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# Acceding to the WTO: Advantages for Foreign Investors in the Ukrainian Market

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Probably no other topic of international economic law has recently sparked such a strong disagreement between industrialized and developing worlds on the one hand, and businessmen and environmentalists on the other, as that of international investment regulation.[1] The problems of direct investment in the global setting reflect all controversies, irregularities and even antagonisms inherent in the highly diverse modern world with an increasing gap between the planet's richest and poorest countries.[2] By and large, the dispute on international investment is a dispute between two worlds over the issues of economic dominance and political sovereignty.[3]

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1. *See* Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?* 34 INT'L LAW. 1033, 1033 (2000) (stating that "the increasing integration of global business through both international trade and foreign direct investment" has raised many social issues, such as "protection of the environment, observance of minimum labour and human rights standards, and development of the least developed countries and regions"); Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1015–28 (1997) (discussing the dispute between the developed and developing nations over the regulation of international investment); *see also* Charles N. Brower and Lee A. Steven, *NAFTA Chapter 11: Who Then Should Judge?: Developing the International Rule of Law under NAFTA Chapter 11*, 2 CHI. J. INT'L L. 193, 197 (2001) (noting that NAFTA has received criticism from many nations and different organizations).

2. According to the World Development Report, the rich countries are becoming wealthier than ever, while poor underdeveloped countries are living in misery. The world's wealthiest country in 1999, Luxembourg, had a per capita GNP of $44,640 with 3.8% annual growth; at the same time, the poorest country, Sierra Leone, had a $130 per capita GNP with annual decline of 8.1%. World Bank's WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 275, 310 (2001); *see also* Sofia Wu, *ROC Emerges As World's 17th Largest Economy*, CENT. NEWS AGENCY, Sept. 14, 2000 (stating that according to a 2000–2001 World Development Report, "the United States remained the world's No. 1 economy, with its GNP reaching US $8.35 trillion; followed by Japan, with a GNP of US $4.08 trillion; and Germany, with GNP of US $2.08 trillion"); Robert Wade, *Winners and Losers*, ECONOMIST, Apr. 28, 2001 (noting that there is a rising income inequality between the nations).

3. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1015–20 (1997) (discussing the fact that the dispute over foreign direct investment is one between the developed and developing nations of the world); David Schneiderman, I*nvestment Rules and the New Constitutionalism*, 25 LAW & SOC. INQUIRY 757, 767 (2000) (noting that the dispute between developed and developing nations is split between the two hemispheres); *see also* Mark B. Baker, I*ntegration of the Americas: A Latin Renaissance or a Prescription for Disaster?*, 11 TEMP. INT'L & COMP. L.J. 309, 318 (1997) (stating that "the degree of economic integration in the Northern Hemisphere is significantly different than in the Southern Hemisphere.").

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as well as a debate on the limits of human expansion into natural life on the earth.[4] Nations have sought a resolution to these two core problems for at least the past 50 years.[5] Many poor countries lack resources to recover from stagnation and thus view foreign investment as the only major source of financing.[6] Unsurprisingly, the World Bank states that opportunities for developing countries require encouraging effective foreign investment and that "[i]nvestment and technological innovation are the main drivers of growth in jobs and labor incomes."[7] It is increasingly recognized that foreign direct investment ("FDI") is an important component of an effective strategy to develop solutions to the global economic crisis, in part because it creates a flow of non-debt equity into developing countries and promotes sustained growth and employment.[8]

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4. *See* Judith Kimerling, *International Standards in Ecuador's Amazon Oil Fields: The Privatization of Environmental Law*, 26 COLUM. J. ENVTL. L. 289, 314 n.69 (2001) (noting the fear that increased environmental protection will lead to decreased foreign investment); David A. Ring, *Sustainability Dynamics: Land-Based Marine Pollution and Development Priorities in the Island States of the Commonwealth Caribbean*, 22 COLUM. J. ENVTL. L. 65, 106 (1997) (commenting that countries often forsake environmental protections in order to encourage foreign direct investment). *See generally* Robin L. Cowling, *Pic, Pops and the Mai Apocalypse: Our Environmental Future as a Function of Investors' Rights and Chemical Management Initiatives*, 21 HOUS. J. INT'L L. 231, 278–79 (1999) (discussing the various studies that analyze the link between foreign investment and the environment).

5. *See* Pedro A. Malavet, *The Foreign Notarial Legal Services Monopoly: Why Should We Care?*, 31 J. MARSHALL L. REV. 945, 948 n.13 (1998) (citing THE INT'L AND COMP. LAW CENTER OF THE SOUTHWESTERN LEGAL FOUND., PRIVATE INVESTMENTS ABROAD: PROBLEMS AND SOLUTIONS (1959–1993) as an annual publication that has existed since 1959 which analyzes the various problems and international solutions to foreign investment). *See, e.g.*, E.I. NWOGUGU, THE LEGAL PROBLEMS OF FOREIGN INVESTMENT IN DEVELOPING COUNTRIES 33 (1965) (a book written over thirty years ago which addresses various nations' attempts at solving the problems of direct foreign investment). *See generally* Myron R. Morales, *Russian Customs Laws as Barriers to Foreign Direct Investment*, 9 CURRENTS INT'L TRADE L.J. 27, 35 (2000) (discussing various proposals to resolve problems of direct foreign investment).

6. *See* Mark B. Baker, *Integration of the Americas: A Latin Renaissance or a Prescription for Disaster?* 11 TEMP. INT'L & COMP. L.J. 309, 331 (1997) (encouraging Latin nations to place more emphasis on foreign investment). *See generally* World Bank, WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 57 (2001) (noting that "global economic advance, access to international markets, global stability, and technological advances are all [crucial] determinants of poverty reduction").

7. World Bank, WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 8 (2001) (stating that "expanding into international markets promotes economic growth in the developing countries"). *See* Bartram S. Brown, *Developing Countries in the International Trade Order*, 14 N. ILL. U. L. REV. 347, 396 (1994) (stating that "since massive additional transfers of foreign aid are unlikely" in the future, foreign investment will be "indispensable"); *see also* Richard Bernal, *Regional Trade Arrangements in the Western Hemisphere*, 8 AM. U. J. INT'L L. & POL'Y 683, 713 (1993) (noting that domestic reforms must be coupled with active participation in international trade).

8. *See* Ibrahim F. I. Shihata, *Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Investment Guarantee Scheme*, 21 INT'L LAW. 671, 674 (1987); Eric M. Burt, Note and Comment: *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1040–41 (1997) (noting the increased recognition of the importance of foreign direct investment); *see also* Giorgio Bernini, *Foreign Investments and Arbitration in the Frame of Globalization of World Economy*, 4 CROAT. ARBIT. Y.B. 83, 84 (1997) (commenting on the "growing awareness" of the importance of FDI).

## Introduction

The World Trade Organization ("WTO") was established with the primary goals of liberalizing the international economic régime, removing tariff and non-tariff barriers to cross-border trade and facilitating settlement of trade-related disputes arising between member states.[9] In May 2001, the WTO embraced 141 members; both industrialized and developing countries.[10] The WTO is a framework institution with the charge of administering multilateral agreements that deal with specific topics of international economic relations, such as reduction of tariffs and trade,[11] agriculture,[12] sanitary measures[13] and trade in textiles and clothing.[14] The shortest of these agreements, Agreement on Trade-Related Investment Measures ("TRIMs Agreement"), deals with an area of protection of foreign investment, the sphere *prima facie* out-

9. *See* John O. McGinnis & Mark L. Movsesian, *The World Trade Constitution*, 114 HARV. L. REV. 511, 530–31 (2000) (discussing the various reasons for establishing the WTO); *see, e.g.*, Kevin C. Kennedy, *Resolving International Sanitary and Phytosanitary Disputes in the WTO: Lessons and Future Directions*, 55 FOOD & DRUG L.J. 81, 82 (2000) (noting that the WTO allows nations to set food standards so long as these standards do not discriminate against foreign goods); *see also* Susan Tiefenbrun, *Free Trade and Protectionism: The Semiotics of Seattle*, 17 ARIZ. J. INT'L & COMP. LAW 257, 267 (2000) (noting that the "WTO acts as both a forum for negotiating international trade agreements and the monitoring and regulating body for enforcing the agreements").

10. *See* Susan Tiefenbrun, *Free Trade and Protectionism: The Semiotics of Seattle*, 17 ARIZ. J. INT'L & COMP. LAW 257, 267 (2000) (noting that WTO contains both "developing" and "developed" nations). *See generally* Richard Bernal, *Regional Trade Arrangements in the Western Hemisphere*, 8 AM. U. J. INT'L L. & POL'Y 683, 713 (1993) (discussing the Uruguay Round of the GATT); *Trading Into the Future: An Introduction to the WTO* (visited Nov. 1, 2001) <http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm> (listing all members of the WTO).

11. The General Agreement on Tariffs and Trade, October 30, 1947, 55 U.N.T.S. 188 (GATT). *See* Thomas J. Schoenbaum, *The Concept of Market Contestability and the New Agenda of The Multilateral Trading System*, AM. SOC'Y INT'L L. NEWSL. (1996) (noting that WTO, through its Committee on Trade and the Environment (CTE), addresses various trade-related issues); *see also* James L. Kenworthy, *US Trade Policy and the World Trade Organization: The Unraveling of the Seattle Conference and the Future of the WTO*, 5 GEO. PUBLIC POL'Y REV. 103, 104 (2000) (stating that the World Trade Organization was successful in the "reduction . . . of tariffs").

12. Agreement on Agriculture, Apr. 15, 1994, WTO Agreement, Annex VII, LEGAL INSTRUMENTS—FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, at 31 (1994). *See* Charlene Barshefsky, *US Trade Policy and the World Trade Organization: Feature Interviews: Interview with Ambassador Charlene Barshefsky, United States Trade Representative*, 5 GEO. PUBLIC POL'Y REV. 117, 121 (2000) (stating that the "WTO has agreed to open negotiations on agriculture"). *See generally* Judith Hippler Bello, *Decision: International Decisions*, 89 A.J.I.L. 772, 776 (1995) (discussing the WTO Agreement on Agriculture).

13. Agreement on the Application of Sanitary and Phytosanitary Measures, Apr. 15, 1994, Agreement Establishing the World Trade Organization, Annex XIV, LEGAL INSTRUMENTS—FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, at 69 (1994). *See* Kevin C. Kennedy, *Resolving International Sanitary and Phytosanitary Disputes in the WTO: Lessons and Future Directions*, 55 FOOD & DRUG L.J. 81, 81 (2000) (stating that "[i]nternational sanitary . . . standards have taken center stage at the World Trade Organization"); David P. Fidler, *Microbialpolitik: Infectious Diseases and International Relations*, 14 AM. U. INT'L L. REV. 1, 34–35 (1998) (analyzing the Agreement on the Application of Sanitary and Phytosanitary Measures).

14. Agreement on Textiles and Clothing, Apr. 15, 1994, AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION, ANNEX IA, LEGAL INSTRUMENTS—FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS, at 85 (1994). *See* Isabella D. Bunn, *Inerfaces: From International Trade To International Economic Law: The Right To Development: Implications for International Economic Law*, 15 AM. U. INT'L L. REV. 1425, 1464 (2000) (stating that the WTO tries to enact trading policies that are "less unfair" to developing nations).

side the scope of world trade.[15] This document attempts to address the problems that result from the imposition of restrictions on free cross-border flow of capital and restrictions on the establishment of commercial enterprises abroad.[16]

This research considers the case of the Ukraine, in light of its prospective accession to the World Trade Organization, as it strives to attract foreign investment but is not bound by multilateral international commitments. The main purpose of this research is to analyze the foreign investment régime under the WTO Agreements and spell out basic principles of protection of foreign investment by the TRIMs Agreement and related international agreements within the WTO framework. In addition, this article will analyze the possible impact of the accession to the WTO by Ukraine (currently not a member) on its national foreign investment régime, taking into account recent and current developments of the domestic law and investment policy.

Part I of this article is devoted to defining FDI, distinguishing between different modes of undertaking investment and discussing the role of FDI in the current globalization of the economic process. In addition, this part makes recourse to different economic theories of FDI and discusses their advantages and flaws.

Part II addresses international regulation of FDI, beginning with a brief discussion of the history of FDI regulation. While primarily focusing on WTO framework agreements, this section also mentions other sources of regulation of FDI, such as the "BITs" and "FIRA" cases. The particular emphasis of this part is on the TRIMs Agreement: its contents, its negotiating history, its place in the entire WTO framework, its relation to GATT 1994 and a discussion of its flaws. Finally, Part II briefly mentions a draft Multilateral Agreement on Investment ("MAI") and analyses the reasons for its failure.

Part III focuses on the national regulation of FDI in the Ukraine; discusses its current foreign investment laws; addresses difficulties foreign investors face in its market; and, in particu-

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15. Agreement on Trade-Related Investment Measures, April 15, 1994, AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION, ANNEX IA, LEGAL INSTRUMENTS—FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (1994). *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1034 (1997) (describing the Trade-Related Investment Measures (TRIMs) Agreement). *See generally* Frederick M. Abbott, *Symposium-Prevention and Settlement of Economic Disputes Between Japan and United States*, 16 ARIZ. J. INT'L & COMP. LAW 185, 205 (1999) (stating that "the Agreement on Trade-Related Investment Measures (TRIMs Agreement) sets forth certain basic principles regarding discriminatory measures affecting imports and exports, but it does not purport to establish general conditions of investment").

16. *See* Ibrahim F. I. Shihata, *Factors Influencing the Flow of Foreign Investment and the Relevance of a Multilateral Investment Guarantee Scheme*, 21 INT'L LAW. 671, 671 (1987) (noting the foreign investment, "operating under appropriate safeguards," can increase "economic growth and development" of a poor country). *See generally* John H. Jackson, THE WORLD TRADING SYSTEM: DEVELOPING COUNTRIES AND WORLD TRADE RULES, 278 (The Royal Institute of Internal Affairs Council on Foreign Relations Press 1990) (stating that GATT programs are designed to benefit the "developing countries"); World Bank, WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 8 (2001) (stating that "expanding into international markets promotes economic growth in the developing countries").

lar, discusses two of the most illustrative cases which involved foreign investors attempting to overcome restrictive practices of the government.

In conclusion, the author seeks to spell out his view on the actual and potential scope of the WTO agreements relating to investment regulation. In addition, this article considers a possible transformation in the government's approach to regulation of FDI with Ukraine's accession to the WTO.

## I. The Concept of Foreign Direct Investment

### 1. Globalization and Foreign Direct Investment

Globalization has become an integral part of corporate strategies in recent years, with FDI becoming an imperative rather than an opportunity.[17] Transnational corporations have increasingly recognized that in order to compete they must penetrate foreign markets; not only by import sales but very often by establishing physical presence overseas.[18] This is often accomplished by hiring local management and employees, thus bringing business closer to potential foreign customers.[19] Increased globalization calls for tighter economic cooperation in order to maximize the use of world resources, newly developed technologies and means of communication, and thus, ease cross-border transactions.[20] During the past decade, both developed and

17. *See* Organization for Econ. Co-operation and Dev., *World Investment Report 2000: Recent Trends in Foreign Direct Investment*, 76 FIN. MARKET TRENDS at 25 (2000); *Protection of Foreign Direct Investment in a New World Order: Vietnam—A Case Study*, 107 HARV. L. REV. 1995, 1995 (1994) (indicating the significance of FDI); *World Investment Report 1995. Transnational Corporations and Investment*, 90 A.J.I.L. 713, 713 (1996) (explaining that FDI has helped stimulate international economic growth).

18. *See* Stephen J. Canner, *The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 658 (1998) (discussing how companies that want to be competitive in foreign markets should establish a physical presence overseas, in part, to integrate themselves into the local fabric); *see also* Harvey S. James, Jr. & Murray Weidenbaum, *When Businesses Cross International Borders: Strategic Alliances and Their Alternatives*, 17 MD. J. INT'L L. & TRADE 259, 259 (1993) (discussing how the formation of trade blocs throughout the world has given rise to the necessity of overseas presence by corporations).

