 276 de la Ley de Concursos Mercantiles, al disponer que el Juez Penal no conocerá de la reparación del daño, no viola el artículo 20, apartados a, fracción i, y b, fracción iv, de la Constitución General de la República Anterior a la Reforma Publicada en el Diario Oficial de la Federación el 18 de Junio de 2008, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo libro XXX, Agosto de 2009, Tesis 1a. CI/2009, Página 60 (Mex.) (Registro No. 166691) (When article 276 of the Bankruptcy law provides that the criminal judge will not rule about the damage repair, it does not violate Article 20, section I and B, or section IV of the Mexican Constitution as it was previous to the amendment published in the official Journal of Federation on 18 June 2008).

\(^{57}\) The concept of “last year earned credits” has been defined by the constitutional tribunals in the following decision: Laboral. Créditos laborales preferentes en caso de concurso o quiebra. Concepto de salarioso sueldos devengados en el último año [Preferent wage claims in case of concurso or bankruptcy. Concept of salaries or wages earned in the last year], Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Courts], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo libro XVII, Diciembre de 2003, Tesis 1.6o.T.199 L, Página 1372 (Mex.) (Registro No. 182671).
by salary or wages, or payments earned in the last year, and by indemnifications will have preference over all other debts in the cases of closing or bankruptcy; 58 and (2) LCM.

Article 224. The following are credits against the Estate and shall be paid in the indicated order and before any of the credits to which Article 217 of this Act refers:

I. Those listed in Article 123, paragraph A, Section XXIII, of the Constitution and its regulating provisions, taking into consideration the wages for the two years preceding the Merchant’s business reorganization declaration; 59

Article 225. The privilege to which the preceding Article refers cannot be made good against creditors with a collateral or special privilege, and only the following have a privilege:

I. The creditors for the items referred to in Article 123, paragraph A, Section XXIII, of the Constitution and its regulating provisions, taking into consideration the wages of the two years preceding the Merchant’s business reorganization declaration. 60

This provision has been challenged as unconstitutional on two occasions. In the first instance, the First Chamber of the Supreme Court upheld the constitutionality of the LCM provision on the grounds that the constitutional protections were only a minimum, so, ordinary laws such as the LCM, could increase labor protection. Next, the Court came the other way around to establish the unconstitutionality of such provisions, reasoning that such extensions of labor credits protection leaves other creditors unprotected, and concluded that this is a violation to the equal justice under law as prescribed by article 1 in the Constitution:

The LCM extends to two years the protection given by the Constitution without any reasonable and objective explanation, violating the equal justice under law protection provided by article 1 in the Constitution, because it damages the equilibrium among the creditors giving to those already protected, additional protection and hurting the rights of the rest of the creditors. 61

Mexican Constitution Article 1. In the United Mexican States, every individual will enjoy the guarantees that this Constitution grants, which shall not be restricted or suspended except in the cases and

58. Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, art. 123, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.).
59. LCM art. 224.
60. Id. art. 225.
61. Concursos mercantiles. Los artículos 224, fracción i y 225, fracción i, de la ley relativa, al establecer la prelación de créditos a favor de los trabajadores por el término de dos años, violan la garantía de igualdad ante la ley, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Décima Época, tomo libro VI, Marzo de 2012, Tesis 1a. VIII/2012 (9a), Página 271 (Mex.) (Registro No. 160,245) (Articles 224, section I, and 225, section I, of the Act on setting the priority of claims by workers for a two year term, does violate the guarantee of equality before the law).
with the conditions under which the same is established.62

This is only the beginning of the history because we can expect this point to be litigated by either creditors or laborers, waiting to reach the number of cases required to get the criteria binding in the future.

C. **Cross Border Insolvency**

1. **Adoption of UNCITRAL’s Cross Border Insolvency Model Law - Title XII**

Mexico was the second country (Eritrea being the first) to adopt, in May 2000, UNCITRAL’s Cross Border Insolvency Model Law, including it in the LCM’s Title Twelve. As a matter of fact, the first case to use the rules of this model law was precisely the *Xacur* case, a recognition of a foreign proceeding started in Texas, in the United States.63

In that case the debtor, a bankrupted person, challenged the constitutionality of all of Title Twelve (i.e., the UNCITRAL’s Model Law). The claim was that it gave a preference to foreign laws, superseding Mexican law and giving different consideration to foreign and national creditors.64

The First Chamber of the Supreme Court of Justice made an analysis of Title Twelve and found that it accomplishes all the constitutional principles and that there was no preference to foreign laws. Rather, article 283 has been held to give priority to Mexican law in cases of conflict between foreign and national laws. Also, the Court found that there is no distinction in treatment to creditors and/or assets, whether in Mexico or elsewhere.65

This ruling is very important because it forms a consolidation of the system created by UNCITRAL and adopted in many other countries (all three NAFTA countries included).

D. **Debtors’ Human Rights**

1. **Preference of Consumer Credits - Articles 217 to 225**

Articles 217 to 225 deal with the order and preference of credits within a bankruptcy case. This order has been only altered by one amendment made to the Social Security Law and now by the decision commented in this paragraph.

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62. *Id.* art. 1 (stating “[i]n the United Mexican States, every individual will enjoy the guarantees that this Constitution grants, which shall not be restricted or suspended except in the cases and with the conditions under which the same is established.”).

63. *Concursos mercantiles. El título décimo segundo de la ley relativa es constitucional al otorgar un trato igualitario a los acreedores nacionales y extranjeros, Primera Sala de la Suprema Corte de Justicia [SCJN] [Supreme Court], Semanario Judicial de la Federación y su Gaceta, Novena Época, tomo libro XXIV, Octubre de 2006, Tesis 1a. CLXIII/2006, Página 276 (Mex.) (Registro No. 174122).

64. *Id.*

65. *Id.* (title twelve of the law is constitutional because it grants equal treatment to domestic and foreign creditors).
In an airline bankruptcy proceeding, the ticket holders requested the assistance of the special office to protect consumer rights in a kind of collective action: the Procuraduría Federal del Consumidor, who represented them, claimed to be granted a privileged status in order to collect their credits. The Congress even issued an order to the Administration that was vetoed by the President because it represented a disruption of the natural legal order.

In a very unique and unexpected decision made by the Tribunal Colegiado, it was established that the credits held by consumers are credits that had to be considered as human rights protected by the Constitution.66

With this decision, the credits of those ticket holders should have preference over all others, including secured credits, tax credits, and privileged credits, giving place only to the labor claims.

This is only one precedent, but a very strong one to be taken into account for similar future litigation. Strong litigation must be expected in this field.

E. Conclusion

As it is easy to extract out of those decisions rendered by the Constitutional Tribunals in Mexico, the general situation is that the Ley de Concursos Mercantiles is a constitutional safe ground. There have been some decisions, not yet binding, that still pose a threat. We can wait and hope that in the future a level of strong litigation will rise around those topics.

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66. Consumidores. Créditos de los, en un concurso mercantil y su prelación; se ubican inmediatamente después de los trabajadores (interpretación de los artículos 217 a 222, 224 fracción i y 225 fracción i de la ley de concursos mercantiles), Tribunales Colegiados de Circuito [TCC] [Collegiate Circuit Courts], Semanario Judicial de la Federación y su Gaceta, Decima Época, tomo libro VIII, Mayo de 2012, Tesis I.7o.C.J/1 (10a.), Página 1820 (Mex.) (Registro No. tesis aislada) (Consumer’s credits in an insolvency proceeding are settled immediately after workers (interpreting articles 217 to 225, section I, of Bankruptcy Law)).
Electric Vehicles, Energy Efficiency, Taxes, and Public Policy in Brazil

José Marcos Domingues & Luiz Artur Pecorelli-Peres*

ABSTRACT

Within the current global scenario, which strives for energy efficiency and environmental protection, there is discussion of tax incentive possibilities as environmentally-oriented public policy tools, in which taxes are not perceived as a traditional fundraising device (fiscal taxation), but rather through their non-fiscal potentiality (extrafiscality). The suggestions of tax policy models aimed at environmental protection found, as a case study, that the context of electric vehicles in Brazil is that they are the victims of legislation that does not take into consideration the basic principles of physics and ecology and does not envisage the most efficient and less polluting transportation models. Moreover, taking as a reference the successful public policies in other countries, the study proposes measures that include tax incentives for the development of sustainable transport in Brazil and take into account the new paradigm represented by electric vehicles.

Keywords: tax incentives – non-fiscal taxation (extrafiscality) – sustainable development – public policies – energy efficiency – environmental protection – electric vehicle.

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2. The seminal essay corresponding to the present article was previously published in Critical Issues in Environmental Taxation, Volume XII – Green Taxation and Environmental Sustainability, published by Edward Elgar Publishing Ltd., 2012, pp. 113-129, as a chapter titled “Electric Vehicles, Taxes and Public Policies in Brazil.”
I. INTRODUCTION

By the end of 2009, the Brazilian Government seemed inclined to push for fiscal policies favoring electric vehicles (EVs). Until 2010 words had not become reality, and a momentous opportunity was lost during Rio de Janeiro Challenge Bibendum.

During the Brazilian Seminar on Technologies for Electric Vehicles (TEC VE 2011), held in Brasília in June 2011, the Ministry of Finance voiced governmental intentions to compel the auto industry to adopt a seal that ranks vehicles based on emissions and fuel consumption. The time has come for the country to discuss the production of EVs that are powered by less or non-polluting electricity, and would reduce dependence on ethanol\(^3\) and gasoline.\(^4\) In fact, battery EVs, or even plug-ins and hybrids, can use several primary energy sources (solar, wind, hydraulic, etc.) that are impossible for combustion-engine vehicles. Despite the adequacy of the Brazilian energetic matrix for EV expansion, there are institutional barriers that need to be addressed now.

A future step would be using the above-mentioned green seal to grant other incentives, such as reducing the present 25 percent federal VAT\(^5\) on electric cars, depending on proper cataloging of energy efficiency along

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4. Another initiative would be granting fiscal incentives within the scope of a new Competitiveness Development Policy (Politica de Desenvolvimento de Competitividade – PDC) linked to required levels of domestic content of Brazilian-made vehicles. \(id\). In fact, while this essay was being written, on August 2, 2011, the Brazilian government launched the Plan “Brasil Maior”, a new industrial policy (under Provisory Measure n. 540, especially articles 5 and 6), in the context of the Competitiveness Development Policy. The policy may encourage scale production of EVs in Brazil, a country that suffers from an unfair heavy tax burden. The lack of public policies for this sector has inhibited the entrance of EVs into the Brazilian sustainable development agenda. Besides credit, the new program will promote tax cuts for automotive manufacturers and auto part industries that come to invest in innovation and nationalization of components; notoriously, EVs represent technology innovation in Brazil and the brazilily index of domestic production is intended to be a natural development induced by the announced fiscal incentive policy. This policy is in line with the generally acknowledged thinking that “new technologies require, in a certain stage of its development, stimulus to research and to initial demand... needing to be organized and supported by governments. As in the case of Brazilian biodiesel, in which action of market stimulus, regulation and tax incentives were complemented by actions of research, laboratorial capacitating and specialized human resource building-up.” Sergio Rezende et al., Os Veículos Elétricos e as Ações do Ministério da Ciência e Tecnologia, in Estrategias de Implantação do Carro Elétrico no Brasil 13, 26 (Rio de Janeiro: INAE – Instituto Nacional de Altos Estudos 2010).

5. Tax on industrialized products (imposto sobre produtos industrializados or “IPI”).
with emission cleanliness of vehicles in the country, which requirement mix would be the basis for creating fair environmental tax benefits.

This essay discusses the possibilities of environmental protection through tax incentives as environmentally oriented public policy tools, in which taxes are not perceived as a traditional fund-raising device (fiscal taxation), but rather through their non-fiscal potentiality (extrafiscality). Next, the essay presents tax-policy models aimed at environmental protection, a context that also presents the case of EVs in Brazil.

II. STATE PROMOTES ENVIRONMENTAL PROTECTION

Environmental protection evolved into a global issue by the end of the twentieth century, especially in view of mounting worries about the disequilibrium of the greenhouse effect caused by unfriendly human behavior. Such protection has a special characteristic because the protected “good” shapes the right to a healthy environment, whose holder is undetermined. The beneficiary of this right is humanity, including those who have not yet been born (the principle of responsibility among generations).

Notwithstanding ancient biblical wording, which may be construed as environmental precepts, and further regulation throughout time, it is a relatively recent phenomenon that states worldwide have produced massive legislation introducing environmental protection as a matter of serious concern.

In Brazil, during the 1980s, environmental legislation became a positive system. The legislation include the following benchmark laws: Law 6,938/1981 (National Environmental Policy Act); Law 7,347/1985 (Public Civil Action Act); the Constitution of 1988 (with a whole chapter on the Environment); and Law 9,605/1998 (Environmental Crimes Act).

The 1988 Constitution concentrates the constitutional supremacy innate to its normative force. It superseded both utilitarianism and

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7. Domingues, supra note 6 (quoting Genesis ch. 1).
8. Edis Milare, Direito do Ambiente 134 (4th ed. 2005) (quoting the Portuguese Alfonsine, Manuiline, and Filipine Ordinations in force in Brazil until the Civil Code of 1916, which also had property-connected environmental rules; the Waters Code of 1934, the Forestry Code of 1965 and the Mining Code of 1967 are examples of legislation with sparse and maybe inadequate environmental rules which were not able per se to impede environmental degradation). See Paulo de Bessa Antunes, Direito Ambiental 148 (9th ed. 2006); Paulo Affonso Leme Machado, Direito Ambiental Brasileiro 61 (14th ed. 2006).
10. Nature as a raw material supplier for man’s development.
preservationism\textsuperscript{11} as visions of environmentalism. The Constitution embraces conservationism,\textsuperscript{12} thus adhering to the idea of sustainable development.

The Brazilian Constitution,\textsuperscript{13} similar to the Spanish Charter,\textsuperscript{14} holds there is a duty on the State to promote environmental protection. Presently, environmental protection, as Germán Orón Moratal puts it, “is not an individual or socially more or less extended desideratum,” but rather a lien, a problem to be solved “inevitably with public financing.”\textsuperscript{15} Because environmental protection ought to be considered a public need, and a public need is precisely one to be met by public services and funded by proper allocation of public means, environmental protection should be funded by public means.\textsuperscript{16}

III. LAW AND SUSTAINABLE DEVELOPMENT

Aside from the symmetry between the words ecology and economics,\textsuperscript{17} there is a strong link between environmental protection and the use of natural resources for industrial production and economic development. It does not seem possible to dissociate man and his respective needs from nature. But infinite human needs cannot be a license to destroy the planet.

Conciliation of economic development must include respect for the environment and for human rights; this is the equation that leads to the

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\textsuperscript{11} Nature is to remain untouched by man, for any human intervention in the environment is deemed to be harmful per se.

\textsuperscript{12} Man may and should intervene in natural processes, looking for the necessary elements for development, though respecting other living beings that are part of the environment.

\textsuperscript{13} “All have the right to an ecologically balanced environment which is an asset of common use and essential to a healthy quality of life, and both the Government and the community shall have the duty to defend and preserve it for present and future generations.” \textit{Constituição Federal [C.F.] [Constitution]} art. 225 (Braz.).

\textsuperscript{14} “Article 45 [Environment] (2) The public authorities \textit{shall concern} themselves with the rational use of all natural resources for the purpose of protecting and \textit{improving} the quality of life and \textit{defending} and \textit{restoring} the environment, supporting themselves on an indispensable collective solidarity.” \textit{Constitución Española, B.O.E. [Constitution]} n. 45(2), Dec. 29, 1978 (Spain).

\textsuperscript{15} Germán Orón Moratal, \textit{Fiscalidad Ambiental: la Ecotasa, in V Conferencias sobre el medio ambiente} 9, 10 (2002).

\textsuperscript{16} \textit{See} Aliomar Baleeiro, \textit{Uma Introdução à Ciência das Finanças} 2 (14th ed. 1990).

\textsuperscript{17} “Ecology” comes from Greek “\textit{aikos},” meaning “house, home” and “\textit{logos}” (logy), meaning science, study. Thus, ecology could be said to mean the science that studies our house, the planet Earth. Another science branch whose vocabulary roots are similar is Economics. It is no mere coincidence: “\textit{aikos},” which means “house” is complemented by “nomia,” meaning management, organization. Therefore, Ecology and Economics are both science branches related to the same object of study, with different respective foci. \textit{See} Antunes, supra note 8 (“sadly, many people’s viewpoint is that ecologists and economists are foes with antithetic visions”).
concept of sustainable development.\textsuperscript{18}

Thus, the Brazilian Constitution fairly provides for environmental protection as a structural element of the economic order, holding incumbent upon the State a mandatory action in favor of sustainable development.

A. **Environmental Law in the 1988 Constitution and Its Connection with Sustainable Development; the Infra Constitutional Legislation**

Article 225 of the Brazilian Constitution, besides providing for the environment as a public good ("res communis hominii"), aims at establishing harmony\textsuperscript{19} among the provisions that discipline its use by integrating those norms of an economic nature with those intended to protect human rights. Because environmental protection is a fundamental aspect of the economic order, the article provides:

Article 170. The economic order, founded on the appreciation of the value of human work and on free enterprise, is intended to ensure everyone a life with dignity, in accordance with the dictates of social justice, with due regard for the following principles: . . .

VI - environment protection, which may include differentiated treatment in accordance with the environmental impact of products and services and of their respective production and delivery processes[.]\textsuperscript{20}

Thus, the Constitution embraces the argument that neither economic development nor environmental protection are absolute values, but each has a respective relative value recognized in the concept of sustainable development.\textsuperscript{21}

This is further evidenced by Law n. 9985/2000, which provides that the National System of Units of Nature Conservation (SNUC) has a goal “to promote sustainable development from natural resources."\textsuperscript{22} And, the Constitution of the State of Rio de Janeiro that provides: “In order to guarantee the effectiveness of this right [to enjoy an ecologically healthy environment], the State shall . . . establish tax policies aimed at implementing the polluter-pays principle and at stimulating the development and implementation of technologies for better environmental control and

\textsuperscript{18} Sustainable development seems to be the harmonization of the permanent tension between economic development and environmental protection: the effective conciliation between development and human quality of life. See Doma\'


\textsuperscript{20} Constituição Federal [C.F.] art. 170 (Braz.).