19. *See* Stephen J. Canner, *The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 658 (1998) (explaining the necessity for a "physical presence" for a business to be successful in foreign markets); *see also* David Schneiderman, *Investment Rules and the New Constitutionalism*, 25 LAW & SOC. INQUIRY 757, 759 (2000) (noting that an actual presence is an essential part of free trade); Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 118 (1998) (discussing the importance of a local presence for services in FDI).

20. *See* Stephen J. Canner, *The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 659 (1998); *see also* David Schneiderman, I*nvestment Rules and the New Constitutionalism*, 25 LAW & SOC. INQUIRY 757, 759 (2000) (indicating that FDI allows more benefits to be received from many resources). *See generally* Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 118 (1998) (discussing U.S. FDI in developing countries).

developing countries have been gradually liberalizing economic regulations, which traditionally restricted foreigners from entering domestic markets.[21]

The modern economic world rests upon two fundamental pillars: international trade and international investment.[22] As statistics prove, foreign direct investment grows faster than world trade and world output.[23] For example, in 1995, the growth of foreign direct investment exceeded the growth of exports by 18%, world output by 2.4% and domestic capital formation by 5.3%.[24] As compared with previous years, the level of foreign direct investment in the world has increased dramatically.[25] In 1995, inward foreign direct investment amounted to $182.6

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21. *See* Paul E. Comeaux & N. Stephen Kinsella, PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW XXII (1997) (noting that "[f]oreign markets are being re-opened to Western investment in many parts of the world, and this tendency is expected to grow"); Stephen J. Canner, *Exceptions and Conditions: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 658–59 (1998) (stating that recent global developments have demonstrated the need for international investment and how the liberalization of government regulations have facilitated the growth of international investments); *see also* Cheryl W. Gray and William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 3 (1995) (discussing that in the past decade many Central and Eastern European countries, which were historically isolated by government regulation, have opened their markets to foreign investment).

22. *See* Michael P. Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement on Investment?* 31 J. MARSHALL L. REV. 1202 (1998); Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 567 (1994) (considering that international investment is a necessary counterpart to international trade since one of the goals of foreign investment is to augment and make profitable domestic and export markets); *see also* Stephen J. Canner, *Exceptions and Conditions: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 659 (1998) (noting that trade and investment are correlative because as companies increase their foreign investments, they increase their domestic exports to maintain balance).

23. *See* Mary E. Footer, *GATT and the Multilateral Regulation of Banking Services*, 27 INT'L LAW. 343, 344 (1993) (noting that international banking has grown about 50% more than world trade and world output); Eric M. Burt, Note and Comment: *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1015–28 (1997) (noting the same); Susan Tiefenbrun, *Free Trade and Protectionism: The Semiotics of Seattle*, 17 ARIZ. J. INT'L & COMP. L. 257, 271 (2000) (discussing that statistical evidence indicates the growth of foreign direct investment is greater than the growth of world economic output).

24. *See* Michael P. Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement on Investment?* 31 J. MARSHALL L. REV. 1202 (1998); *Economic & Social Data*, The PRS Group, June 1, 2000 (showing that foreign investment in the Ukraine grew from $160 million to $270 million from 1994 to 1995); *see also Ukrainian President Declares New Stage of Relations*, INTERFAX NEWS AGENCY, Oct. 20, 1998, *available at* LEXIS (showing that by 1998, the annual increase in direct foreign investment was up to 50%).

25. *See* Mark B. Baker, *Integration of the Americas: A Latin Renaissance or a Prescription for Disaster?* 11 TEMP. INT'L & COMP. L.J. 309, 345 (1997) (discussing the dramatic increase in foreign direct investments shown in recent data); Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience From Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 3 (1995) (discussing the rise in foreign investments from their earlier small numbers); Philip Thornton, *US Slowdown Starts to Bite as CBI Reports Plunge in U.K. Export Orders*, THE INDEPENDENT (LONDON), Feb. 23, 2001, at 18 (noting that FDI reached a record $1.1 trillion in 2000).

billion and outward FDI was $203.1 worldwide.[26] In 1999, inward FDI hit the level of $865.5 billion, and outward FDI reached $799.9 billion.[27] And this growth seems to be even faster now. In 2000, foreign direct investment inflows by transnational corporations may have exceeded $1.1 trillion level, more than 14% over 1999.[28]

However, the contribution of different countries to this achievement still remains highly uneven.[29] The largest share of FDI belongs to traditional capital-exporting countries—the highest income economies.[30] In 1999, the inward investment share of those economies grew by 35% since 1996 and reached $684 billion; outward flows increased by 22% and amounted to $768 billion.[31] In 1999, United Kingdom companies were the largest outward investors, with

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26. *See* Simon Payaslian, *The United Nations and the Developing Countries in the 1990s*, 73 U. DET. MERCY L. REV. 525, 536–37 (1996) (stating that the worldwide total of foreign direct investment in the early 1990's was $500 billion); Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 114 (1998) (explaining that the breakdown of direct investment between inward and outward can be volatile); Cynthia Day Wallace, *Economic Commission for Europe, Geneva*, 86 A.J.I.L. 434, 435 (1992) (reviewing DEANNE JULIUS, GLOBAL COMPANIES & PUBLIC POLICY. THE GROWING CHALLENGE OF FOREIGN DIRECT INVESTMENT (1990)) (explaining that analyzing both inward and outward direct investment levels can help identify new opportunities in international business).

27. *See Slowdown in Foreign Investment Pace Expected this Year, U.N. Agency Says*, TORONTO STAR, Oct. 4, 2000, *available at* LEXIS (citing that global FDI inflows amounted to "$865 billion in 1999" while global FDI outflows totaled "$800 billion in 1999"); *Global Trade Expands Robustly*, NEW STRAITS TIMES (MALAYSIA), Oct. 28, 2000, at 3 (noting that global FDI outflows hit $800 billion in 1999); D Ravi Kanth, *UNCTAD Sees Dive In Investment Flows Into China This Year*, BUSINESS TIMES (SINGAPORE), Sept. 28, 1999, at 22 (noting the same).

28. *See* Philip Thornton, *US Slowdown Starts to Bite as CBI Reports Plunge in U.K. Export Orders*, THE INDEPENDENT (LONDON), Feb. 23, 2001, at 18 (noting that FDI reached a record $1.1 trillion in 2000); *Investment Flows Top $1 Trillion*, THE INDEPENDENT (LONDON), Dec. 8, 2000, at 23 (stating the 2000 levels of FDI inflows topped $1 trillion); Narendra Aggarwal, I*nvestors Pour US $1b Every Day Into the US*, THE STRAITS TIMES (SINGAPORE), December 8, 2000, at 14 (noting the same).

29. *See Asean Countries' FDI Flows Expected to Increase*, ASIA PULSE, November 29, 1999 (illustrating the disparity of the "outward FDI flow" among the member countries); *see also* Richard D. Robinson, *Transnational Corporations in World Development: Trends and Prospects*, 84 A.J.I.L. 639 (1990) (noting that uneven flow into FDI adds to financial disparity between "more-developed and less-developed countries"). *See generally* Xiaoqin Fan and Paul M. Dickie, *The Contribution of Foreign Direct Investment to Growth and Stability; Southeast Asia*, ASEAN ECON. BULLETIN, December 1, 2000, *available at* LEXIS (providing the analysis of "the contribution of FDI to growth within a growth accounting framework").

30. *See India Global Foreign Direct Investment Flows Grow at a Slower Rate*, THE HINDU, July 12, 1997, at a12 (noting the correlation between increased FDI flows and increased capital exports); *East Asia More Closely Tied to Japan*, BUSINESS TIMES (MALAYSIA), October 26, 1996, at 13 (noting that developed and capital-exporting countries receive the largest share of FDI); *Balance Of Payments 4th Quarter And Year 1999*, OFFICE FOR NATIONAL STATISTICS, Hermes Database, Mar. 27, 2000 (citing that in 1999 the United Kingdom invested $190.1 billion abroad).

31. *See Asean Countries' FDI Flows Expected to Increase*, ASIA PULSE, November 29, 1999, *available at* LEXIS (illustrating the disparity of the "outward FDI flow" among the member countries); *see also* Richard D. Robinson, *Transnational Corporations in World Development: Trends and Prospects*, 84 A.J.I.L. 639 (1990) (noting that uneven flow into FDI adds to financial disparity between "more-developed and less-developed countries"). *See generally* Xiaoqin Fan and Paul M. Dickie, *The Contribution of Foreign Direct Investment to Growth and Stability; Southeast Asia*, ASEAN ECON. BULLETIN, December 1, 2000, *available at* LEXIS (providing the analysis of "the contribution of FDI to growth within a growth accounting framework").

$199 billion invested abroad,[32] and being trailed by U.S. firms with $151 billion.[33] As the Organization for Economic Cooperation and Development ("OECD") pinpoints, some countries experienced an unprecedented level of inflows while others recorded historically high outflows during these three years.[34] Led by the United Kingdom, the primary means of foreign direct investment has remained mergers and acquisitions ("M&As"), especially between Europe and the U.S.[35] The main areas of foreign direct investment in industrialized countries remain the telecommunications and chemical industries, electricity and other public utilities, as well as the financial sector.[36] Growth of foreign investment inevitably and dramatically influences the nation-state system: Governments can no longer adopt political measures without affecting the economic interests of neighboring countries.[37]

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32. *See Balance Of Payments 4th Quarter And Year 1999*, OFFICE FOR NATIONAL STATISTICS, Hermes Database, Mar. 27, 2000 (citing that in 1999 the United Kingdom invested $190.1 billion abroad); *see also Investment: UN Forecasts Global Drop in 2001*, EUR. INFO. SERVICE, Sept. 22, 2001, section 2620 (citing the United Kingdom as the largest outward investor in 2000 amongst the members of the European Union). *But see* Stephen J. Canner, *Exceptions and Conditions: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 659–60 (1998) (stating that the United Kingdom trailed the U.S. in outward investment in 1996).

33. *See U.S. International Transactions, Fourth Quarter and Year 1999*, in 80 SURVEY OF CURRENT BUSINESS U.S. GOVERNMENT PRINTING OFFICE 146 (2000) (noting that the U.S. outwardly invested $152.2 billion in 1999). *See generally* Andrew Walter, NGOs, *Business, and International Investment: The Multilateral Agreement on Investment, Seattle, and Beyond; Non-Governmental Organizations*, 7 GLOBAL GOVERNANCE 51 (2001) (finding that the U.S. is the most influential outward investor). *But see* Stephen J. Canner, *Exceptions and Conditions: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 659–60 (1998) (stating that the U.S. was the largest outward investor in 1996).

34. *See Organization for Econ. Co-operation and Dev., World Investment Report 2000: Recent Trends in Foreign Direct Investment*, in 76 FIN. MARKET TRENDS 25 (2000); *The Cutting Edge*, ECONOMIST, Feb. 24, 2001, *available at* LEXIS (reporting levels of foreign direct investment for the U.S., the United Kingdom and other European countries); *see also Inflows Hit Peak*, THE INDEPENDENT, London, Nov. 11, 1998, at 21 (citing record levels of foreign direct investment inflows for 1997).

35. *See European Report: EU Dominates UN Annual Figures,* EUR. INFO. SERVICE, Oct. 7, 2000, *available at* LEXIS (citing that recent foreign direct investments are earmarked by the high presence of mergers and acquisitions); *Another World*, ECONOMIST (U.K. EDITION), Sept. 19, 1992, at 14 (finding a growth in foreign direct investment between the U.S. and foreign countries). *But see* Gene Koretz, *Where Did All the Suitors Go?*, BUS. WK., Sept. 10, 2001, at 34 (reporting a decrease in merger and acquisition inflows to the U.S. because of a drop in European investment).

36. *See Organization for Econ. Co-operation and Dev., World Investment Report 2000: Recent Trends in Foreign Direct Investment*, in 76 FIN. MARKET TRENDS 25 (2000); *see also* Leontine D. Chuang, *Investing in China's Telecommunications Market: Reflections on the Rule of Law and Foreign Investment in China*, 20 NW. J. INT'L. L. BUS. 509, 515–16 (2000) (commenting on the WTO agreement opening up China's telecommunications industry to foreign investment); *see also* Tina Edwin, *Paper Promises*, ECON. TIMES (INDIA), Aug. 4, 2000, *available at* LEXIS (citing foreign investment in key industries, including telecommunications, in India).

37. *See* Michael P. Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement on Investment?*, 31 J. MARSHALL L. REV. 1201, 1225–26 (1998) (noting that under current international economic conditions, a country's political decisions must take into account its international economic impact as it has a residual effect upon other nation-states); Alfred C. Aman, Jr., *The Globalizing State: A Future-Oriented Perspective on the Public/Private Distinction, Federalism, and Democracy*, 31 VAND. J. TRANSNAT'L L. 769, 867 (1998) (asserting that a nation must factor in the effects on the global economy when making internal political decisions); Jiunn-rong Yeh, *Institutional Capacity-Building Toward Sustainable Development: Taiwan's Environmental Protection in the Climate of Economic Development and Political Liberalization*, 6 DUKE J. COMP. & INT'L L. 229, 243–44 (1996) (finding that international trade was intrinsic to the political and economic development of Taiwan).

Despite the fact that foreign direct investment exceeds international trade, the latter is much more efficiently and consistently regulated by a uniform set of international multilateral binding rules.[38] In addition, under GATT, all international disputes involve state-to-state dialogue[39] and private parties are usually resolved by local courts, thus "the intervention of the whole machinery of international law may become necessary for the settlement of disputes arising from foreign investment."[40]

### 2. Definition of Foreign Direct Investment

Generally defined, foreign direct investment is the acquiring of a lasting and controlling interest in an enterprise operating abroad.[41] A lasting interest is defined as the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise.[42] While a controlling interest in an enterprise

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38. *See* Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 544 (1994) (stating that international trade and international investment maintain separate and binding dispute resolution systems); *see also* James R. Holbein & Gary Carpentier, *Trade Agreements and Dispute Settlement Mechanisms in the Western Hemisphere*, 25 CASE W. RES. J. INT'L L. 531, 570 (1993) (stating that the current trend in international trade is binding dispute resolution which will ultimately foster increased international trade); Patrick Specht, *The Dispute Settlement Systems of WTO and NAFTA: Analysis and Comparison*, 27 GA. J. INT'L & COMP. L. 57, 66–67 (1998) (noting that the binding effect of dispute resolution provides needed stability to international trade).

39. *See Understanding on Rules and Procedures Governing the Settlement of Disputes*, Apr. 15, 1994, WTO Agreement, Annex II, LEGAL INSTRUMENTS—FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (1994) ("DSU"); *see also* James R. Holbein & Gary Carpentier, *Trade Agreements and Dispute Settlement Mechanisms in the Western Hemisphere*, 25 CASE W. RES. J. INT'L L. 531, 569 (1993) (finding that openness between countries reduces opposition to international trade). Article I of DSU reads:

> The rules and procedures of this Understanding, shall apply to disputes brought pursuant to the consultation and dispute settlement provisions listed in Appendix I to this Understanding. . . . The rules and procedures of this Understanding shall also apply to consultations and the settlement of disputes between Members concerning their rights and obligations under the provisions of the Agreement Establishing the World Trade Organization.

*DSU*, Apr. 15, 1994, WTO Agreement, Annex II, LEGAL INSTRUMENTS—FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (1994).

40. M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 8 (1994).

41. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT (1994) (noting that "[f]oreign direct investment involves the transfer of tangible or intangible assets from one country into another for the purpose of use in that country to generate wealth under the total or partial control of the owner of the assets"); BLACK'S LAW DICTIONARY 831 (6th ed., 1999) (defining FDI as "[t]he creation, acquisition, or endowment in the host country of enterprises . . . to acquire a lasting interest, with powers of management and control . . . ").