\textsuperscript{21} Sustainable development appears in Brazilian statutes in the mid-1990s, even in budget laws and continuously repeated henceforth as a guideline for the Federal Administration, according to the principles of Agenda 21. See Lei No. 9.082, de 25 de Julho de 1995, art. 2, V, Diário Oficial da União [D.O.U.] de 26.7.1995 (Braz.).

\textsuperscript{22} Lei No. 9985, de 18 de Julho de 2000, art. 3-4, Diário Oficial da União [D.O.U.] de 19.7.2000 (Braz.).
Therefore, it is incumbent upon the State to embrace the practical construction of sustainable development, in concert with societal values and wishes, while taking into account important aspects of the economic system. Beyond drafting environmental texts, the State must not fail to establish tax policies in line with the aforementioned task.

B. PUBLIC FINANCE LAW, TAX LAW AND SUSTAINABLE DEVELOPMENT

Economic instruments are fundamentally based on the environmental law polluter-pays principle, which has a positive meaning (polluter imputation of the costs of environmental public services) and a selective meaning (modulating or adjusting said cost imputation according to the intensity of pollution).

Among the ways to prevent or curb pollution, taxation is an efficient tool to stimulate non-polluting conduct (non-fiscal taxation). These taxes find a legal basis in Hans Kelsen’s premial sanction doctrine based on the retributive principle (vergeltung): the State acknowledges the individual’s effort to comply with the law rather than limiting itself to punishing the breach of the law through repressive sanctions. This doctrine provides fiscal incentives that otherwise would be deemed to be unlawful privileges vis-à-vis the equality principle.

This legal reasoning finds a connection with reasoning developed in Pigou’s economic theory. Symmetrically, a typical Pigouvian tax is one imposed in situations when market failure or distortions must be fought (or corrected) by taxing (or increasing taxes on) the same and using the proceeds as a subsidy in favor of those of an opposite (adequate or friendly) nature.

So, both legal and economic doctrines favor the use of State measures to induce human conduct consistent with social values. In the case of

23. Constituição do Estado do Rio de Janeiro [Constitution] art. 261, §1 (Braz.).
25. “Ce principe est inspiré par la thèorie économique selon laquelle les coûts sociaux externes qui accompagnent la production industrielle (dont le coût résultant de la pollution) doivent être internalisés, c’est-à-dire pris en compte par les agents économiques dans leurs coûts de production.” Michel Prieux, Droit de l’Environnement 89 (2d ed. 1991). Note that the greater the cost share born by the polluter, the greater the adherence to the polluter-pays principle. See Org. for Econ. Co-operation and Dev., The Polluter-Pays Principle: Definition, Analysis, Implementation 6 (1975).
economic choices, those ought to be consistent with environmental goals inasmuch as these are perceived as social values protected by law.\textsuperscript{30} Green taxes are technically designated environmental taxes. The label “green tax” refers to taxes that have environment-friendly motivation.\textsuperscript{31}

Aside from their fundraising function, when taxes are referred to as fiscal or financial (\textit{finanzsteuer}) taxation (hence, fiscal revenues), which correspond to a non-regulatory state policy, taxes may exercise great influence over economic activity—they are one of the main costs of businesses.\textsuperscript{32} In this sense, taxes are referred to as non-fiscal or extra-fiscal taxation because they do not necessarily aim to raise funds for public expenditure (some would aim at no tax collection at all as the true tariff barrier).\textsuperscript{33} Instead, the goal of non-fiscal taxation is to direct the economy and focus on political goals. Non-fiscal taxes are also regulatory taxes, taxes d’orientation, or \textit{marktordnungsschäden}, because, in the words of Xavier Oberson, as \textit{zwucketzsteuern}, they are “money having the goal of affecting taxpayers’ attitudes.”\textsuperscript{34}

Application of environmental taxes may have a fiscal function (corresponding to the positive meaning of the polluter-pays principle) and a non-fiscal function (in the selective meaning of the principle), even though they are both essentially regulatory in nature. The main goal of environmental taxes is to change the taxpayers’ (businesses and consumers) behaviors, producing or enhancing environmental awareness: this is the domain of a specific environmental public policy, specifically, fiscal public policy.

IV. THE CONCEPT OF PUBLIC POLICY

Public policy is an expression from political science\textsuperscript{35} that brings to law

\begin{itemize}
\item \textsuperscript{31} These taxes may be understood as having both a broad and a narrow meaning. The broad meaning of an environmental tax is that of an ordinary or traditional tribute adapted so as to benefit environmental protection efforts. The narrow, or strict, meaning is that of a new, separate tribute charged on the use of the environment by economic actors.
\item \textsuperscript{32} Taxes may be used as an indirect regulatory (\textit{ordnungsteuer}) economic instrument. For example, an activity or product that is highly taxed may be discontinued in favor of activities subject to lower tax rates.
\item \textsuperscript{35} Cf Maria Paula Dallari Bucci, \textit{Buscando um Conceito de Políticas Públicas para a Concretização dos Direitos Humanos, in Direitos Humanos e Políticas Públicas} 5 (Renato Cymbalist ed., 2001), available at http://www.comitepaz.org.br/
a trend of interdisciplinarity, thereby combining the common roots of ethics from the different branches of human knowledge.

Ronald Dworkin\textsuperscript{36} designated “policy [as] that kind of pattern which establishes a goal to be reached, in general an improvement in certain economic, political or social aspect of the community.” This is different than a principle, “an exigency of justice or equity or some dimension of morality,” or even a fundamental judgment of value.\textsuperscript{37}

In Brazil, Professor Fabio Comparato\textsuperscript{38} teaches that “... policy appears, after all, as an activity, i.e., as an organized set of norms and acts leading to the fulfillment of a given goal. ... The policy, as a set of norms and acts, is unified by its goal.”

Thus, public policies ought to be seen as State actions integrated by legislative and administrative activities that produce norms and acts oriented to a given goal.\textsuperscript{39}

In particular, aside from a strong regulatory character, fiscal public policies have a high potential for the coordination of several levels of state action, usually materialized through public budgets ordering account en-

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\texttt{Direitos\%20Humanos\%20e\%20Pol\%C3\%ADticas\%20Pol\%C3\%BAblicas.pdf}
\end{flushright}


\textsuperscript{37} See Oswaldo Aranha Bandeira de Mello, \textit{Princípios gerais de direito administrativo} 404, 406 (2d ed. 1979).

\textsuperscript{38} According to Comparato, and based on the fundamental teachings of Karl Loewenstein (1957), the goal (teleology) of conduct must be considered both in State actions (the public policies) and in peoples’ acting (the acts of juridical life). See Fabio Comparato Konder, \textit{Ensaios Sobre o Juízo de Constitucionalidade de Políticas Públicas}, 737 REVISTA DOS TRIBUNAIS 17, 18 (1997) (Braz.).

\textsuperscript{39} As Comparato puts it, “History gives us several examples of Directing States, of a mercantilist, industrialist or warmonger.” See id. at 16-17. In this sense, public policies have always been produced: the Romans formed their legions by seducing their members with promises of early retirement and the granting of agricultural lots. See Antonio Lima Ribeiro, \textit{Problemas estruturais da previdência social no Brasil}, 175 \textit{Espaço ANCEP – Associação Nacional dos Contabilistas das Entidades de Previdência}, Feb. 23, 2008 (Braz.); see also Silvio Augusto de Bastos Meira, \textit{Direito tributário romano} 56-58 (1978). In the Antiquity and in the Medieval Age, Muslims charged relatively more taxes on Christians, and vice-versa; the latter imposed them on Muslims, in their respective moments in power, sure of “the possibility of promoting the faith through the villainous metal.” See Sérgio Vasques, \textit{Os impostos do pecado} 21-22 (1999) (quoting Ibn Abi Al-Qayrawani, who adds: “... not-Muslims ... thereby over-taxed. This way conversions are promoted and nonbelievers are made to pay for maintenance and expansion of Islam”). The treaties of friendship, commerce, and navigation that the neo-colonial powers imposed on Japan by the end of the XIX century, guaranteeing them minimal import tariffs, extraterritoriality of their laws, and Consul jurisdiction undoubtedly meant a policy of economic domination, the vector of which was the opening of markets in favor of (then) already industrialized countries. See Yosiyuki Noda, \textit{Introduction to Japanese Law} 41 (Anthony H. Angelo trans., 2d. ed. 1977); Hideo Tanaka, \textit{Le Japonais Legal System} 194-95 (3d ed. 1971); John Whitney Hall, \textit{Japan: From Prehistory to Modern Times} 257 (C.E. Tuttle Co. ed.,1971); José Marcos Domingues, \textit{Aspectos da Influência do Direito no Desenvolvimento Japonês}, 279 REVISTA FORENSE, n. 28, 1982, at 45-76.
tries, which ultimately show or express public policies themselves.40

Here, taxation may play a strategic and fundamental role. Taxes in general, and environmental taxation in particular, have a strong regulatory potential, which may enhance sustainable development and environmental protection.

V. TAX BURDEN ON ELECTRIC VEHICLES IN BRAZIL41

Besides a generally acknowledged overall tax burden of more than 35 percent,42 not followed by corresponding efficient public services in Brazil, EVs suffer from a bottleneck tax cost: they are taxed at 25 percent by federal VAT43—the same rate applied to the most polluting combustion motor run vehicles (electric motorcycles pay 35 percent). EVs are also subject to the general state VAT,44 which is between 18 and 19 percent; besides, they are taxed at 11.6 percent again by federal social contributions45 on gross sales. Moreover, there is a yearly state vehicle tax46 of up to 4 percent.47 All of these federal and state taxes have a taxable basis

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40. Article 174 of the Brazilian Constitution provides for mandatory public planning as guidance for the private sector. Constituição Federal [C.F.] art. 174 (Braz.).
41. For a summary of the Brazilian tax system, see José Marcos Domingues, An Introduction to The Brazilian Tax System, 44 Kobe U. L. Rev. 19, 23-24 (2010).
43. Industrialized products tax (“IPI – imposto sobre produtos industrializados”). Constituição Federal [C.F.] art. 153, § IV (Braz.). “In Brazil, electric vehicles do not receive a differentiated treatment. In the case of ‘IPI’, electric vehicles fall within the category ‘others’, on which the tax rate is the highest. An electric car, for example, is taxed at 25%.” See id.; see also Luciano Galvão Coutinho et al., Veículo elétrico, políticas públicas e o BNDES: oportunidades e desafios [Electric Vehicle, Public Policies and the BNDES: Brazilian Economic and Social Development Bank: Opportunities and Challenges], in Estratégias de Implantação do Carro Elétrico no Brasil 33 (2010).
44. Tax on “transactions relating to the circulation of goods and to the rendering of interstate and intermunicipal transportation services and services of communication” (“ICMS – imposto sobre a circulação de mercadorias e serviços”). Constituição Federal [C.F.] art. 155, § II (Braz.).
47. Out of twenty-seven States, a minority seven States have exempted EVs; others, like São Paulo, may charge 3 percent, whereas Rio de Janeiro charges 1 percent, and Mato Grosso do Sul interestingly allows for the Executive to reduce the 2.5 percent to 3 percent tax by 70 percent in order to fulfill programs of pollution control, or technological development, with reference to motor vehicles powered
that is the market value of the vehicle. On the other hand, there is no rebate or tax incentive related to the purchase of an EV in the tax system. Such a tax burden makes it virtually impossible for EV industrialization and trade in scale, preventing their use in cleaning air pollution, especially in large cities. Global sporting events programmed for 2012, 2014, and 2016 may be opportunities to see EVs on the agenda of sustainable development in Brazil.

Noteworthy are the municipal taxes on real estate relating to the infrastructure required for the use of EVs (recharging stations, repair shops, and services rendered therein), including, for example, an annual 2.8 percent tax on the market value of non-residential real estate in Rio de Janeiro and usually between 2 percent and 5 percent of the service price on the rendition of services.48

There is no income tax incentive or financial subsidy provided by law for manufacturers and consumers of EVs.

The Rio de Janeiro State University (UERJ) developed a pioneer partnership between the law and engineering departments, leading to legislative policy proposals by its Nucleus for Studies on Public Finance, Taxation, and Development (NEFIT), in favor of the domestic production and consumption of EVs. Tax incentives and subsidies ought to be put in practice in Brazil, ranging from federal taxes to state and municipal taxes. Presently, NEFIT interacts with the Laboratory of Public Policies and Fiscal Fairness (LAPPJUS) of UERJ.

In order to justify said legislative proposals, the Group of Studies on the Electric Vehicle (GRUVE) at UERJ has prepared the following technical case study.

VI. EV TECHNOLOGY CLAIMING FOR PUBLIC POLICIES

A. THE CASE STUDY

The previous rationale is conducive to the argument that the Brazilian Federation needs to adopt public policies, at the federal, state, and municipal levels, aimed at promoting sustainable development by including fiscal incentives in the country’s tax legislation to encourage research and development in new vehicle technologies, particularly electrical technology.

by electricity or gas. In the case of an ethanol-run motor vehicle, the reduction can be up to 40%. To sum up, only around 1/3 of Brazilian States allow any kind of tax differentiation in favor of EVs. Lei No. 13.296, de 26 de Dezembro de 2008, Diário Oficial de São Paulo [D.O.S.P.] de 12.27.2008 (Braz); Lei No. 2.877, de 22 de Dezembro de 1997, Diário Oficial do Rio de Janeiro [D.O.E.R.J.] de 23.12.1997 (Braz); Lei No. 1.810, de 22 de Dezembro de 1997, Diário Oficial de Mato Grosso [D.O.M.S.] de 23.12.1997 (Braz).

Federal government data is presented in order to identify, in the Brazilian energy matrix, and in atmospheric emission indices for the transport sector, arguments that will make the case for greater encouragement of EVs. Impacts of current atmospheric pollution levels on the health of the population are also addressed.

Finally, some avenues for legislative modifications that will reduce the costs of EV production and maintenance are proposed.

B. Atmospheric Emissions of the Transport Sector

A major element aggravating climate change is the increased concentration of carbon dioxide — CO₂ — in the atmosphere. If emissions of this type of gas are to be reduced, we will necessarily have to review the transport sector, a source of energy that, in Brazil, is based particularly on fossil fuels. This sector is the second major source of CO₂ emissions.

Transport emissions are increasing in urban areas. The 2010 census showed that 84 percent of the Brazilian population lives in cities. By and large, vehicle emissions prevail. In Rio de Janeiro, for instance, in 1998, according to a study by the Pereira Passos Institute, the percentage of transport sector emissions reached 61 percent. Currently, this number is beyond 80 percent, if we include motorcycles, which hardly ever have catalysts.

Creating incentives for EVs will reduce transport sector emission levels. Two facts underpin this argument:

(i) within the transport sector, the highest polluting level corresponds to the road vehicles (Table 1); and

(ii) CO₂ emissions from cars are major pollutants, totaling 35 percent (Table 2).

Table 1: CO₂ Emissions in Brazil’s Transport Sector

<table>
<thead>
<tr>
<th>Modal</th>
<th>CO₂ (t/year)</th>
<th>Participation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Roadways</td>
<td>138,768,000</td>
<td>90.41%</td>
</tr>
<tr>
<td>Air</td>
<td>7,999,000</td>
<td>5.45%</td>
</tr>
<tr>
<td>Maritime</td>
<td>4,279,000</td>
<td>2.91%</td>
</tr>
<tr>
<td>Railways</td>
<td>1,803,000</td>
<td>1.23%</td>
</tr>
<tr>
<td>Total</td>
<td>146,849,000</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Emissions Inventory, Ministry of Science and Technology, 2009


Table 2: CO₂ Emissions per Vehicle Type in Brazil

<table>
<thead>
<tr>
<th>Vehicle Type</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural Gas</td>
<td>3.0</td>
</tr>
<tr>
<td>Heavy Truck</td>
<td>30.0</td>
</tr>
<tr>
<td>Medium Truck</td>
<td>4.0</td>
</tr>
<tr>
<td>Light Truck</td>
<td>1.0</td>
</tr>
<tr>
<td>Highway Bus</td>
<td>3.0</td>
</tr>
<tr>
<td>Urban Bus</td>
<td>14.0</td>
</tr>
<tr>
<td>Diesel Light Commercial</td>
<td>3.0</td>
</tr>
<tr>
<td>Otto Light Commercial</td>
<td>4.0</td>
</tr>
<tr>
<td>Motorcycles</td>
<td>3.0</td>
</tr>
<tr>
<td>Cars</td>
<td>35.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>


The above tables show the need for an effort that will change the structure of the Brazilian road sector, noticeably by means of introducing EVs. In the case of hybrid EVs (those having internal sources of energy to recharge their batteries), emissions are significantly less than in vehicles powered exclusively by fuels. According to tests conducted by the UERJ, in a research and development (R&D) project approved by the Board of the National Electricity Regulatory Agency (ANEEL), battery-only EVs use one third of the energy required for a conventional internal combustion vehicle. Outstandingly, apart from carbon dioxide, which greatly impacts climate change, there are pollutants that are very aggressive to human health, namely carbon monoxide, nitrogen oxides, particulate matter (PM), volatile organic compounds, and aldehydes, all of which are present to a greater or lesser degree in conventional vehicles, including dual-fuel vehicles.

C. Energy Matrix

Brazil has immense hydroelectric potential and the possibility to explore other abundant sources of energy (biomass, wind, and solar). Given the promising exploration of oil & gas pre-salt findings, it is necessary to modify the current utilization of primary energy sources to significantly increase the production of fossil fuels and ethanol to supply traditional vehicles. Without a public policy for EVs, it is not a sound strategy. The penetration of EVs allows for more efficient uses of fossil energy and sugar cane availability, transforming part of it into electricity, even if it is deemed necessary, in the most unfavorable situation, to supplement the needs of the power mix (Table 5). This will reduce the amount of energy for transportation and CO₂ emissions in coming years, because electricity is more efficient, as demonstrated in many interna-
tional analyses. EVs are extremely versatile: they recharge from various sources of energy, which is not the case for internal combustion vehicles.

Attention should be drawn to the dimensions of the transport sector in the final energy consumption grid in Brazil. Considering the baseline year of 2009, the transport sector ranked as the second major energy consumer in Brazil (responsible for 28.6 percent of the total energy produced in the country), with the first being the industrial sector (consuming 40.7 percent) (Table 3).