42. *See* OECD DEFINITION, at 7–8; Matias F. Travieso-Diaz & Alejandro Ferrate, *Recommended Features of a Foreign Investment Code for Cuba's Free Market Transition*, 21 N.C. J. INT'L LAW & COM. REG. 511, 513 n.1 (1996) (defining FDI as "the acquisition of a lasting interest in an economy other than that of the investor"); Mengsteab Negash, *Investment Laws in Eritrea*, 24 N.C. J. INT'L LAW & COM. REG. 313, 354 n.323 (1999) (noting the same).

is the hallmark of FDI, it does not necessarily mean possession of 51% of the corporate stock.[43] Rather, it refers to a number of shares that is practically sufficient to control management of the company, which is estimated as at least 10% of the stock.[44]

Foreign direct investment is distinguished from the so-called portfolio investment, which is placed through the capital markets without entrepreneurial commitment and with the sole purpose of obtaining profit without influencing corporate management.[45] Portfolio investors are believed to be subject to less risk inherent in investment activity as a result of the free transferability of their assets.[46]

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43. *See* Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 3 n.2 (1995) (defining foreign direct investment as a maintenance of an elevated level of control through foreign ownership of a majority of assets or stock in a foreign country); *see also* Celia R. Taylor, *A Modest Proposal: Statehood and Sovereignty in a Global Age*, 18 U. PA. J. INT'L ECON. L. 745, 775 (1997) (remarking that nation-states incorporate the economic needs of major international companies into their economic and political schemes when the investor maintains a large-scale direct international investment in the host country). *But see* William A. Stoever, *Differentiating Extractive, Manufacturing and Service Investments in Less Developed Countries*, 21 REV. BUS. 23, 23 (2000) (citing that host countries frequently require that majority control of their corporations be maintained within the host country).

44. *See* OECD DEFINITION, at 7-8 (stating that "a direct investment enterprise defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 percent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise"); Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L.J. 469, 473 n.27 (2000) (noting that an investor can own "as little as 10% of the stock" for an investment to be characterized as FDI); *see also* Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 3 (1995) (remarking that only an "elevated level of control" is necessary for it to be considered FDI).

45. *See* Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L.J. 469, 473 (2000) (providing a comparative definitional analysis of foreign direct investment and portfolio investment); *see also* Mark Vallianatos, *Exceptions and Conditions: De-Fanging the MAI*, 31 CORNELL INT'L L.J. 713, 714–16 (1998) (denoting the intrinsic differences between foreign direct investment and portfolio investment); Celia R. Taylor, *A Modest Proposal: Statehood and Sovereignty in a Global Age*, 18 U. PA. J. INT'L ECON. L. 745, 782–87 (1997) (providing a comparative analysis of foreign direct investment and portfolio investment).

46. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 8 (1994); *see also* Celia R. Taylor, *A Modest Proposal: Statehood and Sovereignty in a Global Age*, 18 U. PA. J. INT'L ECON. L. 745, 789–90 (1997) (noting that "portfolio investment . . . is the most liquid" of all foreign investments). *See generally* Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L.J. 469, 476 (2000) (finding portfolio investment offers different risk-reduction strategies to foreign investors).

FDI can include ownership of equity participation as well as all kinds of assets, both tangible and intangible.[47] Moreover, both theory and practice distinguish between the so-called greenfield investing (establishing new facilities) and acquisition of ongoing business through purchase of existing shares or assets (merger and acquisition investing).[48] Greenfield investment is considered to be the dominant mode of investment when penetrating markets of less developed countries, where available equipment and technologies may be helplessly outdated.[49] However, the largest portion of FDI is undertaken through international mergers and acquisitions involving vast sums of money, which has led to unprecedented global and economic restructuring in recent years.[50] The preference for acquisition stems from the fact that working with functioning domestic companies is easier than incorporating new ones.[51] However, the

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47. Investment is defined in the 1994 U.S. MODEL BILATERAL TREATY as:

> every kind of investment owned or controlled directly or indirectly by [. . .] national or company, and includes investment consisting or taking the form of:
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> (i) a company; (ii) shares, stock, and other forms of equity participation, and bonds, debentures, and other forms of debt interests, in a company; (iii) contractual rights, such as under turnkey, construction or management contracts, production or revenue sharing contracts, concessions, or other similar contracts; (iv) tangible property, including real property, and intangible property, including rights, such as leases, mortgages, liens and pledges; (v) intellectual property, including: copyrights and related rights; patents; rights in plant varieties; industrial designs; rights in semiconductor layout designs; trade secrets, including know-how and confidential business information; trade and service marks, and trade names; and (vi) rights conferred pursuant to law, such as licenses and permits.

United States 1994 Model Bilateral Treaty, Art. 1, in FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS—DOCUMENTS, edited by Ronald A. Brand (2000), at 126–27. *See* 1994 Model Bilateral Investment Treaty, 1997 BDIEL AD LEXIS 6; *see also* Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 654–55 (1998) (offering Article I of a model U.S. Bilateral Investment Treaty).

48. *See* Michael A. Geist, *Toward a General Agreement on the Regulation of Foreign Direct Investment*, 26 L. & POL'Y INT'L BUS. 673, 678 (1995) (analyzing the foreign direct investment policies of eleven nations and how they treat acquisition and establishment of new facilities differently); *see also* Samuel C. Thompson, Jr., *South African Perspectives: Its Prospects and Its Income Tax System*, 1 CHI. J. INT'L L. 443, 446 (2000) (stating the majority of foreign investment in South Africa is mergers and acquisitions rather than new investment); David Blumental, *Sources of Funds and Risk Management for International Energy Projects*, 16 BERKELEY J. INT'L L. 267, 297 n.18 (1998) (providing that the term "greenfield" means projects that were built anew, as opposed to renovation of existing ones).

49. *See* Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 26 n.121 (1995) (discussing how Levi Strauss chose to build a manufacturing plant in Poland because the cost of converting the existing plants was too high); *see also* Press Release, UNCTAD, *Survival in Global Business Arena is Key Driver of Cross-Border Merger and Acquisition Boom*, TAD/INF 2855 (Oct. 3, 2000) (stating that greenfield investments are still the majority of foreign direct investments in developing countries); Richard B. Stewart, *A New Generation of Environmental Regulation?*, 29 CAP. U. L. REV. 21, 69 (2001) (offering that fear of liability is another factor that forces foreign investors to "greenfield" rather than rebuild existing properties).

50. The UNCTAD WORLD INVESTMENT REPORT 2000: CROSS-BORDER MERGERS AND ACQUISITIONS. *See* John F. Murphy, Book Review, 89 AM. J. INT'L L. 666, 666 (1995) (reviewing M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT (1994)) (discussing UNCTAD's belief that intense competition for foreign direct investment is hurting, not helping developing nations); *see also* Alex Y. Seita, *Conceptualizing Violence: Present and Future Developments in International Law: Panel I: Human Rights & Civil Wrongs at Home and Abroad: Old Problems and New Paradigms: The Role of Market Forces in Transnational Violence*, 60 ALB. L. REV. 635, 645 n.47 (1997) (noting that many of the largest recipients of foreign direct investment are developing nations).

51. *See* Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 26–27 (1995) (discussing various corporations' difficulties with incorporating abroad).

UNCTAD Report 2000 reaches a somewhat different conclusion: under normal circumstances, greenfield investment is more efficient in terms of development and more useful for the host country.[52] M&A investment, however, is considered the most reliable way of undertaking FDI under exceptional circumstances, such as economic crisis or major privatization.[53]

International companies increasingly prefer investing to cross-border trading.[54] Foreign investment is believed to benefit both the investor and the host country.[55] As it is noted in the Preamble to the World Bank Guidelines on the Treatment of Foreign Direct Investment:

> [A] greater flow of foreign direct investment brings substantial benefits to bear on the world economy and on the economies of developing countries in particular, in terms of improving the long-term efficiency of the host country through greater competition, transfer of capital, technology, managerial skills and enhancement of market access and in terms of the expansion of international trade. . . .[56]

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52. The UNCTAD WORLD INVESTMENT REPORT 2000: CROSS-BORDER MERGERS AND ACQUISITIONS, at 19. *See* Nan Zhang, *Moving Toward a Competitive Electricity Market? The Dilemma of Project Finance in the Wake of the Asian Financial Crisis*, 9 MINN. J. GLOBAL TRADE 715, 721 (2000) (discussing how greenfield investing is risky in certain circumstances, such as an unstable political environment); *see also* Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 113–14 (1998) (listing laws and economic conditions of the local area as major factors that firms look at to decide to make greenfield investments or use mergers and acquisitions).

53. The UNCTAD WORLD INVESTMENT REPORT 2000: CROSS-BORDER MERGERS AND ACQUISITIONS, at 19. *See* Michael P. Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement of Investment?*, 31 J. MARSHALL L. REV. 1201, 1227–28 (1998) (discussing the benefits of cross-border M&As for companies seeking to capitalize on privatization).

54. The UNCTAD WORLD INVESTMENT REPORT 2000: CROSS-BORDER MERGERS AND ACQUISITIONS, at 19. *See* Paul D. Cohen, *Securities Trading Via the Internet*, 4 STAN. J. L. BUS. & FIN. 1, 29 (1999) (stating that investors often believe investing in foreign markets is protected by U.S. securities laws); *see also* Frank M. Hellemans, *Substantive Appraisal of Horizontal Mergers under EEC Regulation 4064/89: An Inquiry into the Commission's First Year Decisions*, 13 J. INT'L L. & BUS. 613, 648 (1993) (describing different customs procedures and language barriers as factors that often make cross-border trading impractical).

55. *See* Patricia McKinstry Robin, *The* BIT *Won't Bite: The American Bilateral Investment Treaty Program*, 33 AM. U. L. REV. 931, 931 (1984) (discussing the high levels of profit for foreign investors and the influx of necessary capital into developing countries); *see also* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1020–21 (1997) (listing both the benefits and costs of foreign direct investment for host countries and international firms); Enrique R. Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539, 544 (1996) (describing how foreign investment is vital to developing countries' economies).

56. World Bank, GUIDELINES ON THE TREATMENT OF FOREIGN DIRECT INVESTMENT, in Shihata, LEGAL TREATMENT OF FOREIGN INVESTMENT: THE WORLD BANK GUIDELINES (1993), at 155.

The theory of comparative advantage is a fundamental premise upon which GATT is based.[57] A country is said to have a comparative advantage in the production of a good if it can produce that good at a lower opportunity cost than another country.[58] In such a way the maximum efficiency would be reached, as the comparative advantage stems from the difference in factor prices.[59]

According to the classical theory of foreign investment, international investment promotes comparative advantage and is wholly beneficial for the host country because it allows it to develop its resources.[60] However, it is asserted that the theory of comparative advantage alone cannot explain why the companies prefer to invest rather than to trade. The modern direct investment theory states that under certain circumstances, transnational companies possess advantages over their domestic competitors that allow them to cover the additional costs of investing abroad.[61] These advantages are twofold: location advantages and ownership advan-

57. *See* Jonathan T. Fried, *Two Paradigms for the Rule of International Trade Law*, 20 CAN.-U.S. L.J. 39, 42 (1994) (explaining that the original goal of GATT was to take advantage of the "comparative advantage" between nations to expand trade); *see also* Alex Y. Seita, *Globalization and the Convergence of Values*, 30 CORNELL INT'L L.J. 429, 446 (1997) (describing GATT as a vehicle to use comparative advantage to increase competition in foreign markets).

58. *See* A. V. Deardorff, *The General Validity of the Law of Comparative Advantage*, 88(5) JOURN. OF POLIT. ECON. 941 (1980); Jane L. Seigendall, *A Framework on Consumption Taxes and Their Impact on International Trade*, 18 DICK. J. INT'L L. 575, 593 n.162 (2000) (explaining the theory of comparative advantage as being able to produce goods at a lower cost than competitors); *see also* George P. Patterson, *Does the Commerce Clause Value Public Goods? West Lynn Creamery v. Healy*, 44 CATH. U. L. REV. 977, 985 n.53 (describing how, according to competitive advantage, states should produce goods that they can do at low cost).

59. *See* Cheryl W. Gray & William W. Jarosz, *Law and Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 8, 9 (1995); William J. Snape III & Naomi B. Lefkovitz, *Searching for GATT's Environmental Miranda: Are "Process Standards" Getting "Due Process?"*, 27 CORNELL INT'L L. J. 777, 799–800 (1994) (explaining how comparative advantage allows countries to maximize efficiency by trading goods they make economically for goods which they cannot); *see also* Anthony Scaperlanda, *Trade in the 1990s: Is an International Organization for Multinational Enterprises Needed?*, N. ILL. U. L. REV. 421, 423 (1994) (stating that free trade leads to a normalization of factor prices, which in turn leads to shifts in comparative advantages).

60. *See* Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 546 (1994) (explaining that foreign investment allows some countries to take advantage of resources that they could not without necessary capital, thereby promoting comparative advantage); *see also* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1023 (1997) (explaining that host countries rely on foreign investment to reach certain levels of development).

61. *See* Raymond Vernon, *International Trade and International Investment in the Product Cycle*, 80 Q.J. ECON. 190 (1966); *see also* Cristina Baez, Michele Dearing, Margaret Delatour, and Christine Dixon, *Multinational Enterprise and Human Rights*, 8 U. MIAMI Y.B. INT'L L. 183, 194 (2000) (describing the economic advantages multinational firms have over domestic counterparts); Enrique R. Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539, 549 (1996) (discussing the dangers to a host country when international companies dominate the local economy).

tages.[62] Location advantages involve such factors as cost of resources, raw materials, cost of labor, cost of transportation and favorable tax régime.[63] Such factors will reduce the cost of organizing business abroad and ultimately result in production at a lower cost than that of the competing domestic manufacturers.[64] Generally, ownership advantages are divided into two categories. One is intangible assets, which include intellectual property (such as patents) and advanced methods of management and marketing skills.[65] The other is internalization, which embraces a lower cost of transactions through a more advanced scheme of distribution.[66] Foreign direct investment no longer serves the sole purpose of avoiding trade barriers imposed by

62. *See* Cheryl W. Gray & William W. Jarosz, *Law and Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 10 (1995); William N. Cooke, *The Influence of Industrial Relations Factors on U.S. Foreign Direct Investment Abroad*, 51 IND. & LAB. REL. REV. 3, 5 (1997) (discussing how international companies factor both location and ownership advantages in investment decisions); Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 123 (1998) (explaining location advantages as factors that would cause a company to operate in a foreign country rather than domestically).

63. *See* Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 113–14 (1998) (listing market size, low wages, availability of natural resources and government protection as examples of location advantages); *see also* Janice Fanning Madden, *The Unaddressed Issues of the 2000 Primaries: From the Perspective of Scholars: Jobs, Cities, and Suburbs in the Global Economy*, 572 ANNALS AM. ACAD. POL. & SOC. SCI. 78, 83 (2000) (discussing how location advantages do not help a city unless those advantages, such as transportation, are used); Rose A. Kob, *Riding the Momentum of Smart Growth: The Promise of Eco-Development and Environmental Democracy*, 14 TUL. ENVTL. L.J. 139, 146 (2000) (discussing how suburban development is less economic than urban, due to the untapped location advantages of inner cities, such as transportation and a large potential workforce).

64. *See* Cheryl W. Gray and William W. Jarosz, *Law and Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 3 n.2 (1995) (noting that "[a]s long as the marginal production cost plus the transport cost of the goods exported . . . is lower than the average cost of prospective production in the market of import . . . producers will presumably prefer to avoid an investment."); C. O'Neal Taylor, *Linkage and Rule Making: Observations on Trade and Investment and Trade and Labor*, 19 U. PA. J. INT'L ECON. L. 639, 656–57 (1998) (stating that foreign investment is more likely in countries where the production costs are lower than in the domestic market); Kojo Yelpaala, *In Search of Effective Policies for Foreign Direct Investment: Alternatives to Tax Incentive Policies*, 7 J. INT'L L. BUS. 208, 223 (1985) (maintaining that foreign investment will occur when production costs in the host country are less than the total production costs and the export marketing cost differential).

65. *See* Cheryl W. Gray & William W. Jarosz, *Law and Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 11 (1995); Carlos A. Primo Braga & Carsten Fink, *The Relationship Between Intellectual Property Rights and Foreign Direct Investment*, 9 DUKE J. COMP. & INT'L L. 163, 170 (1998) (stating that ownership assets, consisting of innovative technology and informal business and trade practices, are necessary for successful overseas investment); Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 121 (1998) (categorizing trademarks, patents and trade secrets as intangible assets that provide incentives for multinational investments).