Table 3: Sector Participation in Final Energy Consumption in Brazil 2009

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Road Transport</td>
<td>26.1%</td>
</tr>
<tr>
<td>Residential</td>
<td>10.5%</td>
</tr>
<tr>
<td>Energetic</td>
<td>11.0%</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4.3%</td>
</tr>
<tr>
<td>Commercial</td>
<td>2.8%</td>
</tr>
<tr>
<td>Public</td>
<td>1.7%</td>
</tr>
<tr>
<td>Industrial</td>
<td>34.6%</td>
</tr>
<tr>
<td>Railroads, Airways and Waterways Transport</td>
<td>2.2%</td>
</tr>
<tr>
<td>Others</td>
<td>6.8%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
</tr>
</tbody>
</table>


Since the 1970s, the transport sector has presented a permanent trend of increasing energy consumption, according to the previously mentioned National Energy Balance 2010, with a baseline year of 2009. There is also an overriding awareness that fossil fuels are the main source of energy used in this sector, representing 79.6 percent of the total amount available. Meanwhile, cleaner sources, such as hydroelectricity (which has major participation), are left with minimum consumption rates (0.2 percent), according to Table 4.

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Table 4: Sources of Energy Consumption by Transport Sector in Brazil 2009

<table>
<thead>
<tr>
<th>Power Source</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gasoline</td>
<td>24.3%</td>
</tr>
<tr>
<td>Electricity</td>
<td>0.2%</td>
</tr>
<tr>
<td>Ethyl Alcohol</td>
<td>20.2%</td>
</tr>
<tr>
<td>Natural Gas</td>
<td>3.2%</td>
</tr>
<tr>
<td>Diesel Oil</td>
<td>52.1%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>


The situation is even more frustrating when statistics on the evolution of sector-consumption of oil by-products and electricity, for example in 1973 and 2006, are compared. Participation of oil by-products in the transport sector rose from 45.4 percent in 1973 to 60.5 percent in 2006—a 33 percent growth!\(^{52}\) Conversely, participation of electricity in the transport sector, which was low enough in 1973, dropped from 2.4 percent to 1.7 percent (a 29 percent decrease, considering the sector segments under analysis).\(^{53}\) That situation, particularly considering the low levels of electric power consumption, shows that the Brazilian energy potential, set aside for electric transportation, is truly underused, including its many other applications.

Additionally, Brazil has one of the largest electric power potentials in the world and 76.9 percent\(^{54}\) of the electricity generated in the country is hydroelectricity, meaning it comes from a renewable primary source, as shown in Table 5, where generation supply capacity is included in accordance with the primary source used.

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53. Id.

54. The portions concerning imports refer primarily to the Brazil-Paraguay Itaipu Binacional Company and to the Small Hydroelectric Plants (“SHP”).
Table 5: Structure of Internal Supply According to the Nature of the Primary Source of Electric Power Generation – Brazil 2009

<table>
<thead>
<tr>
<th>Power Generation</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coal</td>
<td>1.3%</td>
</tr>
<tr>
<td>Oil Products</td>
<td>2.9%</td>
</tr>
<tr>
<td>Natural Gas</td>
<td>2.6%</td>
</tr>
<tr>
<td>Wind</td>
<td>0.2%</td>
</tr>
<tr>
<td>Biomass</td>
<td>5.4%</td>
</tr>
<tr>
<td>Nuclear</td>
<td>2.5%</td>
</tr>
<tr>
<td>Imports</td>
<td>8.1%</td>
</tr>
<tr>
<td>Hydro &gt; 30MW</td>
<td>76.9%</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: National Energy Balance 2010 baseline year 2009, page 12
Empresa de Pesquisa Energética (EPE) [Energy Research Company] /
The Ministry of Mines and Energy (MME)

D. TRANSPORT SECTOR IMPACTS ON HEALTH

Another argument favoring the introduction of EVs, and consequent reduction in pollutant and gas emissions, are the high public health costs incurred by air pollution, which, as already stated, are directly connected to transportation.

In that regard, the in-depth study developed by São Paulo University’s Experimental Atmospheric Pollution Laboratory (USP) provides an indispensable contribution: a report entitled “Assessing Environmental, Health and Socio-Economic Aspects Involved in Six Metropolitan Regions.” This study analyzes, from various perspectives, the environmental impact caused by atmospheric pollution and shows, perhaps most significantly, the costs of the damage caused by this type of pollution. These results were made available to the mass media and posted on a number of websites, including a report based on the USP study entitled “Pollution costs U.S. $1 billion per year to Brazil,” that stated “the poor quality of the air costs at least U.S. $1 billion to the Brazilian treasury every year, particularly due to deaths and treatment of diseases that are

55. This is a 421 page study developed jointly with the Laboratory for the Analysis of Atmospheric Processes (LAPAI), the Department of Atmospheric Sciences, and the Institute of Astronomy, Geophysics, and Atmospheric Sciences, USP, whose “Version 0” is dated April 22, 2009. Inst. of Astronomy, Geophysics, and Atmospheric Scis. & LAPAI, Assessing Environmental, Health, and Socio-Economic Aspects Involved in Six Metropolitan Regions (Apr. 22, 2009) (unpublished study).
56. See, for instance, Poluição custa U$$ 1 bilhão por ano no país [Pollution Costs $1 Billion a Year in Country], ABVE, http://www.abve.org.br/destaques/destaque08094.shtml (last visited Mar. 15, 2013), and Poluição custa U$$ 1 bilhão por ano ao Brasil [Pollution Costs $1 Billion a Year to Brazil], ciclista urbano cwB (July 24, 2009), http://cilistaurbanocwb.wordpress.com/2009/07/24/poluicao-custa-us-1-bilhao-por-ano-a-brasil/.
directly or indirectly associated with pollution.”57 According to that report, metropolitan regions that spend the most on overall health and air quality-related health problems is led by São Paulo (U.S. $300 million), followed by Rio de Janeiro (U.S. $250 million), Porto Alegre (U.S. $180 million), Belo Horizonte (U.S. $150 million), Curitiba (U.S. $140 million), and Recife (U.S. $10 million).58 The report further states: “Besides treatment values per se, such as hospitalization costs, the formula calculates indirect factors associated with the diseases: sick leaves, how the absence of an employee affects a company’s production and finances, reduced taxes, disruption of family stability, among others.”59 More than just an environmental problem, the high levels of air pollution in Brazilian cities have become a true public health risk, affecting thousands of people per year, aggravating countless cases of respiratory diseases and, eventually, incurring high health care costs for the State.

E. AVENUES TOWARDS CHANGE AND FIRST SIGNS FROM PUBLIC AUTHORITIES

Although EVs are a significant factor in reducing CO₂ emissions in Brazil, interest in producing EVs nationally is still mild. Part of this paradox lies in the fact that investments in EV technology in the country are currently not attractive.60

First, investing in technology research and development (R&D) is an expensive and risky process, which calls for much reflection. Additionally, many automotive manufacturers doing business in Brazil have started their R&D projects at parent-company labs abroad, and not in Brazil.

Second, the current heavy tax burden demands investments that are even higher and, therefore, riskier. When it comes to emerging EV technology, the issue is further aggravated by high technology costs and unreasonable taxation, which means the final price of an EV produced and marketed in Brazil will be far higher than that of vehicles powered by fossil fuels which rely on older technology and long-standing (cheaper) knowledge. This is true albeit that fossil-fuel-run vehicles are far less efficient, and cause more environmental damage.

57. According to the same news that information refers to the six Brazilian metropolitan regions. Poluição custa US$ 1 bilhão por ano no país, supra note 57.
58. Id.
59. Id.
60. “According to national car manufacturers, the national market would not have enough of a demand to absorb a considerable number of electric cars to pay for the investment in technology for this area, plus the high price that this technology adds to the final product, even in major world markets.” Brasil não tem demanda para investimento em carros elétricos, segundo as montadoras [Brazil Has No Demand for Investment in Electric Cars, According to the Makers], Noticias Automotivas (Sept. 8, 2008), http://www.noticiasautomotivas.com.br/brasil-nao-tem-demanda-para-investimento-em-carros-elétricos-segundo-as-montadoras/ (author’s translation).
Brazil’s entry into this highly competitive market is no simple task, and it will demand efforts from all sides, particularly from Brazil’s government through public policies. But one may now say that, in the global playing field, Brazil may miss major opportunities if it does not have a strategic plan in place.

Several countries are taking a head start by investing in research, encouraging car-assembling facilities, or creating other types of favorable conditions to develop an automotive industry based around the electric car. For the sake of illustration, these countries include German investments in EV technology, U.S. investments of around $2.4 billion by the Obama administration in projects for the development of batteries and electric cars, British Prime Minister Gordon Brown’s call for electric cars in his green policy, and Portugal’s subsidies to buyers of electric cars (which may reach as much as €5,000).

Research developed by the UERJ Electric Vehicles Studies Group (GRUVE) entitled *Quantitative Levels of Efficiency and Emissions from Vehicle Propulsion Systems* points to the need for change in automotive taxation in order to encourage the penetration of EV technology. This change is complex because of the variety of vehicles in the market and their associated primary energy sources. A proposal must be made so that both specific energy consumption, expressed in kWh/km, and vehicle emission levels, particularly carbon dioxide, expressed in kg of CO2/km, be addressed by fair legislation that rewards the most efficient and lowest-emitting vehicle. Several technical considerations are necessary; for instance, internal combustion vehicles running on biodiesel, from a CO2/km emission perspective, are comparable to battery-powered vehicles, because both do not impact climate change. The same would be true for ethanol.

Table 6 contains a classification focused on consumption per km, as indicated in the aforementioned study, considering types of vehicles that use the same platform or model to enable a uniform comparison, which attributes for battery powered EVs 100 percent, or in a per unit base the

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61. See Alemanha quer se tornar líder mundial de carros elétricos [Germany Wants to Become World Leader in Electric Cars], globo.com (Aug. 19, 2009), http://g1.globo.com/Noticias/Carros/0,MUL1273168-9658,00-ALEMANHA+QUER+SE+TORNAR+LIDER+MUNDIAL+DE+CARROS+ELETRICOS.html.
value equal to 1.66

**Table 6: Relative Consumption per km Comparison of Various Types of Vehicles**

<table>
<thead>
<tr>
<th>Vehicle Types (Power Sources)</th>
<th>Relative Energy Consumption (Electric Vehicles = 1.0)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric</td>
<td>1.0</td>
</tr>
<tr>
<td>Parallel Hybrid Electric Vehicle (PHEV)</td>
<td>2.5</td>
</tr>
<tr>
<td>Series Hybrid Electric Vehicle (SHEV)</td>
<td>2.8</td>
</tr>
<tr>
<td>Gas – Internal Combustion Engine (ICE)</td>
<td>2.9</td>
</tr>
<tr>
<td>Biodiesel - Internal Combustion Engine (ICE)</td>
<td>2.95</td>
</tr>
<tr>
<td>Diesel - Internal Combustion Engine (ICE)</td>
<td>3.3</td>
</tr>
<tr>
<td>Compressed Natural Gas</td>
<td>3.9</td>
</tr>
</tbody>
</table>

In Table 7, as indicated in the GRUVE study, a performance comparison is presented in terms of CO₂/km. This Table does not consider CO₂ emissions for EVs and internal combustion vehicles running on biomass.

**Table 7: Emissions from Vehicles Powered by Non Renewable Fuels**

<table>
<thead>
<tr>
<th>Vehicle Types (Power Sources)</th>
<th>Kg (CO₂, Km)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electric</td>
<td>0</td>
</tr>
<tr>
<td>Parallel Hybrid Electric Vehicles (PHEV)</td>
<td>0.2</td>
</tr>
<tr>
<td>Series Hybrid Electric Vehicles (SHEV)</td>
<td>0.23</td>
</tr>
<tr>
<td>Gas – Internal Combustion Engine (ICE)</td>
<td>0.24</td>
</tr>
<tr>
<td>Diesel - Internal Combustion Engine (ICE)</td>
<td>0.24</td>
</tr>
<tr>
<td>Compressed Natural Gas</td>
<td>0.25</td>
</tr>
</tbody>
</table>

The composition of these indices provides the fairest and most accurate attribution of the merits of each vehicle type.

In Brazil, planning new guidelines for levying taxes on vehicles is difficult and attempts have been made since 2008, when the partnership began at the UERJ between the school of law and the school of engineering.67 This initiative has enjoyed collaboration from other entities, such as the Brazilian Electric Vehicle Association and the National Institute of Energetic Efficiency.

At the time this article was written, Brazilian authorities were well aware of this movement in favor of EV technology and have recognized the need for political initiatives in this direction. Along with considering 66. *Id.*

the merits of levying taxes on vehicles, the government adds a third component that shall interact with the fiscal incentive: the introduction of national technology content for vehicles produced by means of the Competitiveness Development Policy (PDC) program, which is already employed in the production of tablets. The plan has been in the hands of the economic team since the Lula administration and now begins in earnest, due to the recent ethanol supply crisis. According to the Executive Secretary for the Ministry of Finance, this is a timely moment for Brazil to discuss manufacturing hybrid vehicles, which pollute less and reduce domestic dependence on ethanol and gasoline.

As it may be observed, the framework being developed shall be used in the near future, and UERJ expects to continuously contribute in the process by bringing together the fields of law and engineering.

VII. LEGISLATIVE PROPOSALS

In order to adapt its tax system to minimize the tax cost for production and consumption of EVs, Brazil should take a series of legislative measures to induce, or at minimum not hamper, domestic initiatives in this sector.

At the federal level, income tax, IPI-value added tax, and social contributions ought to be reduced for an initial period of time (between ten to fifteen years) to allow for reasonable investment amortization. The proposals below should not be construed as tax cuts, because at present there is no EV scale production or imports into Brazil. The only exception are the income tax incentive proposals, which may represent a tax bonus, in lieu of direct governmental subsidies or grants.

68. “The government will force the automotive industry to adopt a label classifying vehicles according to emission levels and fuel consumption. The idea is part of a strategy to improve the quality of national cars and encourage manufacturers operating locally to invest in less polluting and more efficient technologies.” Beck, supra note 4 (emphasis added).

69. “The discussion on new technologies for the automotive sector is still fierce in the world. This process and the ethanol crisis have renewed the importance of bringing the subject back to the agendas,” he stated. The new label combines the other two existing labels: the green note issued by Ibama, (Brazilian Environmental Agency) concerning the level of polluting emissions, and the energy efficiency indicator by Inmetro’s (Brazilian Institute of Metrology) Vehicle Labeling Program. It will not be mandatory right away. The industry shall have some time to adapt. The label is expected to be used in 2012 models. Another way to improve the quality of Brazilian cars should come from tax incentives. In the Competitiveness Development Policy (“PDC”), which will be announced in the coming months, the government will define a rule that will grant tax credits to the production of vehicles with greater national content, in line with tax incentives to electro-electronic products, such as tablets.” Id. (The ethanol crisis referred to above took place in 2010-2011 when Brazilian domestic production was insufficient to meet domestic demand and prices went up; in 2011 Brazil was forced to import 4 billion liters of ethanol from the US) (emphasis added).

A. Suggested Income Tax Deductions for Companies

Suggested income tax deductions for companies are as follows:

- Companies taxed on “real profit” should be allowed to deduct from the tax amount due, up to 10 percent of the amount invested in the purchase of EVs, limited to R$ 20,000.00 per EV.
- As an exception, companies taxed on “presumed profit” should be allowed a tax credit of R$ 20,000.00 per EV purchased, which should be set off against the tax amount due in the year of the respective purchase.
- Companies manufacturing EVs should be granted an income-tax-free treatment on profits from sales of government certified EVs and respective spare parts.

To stimulate equipment acquisition, renovation or modernization of the EV assembling industry would be granted a yearly 20 percent accelerated depreciation limited to the respective asset cost.

Individual consumers would be allowed a maximum deduction of R$ 10,000.00 (or US$ 6,250.00 or € 4,200) from gross revenues in relation to the acquisition of EVs, motorcycles, and tricycles, limited to 20 percent of the total cost of each vehicle.

As for IPI, industrial product VAT, insofar as the tax basis is the market price/cylinder capacity/fuel, the immediate suggested legislative measure is to zero the current tax rates of 25 percent (electric cars) and 35 percent (electric motorcycles). Because EVs do not fall under a specific vehicle type (ordinary cars are taxed at rates from 7 percent to 25 percent), they are treated as “others.” A second step would be a dual-tax basis system (half related to market price/cylinder capacity, fulfilling the ability-to-pay principle; and half related to energy-efficiency and emissions levels, fulfilling the polluter-pays principle applied to environmental taxation). According to the latter criterion, zero-emission EVs would be at least half tax-free. The criteria for modulating the latter half tax burden should derive from a combination of indices shown in Part VI above, that is, energy consumption, expressed in kJ/km, and vehicle emission levels, particularly carbon dioxide, expressed in kg of CO2/km, addressed by fair legislation that rewards the most efficient and less emitting vehicle.

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72. See id. art. 83. An individual’s income tax deductions in Brazil are quite few, such as self-employed professional’s expenses, taxpayers’ dependents (including alimony), medical expenses, educational expenses, and contributions to both public and private social security plans. Id.

73. Decreto No. 6.006, de 28 de Dezembro de 2006, Diário Oficial da União [D.O.U.] de 8.01.2007 (approving the table of IPI tax rates for electric cars) (Braz.).

74. Id.


76. See Decreto No. 4.317, de 31 de Julho de 2002. The criteria for modulating the latter half tax burden should derive from a combination of indices shown in Part VI above, that is, energy consumption, expressed in kJ/km, and vehicle emission levels, particularly carbon dioxide, expressed in kg of CO2/km, addressed by fair legislation that rewards the most efficient and less emitting vehicle.
den should derive from a combination of indices shown in Part VI above (energy consumption, expressed in kJ/km, and vehicle emission levels, particularly carbon dioxide, expressed in kg of CO₂/km), addressed by fair legislation that rewards the most efficient and lowest-emitting vehicles.\textsuperscript{77}

Japan also undertook studies to modernize vehicle taxation. Aside from an initial policy of subsidies\textsuperscript{78} to induce the purchase of EVs, the country has had a policy of reducing and exempting taxes on vehicles related to energy efficiency and reduction of emissions. Electric cars and hybrid cars have been exempted from the “national tax on the weight of vehicles,”\textsuperscript{79} while those running on fuels have been allowed to pay between 50 percent and 75 percent less taxes once they meet or pass fuel-efficiency and emission-reduction standards ahead of certain deadlines.\textsuperscript{80}

In September 2010, a new comprehensive vehicle taxation proposal was submitted to the government\textsuperscript{81} focusing on introducing the concept of emissions as a modulation factor for fair taxation in the global warming context.