66. *See* Cheryl W. Gray & William W. Jarosz, *Law and Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 11 (1995); Carlos A. Primo Braga and Carsten Fink, *The Relationship Between Intellectual Property Rights and Foreign Direct Investment*, 9 DUKE J. COMP. & INT'L L. 163, 170 (1998) (discussing profitable methods of internalizing production rather than utilizing foreign companies); *see also* Kojo Yelpaala, *In Search of Effective Policies for Foreign Direct Investment: Alternatives to Tax Incentive Policies*, 7 NW. J. INT'L L. BUS. 208, 254–55 (1985) (explaining the efficiency benefits of internalizing intangible assets, such as human skills and knowledge, so that goods can be productively traded in the open market).

foreign countries, but also is a way for companies to come in closer contact with increasingly sophisticated consumers and to purchase increasingly expensive and shorter-lived technologies.[67]

On the other hand, the classical theory of foreign investment fails to explain why host states interfere with foreign investment throughout the world.[68] Moreover, it is based on the premise that economic development of the country depends on the flows of foreign investment into the host economy.[69] Often, such flows only benefit the very limited political and economic elite of the host country.[70] Furthermore, many developing nations view foreign investment as a device by which multinational corporations benefit their own shareholders.[71]

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67. *See* David Schneiderman, *Investment Rules and the New Constitutionalism*, 25 LAW & SOC. INQUIRY 757, 759 (2000); Tenley K. Adams, *Protection of Computer Software Programs Under the 1994 Polish Copyright Law*, 18 FORDHAM INT'L L.J. 1005, 1010–11 (1995) (discussing the increased interest in countries where consumers are well-educated and learned in technology). *See generally* Keith E. Maskus, *The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer*, 9 DUKE J. COMP. & INT'L L. 109, 111 (1998) (offering statistics showing that developed countries, such as Japan and Germany, import a lot of technology and product designs from developing countries).

68. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 39 (1994); Mark Baker, *Privatization in the Developing World: Panacea for the Economic Ills of the Third World or Prescription Overused?*, 18 N.Y.L. SCH. J. INT'L & COMP. L. 233, 249 n.71 (1999) (noting that the traditional view of foreign investment often hindered the economic development of the host nation); Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L. J. 469, 479–81 (2000) (detailing the principles of the liberal economic theory of foreign investment and the potential for domestic prosperity from foreign investment).

69. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 39 (1994); Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L. J. 469, 479–81 (2000) (detailing the principles of the liberal economic theory of foreign investment and the potential for domestic prosperity from foreign investment); World Bank, WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 8 (2001) (stating that "expanding into international markets promotes economic growth in the developing countries").

70. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 42 (1994); Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L. J. 469, 483 (2000) (referring to the widening economic and social gap between the wealthy, educated and politically dominant class and the poor in countries affected by foreign investment). *See generally* Linda C. Reif, *MultiDisciplinary Perspectives on the Improvement of International Environmental Law and Institutions*, 15 MICH. J. INT'L L. 723, 740 (1994) (reviewing JAMIE CASSELS, THE UNCERTAIN PROMISE OF LAW: LESSONS FROM BHOPAL (1993)) (comparing the benefits of foreign investment to the elite and technologically advanced classes to the harm suffered by the impoverished).

71. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1021–22 (1997) (comparing the many benefits a multinational enterprise may have on a domestic country's economy to the potential harm to that country's social and political reforms); Guillermo Emiliano del Toro, *Foreign Direct Investment in Mexico and the 1994 Crisis: A Legal Perspective*, 20 HOUS. J. INT'L L. 1, 86–88 (1997) (discussing opposing views of potential benefits of foreign investment in host countries); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 771 (2000) (recognizing that economic benefits caused by foreign commerce must be balanced against a decrease in social and environmental protections).

Nonetheless, the calculation of the efficiency of foreign investment depends heavily on the ability of the investor to project the cost of production overseas.[72] It is asserted that if location and ownership advantages are estimated to be unable to cover the cost and risks of foreign investment, the company should turn to international trade or consider alternative ways of involvement in business transactions in markets abroad, such as agency, licensing or franchising.[73]

## II. International Regulation of FDI

Despite its increasing importance for international economic relations, FDI is still not regulated by a single consolidated document that delineates basic uniform rules binding on all the members to the agreement.

### 1. History

Historically, foreign investment law has developed from the public international law concept of state responsibility for injuries inflicted on foreign citizens.[74] A general principle of international law states that when an alien establishes himself in the foreign state, he must accept the same conditions and liabilities that nationals of the state have; and no state is expected to relinquish its jurisdiction over that alien within its territory.[75] Therefore, a foreign

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72. *See* Raymond Vernon, *International Trade and International Investment in the Product Cycle*, 80 Q.J. ECON. 190, 197 (1966); Amanda Perry, *An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality*, 15 AM. U. INT'L L. REV. 1627, 1629–30 (2000) (noting that a foreign investor's "wish list" can be summarized as two items: certainty and efficiency); *see also* Guillermo Emiliano del Toro, *Foreign Direct Investment In Mexico And The 1994 Crisis: A Legal Perspective*, 20 HOUS. J. INT'L L. 1, 102 (1997) (noting that Mexico should establish greater certainty in their capital markets to improve the prospects for increased FDI).

73. For comparison of advantages of the alternative ways of involvement into business abroad, *see* Ronald A. Brand, FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS 945–49 (2000).

74. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 8 (1994); Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 265 (1994) (reviewing the history of the foreign investment laws and their development as a protective measure against injury to aliens and alien property); *see also* Note, *Protection Of Foreign Direct Investment In A New World Order: Vietnam—A Case Study*, 107 HARV. L. REV. 1995, 1999 (1994) (noting that developing nations have accepted the principle of "state responsibility" in enacting their foreign investment laws).

75. *See* Michael P. Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement on Investment?*, 31 J. MARSHALL L. REV. 1201, 1252 (1998) (noting that under current international economic conditions, a country's political decisions must take into account its international economic impact as it has a residual effect upon other nation-states); *see also* Greta Gainer, *Nationalization: The Dichotomy Between Western and Third World Perspectives in International Law*, 26 HOW. L.J. 1547, 1575 (1983) (explaining the Calvo Doctrine whereby aliens waive their right to diplomatic protection from their own state and agree to abide by the laws of the host state); Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. BUS. 243, 278 (2000) (stating that by deciding to reside in a foreign country, an alien submits to that nation's fiscal and legislative policies).

investor must obey the laws of the host state in exchange for protection of his property and for permission to act in the internal market of that country.[76]

The theory of mercantilism developed in conjunction with the emergence of colonialism in the 16th and 17th centuries.[77] That theory held that economic activity should be extensively regulated by the state for the sake of national interests, and the resources for economic development should be acquired from the colonial possessions.[78] Therefore, investments were made in the context of further colonial expansion.[79] This type of investment did not need any legal protection because it was backed up by the military power of the imperial system.[80] Later, the theory of mercantilism was challenged by the liberal free-market economic theory of Adam Smith

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76. *See* Michael P. Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement on Investment?*, 31 J. MARSHALL L. REV. 1201, 1252 (1998) (noting that under current international economic conditions, a country's political decisions must take into account its international economic impact as it has a residual effect upon other nation-states); Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 NW. J. INT'L L. BUS. 327, 346 (1994) (relating the general rule that foreign investments are subject to the laws and regulations of the host state). *See generally* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1026 n.88 (1997) (noting the ramifications of entering a host state and automatically being submitted to their domestic policies and regulations).

77. *See* DOMINICK SALVATORE, INTERNATIONAL ECONOMICS 26–28 (5th ed. 1995) (noting that the theory of mercantilism developed in the sixteenth and seventeenth centuries); Kenneth J. Vandevelde, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373, 375 (1998) (noting the same). *See generally* Alfred W. McCoy, *From Free Trade to Prohibition: A Critical History of the Modern Asian Opium Trade*, 28 FORDHAM URB. L.J. 307, 317 (2000) (discussing the links between colonialism and mercantilism with regards to the opium trade).

78. *See* Kenneth J. Vandevelde, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373, 375 (1998) (stating that the theory of mercantilism was based on the premise that state regulation of economic activity would further promote the political policies of the State); Matthew Murphy, *Property Rights and the Democratization Process—Sharing the Wealth—Fundamental Legal Foundations in Nation Building and United States Foreign Policy—Haiti and Nicaragua*, 22 SUFFOLK TRANSNAT'L L. REV. 163, 183 (1998) (noting that mercantilism was founded on the notion that government regulation would lead to a strong domestic economy); Rossina Petrova, *Cabotage and the European Community Common Maritime Policy: Moving Towards Free Provision of Services in Maritime Transport*, 21 FORDHAM INT'L L.J. 1019, 1033 (1998) (discussing the establishment of overseas colonies to provide necessary resources and increase the wealth of the colonial powers).

79. *See* Kenneth J. Vandevelde, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373, 375 (1998) (discussing how colonial possessions provided an excellent market for products, thus furthering the policies of mercantilism); *see also* Gerald A. Bunting, *GATT and the Evolution of the Global Trade System: A Historical Perspective*, 11 ST. JOHN'S J. LEGAL COMMENT 505, 508 (1996) (maintaining that the desire to expand foreign markets and acquire natural resources spurred colonial expansion); Lola Clayton Rainey, *Monopolistic Land Tenure and Free Trade in Mexico: Resurrecting the Ghost of Porfirian Economics*, 23 AM. INDIAN L. REV. 217, 238 (1998) (stating that colonies developed as a result of mercantilistic economic policies).

80. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 9 (1994); Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT'L LAW. 1033, 1034 (2000) (stating that colonial investments did not require the protection of international law because the colonies had the security of imperial military power); *see also* Joel P. Trachtman, *Foreign Investment, Regulation and Expropriation: A Debtor's Jubilee*, 89 AM. SOC'Y INT'L L. PROC. 103, 104 (1995) (noting that colonial investors could rely on the military strength of the imperialists rather than the legal system of either the host or colonial state).

and David Ricardo.[81] According to free-market theorists, the wealth of a nation was measured by its productivity, which in turn, was best achieved and maximized through an unregulated market.[82] This theory triggered a movement for free trade in Europe.[83]

Prior to the Second World War, foreign investment was not afforded any degree of sufficient legal protection on the international level.[84] "[E]conomic nationalist states, who linked the protection of their citizens' property with national interest, proved too willing to use military force to collect unpaid private loans."[85] This approach was reflected in the U.S. through the Monroe Doctrine, which justified the use of military force for collecting debts abroad.[86]

The first attempt at international regulation of FDI was made shortly after the Second World War in the Havana Charter.[87] While the Charter never came into force, the draft pro-

81. *See* Kenneth J. Vandevelde, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373, 375–76 (1998) (stating that the theory of mercantilism was based on the premise that state regulation of economic activity would further promote the political policies of the State). *Compare* Adam Smith, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (1776), *with* David Ricardo, ON THE PRINCIPLES OF POLITICAL ECONOMY AND TAXATION (1817).

82. *See* Robert H. Edwards & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade-Related Investment Measures*, 33 STAN. J. INT'L L. 169, 175 (1997) (stating that liberal economists credit increased national and global welfare to a free market trading system, rather than government regulation); Jeffrey Dunoff, *Institutions for International Economic Integration: "Trade and": Recent Developments in Trade Policy and Scholarship—And Their Surprising Political Implications*, 17 NW. J. INT'L L. BUS. 759, 760 (1996) (theorizing that liberalized international trade, free of government regulation, is advantageous to all nations); Arie Reich, *Institutions for International Economic Integration: From Diplomacy to Law: The Juridicization of International Trade Relations*, 17 NW. J. INT'L L. BUS. 775, 781 (1996) (maintaining that free trade with foreign nations "will lead to reciprocal benefits for all the participating States").

83. *See* John J.A. Burke, *The Economic Basis of Law As Demonstrated by the Reformation of NIS Legal Systems*, 18 LOY. L.A. INT'L & COMP. L.J. 207, 250–51 (1996) (noting that the European trade system is a "variation" of Adam Smith's theories). *See generally* Marc W. Brown, Note, *The Effect of Free Trade, Privatization and Democracy on the Human Rights Conditions for Minorities in Eastern Europe: A Case Study of the Gypsies in the Czech Republic and Hungary*, 4 BUFF. HUM. RTS. L. REV. 275, 290–91 (1998) (discussing the impact of free trade on Europe).

84. *See* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 29 (1994); Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 641–42 (1998) (discussing the evolution of binding international agreements to regulate and protect foreign investment). *See generally* Jeffrey Lang, *The International Regulation of Foreign Direct Investment: Obstacles and Evolution*, 31 CORNELL INT'L L.J. 455, 456–57 (1998) (promoting the use of bilateral investment treaties to protect investors' rights in countries where such policies have yet to be adopted).

85. Kenneth J. Vandevelde, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373, 378 (1998).

86. *See* James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 806 (2000) (explaining that the Roosevelt Corollary, a supplement to the Monroe Doctrine, authorized the U.S. to collect foreign debts); *see also* Enrique R. Carrasco and Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539, 547–48 (1996) (citing the U.S.' power to collect debts in Latin America); Major D.J. Lecce, *International Law Regarding Pro-Democratic Intervention: A Study of the Dominican Republic and Haiti*, 45 NAVAL L. REV. 247, 245 n.9 (1998) (stating that the Roosevelt Corollary entitled the U.S. to intervene in the affairs in Latin America).

87. Charter for the International Trade Organization, FINAL ACT AND RELATED DOCUMENTS, U.N. CONFERENCE ON TRADE AND EMPLOYMENT, Mar. 24, 1948, U.N. Doc. ICITO/1/4 (1948).

vided that, as a matter of accepted international law principles, each state had the sole right and jurisdiction to implement rules and impose restrictions relating to regulation of FDI in its territory.[88] The failure of the Havana Charter was in part due to its investment provisions and in part due to the Korean War.[89]

### 2. The FIRA case

One of the treaties that was to operate under the ITO umbrella, the 1947 General Agreement on Tariffs and Trade,[90] did not address the issue of foreign investment.[91] However, in 1955 the GATT Conference adopted the Resolution on International Investment,[92] which recognized that increased investment flows to developing countries help development efforts.[93]

The GATT Treaty, on its face, applies only to international trade.[94] Nevertheless, in 1982, the first investment dispute under GATT arose which required the panel to consider application of GATT rules to restrictive investment measures.[95] The U.S. government, in what is

88. *Id*.

89. *See* ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 4 n.3 (1993) (1991) (providing the general overview of the Havana Charter); Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 556 (1994) (stating that international trade and international investment each maintain separate and binding dispute resolution systems); *see also* John H. Jackson, RESTRUCTURING THE GATT SYSTEM 45–47 (1990) (discussing general problems faced by the Havana Charter).

90. GATT, October 30, 1947, No. 1700, 55 U.N.T.S. 188 (1947).

91. *See* Todd Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 556 (1994) (stating that during the 1950 election there was general dissatisfaction with the ITO charter and the way it dealt with foreign investment provisions); *see also* ROBERT E. HUDEC, THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY 49–52 (2d ed. 1990) (discussing the interrelation of the GATT and ITO); ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 4, 5, 11 (1991) (providing general history and goals of ITO and GATT).

92. Resolution on International Investment for Economic Development, Mar. 4 1955, GATT B.I.S.D. (3rd Supp.) at 49–50 (1955).

93. *See* ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 4, 5, 11 (1991) (discussing the history and objectives of ITO and GATT); ROBERT E. HUDEC, THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY 223–25 (2d ed. 1990) (discussing the general history of GATT's relationship with developing countries); *see also* Todd Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 556 (1994) (stating that during the 1950 election there was general dissatisfaction with the ITO charter and the way it dealt with foreign investment provisions).

94. GATT: Ministerial Declaration on the World Trading System, 22 I.L.M. 445 (1983) (stating that one of the GATT's purposes is to ensure the "effectiveness of its implementations" and aid developing countries to navigate in International Trade). *See* GATT: Agreements on Trade in Goods, 33 I.L.M. 28 (1994) (providing that each member of Council for Trade in Goods has to have an understanding of the manner and effects of the operations on the international trade). *See generally* General Agreement on Tariffs and Trade Multilateral Negotiations: Statement by GATT Director-General on Tokyo Round, May, 18 I.L.M. 553, 555 (1979) (noting that Tokyo Round of GATT called for negotiations on improvements to the workability of international trade).

95. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984).

known as the "FIRA case," challenged Canada's Foreign Investment Review Act (FIRA).[96] Section 2 of FIRA provided that the Canadian government reviewed foreign direct investment and only authorized it if the investment proposal showed significant benefit to Canada.[97] Moreover, FIRA imposed a local content requirement.[98] The U.S. alleged violation of National Treatment under Article III § 4 of GATT, and requested consultations.[99] When consultations failed, the U.S. government referred the matter to the Contracting Parties under Article XXIII (2).[100]

Both parties agreed to bring the matter before the GATT dispute resolution panel, which was supposed to decide the issue of whether the local content and performance requirements were inconsistent with Canada's trade obligations under GATT.[101] The U.S. alleged nullifica-

96. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See* John H. Jackson, THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 191 (1989) (stating a number of reasons why the U.S. brought complaints against Canada's FIRA); ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 4, 5, 11 (1991) (providing examples of dispute resolutions involving the U.S. and Canadian FIRA).

97. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See generally* Canada: Foreign Investment Review Act, 1973, Legislation and Regulation, 12 I.L.M. 1136, 1147 (1973) (stating that only where the Minister finds an investment to be or "likely to be of significant benefit to Canada," he should recommend it to the Governor in Council); ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 146, 170, 177, 362 (1991) (providing history of interrelations between GATT and FIRA).

98. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See* John H. Jackson, THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 191, 284 (1989) (stating a number of reasons why the U.S. brought complaints against Canada's FIRA); *see also* Canada-Mexico-United States: North American Free Trade Agreement, 32 I.L.M. 605 (1993) (proffering the power to impose a local content requirement).

99. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984).

100. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See* Resolution on International Investment for Economic Development, Mar. 4 1955, GATT B.I.S.D. (3rd Supp.) at 49–50 (1955); *see also* GATT: Dispute Settlement Panel Report on United States Superfund Excise Taxes, Adopted June 17, 1987, 27 I.L.M. 1596, 1601.

101. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See* GATT: Dispute Settlement Panel Report on United States Superfund Excise Taxes, June 17, 1987, 27 I.L.M. 1596, 1599 (1988) (stating that for GATT to reach the conclusion that "Canada had met its obligations," Canada would have to show to "GATT as a group" that it had taken all reasonable measures available); GATT: Multilateral Trade Negotiations (The Uruguay Round), December 15, 1993, 33 I.L.M.1, 5 (1994) (providing that member seeking "redress of a violation of obligation" by Dispute Settlement Body (DSB) "must obtain DSB authorization before suspending concessions or other obligations in response to non-compliance with panel report").

tion or impairment of its benefits under Articles III (4),[102] III (5),[103] XI[104] and XVII (1)(c).[105] The panel found nullification or impairment of Article III (4), but based its decision on the ground that by imposing a local content requirement, Canada indirectly discriminated against those countries that sought to export goods to the investor.[106] Therefore, the panel did not explicitly extend the GATT provisions to FDI.[107] It condemned local content requirements as

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102. GATT, art. III(4). Article III(4) states:

> The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

*Id*.

103. GATT, art. III(5). Article III(5) states:

> No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.

*Id*.

104. GATT, art. XI. The relevant part of this article reads:

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.

*Id*.

105. GATT, art. XVII(1)(c). Article XVII(1)(c) states:

> No contracting party shall prevent any enterprise . . . under its jurisdiction from acting in accordance with the principles of subparagraphs (a) and (b) of this paragraph. [Subparagraph (a) establishes the rule that state enterprises shall act in a non-discriminatory way; subparagraph (b) states that such enterprises shall make purchases solely in accordance with commercial considerations and shall give enterprises of another contracting party opportunity to compete].

*Id*.

106. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See* General Agreement on Tariffs and Trade: Dispute Settlement Panel Report on United States Superfund Excise Taxes, Adopted June 17, 1987, 27 I.L.M. 1596, 1599 (1988) (proffering "conservation-based export restrictions" of Canada); *see also* Canada-Mexico-United States: North American Free Trade Agreement, March, 1993, 32 I.L.M. 289, 379 (providing general restrictions to arbitrary and unjustifiable discrimination in order to minimize negative trade effects).

107. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See* European Community: Statement on U.S. Policy on Foreign Direct Investment, February 18, 1992, 31 I.L.M. 467 (stating that European Community and its Members voiced their concern over U.S. Congress interference with "the free flow of FDI"); *see also* World Trade Organization Appellate Body Report: United States—Tax Treatment for "Foreign Sales Corporations," February 24, 2000, 39 I.L.M. 717, 722 (noting that under the 1947 GATT dispute resolution system, only consensus of contracting parties would help findings of the panel to be adopted).

incompatible with GATT, but failed to defeat the export performance requirement.[108] Moreover, the panel agreed that while the local content requirement constituted nullification or impairment in the relations between two developed countries, it would not necessarily have the same result in the dispute involving developing countries.[109] Nevertheless, the FIRA decision was extremely important for developing TRIMs jurisprudence, which eventually was embodied in the investment agreement that became part of the Uruguay Round of the WTO.[110]

### 3. WTO

After 1947, GATT was amended several times with the goal of reducing tariffs and addressing services and foreign investment.[111] In September 1986 in the Punta del Este, Uruguay, a new ministerial meeting was held in order to prepare a draft of a new multilateral agreement that would embrace many other areas of economic relations.[112] After protracted

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108. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). *See* General Agreement on Tariffs and Trade: Report of Eminent Persons on Problems Facing the International Trading System, May, 1985, 24 I.L.M. 716, 742 (setting forward general regulations on export performance); *see also* Canada-United States Free Trade Agreement Binational Secretariat: Background note on the FTA Binational Secretariat and a Status Report of all Cases Filed With the Secretariat Under Chapters 18 and 19, January 30, 1991, 30 I.L.M. 181, 182 (providing general discussions of panel's powers and procedures).

109. Canada Administration of the Foreign Investment Review Act, GATT B.I.S.D. (30th Supp.) at 140 (1984). This ruling was influenced by the position of Argentina, which intervened in the dispute to protect interests of less developed nations.

Argentina further said the dispute before the Panel involved two developed contracting parties. The provisions and arguments invoked against Canada were not necessarily those which could legitimately be invoked against developing countries, considering the protection which those countries had the right to grant under the General Agreement to their developing industries. Argentina asked the Panel to take this into account in its deliberations.

Canada—Administration of The Foreign Investment Review Act, Report of the Panel adopted on 7 February 1984 (L/5504-30S/140), § 4.1. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 105 (1999).

110. GATT: MULTILATERAL TRADE NEGOTIATIONS FINAL ACT EMBODYING THE RESULTS OF THE URUGUAY ROUND OF TRADE NEGOTIATIONS, 33 I.L.M. 1125, 1141 (1994) (indicating the inclusion of TRIMs in GATT); *see* Marrakesh Agreement Establishing the World Trade Organization, April 15, 1994, reprinted in RESULTS OF THE URUGUAY ROUND OF MULTILATERAL TRADE NEGOTIATIONS (GATT Secretariat 1994), at 5. *See generally* Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 186 (1997).

111. *See* John H. Jackson, THE WORLD TRADE SYSTEM—LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 43 (2d ed. 2000); *see also* Susan Tiefenbrun, *Free Trade and Protectionism: The Semiotics of Seattle*, 17 ARIZ. J. INT'L & COMP. LAW 257, 267 (2000) (discussing the amendment of GATT); David A. Gantz, *A Post-Uruguay Round Introduction to International Trade Law in the United States*, 12 ARIZ. J. INT'L & COMP. LAW 7, 8–9 (1995) (exploring various amendments of GATT including the Uruguay Round which established the World Trade Organization (WTO) and the Tokyo Round).

112. *See* John H. Jackson, THE WORLD TRADE SYSTEM—LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 44–46 (2d ed. 2000); David A. Gantz, *Introduction to the World Trading System and Trade Laws Protecting U.S. Business*, 18 WHITTIER L. REV. 289, 295–96 (1997) (explaining the topics covered at the "Uruguay Round" such as national treatment and "multilateral trade agreements"); *see also* David A. Gantz, *A Post-Uruguay Round Introduction to International Trade Law in the United States*, 12 ARIZ. J. INT'L & COMP. LAW 7, 135 (1995) (detailing coverage of the GATT on various economic areas including government subsidies, safeguards and intellectual property).

negotiations, the consolidated document was adopted in 1994, entitled, The Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations ("Final Act").[113] This document established the World Trade Organization with annexes, as well as the Ministerial Declarations and Decisions and the Understanding on Commitments in Financial Services.[114] The main advantage of the Final Act over the previous results of negotiations is the "single package" idea—that accession to the WTO Agreement implies accession to all other documents and agreements embraced by the Final Act.[115] Among the annexes to the WTO Agreement, this article will consider three that have the greatest potential significance for regulation of foreign investment—the General Agreement on Trade in Services ("GATS"),[116] the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPs")[117] and the Agreement on Trade-Related Investment Measures ("TRIMs").[118]

**(a) GATS**

The GATS addresses the issue of services—the area of the economy that traditionally experiences the largest investment flows.[119] For the purpose of FDI, two modes of supply of services are of special relevance: (1) the supply of services by one member through commercial presence in the territory of any other member,[120] and (2) the supply of services by one member through the presence of natural persons of a member in the territory of any other member.[121] The term "commercial presence" within the purview of Article 1(2)(c) of the GATS is defined as "any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch

113. GATT, Apr. 15, 1994, 33 I.L.M. 1125, 1197 (1994).

114. *Id*.

115. *See* Ruth Okediji, *Toward an International Fair Use Doctrine*, 39 COLUM. J. TRANSNAT'L L. 75, 175 (2000) (explaining the "single-package strategy"); *see also* Stephen Reichert, *The World Trade Organization: Constitution and Jurisprudence*, 22 MD. J. INT'L L. & TRADE 430, 431 (1999) (stating that a "single package" under GATT requires that all members must agree to all of its core agreements); Ruth L. Gana, *Has Creativity Died in the Third World? Some Implications of the Internationalization of Intellectual Property*, 24 DENV. J. INT'L L. & POL'Y 109, 110 (1995) (explaining the benefits of a "single package" under GATT today, including the prevention of free riding).

116. General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND, 33 I.L.M. 1168 (1994).

117. Agreement on Trade Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND 31, 33 I.L.M. 1197 (1994).

118. Agreement on Trade Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, LEGAL INSTRUMENTS—RESULTS OF THE URUGUAY ROUND (1994).

119. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1016 (1997) (indicating GATS attention to services, based upon its inclusion of commercial presence as a service).

120. GATS, art. I(2)(c).

121. GATS, art. I(2)(d).

or a representative office, within the territory of a Member for the purpose of supplying a service."[122]

At the core of the GATS, similar to the GATT, are the Most-Favored Nation ("MFN")[123] and national treatment provisions.[124] However, while the GATS requires members to accord MFN treatment immediately and unconditionally,[125] the national treatment provision is subject to special limitations.[126] According to Article XVII, national treatment of foreign service suppliers is limited to sectors and modes of supply specifically reserved by the member state in its Schedule of Commitments.[127] Moreover, the Agreement provides for other limitations that are potentially relevant to FDI. Article XI (1) provides that "[a] Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments," subject however to the exception of imbalance of payments.[128] However, the GATS prohibits members imposing restrictions on market access of foreign service suppliers, in particular, introducing requirements of maximum amount of foreign investment, unless otherwise specified in the schedule of commitments.[129]

While accession to the GATS is mandatory for all WTO members, liberalization of the supply of services in general, and FDI in particular, depends upon including it on a member's Schedule of Commitments.[130] Being potentially unable to compete with domestic suppliers of

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122. GATS, art. XXVIII(d). *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1031 (1997) (noting the term "commercial presence" was chosen "because developing countries sought to avoid the possible interpretation of the commercial presence mode of delivery as constituting an absolute right of establishment").

123. GATS, art. II.

124. GATS, art. XVII.

125. GATS, art. II. Article II states: "With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country."

*Id*.

126. GATS, art. XVII. Article XVII states:

> In the sectors inscribed in its Schedule, any subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than it accords to its own like services and service suppliers.

*Id*.

127. GATS, art. XVII. Each Schedule of Commitments must specify: (a) terms, limitations and conditions on market access; (b) conditions and qualifications on national treatment; (c) undertakings relating to additional commitments; (d) where appropriate the time-frame for implementation of such commitments; and (e) the date of entry into force of such commitments.

*Id*.

128. GATS, art. XI(1).

129. GATS, art. XVI.

130. GATS, art. XVII. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1034 (1997).

like services or barred from entering certain sectors altogether, the best possible treatment that foreign investors can claim under the GATS is the MFN treatment.[131]

**(b) TRIPs**

Although the TRIPs Agreement does not include any reference to FDI, it is of potential significance so long as its rules are specifically designed for international transfers of technology that are common to all FDI transfers.[132] The fundamental concepts of the TRIPs Agreement are national treatment and MFN treatment.[133] Unlike other agreements on trade-related measures, TRIPs provides member states the right to implement stricter protection of intellectual property in their domestic laws, if such protection would not contravene the Agreement.[134]

**4. TRIMs**

The TRIMs Agreement was specifically drafted and adopted to deal with the issue of FDI.[135] Initially, GATT (1947) did not address the issue of trade-related measures, as they were not considered tariffs or custom duties.[136] Until the Uruguay round, the tremendous network

131. *See* Ernesto M. Hizon, *Virtual Reality and Reality: The East Asian NICs and the Global Trading System*, 5 ANN. SURV. INT'L & COMP. L. 81, 91 (1999) (detailing MFN's goal under GATT which is to diversify trade by eliminating trade discrimination); Lawrence J. Spiwak, *From International Competitive Carrier to the WTO: A Survey of the FCC's International Telecommunications Policy Initiatives 1985–1998*, 51 FED. COMM. L.J. 111, 168–69 (1998) (noting that MFN under GATS aims to prevent competitive difficulty between local and foreign dealers); Joel P. Trachtman, *Trade in Financial Services under GATS, NAFTA and the EC: A Regulatory Jurisdiction Analysis*, 34 COLUM. J. TRANSNAT'L L. 37, 98 (1995) (exploring the benefits of MFN such as facilitating harmony and stability under GATT).

132. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L. L. & POL'Y 1015, 1033 (1997); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 810–11 (2000) (indicating that TRIPs play a role with respect to FDI); Frederick M. Abbott, *The New Global Technology Regime: The WTO TRIPs Agreement and Global Economic Development*, 72 CHI-KENT L. REV. 385, 388 (1996) (noting that the technology shift from developed members to undeveloped members is included within the TRIPs).

133. Agreement on Trade-Related Aspects of Intellectual Property Rights, art. 4, 33 I.L.M. 81 (Dec. 15, 1993).

134. Agreement on Trade-Related Aspects of Intellectual Property Rights, art. 1(1), 33 I.L.M. 81 (Dec. 15, 1993).

135. *See* Matthew W. Barrier, *Regionalization: The Choice of a New Millennium*, 9 CURRENTS INT'L TRADE L.J. 25, 28 (2000) (explaining that TRIMs primary role was "to eliminate trade-distorting conditions to FDI"); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 98 (1999) (discussing TRIMs attempt to manage FDI); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 810 (2000) (noting that TRIMs was the initial world-wide agreement aimed directly at FDI).

136. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1033 (1997); Robert E. Hudec, *The New WTO Dispute Settlement Procedure: An Overview of the First Three Years*, 8 MINN. J. GLOBAL TRADE 1, 17 (1999) (explaining that the 1947 GATT did not contain the same trade-related provisions that it does today); *see also* Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 555 (1994) (describing the 1947 GATT's focus on tariffs).

of individually negotiated bilateral investment treaties ("BITs") regulated FDI.[137] Initially, BITs were concluded to protect against expropriation and to set forth standards for compensating investors.[138] BITs provide for national treatment or MFN treatment of foreign investors, protection against expropriation, free repatriation of profits and dispute resolution.[139] BITs quickly became, and still remain, the dominant vehicle through which FDI is governed on the international plane.[140] Moreover, many countries entered into local multilateral investment treaties or free trade area treaties that, in part, provided for liberalization of the FDI movement.[141]

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137. By 1997, more than 1300 bilateral investment treaties (or their European counterparts bilateral investment protection agreements (BIPA)) had been signed involving over 160 countries. *See* Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L.J. 469 (2000); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 810 (2000) (noting the hopes of some countries to consolidate the BITs at the "Uruguay Round"); *see also* Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 567 (1994) (detailing the many BITs used to guard foreign investments).

138. *See* Jeffrey Lang, *The International Regulation of Foreign Direct Investment: Obstacles & Evolution*, 31 CORNELL INT'L L.J. 455, 457 (1998) (discussing BITs role in setting restrictions on expropriation); Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 576 (1994) (detailing BITs use of "specific treatment standards" to safeguard investments); *see also* James R. Holbein & Gary Carpentier, *Trade Agreements and Dispute Settlement Mechanisms in the Western Hemisphere*, 25 CASE W. RES. J. INT'L L. 531, 569 (1993) (explaining BITs use of standards to serve its function of limiting expropriation).

139. *See* Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 544 (1994) (stating that international trade and international investment each maintain separate and binding dispute resolution systems); Catherine Sun, *The E-2 Treaty Investor Visa: The Current Law and the Proposed Regulations*, 11 AM. U. J. INT'L L. & POL'Y 511, 517 n.28 (1996) (explaining how BITs ensure "competitive equality," guarantee American investors the ability to use a market rate of exchange when transferring funds, allow independent international arbiters to settle investment suits and protect American investors if expropriations occur); *see also* Lucien J. Dhooge, *The Revenge of the Trail Smelter: Environmental Regulation as Expropriation Pursuant to the North American Free Trade Agreement*, 38 AM. BUS. L.J. 475, 482 n.32 (2001) (listing the protections typical to a U.S. bilateral investment treaty, specifically capital and profit repatriation, expropriation protection and binding independent arbitration to resolve disputes).

140. *See* Andrew T. Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 640 (1998) (discussing the rise of BITs and their current prominent role in regulating investment); *see also* Timothy R. Hager, *Recognizing the Judicial and Arbitral Rights of Aliens to Review Consular Refusals of "E" Visas*, 66 TUL. L. REV. 203, 225–26 (1991) (explaining the primary purpose of bilateral investment treaties is to promote and protect foreign direct investment). *See generally* Andrea Kupfer Schneider, *The Evolution of Dispute Resolution Regimes in International Trade Organizations*, 20 MICH. J. INT'L L. 697, 714–15 (1999) (discussing how bilateral investment treaties have followed the example of the United Nations Commission for International Trade in permitting individuals to bring actions against states in hopes of encouraging foreign investment).

141. *See, e.g.*, Treaty Establishing the European Community as Amended by the Treaty of Amsterdam, Oct. 2, 1997, 1997 O.J. (C 340) 1; North American Free Trade Agreement, December 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 605. *See generally* Harold K. Jacobson, *Conceptual, Methodological and Substantive Issues Entwined in Studying Compliance*, 19 MICH. J. INT'L L. 569, 577 (1998) (discussing the importance of multilateral agreements in securing foreign direct investment which plays an important role in a liberalized global economy).

### (a) TRIMs – Negotiating History

Nevertheless, capital-exporting countries, especially the U.S., advocated the idea of a single act regulating all aspects of FDI.[142] After the FIRA dispute, when it became obvious that existing rules of the GATT were inadequate to properly address the issue of investment, the U.S. and other industrialized countries tenaciously pushed for negotiation of a treaty that would cover restrictive TRIMs.[143] In 1987, the Negotiating Group met with a purpose of clarifying the relationship between the GATT and investment measures.[144] From the very beginning, participants to the negotiations split into two groups: Developing countries vehemently opposed to any restrictions on investment measures, and developed nations, including the U.S., who supported the idea of a multilateral set of rules which would allow effective oversight of investment treatment.[145] The U.S., with the support of the European Union and Japan, proposed a very broad list of investment measures, which it considered trade-distorting.[146]

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142. *See* 2 THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986–92) 2072–74 (Terence P. Stewart ed., 1993). During the formal negotiations of trade-related investment measures at Uruguay Round, the U.S. was a *demandeur* of a TRIMs Agreement; C. O'Neal Taylor, *Observations on Trade and Investment and Trade and Labor*, 19 U. PA. J. INT'L ECON. L. 639, 645 n.14 (1998) (discussing the U.S.' push for a uniform set of rules to govern investment even prior to the Uruguay Round); *see also* Cheryl Tate, *The Constitutionality of State Attempts to Regulate Foreign Investment*, 99 YALE L.J. 2023, 2029–30 (1990) (discussing that it is important for the U.S. to have a coherent policy on FDI in order to remain competitive in the global economy).

143. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 106–07 (1999); Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1049 (1997) (discussing that during the Uruguay Round, the U.S. aggressively pushed for multilateral agreements but they were rejected because of resistance by developing countries). *See generally* Gus Van Harten, *Guatemala's Peace Accords in a Free Trade Area of the Americas*, 3 YALE HUM. RTS. & DEV. L.J. 113, 128–30 (2000) (discussing how the negotiations of the Free Trade Area of the Americas is part of a wider push, driven by capital-exporting countries, to include protections for investors at an international level).

144. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 106–07 (1999) (remarking that the Negotiating Group's mandate was to clarify GATT's effect on investment measures); Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 193–94 (1997) (noting the same); *see also* Daniel M. Price & P. Bryan Christy III, *Agreement on Trade Related Investment Measures (TRIMS): Limitations and Prospects for the Future*, in THE WORLD TRADE ORGANIZATION: THE MULTILATERAL TRADE FRAMEWORK FOR THE 21ST CENTURY AND U.S. IMPLEMENTING LEGISLATION 447–51 (Terence P. Stewart ed., 1996) (discussing the goals of the 1987 Negotiating Group on TRIMs).

145. *See* 2 THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986–92) 2072–74 (Terence P. Stewart ed., 1993); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 810 (2000) (discussing how developing countries prefer bilateral investment treaties instead of multilateral investment treaties which are closely tied with GATT). *See generally* Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 194 (1997) (discussing the mandate given to the Negotiating Group regarding the operation of GATT articles, specifically the trade restriction and distorting effects on investment measures).

146. In its Submission, the U.S. defined TRIMs as all the measures which (a) prevent, reduce or divert imports by limiting the sale, purchase and use of imported products; (b) restrict the ability to export by home and third country producers, and (c) artificially inflate exports from a host country, thereby distorting trade flows in world markets. *Submission by the United States*, GATT Doc. No. MTN.GNG/NG12/W/4 (June 11, 1987), at 1. *See* 2 THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986–92) 2079 (Terence P. Stewart ed., 1993); Stephen J. Canner, *Exceptions and Conditions: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 663 (1998) (relating that prior to the Uruguay Round, The U.S. wished to push for broad rules regarding investment largely following the example of their own bilateral investment treaties); *see also* Sol Picciotto, *Linkages in International Investment Regulation: The Antinomies of the Draft Multilateral Agreement on Investment*, 19 U. PA. J. INT'L ECON. L. 731, 732 n.3 (1998) (explaining that during the Uruguay Round, there was extreme pressure to broaden the discussion regarding foreign investment despite resistance by developing countries).

To the contrary, developing countries submitted that trade-related investment measures should stay outside the scope of GATT, with the exception of tariff restrictions.[147] They argued that certain TRIMs are necessary to protect emerging economies against the abusive and equally trade-distorting practices of multinational enterprises.[148] One of the strongest opponents of the developed nations' proposed TRIMs Agreement was India.[149] India asserted that TRIMs are necessary to ensure that investment incentives and conditions are in line with national priorities and do not adversely affect the domestic economy.[150] The developing nations advocated the so-called "effects test," under which the country alleging TRIMs must prove the inflicted trade distortion.[151]

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147. *See* John H. Jackson, THE WORLD TRADE SYSTEM—LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 245 (2d ed. 2000); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 107 (1999) (discussing how the developing nations of Asia, Africa and Latin America felt that investment measures were outside of the scope of GATT and should remain that way); *see also* Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 194 n.149 (1997) (discussing that developing countries did not want to include within GATT a new system that regulated TRIMs).

148. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1049 (1997) (discussing how developed countries experience relatively few barriers regarding foreign direct investment while developing countries face substantial barriers that are in their interest to overcome); *see also* Riyaz Dattu, *A Journey from Havana to Paris: The Fifty-Year Quest for the Elusive Multilateral Agreement on Investment*, 24 FORDHAM INT'L L.J. 275, 290–91 (2000) (explaining developing countries' belief that the prohibition of TRIMs would not account for restrictive business practices of multinational enterprises).

149. *See India Has a Strong Case Against US List*, STATESMAN (INDIA), Nov. 24, 1999, *available at* LEXIS (discussing India's intention at the Seattle World Trade Organization Conference to oppose multilateral agreements regarding investment and competition); *see also* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1016–17 (1997) (discussing how India has led the developing nations in resisting multilateral efforts to regulate direct investment); Riyaz Dattu, *A Journey from Havana to Paris: The Fifty-Year Quest for the Elusive Multilateral Agreement on Investment*, 24 FORDHAM INT'L L.J. 275, 290 (2000) (discussing how the U.S. wanted to strongly protect investment in GATT while India and other developing countries opposed the restrictions on TRIMs because it would hinder their ability to use their own development strategies).

150. The most restrictive statute, enacted during the Indira Ghandi administration, the Foreign Exchange Regulation Act of 1973, prohibited using foreign brand names and subjected corporate expansion by companies with foreign element to compulsory governmental approval. *See* 2 THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986–92) 2045 (Terence P. Stewart ed., 1993). Later, after the change of government, that drastic approach was gradually relaxed. *Id*, at 2047. *See also* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1016–17 (1997) (discussing that India's resistance to multilateral direct investment stems from the belief that strict regulation is something that should be controlled by India and is an important part of India's economic policy).

151. *See* 2 THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986–92) 2083–84 (Terence P. Stewart ed., 1993); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 107 (1999) (commenting that the developing countries argued at the Uruguay Round that GATT should be left alone and an "effects test" based on empirical evidence of trade distortion should be used); *see also* C. O'Neal Taylor, *Observations on Trade and Investment and Trade and Labor*, 19 U. PA. J. INT'L ECON. L. 639, 645 n.14 (1998) (commenting how developing nations wanted to limit negotiations regarding TRIMs to essentially an enhanced version of GATT articles using an "effects test" to determine if an activity fell within its scope).

On the other hand, industrialized countries such as the U.S., Japan, Switzerland, the Nordic countries, as well as the European Community, supported prohibition of TRIMs *per se*, no matter what effect they would exert on trade.[152] Yet, even among those regions there were disagreements over how to interpret TRIMs.[153] Therefore, it is not surprising that the final text of the TRIMs Agreement embodies consensus between two diametrically opposed positions. The developed countries managed to prohibit the most egregious investment measures, while developing countries succeeded in substantially limiting the scope of the agreement to the trade in goods.[154]

**(b) TRIMs—Contents**

The TRIMs Agreement is a supplementary document to the GATT, mostly related to interpreting the national treatment provision of Article III of the GATT.[155] The core provision of the TRIMs Agreement is Article 2, which prohibits TRIMs inconsistent with Article III

152. *See* 2 THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986–92) 2083–84 (Terence P. Stewart ed., 1993); Michael Gregory, *Environment, Sustainable Development, Public Participation and the NAFTA: A Retrospective*, 7 J. ENVTL. L. & LITIG. 99, 150 (1992) (noting how industrialized nations oppose TRIMs because they view them as restrictions on trade while developing nations embrace several of their purposes). *See generally* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1034–36 (1997) (discussing the U.S. and other developed countries opposing TRIMs because they interfered with liberal trade regimes while others served to distort trade).

153. *See* Charles O. Roehrdanz, *Reducing the U.S.-Japan Trade Deficit by Eliminating Japanese Barriers to Foreign Direct Investment*, 4 MINN. J. GLOBAL TRADE 305, 326 (1999) (discussing that there is no international agreement between the U.S. and Japan regarding foreign direct investment and that TRIMs themselves do not necessarily deal with foreign direct investment). *See generally* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1034–36 (1997) (discussing the list of TRIMs the U.S. had problems with and examining which ones the European Community and Japan both supported and opposed); Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 198 (1997) (stating that in recent TRIM developments the U.S., Japan, Korea, Canada and the European Union held meetings regarding Brazil as part of the World Trade Organization (WTO) and have not come to a concrete agreement).

154. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 108 (1999) (noting that "[t]he salient fact about the Dunkel draft text is that it is not the negotiated result of the six years work of the countries who participated in the TRIMs negotiations, but a compromise created at the end of 1991 by Director-General Dunkel and his staff"); 2 THE GATT URUGUAY ROUND: A NEGOTIATING HISTORY (1986–92) 2129 (Terence P. Stewart ed., 1993); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 810 (2000) (discussing how the industrialized nations, who pushed for investment measures, and developing nations, who resisted those efforts, compromised on the final TRIM agreement which directly impacted trade flows in goods).

155. *See* John H. Jackson, THE WORLD TRADE SYSTEM—LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 244 (2d ed. 2000); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 113 (1999) (noting that TRIMs article 2.1 will not allow TRIMs that are inconsistent with Article III of GATT); *see also* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1036 n.166 (1997) (arguing the TRIMs only serve to interpret GATT Article III).

(national treatment) or Article XI (prohibition of quantitative restrictions) of the GATT.[156] As an example, Article 2(2) refers to the Annex, which contains an illustrative list of TRIMs that are inconsistent with national treatment and obligations of members as to non-introduction of quantitative restrictions.[157] This illustrative list contains investment measures that are deemed inconsistent with the GATT obligations.[158] For those measures to fall within the scope of the list, they must be "mandatory or enforceable under domestic law . . . or in compliance with that which is necessary to obtain any advantage."[159]

The TRIMs Agreement split the measures into two groups: (1) those inconsistent with national treatment; and (2) those inconsistent with the obligation of general elimination of quantitative restrictions.[160] TRIMs that are inconsistent with national treatment include both outright and indirect local content requirements.[161] TRIMs are deemed to impose quantitative restrictions within the meaning of Article XI of GATT if they amount to "performance requirements" in that they make the importation dependent upon the amounts of exportation or foreign currency inflows, or make the exportation contingent on amounts of local production.[162]

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156. TRIMs, art. 2(1). *See also* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1021–22 (1997).

157. TRIMs, annex 1A, art. 2, § 2. *See also* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 113 (1999) (explaining that Article 2.2 of the TRIMs refers to an illustrative list which points out examples of inconsistent TRIMs); Kevin C. Kennedy, *The GATT-WTO System at Fifty*, 16 WIS. INT'L L.J. 421, 522 (1998) (stating that Article 2.2 of the TRIMs agreement refers to an illustrative list of TRIMs that are not consistent with Article III).

158. TRIMs, annex 1A, art. 2, § 2. *See also* Merit E. Janow, *Institutions For International Economic Integration: Assessing APEC's Role in Economic Integration in the Asia-Pacific Region*, 17 NW. J. INT'L. L. BUS. 947, 983 (1996–1997) (stating that the TRIMs agreement identified an illustrative list of measures that were not consistent with GATT obligations). *See generally* Stephen J. Canner, *Exceptions and Conditions: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 664 (1998) (discussing that Trade-Related Investment Measures have an illustrative list of certain TRIMs that are inconsistent with articles of GATT).

159. TRIMs, annex 1A, art. 2, § 2.

160. TRIMs, annex 1A, art. 2, § 2. *See also* Merit E. Janow, *Institutions For International Economic Integration: Assessing APEC's Role in Economic Integration in the Asia-Pacific Region*, 17 NW. J. INT'L L. BUS. 947, 983 (1996–1997) (identifying the two categories within the GATT obligations—national treatment and elimination of qualitative restrictions—that are considered to be inconsistent by the TRIM illustrative list). *See generally* Paul Demaret, *The Metamorphoses of the GATT: From the Havana Charter to the World Trade Organization*, 34 COLUM. J. TRANSNAT'L L. 123, 150 (1995) (discussing that members of the World Trade Organization may not use TRIMs that violate either of two provisions; the granting of national treatment to imported products and the elimination of quantitative restrictions).

161. TRIMs, annex 1A, art. 2, § 2(1)(a). *See also* TRIMs, annex 1A, art. 2, § 2(1)(b). *See generally* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 109–10 (1999) (arguing that this provision is exactly the measure the Canadian Government imposed on the U.S. investor through the purchase undertaking in the FIRA case).