As for PIS-COFINS (11.6 percent social contribution charged on gross revenues from vehicle sales), as an exception, EV taxation ought to be brought down from its present special rate to zero or at least to 3.65 percent, which is the ordinary rate\textsuperscript{82} for such taxation.

At the state level, the “ICMS” (VAT) on vehicles is established at a

\begin{itemize}
\item \textsuperscript{77} Similar legislation, though focused on emissions, has been implemented in some European jurisdictions. Portugal has significantly improved air quality standards as acknowledged by the recent OECD Environmental Performance Review 2011. “Overall, revenue from environmentally related taxes has stabilizes at a level below that of the late 1990s. . . . As explained below, reduced revenue from vehicle taxation in the 2000s is the main factor underlying this trend . . . . Following the 2007 reform, both the registration tax on vehicle purchases and the annual circulation tax are now differentiated on the basis of CO₂ emission levels and cylinder capacity, with the former gradually becoming more important.” ORG. FOR ECON. CO-OPERATION AND DEV., OECD ENVIRONMENTAL PERFORMANCE REVIEWS: PORTUGAL 2011 42 (2011).
\item \textsuperscript{79} Id.
\end{itemize}
general rate of 18 percent. The National Council for Tax Policy has allowed topic reductions of this rate under article 155, § 2, XII, “g” of the Constitution, to reduce the final tax burden on basic consumption food-stuff down to 7 or 8 percent of the respective consumer price.

States also charge an annual “IPVA” property tax on vehicles, ranging from 0.5 percent to 4 percent of the respective market value. Some states have already exempted EVs. It is proposed that all twenty-seven states proceed accordingly as a first step, as main Japanese prefectures, like Kanagawa, Kyoto, and Tokyo, have done; and then, as a second step, implement a dual tax-basis system (half related to market price, fulfilling the ability-to-pay principle; and half related to emissions, fulfilling the polluter-pays principle applied to environmental taxation). According to this latter criterion, zero-emission EVs would be at least half tax-free.

Municipalities charge two taxes which can be greened in favor of EVs: the annual property tax on urban real estate (2.8 percent tax on the market value of non-residential real estate in Rio de Janeiro, for example), and the service tax on the rendition of services in general (in Rio de Janeiro, rates usually range from 2 percent to 5 percent on the service price).

Taxes ordinarily imposed on real estate include those properties used as assembling plants, EV-charging stations, and EV workshops, and on related services rendered therein, respectively.

As a common practice, municipalities have granted ten-year-long property tax exemptions for strategic businesses interested in establishing in given cities. This tax expenditure can only be legitimate in view of predicted increases of economic activity, services, jobs, and income, thus


84. Id. at 3.


87. See Decreto No. 4.317, of 31 of Julho de 2002.


generating future growth of tax revenues. So it is proposed, in favor of the emerging EV industry, that exemptions be allowed for real estate involved with manufacturing and repairing EVs, as well as charging stations and workshops. Additionally, service tax exemptions ought to be granted to services surrounding the EV market, such as designing and repairs.

VIII. Final Remarks

In Brazilian cities with more than 500,000 inhabitants, the most significant cause of air pollution is pollution generated from automotive vehicles.

This is a situation to be addressed by efficient public policy. In federative Brazil, this means integrated federal, state, and municipal public policies.

Since the Brundtland Report (1987), produced in the wake of the 1972 UN Conference on the Environment, sustainable development has been the key concept for environmental policies worldwide. Brazil has constitutionally committed to such a trend as the country has signed several international conventions and protocols to this effect.

The Brazilian tax burden on EVs has been criticized and suggestions have been made in order to allow for EV production and consumption in line with the foregoing analysis. Brazilian tax laws inhibit technological innovation and research, new business activities, job generation, and future optimization of tax revenues; they now deserve tax incentives, among other public policy measures.

Because the Brazilian energy matrix is one of the cleanest in the world, meaning electrically powering EVs is not environmentally disruptive, and considering the momentum generated by the international events scheduled to take place in the country, such as the 2014 Fédération Internationale de Football Association (FIFA) World Cup and the 2016 Olympic Games, the authors believe the time has come for a Brazilian plan in favor of EVs, and that Rio de Janeiro must lead the movement.

It is not only a negative contribution to global warming that is at stake; it is the rescue of life itself, and of surmounting resource losses in an emergent economy. These goals have moved the authors to join in interdisciplinary research, in which non-fiscal taxation has proved to be a worthwhile measure.

90. “As to non-fiscal exemptions, they will only be legitimate if intended to protect constitutionally significant values such as relative equality, employment, soil productive occupation and development, environmental protection, etc., so as to enhance future well-being and increment of wealth as well the ability to pay taxes of those indirectly and teleologically targeted by them.” See José Marcos Domingues, Capacidade contributiva: conteúdo e eficácia do princípio [Ability to Pay: Content and Effectiveness of the Principle] 120 (2d ed. 1998).

With a solid technological basis, the right tax incentives may become a suitable tool in favor of socio-environmental awareness and responsibility. EV taxation in Brazil has proved to be a strong case in favor of such a public policy approach. The country urgently needs a green tax reform in favor of less pollution, especially in Brazil’s big cities where so many depend on public transportation.
Case Note
Developments in Anti-Corruption Law in Mexico: Ley Federal Anticorrupción en Contrataciones Públicas

Allie Showalter Robinson*

I. INTRODUCTION TO ANTI-CORRUPTION LAW AND ISSUES IN MEXICO

ACED with an ongoing battle against corruption, the Mexican government recently adopted the Ley Federal Anticorrupción en Contrataciones Públicas (LFACP), which was published in the Diario Oficial on June 12, 2012.1 The new legislation illustrates the Mexican government’s continued commitment to fight corruption. Additionally, the country’s commitment coincides with growing international interest in the country’s emerging markets as countries everywhere try to “combat [ ] the lingering ill effects of worldwide recession.”2 But, there remain numerous questions about the ability of the LFACP to adequately address the issues of corruption on the national and local level and whether the new legislation will lead to increased investigation and prosecution of incidents of corruption within the country. Furthermore, there exist international concerns about the level of corruption in the wake of the recent Wal-Mart bribery investigation in Mexico. In analyzing the anti-corruption legal developments in Mexico, it is important to consider the legal importance of anti-corruption laws both in Mexico and internationally, the three major international anti-corruption conventions Mexico has joined, and how the changes in the new legislation affect and advance prior Mexican anti-corruption laws and international obligations.

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1. Ley Federal Anticorrupción en Contrataciones Públicas [LFACP] [Anti-Corruption in Public Contracts Law], Diario Oficial de la Federación [DO], 12 de Julio de 2012.

2. Frederick T. Stocker, MFRS, Alliance for Productivity and Innovation (MAPI), Surveying Mexico’s Anti-Corruption Landscape 2 (2012), available at http://www.mapi.net/system/files/PA-110_0.pdf (link to download the document).
II. LEGAL IMPORTANCE OF COMBATING THE CORRUPTION IN MEXICO

A. Statistics of Corruption in Mexico

Fighting corruption is a stated priority for the Mexican government and the international community. Mexico is the world’s fourteenth largest economy in terms of GDP and has shown “positive, albeit low, rates of growth” since 2006. With such a large and connected economy, it is important to note that the National Index of Corruption and Good Governance reported that Mexicans spent around 32 billion pesos based on 200 million identified “acts of corruption” in 2010. That expenditure is equivalent to an average “tax” of 14 percent on each Mexican family’s annual income. The report also found “Mexicans paid bribes in more than 10 percent of cases where they were accessing a range of public procedures or services.” Mexico ranked 100 out of 183 countries based on the perceived levels of public sector corruption. Furthermore, Mexico’s ranking in other important governance indicators has deteriorated between 2003 and 2009, including in Control of Corruption, Government Effectiveness, Voice and Accountability, and Political Stability and Rule of Law. Specifically, the World Bank’s Control of Corruption indicator has decreased every year since 2002, and fell from 51.2 in 2002 to 45.5 in 2011. That drop represents a decrease in the overall control of corruption while overall corruption increased. Additionally, APEC statistics show “Mexico ranks in the 25th to 50th percentile, meaning that more than half of the 213 countries surveyed are better at controlling corruption than Mexico is.” Furthermore, the World Bank’s International Finance Corporation ranks Mexico’s economy 48th in terms of ease of doing business.

5. APEC Procurement Transparency Standards in Mexico: Time to Engage the Private Sector 10 (Laura B. Sherman & Anna Nadgrodkiewicz eds., 2011) [hereinafter APEC Procurement Transparency Standards].
7. Stocker, supra note 2, at 5.
9. APEC Procurement Transparency Standards, supra note 5.
10. World Bank, Worldwide Governance Indicators: Country Data for Mexico, 1996-2011 7 (2011), available at http://info.worldbank.org/governance/wgi/pdf/c141.pdf. The scale ranges from zero to 100, with 100 being the lowest level of corruption. This decrease from 2002 to 2011, then, represents an increase in the country’s ability to control corruption.
11. APEC Procurement Transparency Standards, supra note 5.
B. Wal-Mart Bribery Scandal

Mexico has also recently gained international attention in the aftermath of the Wal-Mart bribery and corruption investigation that created new concerns for foreign investors about the level of corruption in Mexico.\(^{13}\) On April 21, 2012, The New York Times published a shocking article alleging that Wal-Mart, the country’s largest private employer, made regular payments to Mexican officials to expedite the construction of new stores in its campaign for ambitious growth in the country.\(^{14}\) Specifically, Wal-Mart de Mexico, the largest foreign subsidiary of the store, had been accused of keeping books and records of the payments to the third parties.\(^{15}\) According to the article, an internal investigation carried out by Wal-Mart “found a paper trail of hundreds of suspect payments totaling more than $24 million . . . [and] found documents showing that Wal-Mart de Mexico’s top executives not only knew about the payments, but had taken steps to conceal them from Wal-Mart’s headquarters in Bentonville, Ark[ansas].”\(^{16}\) The Secretaría de la Función Pública (SFP), in an official press release on April 25, 2012, stated it would begin an investigation through its Órganos Internos de Control (Internal Control Organs) and stated its commitment to the international anti-corruption conventions signed and ratified by Mexico.\(^{17}\) The shocking front-page story of the alleged Wal-Mart corruption and bribery scandal in Mexico and the United States sent concerns throughout Mexico and the international community.\(^{18}\) The Wal-Mart scandal became a key issue in the recent Mexican presidential election and resulted in a demand for a full investigation by the then president-elect, Peña Nieto.\(^{19}\)

Legal authorities in both the United States and Mexico have begun investigations that include Mexico’s Comptroller’s Office analyzing “a decade’s worth of federal paperwork and permits that Wal-Mart de Mexico obtained to open its stores and operate within the country.”\(^{20}\) Although the Comptroller’s Office has been criticized in its prior enforcement efforts, the Manufacturers Alliance for Productivity and Innovation (MAPI) Policy Analysis report pointed to two reasons why this investigation may lead to tough consequences for Wal-Mart: 1) Mexico chairs the “Group of 20” economic powers, and specifically co-chairs the anti-corruption panel, so there exists considerable international pressure

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14. Id.; Stocker, supra note 2, at 6.
16. Id.
18. See id.
20. Id. at 6.
on the success of the investigation; and 2) if the investigation is not properly handled, the scandal could negatively affect foreign investment in the Mexican economy. It is unknown how the LFACP law will affect the Mexican government’s ability to investigate the issue and penalize Wal-Mart. But, it appears the LFACP may be quickly put to use in the aftermath of the scandal’s international attention.

C. IMPORTANCE OF PUBLIC PROCUREMENT IN MEXICO

Because the LFACP deals specifically with Public Procurement, it is also important to understand the significant role of public procurement in the Mexican economy. In 2008, the Ministry of Public Administration stated there were 70,230 registered federal procurement contracts that were worth $59 billion, and these public sector activities “constituted about 18.4 percent of Mexico’s GDP . . . .”22 The “general rule” is that public procurement be conducted through open competitive tender, and “the legal framework stipulates that public procurements must be governed by criteria such as open access, open competition, equal opportunity for tender participants, and fair dispute resolution in all stages of the process.”23 The high percentage of GDP involved, along with the government’s commitment to fairness and openness in the process, demonstrate that procurement is important to Mexico’s economy and its handling of corruption issues. A look at international efforts to combat corruption is also important to analyze the potential effects of the LFACP.

III. BEFORE THE LFACP: ANALYZING EXISTING ANTI-CORRUPTION LAWS AND TREATIES

A. GLOBAL PERSPECTIVE AND INTERNATIONAL CONVENTIONS

The development of Mexico’s anti-corruption laws has occurred simultaneously with the country’s participation in a “global anticorruption movement.”24 The global focus on corruption provides an insightful framework for analyzing the LFACP’s potential effects on corruption in Mexico and the extent to which Mexico fulfills its commitments to various international conventions. Mexico has signed and ratified three major international anti-corruption conventions: The Organization of American States (OAS) Inter-American Convention Against Corruption (ICAC),25 the Organization for Economic Co-operation and Development (OECD) Convention on Combating Bribery of Foreign Public Offi-

21. Id. at 8.
22. APEC Procurement Transparency Standards, supra note 5, at 11-12 (discussing the importance of procurement and procurement procedures in greater details).
23. Id. at 15.
cials in International Business Transactions, and the United Nations Convention Against Corruption. The Ley Sobre la Celebración de Tratados is the Mexican legal authority on international law, and the law requires Mexico to “implement a treaty’s provisions through national legislation” after “ratifications, accession, or acceptance.”

The ICAC was the “first international legal agreement for combating corruption,” and it required its members to “take judicial and public policy steps to prevent, detect, sanction, and eradicate corruption.” The law became effective in Mexico on July 1, 1997. Mexico next signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Sanctions on July 26, 1999. The OECD Convention’s purpose is “to assure a functional equivalence among the measures taken by the Parties to sanction bribery of foreign public officials, without requiring uniformity or changes in fundamental principles of a Party’s legal system.” The OECD Convention is largely considered to be the “impetus” for leading the way in anti-corruption legal reform and changing legislation across the world regarding business transactions. The most recent international convention entered into by Mexico was the United Nations Convention Against Corruption (UNCAC) that became binding on the country on December 14, 2005.

Among global developments in anti-corruption measures, the OECD, the Federal Competition Commission (CFC), and the Mexican Institute of Social Security (IMSS) signed the Memorandum of Understanding on the Implementation of the Guidelines for Fighting Bid Rigging in Public Procurement in 2011. As the third largest public buyer of goods and services in Mexico, IMSS sought help from the OECD to help them

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28. See Ley Sobre la Celebración de Tratados [Law on the Adoption of Treaties], Diario Oficial de la Federación [DO], 2 de enero de 1992; Stocker, supra note 2, at 10.

29. Stocker, supra note 2, at 10; see OAS Convention Against Corruption, supra note 25.

30. Stocker, supra note 2, at 10.

31. Id. at 11; see OECD Convention, supra note 26.

32. OECD Convention, supra note 26, at 14.

33. Barbara Crutchfield George et al., The 1998 OECD Convention: An Impetus for Worldwide Changes in Attitudes Toward Corruption in Business Transactions, 37 Am. Bus. L.J. 485, 485 (2000). The requirement that bribery of foreign public officials was a criminal act in each signatory country was one example of a profound change resulting from the Convention.

34. Stocker, supra note 2, at 11; see UN Convention Against Corruption, supra note 27.

adopt best practices in combating corruption in the bidding process. This collaboration in confronting corruption represents an important step towards companies’ self-initiated compliance with anti-corruption laws in Mexico. Continued partnerships between companies and international institutions could represent a new attitude toward corruption within the Mexican business community.

Even with Mexico’s participation in international agreements to combat corruption, the Mexican and international business communities still have concerns that “adherence to various international conventions designed to combat corruption, domestic and foreign, has been widely viewed as insufficient . . . .” These concerns represent the view that “Mexico has been plagued by significant corruption problems that have posed obstacles for investing and doing business there.” The previous president, Felipe Calderón, grew increasingly concerned about the level of corruption, and his administration took steps toward “adopting legislation to combat corruption and ensure adherence to international conventions.” From this viewpoint, the LFACP illustrates Mexico’s attempt to join the global movements that have emerged over the past decade to take an overall harder position against corruption. Therefore, the LFACP represents needed legal reform in Mexican anti-corruption law.

**B. THE EXISTING LEGAL FRAMEWORK AND IDENTIFIED PROBLEMS IN PUBLIC PROCUREMENT**

Before the enactment of the LFACP, the Código Penal Federal (FCC), Mexico’s Federal Criminal Code, punished “certain crimes committed by public officers, such as bribery (cohecho), bribery of foreign public officials (cohecho a servidores públicos extranjeros),” influence peddling, and bid rigging. Violation of an anti-bribery provision in the FCC can lead to “imprisonment, fines, and dismissal of the involved public official.” Several other Mexican laws prohibit bribery of domestic officials, including the Ley Federal de Responsabilidades Administrativas de los Servidores Públicos (the Federal Law of Administrative Accountability of Public Officials), and the Ley Federal de los Servidores Públicos (the...
Federal Law of the Accountability of Public Officials). Additionally, Mexico has enacted a Freedom of Information type of law that functions as another tool in fighting corruption.

Before enactment of the LFACP, in the specific area of public procurement, there were concerns about the legal framework in Mexico. For example, the OECD Collusion and Corruption in Public Procurement Roundtable stated that Mexico’s procurement regulations “lack[ed] the incentives to promote competition,” and can create extra costs and increase the probability of corruption. The report looked at several occurrences of bid rigging and argued there exist continued concerns about procurement despite Mexican laws mandating “public tendering in government procurement.” Additionally, the report raised concerns that there is not enough emphasis on promoting a more competitive environment in the procurement process. Considering these inadequacies of Mexico’s public procurement laws, the new LFACP law is a significant addition to Mexican anti-corruption laws.