162. TRIMs, annex 1A, art. 2(2)(a). *See also* TRIMs, annex 1A, art. 2(2)(b); TRIMS, annex 1A, art. 2(2)(c).

Article 3 of the TRIMs Agreement provides that all exceptions under the 1994 GATT are applicable to the provisions of the TRIMs where appropriate.[163] This further limits the scope of the TRIMs Agreement, because GATT authorizes a potentially large number of exceptions under different exceptional circumstances.[164]

Many scholars blame the TRIMs Agreement for the weakness and redundancy of already existing GATT rules.[165] For example, the TRIMs Agreement covers those investment measures that have direct distorting effect, but omits dealing with many other measures and the public policies behind them.[166] The blame for this is placed on the fact that the TRIMs Agreement was a product of consensus between the two opposite camps of the developed and the developing world.[167]

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163. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 126 n.85 (1999) (stating that Article 3 stipulates that exceptions under GATT would apply to the TRIMs Agreement); *see also* Edward A. Laing, *Equal Access/ Non-Discrimination and Legitimate Discrimination in International Economic Law*, 14 WIS. INT'L L.J. 246, 313 n.357 (1996) (mentioning that the TRIM agreement incorporates all exceptions under the 1994 GATT); Paul Demaret, *The Metamorphoses of the GATT: From the Havana Charter to the World Trade Organization*, 34 COLUM. TRANSNAT'L L. 123, 150 (1995) (discussing how certain countries, including the U.S. and Japan, have urged elimination of TRIMs which are inconsistent with Article III).

164. GATT, art. XXV, § 2. *See also* GATT, art. XII; William J. Snape, III & Naomi B. Lefkowitz, *Searching for GATT's Environmental Miranda: Are "Process Standards" Getting "Due Process?"*, 27 CORNELL INT'L L.J. 777, 786 (1994) (stating that one of a number of exceptions to GATT rules exists within Article XX). *See generally* John H. Jackson, THE WORLD TRADE SYSTEM—LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 54–55 (2d ed. 2000).

165. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN J. GLOBAL TRADE 97, 126 (1999) (arguing that one of the inadequacies of the TRIMs Agreement is its failure to move GATT towards an agreement which focuses on Foreign Direct Investment); Edward M. Graham, *National Treatment of Foreign Investment: Exceptions and Conditions*, 31 CORNELL INT'L L.J. 599, 601 (1998) (discussing how some experts felt that a panel decision made by GATT exposed major weaknesses within its law); Lisa C. Thompson and William J. Thompson, *The ISO 9000 Quality Standards: Will They Constitute a Technical Barrier to Free Trade under the NAFTA and the WTO?*, 14 ARIZ. J. INT'L & COMP. L. 155, 176 n.184 (1997) (stating that one of the reasons for GATT 1994 was to remedy the perceived weakness from the original GATT in 1947).

166. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1034 (1997); Jonathan T. Fried, T*wo Paradigms for the Rule of International Trade Law*, 20 CAN.-U.S. L.J. 39, 44 (1994) (arguing that the purpose of the current TRIMs Agreement is to cover investment regulations that have a distorting effect on the trade of goods); *see also* Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 313 (1994) (discussing that at the Uruguay Round, TRIMs are being established to bring, within GATT rules, those measures that have a distorting effect on investment measures).

167. *See* James L. Kenworthy, *US Trade Policy And The World Trade Organization: The Unraveling Of The Seattle Conference And The Future Of The WTO*, 5 GEO. PUBLIC POL'Y REV. 103, 103–04 (noting that GATT created a consensus between developed and developing nations, but is inherently flawed, as its rules are often ignored); Susan Tiefenbrun, *Free Trade and Protectionism: The Semiotics of Seattle*, 17 ARIZ. J. INT'L & COMP. LAW 257, 273 (2000) (commenting that GATT's many failures stem from the fact that developed nations "bullied" developing nations into a consensus). *See generally* Jonathan Carlson Hunger, *Agricultural Trade Liberalization, and Soft International Law: Addressing the Legal Dimensions of a Political Problem*, 70 IOWA L. REV. 1187 (1985) (discussing and analyzing the various weaknesses of GATT).

### (c) TRIMs in Automotive Industry

In order to illustrate the inadequacy of the TRIMs Agreement, a number of cases will be analyzed. To date, only a few cases have been decided under TRIMs and almost all of them concern the automobile industry.[168] Automobile production is traditionally considered to be one of the most important activities in terms of impact on employment, GNP, tax revenue and even national prestige on the international plane.[169] As a consequence, both developed and developing nations tend to protect their motor vehicle industries from foreign influence by imposing protectionist limitations, local content requirements and by introducing quotas.[170] At the same time, major motor vehicle manufacturers strive to open foreign markets for their production, and sometimes this overseas expansion is a matter of survival for the whole industry.[171]

In November 1996, Brazil doubled the duty on automobile imports and announced a tariff increase to 16% in 2000 in an effort to establish and develop its own national motor vehicle manufacturing.[172] Another government act introduced two TRIMs: local content require-

168. *See* Eric Phillips, *World Trade and the Environment: The Café Case*, 17 MICH. J. INT'L L. 827, 828 (1996) (discussing one of the GATT panel decisions which involved the U.S. placing certain taxes on automobiles); *see also* Daniel C. Esty & Damien Geradin, *Market Access, Competitiveness, and Harmonization: Environmental Protection in Regional Trade Agreements*, 21 HARV. ENVTL. L. REV. 265, 327 (1997) (discussing a GATT case that served to change the regulations governing gasoline under the 1990 Clean Air Act); Kazumochi Kometani, *Trade and Environment: How Should WTO Panels Review Environmental Regulations Under GATT Articles III and XX?*, 16 J. INT'L L. BUS. 441, 444 (1996) (discussing a panel decision made by GATT regarding environmental regulations that the U.S. had placed on automobiles).

169. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 110 (1999) (stating the significant impact a nation's auto industry has on the nation's employment, gross national product and tax revenue); William G. Kanellis, *Reining in the Foreign Trade Zones Board: Making Foreign Trade Zone Decisions Reflect the Legislative Intent of the Foreign Trade Zones Act of 1934*, 15 J. INT'L L. BUS. 606, 624 (1995) (showing an example of how employment increases when auto manufacturers set up assembly plants in Foreign Trade Zones). *See generally* Philipp Duffy, *Legal Perspectives on the Place of an Independent Quebec in the North American Auto Industry*, 29 OTTAWA L. REV. 81, 85 (1997–1998) (discussing the significant impact the auto industry plays within the Province of Quebec and in Canada as a whole, particularly in regards to employment and gross domestic product).

170. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 110 (1999); Robert W. McGee, *The Case to Repeal the Antidumping Laws*, 13 NW. J. INT'L L. & BUS. 491, 521 (1993) (arguing that the government has shielded the auto industry from foreign competition by using tariffs and quotas); *see also* Robert W. McGee & Yeomin Yoon, *Trade Policy in the Computer Industry: Time for Change*, 8 TEMP. INT'L & COMP. L.J. 219, 250 (1994) (discussing the possible effect of legislation by Congress that would impose a quota or tariff on foreign products in order to protect the auto industry).

171. *See* Louis B. Schwartz, Justice, *Expediency, and Beauty*, 136 U. PA. L. REV. 141, 162 (1987) (discussing General Motors involvement internationally, in terms of development and technology); *see also* Sadananda Mukherjee, *Honda O.K.'s Venture To Build Civic in India*, AUTOMOTIVE NEWS, September 18, 1995 at 41 (stating that Honda is one of several foreign automakers to establish plans to produce automobiles in India). *See generally* David Adams, *Global Automobile Industry Changes Conceptions of Import*, AKRON BEACON JOURNAL, July 16, 1998, available at LEXIS (arguing that automobile manufacturers are willing to go wherever they may have potential sales).

172. *See* Brazil—Certain Automotive Investment Measures, Request for Joint Consultations, Communication from the United States, WTO Doc. WT/DS51/4 (Aug. 15, 1996); Jon M. Tate, *Sweeping Protectionism Under the Rug: Neoprotectionist Measures Among Mercosur Countries in a Time of Trade-liberalization*, 27 GA. J. INT'L & COMP. L. 389, 410 (1999) (noting additional duties imposed on auto industry in Brazil in 1996); *see also* Stephen P. Sorensen, *Open Regionalism or Old-Fashioned Protectionism? A Look at the Performance of Mercosur's Auto Industry*, 30 U. MIAMI INTER-AM. L. REV. 371, 385 (1999) (discussing the effects of Brazil's auto tariff on imports).

ments (manufacturers of motor vehicles could qualify for a very considerable tariff reduction only if they met a requirement of 60% domestically produced parts in domestically produced automobiles) and trade-balancing requirements (in order to qualify for tariff reduction, the imports of raw materials and assembled vehicles could not exceed the net exports of the manufacturer, and import of the parts for the vehicles could not exceed 2/3 of net exports).[173] The stated purpose of such measures was to encourage foreign investors to establish manufacturing plants in Brazil.[174] The first complaint was brought by Japan, the country with one of the largest automotive industries in the world, which alleged nullification or impairment of its obligations under Article 2 of the TRIMs Agreement, and invoked GATT Articles I:1 (MFN treatment), III:4 (national treatment) and XI:1 (Elimination of Quantitative Restrictions), and also the Agreement on Subsidies and Countervailing Measures (SCM Agreement) Articles 3, 27.2 and 27.3.[175] The U.S. and European Union followed with complaints that alleged the same violations.[176] The parties involved preferred not to establish a panel, but to resolve their dispute through negotiations.[177] This case, however, highlighted the inadequacy of the TRIMs Agreement provisions, such as their inability to be invoked independently from the GATT rules; and that Article 2 of the TRIMs Agreement clearly refers to GATT national treatment and elimination-of-quantitative-restrictions provisions.[178]

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173. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 111 (1999) (indicating Brazil's adoption of "local content and trade-balancing requirements"); Robert H. Edwards, Jr. & Simon N. Lester, T*owards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 184 (1997) (describing Brazil's "local content" requirement required of foreign manufacturers); Jon M. Tate, *Sweeping Protectionism Under the Rug: Neoprotectionist Measures Among Mercosur Countries in a Time of Trade-liberalization*, 27 GA. J. INT'L & COMP. L. 389, 413 (1999) (detailing the effectiveness of local content rules in Brazil's industry).

174. *See* Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 197 (1997).

175. *See* Brazil—Certain Automotive Investment Measures, Request for Consultations by Japan, WTO Doc. WT/DS51/1 (Aug. 6, 1996); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 112 (1999) (noting that Japan filed the initial complaint against Brazil to the WTO in 1996 claiming that it had violated provisions of TRIMs and GATT); *see also* Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 197 (1997) (noting that Japan filed a complaint through the WTO in response to Brazil's auto industry policies).

176. *See* Brazil—Certain Automotive Investment Measures, Request to Join Consultations, Communication from the United States, WTO Doc. WT/DS51/4 (Aug. 15, 1996); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 112–13 (1999) (noting complaints filed by the U.S. and European Union against Brazil); *see also* Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 197 (1997) (indicating that the U.S. filed a complaint against Brazil as a result of its auto industry restrictions).

177. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 112–13 (1999) (noting the parties' preference to settle this dispute through negotiations, not a GATT panel); Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 198 (1997) (noting the use of consultations among Brazil, Japan, the European Union and the U.S. in an attempt to resolve complaints surrounding Brazil's auto industry); *see also* Brazil—Certain Automotive Investment Measures, Request for Consultations by Japan, WTO Doc. WT/DS51/1 (Aug. 6, 1996).

178. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 113 (1999) (arguing that the TRIMs Agreement is redundant); *see also* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1035–36 (1997) (detailing that TRIMs foundation was based on GATT's national treatment ideology); Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 566 (1994) (discussing the limitations of TRIMs under GATT, including lack of resolution for disputes under GATT).

Another example of the imposition of egregious TRIMs is the case of Indonesia's campaign for an indigenous car. In 1996, President Suharto signed an edict and thereby launched the so-called Pioneer Auto Program that envisaged the creation of a national car.[179] From the very beginning, there was substantial evidence of corruption.[180] For example, the sole company that qualified for that program was PT Timor Putra Nasional, owned by the president's son.[181] The prospective national car "Timor" was the first to be produced as a joint venture enterprise with Kia in Korea, while Indonesia would build its own manufacturing plant on Java.[182] The fully assembled "Timors" were to be granted duty-free régime for importation into Indonesia with the only requirements being that Kia use at least 20% of Indonesia-manufactured parts and employ a certain number of Indonesian workers.[183] The first complaint was brought by European communities alleging violations of different WTO-established agreements by the introduction of a local content requirement and an import preference.[184] The U.S. and Japan followed with their complaints claiming that Indonesia locked them out of the market by granting this enormous advantage to Kia.[185] When the negotiations with Indonesia failed, all the complainants requested establishment of the panel.[186]

The panel began the hearing, but eventually the complaint was dismissed as moot: the Asian economic crisis intervened and frustrated Suharto's ambitious plans.[187] The crisis hit not

179. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 118 (1999) (explaining that President Suharto commenced the "Pioneer Auto Program" in 1996 to bolster Indonesia's industry).

180. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 119 (1999).

181. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 118 (1999) (providing that only the President's son qualified for participation in the "Pioneer Auto Program").

182. Joint venture was also 70% owned by Suharto's son. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 118 (1999) (indicating the program's attempt to form a joint venture with Kia Motors, a Korean based company).

183. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 118–19 (1999) (detailing the conditions upon which Indonesia would import 45,000 automobiles from Korea, including requirements for the use of 20 percent Indonesian auto parts, and a minimal number of Indonesian workers employed at those plants).

184. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 119 (1999) (noting that the European Union filed the first complaint against the "Pioneer Auto Program"). The EC alleged that there was a violation of GATT Articles I and III, Article 2 of the TRIMs Agreement and Article 3 of the SCM Agreement. *Id*.

185. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 119 (1999) (explaining that soon after the European Union filed its suit, the U.S. and Japan filed similar complaints with the WTO).

186. *See* Robert H. Edwards, Jr. & Simon N. Lester, *Towards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 181–82 (1997) (explaining that Japan filed a complaint through the WTO in response to Brazil's auto industry policies); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 119 (1999) (noting that the European Union, the U.S. and Japan eventually petitioned to have their complaints heard before a panel).

187. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 120 (1999) (explaining the interference of the Asian economic crisis with the "Pioneer Auto Program"); Paulsen K. Vandevert, Esq., *The Uruguay Round and the World Trade Organization: A New Era Dawns in The Private Law of International Customs and Trade*, 31 CASE W. RES. J. INT'L L. 107, 126–27 (1999) (discussing how the Asian economic crisis eclipsed the WTO's decision); *see also* Ellen J. Shin, *The International Monetary Fund: Is it the Right or Wrong Prescription for Korea?*, 22 HASTINGS INT'L & COMP. L. REV. 597, 615 (1999) (noting that the Asian economic crisis extended to Indonesia).

only Indonesia, but also Korea, and Kia abandoned the whole investment project.[188] Later, the IMF forced Indonesia to gradually remove all preferences.[189] This automotive debate did not result in a panel decision, but it revealed one more shortcoming of the TRIMs Agreement: it fails to cover widespread types of TRIMs such as import preferences and equity requirements.[190]

As it can be seen from the above examples, the TRIMs Agreement does not fully address the complicated issue of the protection of foreign investors in the host state.[191] In particular, it fails to cover such important instances as:

1) nontrade-related TRIMs (they are covered in part by GATS);
2) other types of TRIMs except local content requirements and performance requirements (such as equity requirements or remittance restrictions);
3) political risks, such as expropriation, nationalization, requisition;
4) repatriation of profits.[192]

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188. *See* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 120 (1999) (indicating that the Asian economic crisis adversely impacted the Kia Group); Paulsen K. Vandevert, Esq., *The Uruguay Round and the World Trade Organization: A New Era Dawns in The Private Law of International Customs and Trade*, 31 CASE W. RES. J. INT'L L. 107, 126–27 (1999) (noting that Kia went bankrupt at the time the WTO reached its decision); *see also* Ellen J. Shin, *The International Monetary Fund: Is it the Right or Wrong Prescription for Korea?*, 22 HASTINGS INT'L & COMP. L. REV. 597, 601 (1999) (detailing the economic struggles of Korea at the time of the Asian economic crisis).