IV. THE NEW ANTI-PROCUREMENT LAW

A. CHANGES AND DEVELOPMENTS IN THE NEW ANTI-CORRUPTION LAW

Mexico’s obligations under international treaties, the attention of the recent Wal-Mart corruption scandal, and overall statistics and concerns about corruption resulted in the LFACP and additional proposed changes to the Ley Federal de Responsabilidades Administrativas de los Servidores Públicas. The LFACP aims to “not only punish individuals involved in corrupt acts, but will also reward individuals who report cases of corruption,” while setting out clear procedures. One of the main features of the new law is the scope of its application to “domestic or foreign individuals,” legal entities like corporations, and all members of the government, including officials directly or indirectly participating in federal public contracting procedures. The statute makes it illegal for these entities “to give or offer to give, directly or through a third party, to a government official any type of bribe or gift to obtain or retain a privilege or

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43. Id. The Ley Federal de Responsabilidades Administrativas de los Servidores Públicos “applies general anti-bribery standards to all federal public officials,” which includes basically any official “who handle[s] or appl[i]es federal public resources.”
44. Id. at 13.
46. Id. at 248.
47. Id. at 253.
48. APEC Procurement Transparency Standards, supra note 5, at 11.
49. Id.
50. Stocker, supra note 2, at 13-14. The public officials who are accountable are defined in Title Four of the Mexican Constitution, which is further regulated by the Federal Law of Administrative Accountability of Public Officials. See Constitución Política de los Estados Unidos Mexicanos [C.P.], as amended, Titulo Cuarto, Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.).
improper business advantage when procuring public contracts with the federal government.”51 Much like the Foreign Corrupt Practices Act (FCPA) in the United States, the LFACP prohibits “individuals and companies from bribing foreign . . . government officials,” which includes non-Mexican government officials.52

Additionally, the new law contains a more expansive definition of the “territorial requirement” than the requirements of the Federal Criminal Code.53 The act of “federal public contracting” includes “procedures, prior acts, or acts that derive from contracting, entering into, and the execution and performance of contracts dealing with acquisitions, leases, services, and public works and related services, that are undertaken by [various types of] contracting public institutions.”54 Importantly, liability or sanctions can be imposed even if the “conduct occurs through a third party or the money or gift is not accepted.”55 The third-party liability addition in the LFACP is interesting considering the potential third-party issues in the pending Wal-Mart case.

Equally important to the scope of the LFACP is the framework for enforcing the law. The law can be enforced by several Mexican agencies, including the Ministry of Public Administration (the Ministry).56 Additionally, the Anti-Corruption law “regulates the procedure for imposing sanctions and charges the Ministry . . . with the responsibility for conducting investigations and sanctions under the law.”57 The Ministry may begin investigating an allegation of corruption based on its direction alone, or from “a sworn statement filed by a government entity, public servant or person with relevant knowledge.”58 Enforcement of the law is a two-step procedure that begins with the initial investigation and concludes with administrative proceedings, and the law grants authorities a broad ability to request information that may otherwise be considered confidential.59 At the end of the investigation, a party being investigated is given fifteen days to respond and a decision can be made as quickly as forty days “from the closing of the evidentiary phase.”60 The LFACP also introduced new fines for violations of the law that includes fines ranging between $5,000 to $250,000 for individuals, and between $50,000 to $10 million for companies, plus the possibility of being disbarred for up to ten years.61 Additionally, companies who self-report can “receive up to a seventy percent reduction in sanctions.”62

51. Stocker, supra note 2, at 13.
53. Stocker, supra note 2, at 14.
54. Id.
56. Stocker, supra note 2, at 14.
58. Id.
59. Stocker, supra note 2, at 14.
60. Barrera et al., supra note 38, at 2.
61. Stocker, supra note 2, at 14.
62. Id.
An additional component of the LFACP is focused on encouraging companies and individuals to create “policies and procedures for self-regulation, internal controls, and ethics programs in order to promote and develop a compliance culture within their organizations.” These programs stress the importance of the international conventions Mexico has joined. Furthermore, the law “gathers into a single statute . . . the actions or omissions which constitute corruption,” and appears to demonstrate the country’s attempt to compile and simplify the anti-corruption laws. From this view, the LFACP will hopefully lead to less confusion about what compliance looks like for both foreign and domestic individuals and entities. Lastly, an important addition to Mexico’s anti-corruption laws is the clear “legal obligation of public officials to report corruption,” and is representative of a desire to increase the amount of reporting in the country.

B. POTENTIAL IMPROVEMENTS TO THE LFACP AND THE NECESSITY OF ENFORCEMENT

Although the LFACP makes numerous additions to Mexico’s anticorruption legal framework, various organizations and legal analysts have raised potential problems with the LFACP. For example, the Phase 3 Report on Implementing the OECD Anti-Bribery Convention in Mexico states numerous shortfalls of the new legislation. One shortfall of the LFACP is that “the law does not cover the full range of foreign bribery as required by the [OECD] Convention” because it only deals with “foreign bribery committed by Mexican nationals in connection with public procurement.” On the other hand, the new legislation does include and cover a broad definition of “foreign bribery committed by Mexican nationals in connection with public procurement.” Although the law introduced new and more stringent fines, individuals still “cannot be punished by incarceration because the Bill is not criminal in nature.” Additionally, the OECD report raised concerns about the investigative powers of the LFACP, the lack of coordination between law enforcement bodies, and the lack of supporting case law. Specifically, the OECD Report noted that when bribery cases are opened “the Mexican authorities do not appear to have investigated and prosecuted them with priority and urgency.” The report stated that “relatively few criminal domestic bribery cases” are reported, and of those reported “only 28 [percent] resulted in prosecution.” The report relied on the fact that there have

63. Id. at 15; see supra notes 25-27.
64. Barrera et al., supra note 38, at 1.
65. Id.
66. OECD Phase 3 Report, supra note 3, at 8.
67. Id.
68. Id.
69. Id.
70. Id.
71. Id. at 20.
72. Id.
existed only two reported cases of foreign bribery since the publication that occurred in 2004 and 2005. Because those investigations are still ongoing, the new law’s effect on increased reporting and sanctioning of bribery is yet to be seen. The results of the report indicate the LFACP’s enactment will need to coincide with increased enforcement efforts by the Mexican government and officials for the new legislation to have a significant effect on corruption and bribery in the country.

In a separate analysis of legal mechanisms for preventing and combating corruption, the OAS conducted a visit to Mexico as part of its “peer mechanism” (MESICIC) for analyzing compliance with the OAS Convention. The results of the visit called for the following improvements: strengthening “inter-institutional coordination”; streamlining the time between decisions and the administration of punishments; “strengthening the units responsible for the investigation and prosecution of acts of corruption;” and increasing efforts to issue new regulatory provisions. The MESICIC also recommended strengthening the legal framework by adding to existing legislation the protection of whistleblowers, and this is acknowledged as an area of progress that has been made through the new LFACP. This area of progress is vital in “persuad[ing] the private sector to support anti-corruption efforts, mainly through encouraging reporting acts of corruption.” Additionally, APEC conducted a Private Sector Consultation that resulted in agreement that Mexico’s procurement regulatory framework “is generally of high quality and more than adequate,” but at the same time identified two key problems in the area: “different levels of development between legislation at the federal and state levels; and [t]he need to make timely regulatory changes whenever legislative amendments are made.” The two problematic areas stem from the complexities of procurement laws in Mexico and the amount of resources required by individuals and companies to comply with public procurement laws. The report suggests the LFACP will be a meaningful addition to the Mexican legal framework, but will only result in a decrease in corruption if there is simultaneous compliance with the legal framework, increased investigation and prosecution of bribery cases, advertisement of procurement opportunities, open participation, and fair

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73. Id. at 7, 18. According to the OECD Phase 3 Report, the two reported bribery cases cited were ongoing at the time of the report and do not involve “complex, corporate bribery schemes.”


76. OAS Anti-Corruption Newsletter, supra note 74, at 1-2.

77. MESICIC, supra note 75, at ii, 12.

78. Id. at 12.

79. APEC Procurement Transparency Standards, supra note 5, at 24-25.

80. Id. at 25.
In conjunction with the LFACP legislation, additional changes will likely be necessary. Interestingly, the newly elected President Peña Nieto knows he needs to emphasize combating corruption due to his party’s problematic history with respect to corruption. The emphasis on corruption is necessary because the legal framework appears relatively strong, but problems “persist in the country’s enforcement of [the anti-corruption] laws.” An example of the President’s attention to corruption was seen in his promise to “breach the monopoly of Mexico’s state-owned energy giant, Petroleos Mexicano (PEMEX),” due to its estimated $2 billion loss per year from fuel theft. PEMEX is frequently alleged to have high levels of corruption, and is a great starting point for the new President to address corruption concerns through the LFACP.

V. CONCLUSION – THE UNKNOWN EFFECT OF THE LFACP IN COMBATING CORRUPTION IN MEXICO

Mexico is making progress combating corruption through legislative reform and increased compliance with international conventions. But, Mexico still needs considerable improvement in implementing and enforcing the LFACP. Mexico will likely attract a greater number of foreign investors in the future if it is able to effectively enforce the LFACP. Additional legal reform could be necessary, as evidenced by the recommendations made by MESICIC, MAPI, and the OECD, but legal reform is futile without increased enforcement of the law’s stricter sanctions. The LFACP is likely to deter future acts of corruption if it is implemented fully on both the local and national level, and there is an overall increase in compliance efforts by companies conducting business in Mexico.

The effect of the LFACP on anti-corruption law in Mexico is not yet known. As the Wal-Mart bribery scandal remains unresolved, Mexico has an opportunity to show the international community that it is committed to strengthening its corruption laws and prosecuting individuals who violate the LFACP. As the statistics concerning the level of corruption in Mexico demonstrate, there is ample opportunity to enforce and utilize the new anti-corruption law in Mexico, but only time will demonstrate whether the LFACP enables Mexico to more adequately fulfill the country’s stated commitment of combating corruption.

81. Id. at 25-26.
82. Stocker, supra note 2, at 8-9.
83. Id. at 10.
84. Id. at 9.
85. Id.
86. See, e.g., Transparencia Mexicana, supra note 6.
Updates
ARGENTINA’S ECONOMIC TROUBLES: DEBT AND THE IMF

Fernando Avelar*

N recent times, Argentina has had several economic troubles that have all stemmed from a recession that began at the turn of the 21st century,¹ rooted even farther in the past.² Whatever the original cause, Argentina is currently faced with new economic troubles and potential sanctions by the International Monetary Fund (IMF).³ Argentina faces financial trouble in the form of a highly devalued Argentine peso and lawsuits against it for failure to pay outstanding bonds that were defaulted on in 2002.⁴ In addition to Argentina’s financial troubles, Argentina has to deal with warnings by the IMF for failure to provide adequate economic reports and the IMF has implied that more severe sanctions are in line if Argentina fails to comply.⁵

I. 2002 DEBT DEFAULT STILL HAUNTS ARGENTINA

One of the more recent disputes that has arisen involving Argentina deals with outstanding bonds that were defaulted on back in the early 2000s, which was the largest default by a sovereign nation in history.⁶ After the 2002 debt default, Argentina began the process of restructuring its debt and refinanced most of it to a more manageable level and a steep

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Approximately 93 percent of the bondholders agreed to swap out the defaulted debt for new restructured debt. The 93 percent of bondholders who accepted the restructured debt did so with a huge discount to Argentina because the new bond swaps are only paying 25 to 29 percent of what the initial bonds paid. The holdouts who refused to take the significant drop in payment and demanded a better payment sued Argentina in U.S. courts at various times between 2009 and 2011.

These lawsuits occurred because Argentina previously declined to pay the holdouts any money. Argentinan stated that it would only pay money to those bondholders who accepted the new bond swaps and that it would refuse to pay the holdouts. The U.S. Second Circuit disagreed with Argentina’s position in NML Capital, Ltd. v. Argentina, and ordered Argentina to pay the holdout bondholders.

In NML Capital, the Second Circuit focused on an equal treatment provision (i.e., a “pari passu clause”) that was written into the initial bond contracts that obligated Argentina to treat all bondholders equally. According to Judge Parker from the Second Circuit, the equal treatment provision “bars Argentina from discriminating against [bondholders’] bonds in favor of bonds issued in connection with the restructurings and that Argentina violated that provision by ranking its payment obligations on the defaulted debt below its obligations to the holders of its restructured debt.” This case affirmed the lower court’s ruling and enforced the lower court’s order by Judge Griesa, which called for $1.3 billion to be deposited into an escrow account to be used to pay the holdouts. The problem with this order, at least from Argentina’s point of view, is that the Argentine government is due to pay the restructured debt bondholders a minimum of $3.3 billion in principal and interest in December of 2012. Part of the order from Judge Griesa includes barring payments by Argentina to the holders of restructured debt until payment of the $1.3 billion is made to the holdouts. If Argentina ultimately refuses to pay the holdouts, the “U.S. courts could [potentially] embargo payments to the creditors who accepted the debt restructurings,” which would ulti-

7. Popper & Bas, supra note 4.
8. Id.
10. NML Capital, Ltd. v. Argentina, 699 F.3d 246, 253 (2d Cir. 2012).
12. Id.
13. NML Capital, Ltd., 699 F.3d at 250.
14. Second Circuit Orders Argentina to Pay $1.33 Billion to Bondholders, supra note 11.
15. NML Capital, Ltd., 699 F.3d at 250.
16. Id.; Popper & Bas, supra note 4.
17. Popper & Bas, supra note 4.
mately cause a technical default. Another default by Argentina on its bonds would likely cause economic and political turmoil in Argentina.

Argentina has not hidden its intent to refuse to pay the holdouts which are mostly hedge funds any of the money owed under the defaulted debt. Argentina has been using strong rhetoric against the hedge funds, calling them “vulture funds” because of their investments in distressed sovereign bonds. After the court ruling, the Argentine Economic Minister wrote on Twitter, “[w]e shall not pay a single dollar to the vulture funds.”

Even though no material decisions have been made by Argentina, it is already feeling the pressure from the ruling, as Fitch Ratings has downgraded Argentina’s credit rating. Fitch Ratings cut Argentina’s credit rating down to CC, which means a “default by Argentina is probable.”

The financial market responded to the credit rating decrease with a 13 percent decrease in Argentine dollar bonds.

In October 2012, another event raised financial market concerns about Argentina’s economic well-being. The governor of Chaco, a province in Argentina, paid U.S. dollar-denominated bonds in Argentine pesos. This was frowned upon by the financial markets because of how devalued the Argentine peso is compared to the U.S. dollar, and in effect, the province paid less than what was owed because of the way the two currencies are valued. The exchange rate that was used to calculate the equivalent of the U.S. dollar amount due in Argentine pesos was the official rate, but the official rate does not take inflation into account. The unofficial rate, which does take inflation into account, is valued approximately 20 percent higher than the official rate. On October 16, just a few weeks after payment was made by the Chaco governor, the U.S. dollar sold for $4.73 Argentine pesos when using the official rate, but the unofficial rate was $6.20 Argentine pesos, which meant that the bondholders were underpaid.

Chaco was forced to pay in Argentine pesos because it was unable to

21. Id.
22. Id.
23. Porzecanski, supra note 18.
24. Id.
25. Id.
27. See Argentina Vows to Honor Bond Maturity Of $200M Amid Market Fears of Default, supra note 4.
29. Id.
30. See Argentina Vows to Honor Bond Maturity Of $200M Amid Market Fears of Default, supra note 4.
purchase dollars at the regulated exchange market in Argentina.\textsuperscript{31} Argentine President Cristina Fernández de Kirchner has started to ration hard currency and enact trade barriers to increase the central bank’s international currency reserves, which are used to pay the Argentine government’s creditors.\textsuperscript{32} Chaco’s payment in pesos triggered a “massive Argentine securities selloff” based on the fear that other Argentine provinces would follow Chaco’s lead.\textsuperscript{33} The securities selloff prompted the Argentine Central Bank to issue a statement guaranteeing that all provinces will be sold enough dollars to cover their debts notwithstanding the restrictions in place.\textsuperscript{34}

If the above is any indication as to how financial markets react to the idea of Argentine default, then a technical default that could be triggered by the \textit{NML Capital} order would likely lead Argentina into a recession like the one in the early 2000s.

\section*{II. IMF WARNS ARGENTINA}

On September 17, 2012, the IMF board held a meeting to discuss whether Argentina had met its obligation to report some of its economic figures.\textsuperscript{35} Argentina has been the target of increased criticism over the years for alleged under-reporting of inflation and exaggerated economic growth figures.\textsuperscript{36} As a member of the IMF, Argentina has a duty to make accurate economic reports.\textsuperscript{37} But, as of September 17, the IMF was not satisfied with the numbers reported by Argentina.\textsuperscript{38}

Under Article IV of the IMF’s Articles of Agreement, Section 3 allows the IMF to survey the exchange rate policies of members.\textsuperscript{39} In order for the IMF to do this, the member country “shall provide the [IMF] with the information necessary for such surveillance, and, when requested by the [IMF], shall consult with it on the member’s exchange rate policies.”\textsuperscript{40} In addition, Section 5 of Article VIII gives the IMF the power to require national data from a member country in order for the IMF to effectively discharge its duties.\textsuperscript{41}

Despite the IMF requirements for its members, Argentina seems to consistently provide inaccurate national data figures. For example, Argentina has reported its annual inflation rate at 10 percent, but private

\begin{itemize}
\item \textsuperscript{31} Parks, \textit{supra} note 26.
\item \textsuperscript{32} \textit{Id.}
\item \textsuperscript{33} \textit{Argentina Vows to Honor Bond Maturity Of $200M Amid Market Fears of Default}, \textit{supra} note 4.
\item \textsuperscript{34} Radicella, \textit{supra} note 28.
\item \textsuperscript{35} \textit{IMF Warns Argentina}, \textit{supra} note 3.
\item \textsuperscript{36} \textit{Id.}
\item \textsuperscript{38} \textit{IMF Warns Argentina}, \textit{supra} note 3.
\item \textsuperscript{39} IMF Articles, \textit{supra} note 37, art. IV, § 3.
\item \textsuperscript{40} \textit{Id.}
\item \textsuperscript{41} \textit{Id.} art. VIII, § 5.
\end{itemize}
economists have said that it is actually 24 percent.\textsuperscript{42} The well-known newspaper, \textit{The Economist}, published an article in February 2012 explaining why it would no longer publish the figures provided by Argentina’s National Institute of Statistics (INDEC).\textsuperscript{43} \textit{The Economist} explained that because the figures did not match reports by independent economists, it would no longer rely on INDEC’s numbers to provide data about Argentina.\textsuperscript{44}

Argentina’s erroneous reporting dates back to 2007,\textsuperscript{45} which suspiciously coincides with the time period in which Argentine President Kirchner began to replace the personnel at INDEC in order to “improve operations.”\textsuperscript{46} The government also fined several researchers as much as 500,000 Argentine pesos each for reporting inflation rates that were above the official data.\textsuperscript{47} As a result of these figures being consistently under-reported, the IMF warned Argentina that it had until December 17, 2012 to respond to the IMF’s concerns about the data.\textsuperscript{48} The IMF also stated that depending on Argentina’s response on December 17, the IMF Executive Board would review the issue and take any additional steps necessary according to IMF procedures.\textsuperscript{49}

The procedures that the IMF refers to are located in the IMF Articles of Agreement. Under Article XXVI, when a member does not fulfill its obligations under the Articles of Agreement, the IMF may declare the violator ineligible to use the IMF’s resources.\textsuperscript{50} The resources mentioned refer to several different funds that are available to the member-countries to use to overcome economic difficulties or to combat poverty levels in developing countries.\textsuperscript{51} Article XXVI further provides ways to sanction members who persist in their failure to fulfill their obligations, including temporary suspension from the IMF\textsuperscript{52} and expulsion from the IMF completely.\textsuperscript{53}

\begin{itemize}
  \item[44.] \textit{Id.}
  \item[45.] \textit{Id.}
  \item[47.] \textit{Id.}
  \item[48.] Press Release, \textit{Int’l Monetary Fund}, Statement by the IMF Executive Board on Argentina (Sept. 18, 2012).
  \item[49.] \textit{Id.}
  \item[50.] IMF Articles, supra note 37, art. XXVI, § 2(a).
  \item[52.] IMF Articles, supra note 37, art. XXVI, § 2(b).
  \item[53.] \textit{Id.} art. XXVI, § 2(c).
\end{itemize}
III. MEDIA CONTROLS

The people of Argentina have not remained silent. Kirchner was re-elected last year, but only by a narrow margin, receiving 54 percent of the vote. On November 8, 2012, the people of Argentina showed their discontent when they took to the streets for massive demonstrations. The demonstrators—estimated to be between 250,000 and 500,000 people—rallied together to show their discontent with inflation, corruption, and media control.

The ruling party’s principal opposition, the Radical Civic Union, has been weak for more than a decade since Argentina’s recession in the early 2000s. Because of this opposition vacancy, Argentina’s media conglomerate Clarin has taken its place as Kirchner’s primary political opponent. Kirchner has responded to Clarin’s opposition by pushing an anti-monopoly media law against Clarin that will effectively result in the dismantling of Clarin by requiring it to sell most of its broadcast stations in addition to its Cablevision network.

Clarin sought an injunction, challenging as unconstitutional a key article in the media law that limits the number of media stations a company can own. The night before Clarin’s December 7 deadline to present a plan to reduce its holdings, an Argentinian court granted the injunction. The injunction will suspend Clarin’s deadline until a lower court rules on whether the article in the media law is consistent with the Argentine constitution. The agency representing the government in the action had previously taken the position that the judges presiding over the case were being impartial because they had accepted benefits from Clarin and sought to recuse them.

Argentina’s economic troubles are many, but all seem to relate to common factors, such as the debt default of the early 2000s. People outside of Argentina have also increasingly pointed to Argentina’s current administration as borderline authoritarian because of how it has chosen to

56. Id.
57. Gilbert, supra note 54.
58. Id.
60. See id.; Jude Webber, Argentina Grants Clarin Late Reprieve, Fin. Times (Dec. 6, 2012, 12:36 AM), http://www.ft.com/intl/cms/s/0/f506d986-3fc6-11e2-9f71-00144fe1b6e0.html#axzz2ELNJJoeO (requires a subscription login).
61. See Grupo Clarin Wins Reprieve on Argentina Media Law, supra note 59; Webber, supra note 60.
62. Id.
63. Webber, supra note 60.
handle some of the country’s more pressing issues. The country’s current economic outlook is in a state of flux because many variables exist that could ignite and cause another recession, which makes investing in the country a risky situation. If Argentina is to overcome its financial challenges, then it must start by meeting its legal responsibilities without jeopardizing its integrity.

HIS article begins by briefly considering some of the recent changes to Canada’s immigration laws and their collateral effects. Next, the case of R. v. Prokofiew is discussed. This recent case involves an accused’s fundamental right to silence. Lastly, through the lens of Canada v. GlaxoSmithKline, the problematic gray area created by the current regulations on transfer pricing will be addressed.

I. RECENT CHANGES TO CANADA’S IMMIGRATION LAWS

On June 29, 2012, numerous changes to Canada’s Immigration and Refugee system were passed and received Royal Assent.1 The changes include provisions designed to stop foreign criminals and human traffickers from abusing Canada’s immigration system and to expedite the refugee claim process.2

Many of these changes focus on reducing the timeline on several components of the immigration system.3 The goal of the changes is ensure that Canada has a “fair and generous” immigration and refugee program, while at the same time ensuring “the safety and security of Canadians will be protected.”4

While the goal of these changes is noble and necessary, there are some collateral effects. For example, tougher conditions, like a two-year co-
habitation requirement, have been enacted to help curb marriage fraud. Clear evidence of widespread marriage fraud necessitated the stricter requirements.

A more controversial collateral effect involves the backlog of applications. Over the past several years, more applications have been submitted than can be processed. As a result, the number of unprocessed applications has been steadily increasing. The backlog is largely caused by applicants utilizing the Federal Skilled Worker program. This is the group of applicants that will likely suffer the most as a result of collateral changes to the immigration system.

The reality is clear, but it is also unfortunate. Canada cannot process all of the applications in its backlog in a reasonable amount of time, and these backlogged applications are diverting attention from more recent applicants who may be better qualified under the Federal Skilled Workers program.

The response was simply to delete all applications submitted before February 27, 2008. This change was made through a massive budget bill, which received Royal Assent on June 29th, 2012. Any fees that the applicants have paid can be returned, and the applicants may reapply. Citizenship and Immigration Canada expects that this reduction in the backlog will affect about 280,000 applicants. While this rather draconian approach alleviates the backlog problem, whether it was the best method remains to be seen.

II. R. v. PROKOFIEW: ARE FUNDAMENTAL RIGHTS REALLY FUNDAMENTAL RIGHTS?

In this case, only one codefendant of two testified. Counsel for the testifying codefendant asked the jury to consider the silent codefendant’s choice not to testify as evidence of his guilt. In short, he suggested that innocent people testify and guilty people do not.

6. Id.
8. Id.
9. Id.
11. Id.
This case interprets a poorly worded provision in the Canada Evidence Act and finally sheds light on what it really means. But more importantly, it raises a question. The dissent is not arguing over the meaning of the Canada Evidence Act, but rather whether these improper arguments that mislead the jury should result in a new trial for the accused that chose not to testify.

A. The Facts

Before jumping into an analysis of the Court’s reasoning, a deeper look at the facts is necessary. This case was initially brought against three men charged with a fraudulent tax scheme.\(^{14}\) They were accused of generating sales tax through fictitious sales of heavy machinery and not remitting the tax to the government.\(^{15}\) The question for the jury was not whether this was a fraudulent scheme, but rather “whether [the] accused were aware of the fraudulent nature of the scheme.”\(^{16}\)

This is important to understand because, of the three original defendants, one defendant, Mr. Tulloch, pleaded guilty prior to trial, and another defendant, Mr. Solty, chose to go to trial and testify.\(^{17}\) The third defendant, Mr. Prokofiew, chose not to testify.\(^{18}\) Mr. Tulloch was a witness for the Crown, and both Mr. Tulloch and Mr. Solty testified that Mr. Prokofiew was the mastermind behind the scheme.\(^{19}\) The testimony of the coconspirators provided evidence that Mr. Prokofiew was conducting this scheme with fraudulent intent, and the strength of the Crown’s case depended on their credibility.\(^{20}\)

The real problem in this case arose when counsel for Mr. Solty argued that the jury should consider Mr. Prokofiew’s silence as evidence of guilt. Specifically, Mr. Solty’s counsel stated,

Peter Solty took the stand and told his story, warts and all. Ewaryst Prokofiew did not. Mr. Solty accused him of massive monetary fraud, and backed up that accusation with the hand-written invoices and other documentation that he provided to the police. What was Mr. Prokofiew’s response? Ask yourself why Ewaryst Prokofiew did not testify. Did he have something to hide or did he simply have no response that could help him since there is no point in trying to contradict the truth?\(^{21}\)

The trial judge felt these comments undermined Mr. Prokofiew’s right to a fair trial. He believed there was a “significant risk” that the jury would consider this argument and interpret Mr. Prokofiew’s silence as

\(^{15}\) Id.
\(^{16}\) Id. (emphasis added).
\(^{17}\) Id. at para. 107.
\(^{18}\) Id. at para. 1.
\(^{19}\) Id. at para. 107.
\(^{20}\) Id. at para. 106.
\(^{21}\) Id. at para. 51.
evidence of his guilt.22 The trial judge initially stated that he would provide the jury with a strong remedial instruction.23

The following day the trial judge found himself in a conundrum. Fully aware that there was a significant risk the jury would listen to Mr. Solty’s counsel and use Mr. Prokofiew’s silence as evidence of guilt, the judge determined he was constrained by section 4(6) of the Canada Evidence Act.24 Section 4(6) states: “The failure of the person charged, or of the wife or husband of that person, to testify shall not be made the subject of comment by the judge or by counsel for the prosecution.”25

The confusion is easy to understand. The pertinent section states that the judge cannot comment on the accused’s right to silence. The Court ruled that the Act does not prohibit the trial court from affirming the right to silence, but merely prohibits the trial judge from suggesting the jury consider the silence as evidence of guilt.26 Fully conceding the fact that a remedial instruction would have been proper in this case, the majority explained why this was not reversible error.

B. Why the Majority Erroneously Concluded This was Harmless Error

The majority arrived at its conclusion through a string of assumptions. First, the majority considered it significant that no one raised the prospect of severance.27 The assumption here was that if Mr. Prokofiew’s counsel, or the judge, thought that the risk was so great that the jury would consider the improper argument, they would have severed Mr. Prokofiew’s case from Mr. Solty’s.28

Second, the majority drew the assumption that the reason for not sev- ering the case was that Mr. Prokofiew’s counsel and the trial judge believed that they could give a proper instruction without actually telling the jury not to consider Mr. Prokofiew’s silence as evidence of guilt.29 Part of this assumption recognized that the counsel for Mr. Prokofiew argued in his closing that the Crown bore the burden of proof.30

The majority then drew from these facts the assumption that the jury understood that the Crown bore the burden of proof and therefore also understood that one’s silence is not evidence of guilt.31 Then it followed this up with a final assumption. The majority recognized that the instruction advised the jury they should ask the judge if they have any ques-tions.32 The majority assumed that the jury, which was faced with two

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22. Id. at para. 52.
23. Id. at para. 13.
24. Id.
27. Id. at para. 14.
28. Id. at paras. 14-15.
29. Id.
30. Id. at paras. 16, 19, 23-24.
31. Id. at paras. 21, 24.
32. Id. at para. 17.
conflicting statements of law, would have asked the judge for clarification if it was confused.\textsuperscript{33} The reasoning assumes that, because the jury did not ask the judge for clarification, the jury must not have been confused and understood that silence is not evidence of guilt.

The majority’s conclusion overlooks the fact that there is no evidence to suggest this line of reasoning is correct, and that the conclusion is wholly based on assumption and speculation. Moreover, common sense requires one to view the statement made by Mr. Solty’s counsel as logical. An ordinary jury would likely consider persuasive the logical fallacy that if Mr. Prokofiew were innocent he would have said something. The only thing that might dissuade the jury is a strong remedial instruction from the judge telling them they cannot consider his silence as evidence of his guilt.

The dissent’s opinion is based upon the simple fact that no one knew what the jury considered because it was free to consider Mr. Prokofiew’s failure to testify as evidence of guilt.\textsuperscript{34} As the dissent pointed out, trial judges “must take care to ensure that the right to silence becomes neither a snare nor a delusion.”\textsuperscript{35}

This is not merely a case of an accused being stripped of a fundamental constitutional right; the right was used to further the case against Mr. Prokofiew. An erroneous admission of hearsay evidence compounded this error.\textsuperscript{36} While this article has not addressed this portion of the case, the effect of multiple errors was significant as to why a new trial should have been granted. But the lack of a remedial instruction was, by itself, grounds for a new trial.\textsuperscript{37} Not only did the majority get this wrong, its opinion had the collateral effect of overruling longstanding precedent that holds “a trier of fact may not draw an adverse inference from the accused’s failure to testify and that the accused’s silence at trial may not be treated as evidence of guilt.”\textsuperscript{38}

C. Conclusion

The trial judge was aware of the “significant risk” posed by a lack of a remedial instruction. Substituting its own judgment, the majority found the jury probably did not consider Mr. Prokofiew’s silence as evidence of his guilt. The Canadian Charter of Rights and Freedoms provides:

Any person charged with an offence has the right . . . not to be compelled to be a witness in proceedings against that person in respect of the offence . . . [and] to be presumed innocent until proven guilty according to law in a fair and public hearing by an independent and

\textsuperscript{33} Id. at paras. 18-19.
\textsuperscript{34} Id. at paras. 92.
\textsuperscript{35} Id. at para. 94 (citing R. v. Noble, [1997] 1 S.C.R. 874, para. 72).
\textsuperscript{36} Id. at para. 112.
\textsuperscript{37} Id.
\textsuperscript{38} Id. at paras. 64-65 (citing Noble, [1997] 1 S.C.R. 874).
impartial tribunal.39

Interestingly, the majority did not cite to Canadian Charter of Rights and Freedoms in its entire opinion, it is only cited to by the dissent.40

The question of what rights an accused really has remains unanswered. It is ironic that the majority interpreted a poorly worded section in the Canada Evidence Act to be consistent with the Canadian Charter of Rights and Freedoms, while simultaneously ignoring the Charter’s plain language.

III. CANADA V. GLAXOSMITHKLINE INC.: TRANSFER PRICING AGREEMENTS

Recently, the Supreme Court of Canada decided the case of Canada v. GlaxoSmithKline Inc. While this case is about a vague concept of tax law called “titled transfer pricing,” it is nonetheless quite interesting. This case demonstrates two things: it shows how simple concepts can be very difficult to put into practice, and it illustrates how some economic theories are very elusive when an attempt is made to ground them in reality.

A. Transfer Pricing

The case involves a transfer pricing agreement. While the various methods that are used to calculate a transfer pricing agreement can be complex and require a fairly adept understanding of economics, the concept itself is simple. Transfer pricing is merely a term used to describe the prices that related parties use to trade “services, tangible property, and intangible property . . . across international borders.”41 For example, if Amcar, an American car manufacture, is selling cars to its Canadian subsidiary, Cancar, the price that the cars are sold for would be called the transfer price.42

The implications of such a transaction are obvious. Because the transaction is not an arm’s length transaction, the entities could be less focused on negotiating a reasonable price. Instead, they may be focused on setting up the transaction to ensure that, together, they pay the lowest tax possible.

The purpose of transfer pricing legislation is to ensure that parties to a transfer pricing agreement “report substantially the same amount of in-

42. This article cannot, in the limited space provided, explain in any amount of detail the nuances of transfer pricing. For a more in-depth introduction to Canadian Transfer Pricing, see Mark Kirkey, An Introduction to Transfer Pricing in Canada: Avoiding Double Taxation, GOWLINGS 76-80, http://www.gowlings.com/resources/PublicationPDFs/Kirkey_IntroTransfer.pdf (last visited Feb. 26, 2013).
come as they would if they had been dealing with each other at arm’s length.” Canada’s legislation embraces the arm’s length principle. The reasonableness of the transaction is judged by whether the agreement would be substantially the same if the parties would not have been related entities and the transaction had, instead, been an arm’s length deal.

The concept is not new. Since 1939, Canada’s Income Tax Act has provided that a company involved in transfer pricing may be reassessed the difference between the price paid and the price that would have been paid if the transaction had been made at arm’s length. The statute that was applicable to the reassessment years in Canada v. GlaxoSmithKline Inc. states:

Where a taxpayer has paid or agreed to pay to a non-resident person with whom the taxpayer was not dealing at arm’s length as price, rental, royalty or other payment for or for the use or reproduction of any property, or as consideration for the carriage of goods or passengers or for other services, an amount greater than the amount (in this subsection referred to as “the reasonable amount”) that would have been reasonable in the circumstances if the non-resident person and the taxpayer had been dealing at arm’s length, the reasonable amount shall, for the purpose of computing the taxpayer’s income under this Part, be deemed to have been the amount that was paid or is payable therefor.

While the concept of transfer pricing regulation is simple, the mechanics of these types of transactions are extremely complex. Dealing with the potential enforcement of transfer pricing regulations can be very costly for companies that are selected for examination. This is widely regarded as a gray area of tax law. The Canada Revenue Agency recognizes this and states, “transfer pricing is not an exact science.”

Despite the difficulty and seeming subjectivity of auditing a transfer pricing agreement, audits do occur and cases like GlaxoSmithKline arise.

Ever since the global recession began, the number of these audits appears to be on the rise. With less tax revenue available, countries appear to be growing more aggressive in auditing transfer pricing agreements and seeking to increase their tax revenue through these

43. Information Circular No. 87-2R, supra note 41, at para. 7.
44. Id.
46. Id. at para. 18 (quoting Section 69(2) of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)). While applicable to this case, Section 69(2) has since been repealed and replaced by Section 247(2) of the Income Tax Act.
48. See, e.g., Tammy Whitehouse, Tax Collectors Start Circling on Transfer Pricing, 7 Compliance Week 73 (Feb. 2010).
49. Information Circular No. 87-2R, supra note 41, at para. 34.
50. Whitehouse, supra note 48.
audits.\footnote{\textit{Id}.}

Canada recognizes several different methods to determine if the transfer price is what would have resulted from an arm’s length agreement.\footnote{\textit{Id.} at para. 48.} While there is not an explicit hierarchy of the methods, it is generally recognized that the taxpayer must use the most appropriate method in determining whether the transfer price is substantially the same as an arm’s length price would have been.\footnote{\textit{Id.} at para. 49.} This is a main cause of confusion. As the following case illustrates, the methods can be manipulated not only by the taxpayer, but also by the auditor.

\section*{B. The Facts of Canada v. GlaxoSmithKline Inc. and the Supreme Court’s Ruling}

In this case, Glaxo Group was selling a licensing agreement to GlaxoSmithKline Inc. ("Glaxo Canada") and requiring the Canadian subsidiary to purchase the active ingredient for Zantac from an approved supplier.\footnote{\textit{GlaxoSmithKline}, [2012] 3 S.C.R. 3 at para. 2.} The approved supplier was also a subsidiary of Glaxo Group.\footnote{\textit{Id.}} Other generic pharmaceutical companies purchased the active ingredient in the drug in arms-length transactions from other suppliers.\footnote{\textit{Id.} at paras. 4, 9.}

The contention arose when the tax assessor realized that the non-affiliated companies who were purchasing the active ingredient were doing so in arm’s length transactions for between $194 and $304 per kilogram. But Glaxo Canada was purchasing the active ingredient from a related company for $1,500 per kilogram.\footnote{See \textit{id.} at paras. 8, 9.} Superficially, Glaxo Canada’s transfer price would appear to be an artificially inflated price that would not have resulted if they were dealing at arm’s length with the supplier. But this is only the case if the supply price is considered in isolation.

In reality, Glaxo Canada was required to purchase the active ingredient in accordance with the licensing agreement.\footnote{\textit{Id.} at para. 49.} The licensing agreement, among several other things, granted Glaxo Canada the right to market the drug under the name Zantac.\footnote{\textit{GlaxoSmithKline}, [2012] 3 S.C.R. at para. 11.} The tax assessor did not agree that this was a factor that should be considered, but instead argued that the transaction should be viewed in isolation.\footnote{\textit{Id.} at para. 7.} The Tax Court largely agreed with the assessor and upheld the reassessment.\footnote{\textit{Id.} at para. 12.}

The specific methods are beyond the scope of this paper, but an understanding of these different methods is not necessary to comprehend that the tax assessor was wrong in this case. It is common knowledge that Zantac, like all name brand pharmaceuticals, sells for a higher price than
its generic counterpart. The rights conferred by the licensing agreement are without question a part of the price at which the active ingredient was being sold to Glaxo Canada.

The Supreme Court of Canada understood this, as did the Federal Court of Appeal, and held that the licensing agreement should be considered in determining whether the transfer price was reasonable. The Supreme Court offered a small amount of guidance before remanding the matter to the Tax Court for reassessment. The Court reminded the tax court that this was not an “exact science” and the reassessment should reflect business realities. While conducting the reassessment, the tax court should consider a broad range of circumstances as well as the respective roles of Glaxo Canada and Glaxo Group. Glaxo Group is the owner of the intellectual property, and Glaxo Canada is a secondary manufacturer. The Court appeared to be suggesting that, if Glaxo Group bore more risk in developing the product, this risk may be reflected in a higher profit margin and this should be taken into consideration.

The Court also pointed out that the statute uses the term “reasonable amount.” The statute allows for reassessment only when the transfer price is higher than what a “reasonable amount” paid would have been had the transaction been an arm’s length deal. The only question should be: could this be a reasonable price if this were an arm’s length deal.

C. Conclusion

The decision was correct, and the advice the Court gave should not be ignored, but the advice of the Court lacks specificity. This is not a failing by the Court, but rather an indication of just how uncertain this area of taxation is. Further, this case reveals a significant factor in transfer pricing. Specifically, that it is not realistic for one to ascertain an arm’s length price in a non-arm’s length deal. Alternatives need to be developed. Canada does offer the ability for a company to enter into an advance pricing agreement, whereby the transfer price would essentially be preapproved by the Canada Revenue Agency. But the average time required to complete a bilateral advance pricing agreement is currently reported to be forty-nine months.

62. Id. at paras. 14-16, 60.
63. Id. at para. 61.
64. Id. at paras. 61, 62.
65. Id. at para. 62.
66. Id. at paras. 61, 64.
67. Id. at para. 18 (quoting Section 69(2) of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)).
Companies incur a number of costs to ensure compliance with transfer pricing regulations, and those costs rise sharply if the company is audited.\textsuperscript{69} But these costs are not just allocated to the company. The government also incurs heavy costs to prosecute cases involving transfer pricing violations.\textsuperscript{70} The end result is economists arguing over something that is, to a large extent, subjective.

As the number of multinational companies continues to increase, the idea of tax dollars going to pay for an army of government economists grows more unappealing. Despite the seeming impossibility, a safe harbor should be considered, for the benefit of both companies and taxpayers.

The problems with transfer pricing regulations are not confined to Canada, and the issues implicated by the current system of transfer pricing need to be addressed on a global level. Thankfully, a system of safe harbors may soon be coming from the Organization for Economic Cooperation and Development (OECD).\textsuperscript{71} This possibility is partially motivated by the increasing enforcement costs of the various statutory regimes.\textsuperscript{72} Until the safe harbors are in place, every multinational company should aggressively fight reassessments. Perhaps by keeping enforcement costs high, a better and more reasonable method will emerge.

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{69} See, e.g., Durst & Culbertson, supra note 47.
\item \textsuperscript{70} Id.
\item \textsuperscript{71} Patricia Gimbel Lewis, \textit{United States: Safe at Last? Transfer Pricing Safe Harbors On The Horizon}, 21 TAX MGMT. TRANSFER PRICING REP. 9, 1 (2012).
\item \textsuperscript{72} Id.
\end{itemize}
\end{footnotesize}
NAFTA Updates and American Trade News Highlights for Fall 2012

Sarah Bridges*


The U.S.-Panama Trade Promotion Agreement (TPA or Agreement) went into effect on October 31, 2012, beginning a relationship the Obama Administration believes will create more opportunities for American businesses and more American jobs.\(^1\) While the significant reductions on tariffs have some U.S. exporters thrilled, some question Panamanian sincerity in enforcing labor standards and fear adverse effects to local markets.

A. SETTING THE STAGE — THE TRADE MARKET IN THE MODERN AMERICAS

The highly-specialized economies in the modern world have become increasingly and inevitably interdependent, leaving behind the days of self-sufficiency and closed-door tariff and taxation policies. The Western Hemisphere is no exception, nor the United States, as President Obama has commenced trade agreements with Colombia, Korea, and now, the Republic of Panama.\(^2\)

Panama claims one of the fastest-growing economies in the Americas, expanding over 6 percent in 2010 and projecting similar growth for the first half of the following decade.\(^3\) Not only is Panama’s market one of few Western economies rising steadily, its strategic location makes it a major shipping access route; two-thirds of the transits traveling through

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the Panama Canal are arriving at or departing from U.S. ports.\textsuperscript{4} Panama is not ignorant of its place in the global market—for example, it finalized a trade agreement with Canada in 2010\textsuperscript{5} and entered into an Association Agreement with the European Union on March 22, 2012.\textsuperscript{6} These and other competing markets’ increased exports to Panama have made the U.S. stake in this thriving cross-oceanic gateway much less secure. In actuality, given that U.S. industrial goods have faced tariffs as high as 81 percent in Panama, with agricultural goods facing tariffs of over 200 percent, a U.S. role in the Panamanian economy would not have been a possibility before the Agreement.\textsuperscript{7}

B. The Trade Agreement

1. Enacting the Agreement

The Caribbean Basin Initiative (Initiative) previously governed trade between Panama and the United States. The Initiative gave Panama great access to the U.S. market, but did not afford the United States equal treatment—for example, it allowed over 99 percent of Panamanian agricultural exports to enter the United States duty-free, but less than 40 percent of U.S. agricultural exports had the same access to the Panamanian market.\textsuperscript{8}

Negotiations for the TPA began under the Bush Administration in April of 2004\textsuperscript{9} and concluded in 2006.\textsuperscript{10} While the Panamanian government approved the Agreement in 2007, it took the United States considerably more time to issue its stamp of approval—the Agreement was not signed into law until October of 2011.\textsuperscript{11} Just as with the U.S.-Colombia Free Trade Agreement, U.S. congressional and executive committees expressed concern over the state of labor and environmental laws and lack of enforcement thereof in Panama.\textsuperscript{12} As such, Panama spent 2009 through 2011 enacting a series of legislative and administrative changes


\textsuperscript{5} Benefits of the U.S.-Panama Trade Promotion Agreement, WHITE HOUSE, http://www.whitehouse.gov/sites/default/files/panama_trade_agreement_benefits.pdf (last visited Dec. 22, 2012). The agreement, however, has not yet entered into force.

\textsuperscript{6} Key Facts, supra note 4.

\textsuperscript{7} Id.


\textsuperscript{10} Wheeler, supra note 1.

\textsuperscript{11} Id.

meant to strengthen its labor laws (considered in more detail below) and enforcement in a number of areas, including environmental protection. In addition to the Agreement, and in response to concerns regarding Panama’s tax structure, Panama and the United States entered into a Tax Information Exchange Agreement, discussed below, which is intended to enable each country to improve their tax information exchange networks on a global scale.

2. Content and Effects of the Agreement
   a. Generally

   The TPA itself is a significant liberalization of trade between the two countries—both in goods and in the service sector. Almost 90 percent of U.S. consumer and industrial exports to Panama became duty-free immediately, and what tariffs remain are to be phased out over the next decade. Over half of U.S. farm and ranch exports now enjoy duty-free status, including beef, soybeans, corn oil, almost all fruit products, wheat, and cotton; the majority of the remaining tariffs will be eliminated in the next fifteen years. The Agreement also provides for an expansion of Panamanian intellectual property laws and increased enforcement thereof, bringing such laws in line with U.S. standards. These protections will cover new and emerging technologies in software, music, and text, and are accompanied by a new electronic registration system for trademark maintenance.

   In addition to reducing barriers to the exchange of goods and services, the TPA opens doors for the United States to participate in over ten billion dollars’ worth of anticipated infrastructure projects in Panama—and that number does not include the Panama Canal expansion, which is projected to require over five billion dollars of equipment, materials, and labor. Eliminating tariffs in this area allows the United States to remain sufficiently competitive to participate in this project. The expansion project and Panama’s prime shipping location make the Agreement that

15. Id.
16. Key Facts, supra note 4. Those products that became duty-free upon enactment of the TPA include information technology equipment, agricultural equipment, construction equipment, environmental products, aircraft parts, medical equipment, pharmaceuticals, fertilizers, and agro-chemicals.
17. Farm and Ranch Benefits, supra note 8.
19. Id. Construction equipment exports to Panama formerly bore a 5 percent tariff—this was one of the duties eliminated immediately upon enactment of the Agreement.
much more essential to continued U.S. viability in the modern American market.  

b. Labor Provisions

In May of 2007, bipartisan action resulted in a U.S. Congressional-Executive agreement to incorporate increased labor standards into the country’s trade agreements. This sentiment is reflected in the 2007 report of the U.S. Executive Labor Advisory Committee for Trade Negotiations and Trade Policy addressing the primary drafts of the TPA. The 2007 report detailed concern that the TPA draft did not contain enforceable provisions requiring Panama to meet labor standards promulgated by the International Labor Organization, did not prevent Panama from weakening its local labor laws to increase competitiveness, and did not provide for sanctions or other fines to ensure compliance with labor standards. In response to U.S. concerns, Panama began strengthening its labor laws in 2009, particularly in the areas of subcontracting, temporary employment, employer interference with unions, bargaining with non-union workers, and strikes in essential services. These changes clarified existing laws, increased monitoring and enforcement thereof, and provided protections where none had existed.

The TPA commits both the United States and Panama to adopt, effectively enforce, and not waive fundamental labor rights. Both countries’ labor standards are to conform with the fundamental labor rights as stated in the 1998 International Labor Organization Declaration on Fundamental Principles and Rights at Work. The Declaration commits 185 member states of the International Labor Organization—a specialized agency of the United Nations—to respect and promote principles with regards to four categories of rights: freedom of association and the effective recognition of the right to collective bargaining, the elimination of forced or compulsory labor, the abolition of child labor, and the elimination of discrimination in respect of occupation. The Agreement’s labor obligations will be under the same level of accountability for dispute set-

22. LAC Report, supra note 12.
23. Id.
25. Id.
27. Id.
tlement as its commercial obligations, indicating the gravity of the U.S. appraisal of the state of Panama’s labor regime.\textsuperscript{30} Trade sanctions and fines are among the available remedies for violations of the labor obligations.\textsuperscript{31}


To cure U.S. hesitations regarding the transparency—or lack thereof—in Panama’s tax system, Panama and the United States signed a Tax Information Exchange Agreement (TIEA) approximately a year before the TPA went into play.\textsuperscript{32} In addition, Panama published two notable laws pertaining to tax transparency. Law 33, published in 2010, allows the Panamanian government to obtain and share information as needed to comply with international conventions—including the TIEA—even if the information obtained was not otherwise a domestic tax concern.\textsuperscript{33} The other is Law 2, the “Know Your Client” law, which deals with the Panamanian problem of anonymous accounts by requiring law firms that incorporate corporations to conduct due diligence in verifying the identity of the corporation’s owners, and mandates that they share that information with the government upon request.\textsuperscript{34} These changes, coupled with the TIEA, allowed the level of transparency required to ensure compliance with the TPA.

C. Pitfalls and Praises

1. Praises — Support for the Agreement

Reports issued by various advisory committees indicate full-fledged support for the TPA. The report issued by the Advisory Committee evaluating the Agreement’s effect on consumer goods was clearly positive, touting a unanimous agreement by the Advisory Committee that the Agreement “promotes the economic interests of the United States.”\textsuperscript{35} Not surprisingly, considering the immediate and long-term benefits to exports of various crops, livestock, and poultry, the Agreement was hailed by the reports of the Agricultural Policy Advisory Committee for Trade and the Animal and Animal Products Advisory Committee for Trade.\textsuperscript{36}

\begin{itemize}
\item \textsuperscript{30} Labor Protections, supra note 24.
\item \textsuperscript{31} Id.
\item \textsuperscript{32} U.S.-Panama Trade Promotion Agreement, supra note 3.
\item \textsuperscript{34} Id.
\item \textsuperscript{35} Industry Trade Advisory Committee on Consumer Goods (ITAC-4), The U.S.-Panama Trade Promotion Agreement 3 (2007), available at http://www.ustr.gov/archive/assets/Trade_Agreements/Bilateral/Panama_FTA/Reports/asset_upload_file907_11226.pdf.
The Animal and Animal Products Committee specifically approved of the immediate and phase-out tariffs, and proclaimed that the increased U.S. access for beef and poultry to the Panamanian market met international standards.  

In its initial report on the 2007 draft of the TPA, the Industry Trade Advisory Committee for Chemicals, Pharmaceuticals, Health/Science Products and Services felt the Agreement lacked intellectual property protection within its industry. Its May 2011 report on the TPA not only hailed the Agreement’s tariff provisions, but also stated:

The U.S.-Panama TPA requires high levels of intellectual property protection, consistent with U.S. standards of protection, and will support the growth of trade in digital and other intellectual property-based products. This Agreement provides protection for copyrighted works, stronger protection for patents and trade secrets and the high level of enforcement required provides tough penalties for piracy and counterfeiting.

2. Pitfalls — Criticisms of the Agreement

While some criticisms of early drafts of the TPA were quelled prior to its 2012 enactment, others persist. One area of frustration involves local concerns regarding specific markets. For example, North Carolina opposed the TPA, arguing that it would accelerate the loss of textile jobs in the state while failing to provide additional protection to its working population.

Additionally, several complaints lodged by the Intergovernmental Policy Advisory Committee pertaining to investment provisions were not cured by the ensuing final draft of the Agreement. The Committee complained that the definition of “investment” was overbroad and problematic, in that it was “far more expansive than NAFTA, includes concepts of ‘investment authorization,’ licenses, and permits, and is less linked to business enterprises.” The final TPA text disregards the Committee’s warnings, as the definition for that section of “investment” expressly includes “licenses, authorizations, permits, and similar rights conferred pur-

Agreements/Bilateral/Panama_FTA/Reports/asset_upload_file574_11222.pdf [hereinafter Animal Food Report].
41. Id. at 3.
suant to domestic law.”42 The Committee was also concerned over the use of unclear international standards to evaluate due process, rather than those based on the U.S. Constitution, as required by the Trade Act of 2002.43 Section 1 of Article 10.5 of the final text sets the standard for government protection of foreign investors as “in accordance with customary international law,” and provides further that the “customary international law minimum standard of treatment of aliens” is the minimum protection to be afforded investments under the Agreement, and that fair treatment and due process “do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights.”44 Essentially, the TPA provides that Americans investing in Panama’s sectors lose Constitutional protection and submit to vague standards of legal treatment that are not even the same as those offered by Panama to its own citizens.

II. CANADA EXPANDS ITS INFLUENCE IN THE WORLD MARKET

Under the Harper Government, Canada has made massive steps to secure its place in the global economy. In the last six years, for example, Canada secured trade agreements with nine countries: Colombia, Honduras, Jordan, Panama, Peru, Iceland, Liechtenstein, Norway, and Switzerland.45 Several of the key steps occurred in the fall of 2012, making the country a stand-out deserving of its own treatment. Not only did the country gain admission to negotiations in the Trans-Pacific Partnership, it, like the United States, made steps in a free trade agreement with Panama, and has recently tabled a free trade expansion with Chile.

A. CANADA JOINS THE TRANS-PACIFIC PARTNERSHIP NEGOTIATIONS

On October 9, 2012, Canada announced it had formally joined the Trans-Pacific Partnership (TPP) trade negotiations.46 The country’s joiner of the now-eleven nations was announced six months ago, but the member countries had to ratify the inclusion before Canada’s formal acceptance.47 The last hurdle was ratification by the United States, which

43. IPAC Report, supra note 40, at 2, 15.
44. United States-Panama Trade Promotion Agreement, supra note 42, at art. 10.5 (emphasis added).
46. Id.
completed its ninety-day Congressional consultation in early October.\footnote{57}

1. The Trans-Pacific Partnership

The TPP countries—the United States, Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, Mexico, and, now, Canada\footnote{56}—represent more than 650 million people and a gross domestic product exceeding 20 trillion U.S. dollars.\footnote{55} The partnership covers core topics traditionally found in such agreements, such as commercial goods, agriculture, and textiles, and also the more modern issues presented by intellectual property, technical trade barriers, and the environment.\footnote{54} But the TPP reaches beyond such topics, addressing “cross-cutting” issues typically excluded from trade agreements—encouraging compatibility in regulatory systems, for example, and helping small- and medium-sized businesses become more active in international trade.\footnote{53}

2. Canada Joins the TPP

According to the Canadian Minister on International Trade, “[o]pening new markets and increasing Canadian exports to fast-growing markets throughout the Asia-Pacific region is a key part of our government’s plan to create jobs, growth and long-term prosperity.”\footnote{52} The government sees the Asia-Pacific region as a priority market for Canadian exports.\footnote{51}

Canada was asked to join the TPP negotiations in June during the summit of leaders from the Group of Twenty nations in Mexico.\footnote{50} After the matter was submitted to member countries for approval, the Office of the U.S. Trade Representative held a public hearing on the matter of Canada’s participation,\footnote{49} during which the U.S. Trade Representative for Southeast Asia and the Pacific testified as to Canada’s likely role in regional economic stimulation.\footnote{48} Stakeholders representing multiple, different industries testified and raised topics for discussion relating to

\footnote{57} Andrew Mayeda, \textit{Canada Joins Trans-Pacific Partnership Trade Negotiations}, \textit{Bloomberg Businessweek} (Oct. 9, 2012 3:00 PM), \url{http://www.businessweek.com/news/2012-10-09/canada-joins-trans-pacific-partnership-trade-negotiations}.


\footnote{48} Id.
Canada’s joiner. Multiple hot button topics were discussed, some echoing the U.S. Trade Representative’s 2012 report on trade barriers to exports. Included in this report were over-arching problems, such as supply management, and also more specific issues, such as Canadian copyright and pharmaceutical patent regimes, provincial liquor board policies favoring Canadian wines, and dairy-related regulations that control and limit the ingredients and techniques of cheese-making. The U.S. poultry and egg industries were sore at Canada’s consider, pointing out the Canadian government’s long-standing assertion that it will maintain supply-management measures for dairy and poultry — largely consisting of matching production to domestic demand and levying large tariffs to discourage imports.

3. Looking Forward

As the U.S. Chamber of Commerce observed, despite these issues, “lowering tariffs, reducing non-tariff barriers to trade, and aligning regulatory measures could strengthen this relationship even further, acting as an ‘economic shot in the arm.’” As such, the United States approved Canada’s entry into the TPP, and Canada joined the other countries in December 2012 for the fifteenth round of negotiations in New Zealand. But it missed being heard in the prior rounds of negotiation, including the most recent in September 2012. As such, it will likely be expected to adopt decisions already reached by the other member countries. But, as one Canadian trade attorney put it, “the TPP has a long, long way to go and once Canada gets into the game in December we’ll have as much influence as any of the others in the remaining issues . . . and there are many still on the table.”

B. Canada’s Free-Trade Agreement with Panama Passes the House of Commons

The Canada-Panama Economic Growth and Prosperity Act (the Act) passed the Canadian House of Commons early in November, and, after
approval by the Senate, will be put forward for Royal Assent.66 Along with the Act, Canada and Panama negotiated the Canada-Panama Agreement on Environmental Cooperation and the Canada-Panama Agreement on Labor Cooperation.67

1. Background

In 2007, merchandise traveling between Canada and Panama totaled over 100 million dollars.68 Panama is the second largest importer of Canadian goods in Central America, after Costa Rica.69 Like the United States, however, Canadian exports to Panama far exceed its imports—for example, in 2007, its exports were valued at roughly four times its imports.70 Many of Canada’s exports to Panama mirror those of the United States, as discussed above, so ensuring free trade has become essential to the federal state.

The Canada-Panama market was formerly governed by a 1998 Foreign Investment Promotion and Protection Agreement (FIPA)—a bilateral agreement with the goal of promoting foreign investment through binding rights and obligations.71 The Investment portion of the Act will replace the existing FIPA, a move the Canadian government claims is “further locking in and expanding access for Canadian investors and their investments.”72

2. The Act

Negotiations for the Act began in 2008 and concluded in 2009, resulting in agreements on the terms of the Act as well as labor cooperation and the environment.73 Once fully approved by the Canadian government, the Act will immediately remove tariffs on greater than 90 percent of Canadian exports of goods to Panama.74 Like the United States, Canada also hopes to secure access to the government construction market in

70. Economic Analysis, supra note 68.
72. C-P FTA, supra note 67.
73. Id.
Panama. As discussed, this movement is in direct competition with the United States, making both countries’ recent actions all the more significant.

C. An Agreement to Expand Trade with Chile is Tabled in the House

The Minister of International Trade tabled an agreement to expand the scope of the existing Canada-Chile Free Trade Agreement (FTA) and bring it into the modern world. The amended agreement will contain a new chapter regarding financial services, essential to keeping Canada’s agreement with what it calls its “priority market” relevant. Prime Minister Harper and the Chilean President witnessed the signing of the amending agreement, which was tabled in the House of Commons for twenty-one sitting days in April of 2012.

Not only is Chile an importer of Canadian goods, it is one of many Central American countries that have become a prime spot for Canadian investment—eighth, in fact, among such countries. As such, this expansion could combine with the other movements of the Harper Government to increase Canada’s stance as a world player. A study is underway to assess the impact of the FTA expansion, but with multiple new or changing agreements underway, the Government anticipates it will be some time before enough data is available to measure the impact of these agreements.

III. NAFTA Updates

With all the evolving trade patterns and agreements in the Western Hemisphere, it is somewhat a surprise to report that all is relatively quiet on the North American Free Trade Agreement (NAFTA) front. Two developments are worth noting.

The Spring NAFTA updates reported on the NAFTA binational panel’s affirmation of the U.S. Department of Commerce’s holding in the administrative review regarding Carbon and Certain Alloy Steel Wire Rod from Canada, NAFTA Secretariat File Number USA-CDA-2008-1904-02. While the panel affirmed the Department’s holding that the

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75. Economic Analysis, supra note 68.
77. Id.
79. Harper Tables Agreement, supra note 76.
81. Id.
Canadian company made sales in the United States below its commodity’s normal value, it also remanded the case to have the Department explain its methodology in reviewing the company.\textsuperscript{83} In October 2012, the panel finally ended the seven-year case, affirming the Department’s methodology—specifically, its use of zeroing in calculating the commodity’s prices—and holdings.\textsuperscript{84}

Additionally, Golden Dragon, a Mexican producer and exporter of copper pipe, has requested panel review of the Department’s final determination regarding Seamless Refined Copper Pipe and Tube from Mexico in its New Shipper Anti-Dumping Review (the Report) spanning 2011 and 2012.\textsuperscript{85} The Report found Golden Dragon’s weighted-average dumping margin was over 5.5 percent (of the export price of the product), which was well above the 2 percent cut-off for ending an investigation due to de minimus dumping.\textsuperscript{86} As the Department’s determination will result in anti-dumping duties being levied on Golden Dragon, the company is seeking review through NAFTA’s binational panel review system. The NAFTA Secretariat has assigned Case Number USA-MEX-2012-1904-03 to this request.\textsuperscript{87}

\textsuperscript{83} Id.


\textsuperscript{87} Notice of First Request for Panel Review, 77 Fed. Reg. at 66,441.
PRESIDENT OBAMA’S BLUEPRINT FOR A CLEAN AND SECURE ENERGY FUTURE

The United States is on the path to a cleaner and more secure energy future. Since President Obama took office, responsible oil and gas production has increased each year, while oil imports have fallen to a 20 year low; renewable electricity generation from wind, solar, and geothermal sources has doubled; and our emissions of the dangerous carbon pollution that threatens our planet have fallen to their lowest level in nearly two decades. In short, the President’s approach is working. It’s a winning strategy for the economy, energy security, and the environment.

But even with this progress, there is more work to do. Rising gas prices serve as a reminder that we are still too reliant on oil, which comes at a cost to American families and businesses. While there’s no overnight solution to address rising gas prices in the short term, President Obama today reiterated his commitment to a sustained, all-of-the-above energy strategy and urged Congress to take up common-sense proposals that will further reduce our dependence on oil, better protect consumers from spikes in gas prices, and reduce pollution.

I. BACKGROUND: THE ENERGY SECURITY TRUST

The Obama Administration is calling on Congress to establish a new Energy Security Trust, which is designed to invest in breakthrough research that will make the technologies of the future cheaper and better – technologies that will protect American families from spikes in gas prices and allow us to run our cars and trucks on electricity or homegrown fuels.

The Energy Security Trust, which builds on a proposal supported by a broad bipartisan coalition including retired military leaders, will provide a reliable stream of funding for critical, breakthrough research focused on developing cost-effective transportation alternatives.

The President’s proposal sets aside $2 billion over 10 years and will support research into a range of cost-effective technologies – like advanced vehicles that run on electricity, homegrown biofuels, fuel cells, and domestically produced natural gas. The mandatory funds would be set aside from royalty revenues generated by oil and gas development in Federal waters of the Outer Continental Shelf (OCS), already included in the administration’s five year plan. These revenues are projected to in-

crease over the next several years based on a combination of leasing, production, and price trends, with additional revenues potentially generated as a result of reforms being proposed in the FY 2014 Budget. The Trust is paid for within the context of the overall budget.

Paired with other Administration policies, including our historic new fuel economy standards, the Trust would help solidify America’s position as a world leader in advanced transportation technology.

For example, the Environmental Protection Agency (EPA) has released a new report that underscores the progress we have made to improve fuel economy, save American families money at the pump, and reduce carbon pollution that contributes to climate change. According to the report, from 2007 to 2012, EPA estimates that CO2 emissions have decreased by 13 percent and fuel economy values have increased by 16 percent. In addition, compared to five years ago, consumers have twice as many hybrid and diesel vehicle choices, a growing set of plug-in electric vehicle options, and a six-fold increase in the number of car models with combined city/highway fuel economy of 30 mpg or higher.

The Energy Security Trust builds on this historic progress, continuing to increase momentum towards a cleaner, more efficient fleet that is good for consumers, increases energy independence, and cuts carbon pollution.

II. PRODUCING MORE AMERICAN ENERGY

President Obama is committed to an “all-of-the-above” approach that develops all American energy sources in a safe and responsible way and builds a clean and secure energy future. That’s why the President’s plan:

- **Challenges Americans to double renewable electricity generation again by 2020.** In order to double generation from wind, solar, and geothermal sources by 2020, relative to 2012 levels, the President called on Congress to make the renewable energy Production Tax Credit permanent and refundable, which will provide incentive and certainty for investments in new clean energy. Instead of continuing century-old subsidies to oil companies, the President believes that we need to invest in the energy of the future. During the President’s first term, clean energy tax incentives attracted billions of dollars in private investment in almost 50,000 clean energy projects, creating tens of thousands of jobs. Permanent extension keeps the momentum building, while creating new jobs in clean energy.

- **Directs the Interior Department to make energy project permitting more robust.** Last year, the President set a goal to permit 10,000 megawatts of renewables on public lands – a goal the Interior Department achieved. But there is more work to do. That is why the Department is continuing to take steps to enable responsible development of American energy on public lands. In support of this work, the President’s Budget will increase funding for energy programs of the Bureau of Land Management by roughly 20 percent.
A significant share of these resources will support better permitting processes for oil and gas, renewable energy, and infrastructure, including the transition to an electronic, streamlined system for oil and gas permits that will significantly reduce the time for approval of new drilling projects. The Department will also propose more diligent development of oil and gas leases through shorter primary lease terms, stricter enforcement of lease terms, and monetary incentives to get leases into production.

- **Commits to safer production and cleaner electricity from natural gas.** Our domestic natural gas resources are reducing energy costs across the economy – for manufacturers investing in new facilities and families benefiting from lower heating costs. This abundant, nearly 100-year resource can support new jobs and growth, but there are steps we should take to make this growth safe and responsible. The President’s budget will invest more than $40 million in research to ensure safe and responsible natural gas production. And as part of a $375 million investment in cleaner energy from fossil fuels, the President’s budget includes significant funding for clean coal technology and a new $25 million prize for the first, natural gas combined cycle power plant to integrate carbon capture and storage.

- **Supports a responsible nuclear waste strategy.** Under President Obama’s direction, the Energy Department created a Blue Ribbon Commission on America’s Nuclear Future to recommend how to manage the challenges associated with nuclear waste storage and disposal. After careful consideration of the Commission’s input, the Administration has issued a strategy for action in response to the recommendations and looks forward to working with Congress on implementing policies that ensure that our Nation can continue to rely on carbon-free nuclear power.

### III. INVESTING IN ENERGY SECURITY

During the President’s first term, the United States cut foreign oil imports by more than 3.6 million barrels per day, more than under any other President. To ensure that we continue on a path towards greater energy security, the President’s plan:

- **Sets a goal to cut net oil imports in half by the end of the decade.** Increased production of domestic oil, natural gas, and biofuels, and improvements in the fuel economy of our cars and trucks allowed the United States to cut imports of oil by almost one-third since 2008. To build on this progress, the President will direct new policies and investments to set us on a course to cut net oil imports in half by the end of the decade, relative to 2008 levels.

- **Commits to partnering with the private sector to adopt natural gas and other alternative fuels in the Nation’s trucking fleet.** Private sector investments are building natural gas fueling infrastructure across the United States just as natural gas vehicle research is mak-
crease over the next several years based on a combination of leasing, production, and price trends, with additional revenues potentially generated domestically abundant fuel and other alternative fuels in the transportation sector in a way that benefits our planet, our economy, and our energy security: putting in place new incentives for medium- and heavy-duty trucks that run on natural gas or other alternative fuels, providing a credit for 50 percent of the incremental cost of a dedicated alternative-fuel truck for a five-year period; supporting research to ensure the safe and responsible use of natural gas; and funding to support a select number of deployment communities: real-world laboratories that leverage limited federal resources to develop different models to deploy advanced vehicles at scale.

IV. MAKING ENERGY GO FARTHER ACROSS THE ECONOMY

Cutting the amount of energy we waste in our cars and trucks, in our homes, buildings, and in our factories, will make us a stronger, more resilient, and more competitive economy. Improvements in energy efficiency are critical to building a clean and secure energy future. To advance this priority, the President’s plan:

- **Establishes a new goal to double American energy productivity by 2030.** The President has set a goal to cut our economy’s energy waste in half over the next twenty years. More specifically, the Administration will take action aimed at doubling the economic output per unit of energy consumed in the United States by 2030, relative to 2010 levels. This includes a new Energy Efficiency Race to the Top challenge; building on the success of existing partnerships with the public and private sectors to promote energy efficiency; and continuing investments in technologies that improve energy productivity and cut waste.

- **Challenges States to Cut Energy Waste and Support Energy Efficiency and Modernize the Grid.** Modeled after a successful Administration approach in education reform designed to promote forward-leaning policies at the State-level, the Budget includes $200 million in one-time funding for Race to the Top performance-based awards to support State governments that implement effective policies to cut energy waste and modernize the grid. Key opportunities for States include: modernizing utility regulations to encourage cost-effective investments in efficiency like combined heat and power, clean distributed generation, and demand response resources; enhancing customer access to data; investments that improve the reliability, security and resilience of the grid; and enhancing the sharing of information regarding grid conditions.

- **Commits to build on the success of existing partnerships with the public and private sector to use energy wisely.** Over the next four years, the President is committed to accelerating progress on energy
productivity including through the Better Buildings Challenge, improving energy data access for consumers through the “Green Button” initiative, and making appliances even more efficient - saving consumers money, spurring innovation, and strengthening domestic manufacturing.

- **Calls for sustained investments in technologies that promote maximum productivity of energy use and reduce waste.** The President’s Budget expands applied research and development of innovative manufacturing processes and advanced industrial materials. These innovations will enable U.S. companies to cut manufacturing costs, enhance the productivity of their investments and workforce, and reduce the life-cycle energy consumption of technologies, while improving product quality and accelerating product development.

V. INTERNATIONAL LEADERSHIP

The Administration has worked not only to strengthen our energy security at home, but also around the world. In concert with our domestic actions, we have pursued a robust international agenda that:

- **Leads efforts through the Clean Energy Ministerial and other fora to promote energy efficiency and the development and deployment of clean energy.** Our efforts have helped to accelerate the global dissemination of energy-efficient equipment and appliances through the Super-Efficient Equipment and Appliance Deployment (SEAD) Initiative, improved energy savings in commercial building and industry through the Global Superior Energy Performance Partnership (GSEP), and supported the large-scale deployment of renewable energy through the 21st Century Power Partnership.

- **Works through the G20 and other fora toward the global phase out of inefficient fossil fuel subsidies.** Inefficient subsidies exact a steep toll on our economies, our energy security, and our environment, and the United States is leading efforts internationally to accelerate progress in eliminating them.

- **Promotes safe and responsible oil and natural gas development.** The Administration has worked to promote safe and responsible oil and natural gas production through initiatives like the Energy Governance and Capacity Initiative, which provides technical and capacity building assistance to countries that are on the verge of becoming the world’s next generation of oil and gas producers, and the Unconventional Gas Technological Engagement Program, which works to help countries with unconventional natural gas resources to identify and develop them safely and economically and can support switching from coal to cleaner-burning natural gas.

- **Updates our international capabilities to strengthen energy security.** We are working with the International Energy Agency (IEA) and others to ensure that our international institutions and processes reflect changes in global energy markets.
• Supports American nuclear exports. We are providing increased support for American nuclear technology and supply chains to promote safe, secure, low-carbon nuclear power growth in countries that are pursuing nuclear energy as part of their energy mix.”