189. *See* Paul Civello, *The TRIMS Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 121 (1999) (discussing the IMF's decision to eliminate import preferences in Indonesia). *See generally* Sue Ann Mota, *The World Trade Organization: An Analysis of Disputes*, 25 N.C. J. INT'L LAW & COM. REG. 75, 101 n.219 (1999) (providing that Indonesia was forced to eliminate its automotive program because import preferences violated GATT provisions); Paulsen K. Vandevert, Esq., *The Uruguay Round and the World Trade Organization: A New Era Dawns in the Private Law of International Customs and Trade*, 31 CASE W. RES. J. INT'L L. 107, 126 (1999) (stating that the World Trade Organization found that Indonesia had violated TRIMs because of its local content requirement and the import preferences granted to Indonesia).

190. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1037–38 (1997) (listing investment measures, including local equity and manufacturing requirements, that are not covered by the TRIMs Agreement); Paul Civello, *The TRIMS Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 121–22 (1999) (detailing how import preferences invoked by Indonesia's "Pioneer Auto Program" are not covered under the TRIMs Agreement); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 848 n.112 (2000) (stating that local equity and other investment measures are not addressed by the TRIMs Agreement).

191. *See* Matthew B. Cobb, *The Development of Arbitration in Foreign Investment*, 16 NO. 4 MEALEY'S INT'L ARB. REP. 48 (2001) (discussing the deficiency of the TRIMs Agreement to protect foreign investors in disputes); J. Patrick Kelly, *The Twilight of Customary International Law*, 40 VA. J. INT'L L. 449, 503 (2000) (characterizing the TRIMs Agreement as a failure because of its lack of investment protection measures); Todd S. Shenkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT: Moving Toward a Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 566 (1994) (stating that under the TRIMs Agreement, foreign investors have no legal recourse when their investments are directly affected by a host country).

192. *See* David R. Adair, *Investor's Rights: The Evolutionary Process of Investment Treaties*, 6 TULSA J. COMP. & INT'L L. 195, 199 (1999) (discussing the lack of a provision for repatriation of capital in the TRIMs Agreement); Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1038 (1997) (providing that the TRIMs Agreement does not require repatriation of capital). *But see* Robert H. Edwards, Jr. & Simon N. Lester, T*owards a More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 201 (1997) (stating that disincentive TRIMs, which encompass performance requirements, restrict repatriation of profits by imposing additional costs on foreign investors).

Moreover, the TRIMs Agreement does not have a specific dispute settlement procedure, therefore all the disputes arising out of its rules are resolved according to the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU").[193] This fact also adds to the inadequacies of the TRIMs Agreement as investment disputes usually involve a private party and a host government, and under the rules of DSU, only states have standing.[194] On the other hand, it does require a national treatment régime (Article 2) and prohibit quantitative restrictions (Article 2) and the most egregious forms of trade-related investment measures (Annex—Illustrative list).[195]

### 5. MAI and its Failure

The apparent inadequacy of the TRIMs Agreement raised the question of negotiating and adopting the Multilateral Agreement on Investment (MAI).[196] This would be a separate treaty outside the framework of WTO that would deal with issues of FDI, such as market access, prohibition of TRIMs, protection against expropriation and nationalization, and repatriation of

193. *See* David R. Adair, *Investors' Rights: The Evolutionary Process of Investment Treaties*, 6 TULSA J. COMP. & INT'L L. 195, 201 (1999) (stating that the DSU is the sole governing body of disputes concerning foreign investment); C. O'Neal Taylor, *Linkage and Rule-Making: Observations on Trade and Investment and Trade and Labor*, 19 U. PA. J. INT'L ECON. L. 639, 696 n.158 (1998) (maintaining that all violations of the TRIMs Agreement must be settled by the DSU); Malcolm Richard Wilkey, *Introduction to Dispute Settlement in International Trade and Foreign Direct Investment*, 26 LAW & POL'Y INT'L BUS. 613, 615 (1995) (explaining that all disputes resulting from the TRIMs Agreement will be subject to the procedures set forth by the DSU).

194. *See* Cheryl W. Gray and William W. Jarosz, *Law and Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 3 (1995); Andrea K. Schneider, *Democracy and Dispute Resolution: Individual Rights in International Trade Organizations*, 19 U. PA. J. INT'L ECON. L. 587, 602 (1998) (discussing that private investors have no standing under the DSU system since that resolution system is only available to states); *see also* C. O'Neal Taylor, *Linkage and Rule-Making: Observations on Trade and Investment and Trade and Labor*, 19 U. PA. J. INT'L ECON. L. 639, 696, n.158 (1998) (stating that the DSU makes no provision for disputes between investors and host states, since it was established for complaints only for disputes among states).

195. *See* Riyaz Dattu, *A Journey From Havana To Paris: The Fifty-Year Quest For The Elusive Multilateral Agreement on Investment*, 24 FORDHAM INT'L L.J. 275, 291 (2000) (stating that the Annex to the TRIMs Agreement includes examples of certain TRIMs that are inconsistent with provisions of the GATT, including local content requirements and trade balancing measures); Robert H. Edwards, Jr. & Simon N. Lester, *Towards A More Comprehensive World Trade Organization Agreement on Trade Related Investment Measures*, 33 STAN. J. INT'L L. 169, 196–97 (1997) (listing prohibited TRIMs that breach the GATT provision for national treatment, including TRIMs that were implemented for either performance requirements or incentives); Kevin C. Kennedy, *The GATT-WTO System at Fifty*, 16 WIS. INT'L L.J. 421, 522–23 (1998) (explaining that the Annex delineates mandatory measures providing for the prohibition of local content requirements, trade-balancing requirements and foreign-exchange balancing restrictions).

196. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations in Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1042–44 (1997) (noting that the MAI addresses many of the inadequacies of the TRIMs); Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 126 (1999) (noting that the MAI was intended to accomplish that which was not by the TRIMs: "global investment liberalization").

profits—all the issues the TRIMs Agreement fails to address.[197] This agreement was negotiated under the auspices of the OECD, which is comprised mainly of the world's largest capital-exporting countries with the largest per capita GDP.[198] The agreement was intended to be based on three main pillars: a broad set of rules for investment protection, the liberalization of the investment régime and an effective dispute settlement procedure.[199] One of the hallmarks of the MAI was to be a very broad definition of investment (it was designed to cover all existing and evolving forms of investment, but at the same time, exclude the products of investment).[200] The MAI was intended to become a reflection of the so-called new constitutionalism, limiting the power of government to interfere with the rights of private capital to enter the market, operate commercial facilities and exit and remit investments without restrictions.[201]

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197. *See* Stephen J. Canner, *The Multilateral Agreement on Investment*, 31 CORNELL INT'L L. J. 657, 659 (1998); Eric M. Burt, *Developing Countries and the Framework for Negotiations in Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L L. & POL'Y 1015, 1043–44 (1997) (stating that the MAI will be successful since it will prohibit all TRIMs and liberalize investment measures); *see also* Paul Civello, *The TRIMs Agreement: A Failed Attempt at Investment Liberalization*, 8 MINN. J. GLOBAL TRADE 97, 123–24 (1999) (discussing the MAI's objectives of prohibiting performance requirements and regulation on investment incentives and promoting national treatment and most favored nation obligations for investment).

198. To date, OECD represents the following countries: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, The Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, U.S., United Kingdom. *See* OECD, Member Countries List, *available at* <http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-countrylist-0-nodirectorate-no-no-159-0,FF.html> (last visited Nov. 1, 2001). *See also* James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 776 (2000) (offering that OECD member countries comprise two-thirds of the world's goods and services). *See generally* Wesley Scholz, *Direct Investment: International Regulation of Foreign Direct Investment*, 31 CORNELL INT'L L.J. 485, 487 (1998) (characterizing the 30 member countries as advanced countries with the largest sources of and uses for foreign investment).

199. *See* Stephen J. Canner, *The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 657 (1998); Rainer Geiger, *Direct Investment: Towards a Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 467, 471 (1998) (discussing the objectives of the MAI are to provide security to existing investments, secure the repatriation of capital and to offer dispute procedures that will address investor and state conflicts); *see also* Jeffrey Lang, *The International Regulation of Foreign Direct Investment: Obstacles & Evolution Address*, 31 CORNELL INT'L L.J. 455, 461–62 (1998) (stating the intentions of the MAI to liberalize investment regimes, protect investment and establish a more effective dispute settlement procedure).

200. *See* Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 483 n.69 (1999) (citing to the MAI Commentary); Sol Picciotto, *Linkages in International Investment Regulation: The Antinomies of the Draft Multilateral Agreement on Investment*, 19 U. PA. J. INT'L ECON. L. 731, 755–56 (1998) (stating that the expansive definition of investment encompasses all type of contractual rights, loans and intellectual property rights); *see also* Robert Stumberg, *Direct Investment: Sovereignty by Subtraction: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 491, 501 (1998) (commenting that the MAI's definition of investment includes all assets and extends the protection of investors and investments).

201. *See* David Schneiderman, *Investment Rules and the New Constitutionalism*, 25 LAW & SOC. INQUIRY 757, 767 (2000) (discussing new constitutionalism); Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT'L LAW 1033, 1033 (2000) (relating that the theory of "new constitutionalism" focuses on preventing national interference with private capital and investment). *See generally* Robert Stumberg, *Direct Investment: Sovereignty by Subtraction: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 491, 522 (1998) (discussing that the MAI should allow companies and governments to decide how to promote investment and the MAI should refrain from interfering in investment activities).

The MAI was expected to overturn the framework of world investment relationships, but instead it raised a storm of protests, mainly over constitutional, labor and environmental issues.[202] From the very beginning, OECD negotiations were blamed for being unrepresentative and lacking any reasonable transparency.[203] The draft text of MAI remained a restricted internal document until it was leaked on the Internet in August 1997.[204] This initial atmosphere of secrecy, the unwillingness to invite social groups into the discussion and its potentially profound impact on the economies of all participating states spurred a wave of hostility toward the very idea of the project.[205] Social groups were especially concerned with the absence of provisions addressing protection of the environment and domestic employees.[206] On April 23, 1998, the Canadian Liberty Committee sued the national government to enjoin it from participating in the MAI negotiation on the grounds that the MAI contradicted the Canadian Constitution and this would lead to breach of constitutional order, diminish the constitutional rights of natural persons, and that the signing of the Agreement by the executive branch would

202. *See* James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 818–19 (2000) (describing how the Canadian government and European Parliament, among others, criticized the MAI as ignoring society, the environment and human need, while protecting only corporations and investors); Lance Compa, *The Multilateral Agreement on Investment and International Labor Rights: A Failed Connection*, 31 CORNELL INT'L L.J. 683, 687 (1998) (stating that despite good intentions, the language of the MAI did not properly address violations of laborers' rights); John Wickham, *Toward a Green Multilateral Investment Framework: NAFTA and the Search for Models*, 12 GEO. INT'L ENVTL. L. REV. 617, 618 (noting that environmental groups felt left out of the drafting of the MAI and were not satisfied with its substance).

203. *See* Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT'L LAW. 1033, 1039 (2000); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 816 (2000) (commenting that, despite the fact that MAI negotiations were not officially secret, critics assert that, nonetheless, they did occur behind closed doors).

204. *See* Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT'L LAW. 1033, 1039 (2000) (noting that the text of the MAI was published on the Internet in August 1997); *see also* Jan McDonald, *The Multilateral Agreement on Investment: Heyday or MAI-day for Ecologically Sustainable Development?*, 22 MELB. U. L. REV. 617, 622 (1998) (stating that the MAI was leaked on the Internet in 1997); James Salzman, *Labor Rights, Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 824 (2000) (revealing that Ralph Nader's Public Citizen group had a copy of the draft as early as February 1997).

205. *See* Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT'L LAW. 1033, 1039 (2000); Stephen J. Canner, *The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 657, 673 (1998) (asserting that the secrecy of MAI negotiations so angered environmental groups that it made debate nearly impossible); *see also* Mark Vallianatos, *De-Fanging the MAI*, 31 CORNELL INT'L L.J. 713, 725 (1998) (stating that secrecy in negotiations for agreements such as the MAI undermines public confidence in the entire project).

206. *See* John Wickham, *Toward a Green Multilateral Investment Framework: NAFTA and the Search for Models*, 12 GEO. INT'L ENVTL. L. REV. 617 (2000) (suggesting the introduction of a NAFTA-like "three anchor" approach to environmental protection into the MAI text); *see also* Isabella D. Bunn, *The Right to Development: Implications for International Economic Law*, 15 AM. U. INT'L L. REV. 1425, 1458 (2000) (stating that environmental groups were troubled by the MAI's power to limit a country's right to regulate its own policy); Gus Van Harten, *Guatemala's Peace Accords in a Free Trade Area of the Americas*, 3 YALE HUM. RTS. & DEV. L.J. 113, 140 (2000) (commenting that the EPA is concerned that international investment treaties will diminish a country's regulatory power over its own environment).

be a constitutional *ultra vires* act.[207] The same year, French Prime Minister Lionel Jospin announced France's withdrawal from further negotiations since the draft MAI, as formulated at that time, was an unacceptable threat to national sovereignty.[208] The MAI was also condemned in Australia.[209] Eventually, as a result of worldwide public and political pressure, the OECD suspended and eventually gave up negotiations.[210]

The existing régime of FDI regulation cannot be called perfect. The main vehicle of the regulation still remains bilateral investment treaties individually negotiated and concluded between capital-exporting (industrialized) and capital-importing (developing) countries.[211] The current WTO framework fails to adequately address the issue of FDI primarily because of the resistance of developing countries. However, it does provide for a national standard of treatment of foreign investors and prohibits the most egregious forms of TRIMs, namely, local con-

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207. Constance Clara Fogel and the Defense of Canadian Liberty Committee v. Canada, (1999) 3 F.C.D. 49. The complaint alleged, *inter alia*, that the MAI (i) relinquishes the effective control and jurisdiction over property and civil rights to foreign investors and international tribunals; (ii) grants primary rights to foreign investors and corporations over those of natural persons; (iii) renders the treaty and investor rights superior to that of the Canadian and provincial governments and removes the jurisdiction for disputes out of Canada from the Canadian courts to an international tribunal. The court dismissed the complaint due to mootness: by the day of rendering the judgment, the MAI negotiations had already been abandoned due to sheer social pressure. *Id. See* Michel Chossudovsky, *Citizens Take Canadian Government to Court: Questioning the Constitutionality of MAI Negotiations*, PEACE MAG., Apr. 1999, at 22 (stating that the Defence of Liberty Committee sued the Canadian government to enjoin them from MAI negotiations because they believed it was outside the authority of the federal government and would give rights to foreign businesses that Canadian citizens do not maintain); *see also Fence Fit to Stand: Judge*, THE OTTAWA SUN, Apr. 19, 2001, at 8 (showing that the Defence of Canadian Liberty Committee was also involved in protesting the erection of a security fence around the Summit of the Americas conference in Ottawa as a violation of the public's rights).

208. *See* Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT'L LAW. 1033, 1048–49 (2000); Chris Baumgartner, *Trade and the Environment: The Demise of the Multilateral Agreement on Investment*, 1998 COLO. J. INT'L ENVTL. L. Y.B. 40 (quoting French Prime Minister Jospin as stating that France rejected the MAI as being a threat to state sovereignty); *see also* John A. Ragosta, *NAFTA Revisited: The Cultural Industries Exemption from NAFTA—Its Parameters*, 23 CAN-U.S. L.J. 165, 174 (1997) (stating that both France and Canada wanted exemptions from the MIA agreements to protect their cultural identities).

209. *See* Chris Baumgartner, *Trade and the Environment: The Demise of the Multilateral Agreement on Investment*, 1998 COLO. J. INT'L ENVTL. L. Y.B. 40 (stating that Australia backed France's decision not to support the MAI); *see also* Joel Richard Paul, *Cultural Resistance to Global Governance*, 22 MICH. J. INT'L L. 1, 39–40 (2000) (stating that Australia had similar concerns about cultural identity as European countries that rejected the MAI). *See generally* LIBRARY OF CONGRESS, ECUADOR: A COUNTRY STUDY 137 (1991) (stating that the role of the Superintendent of Banks is to supervise and control banks as well as collect and publish statistics on the banks in Ecuador).

210. *See* Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 483 (1999); Lance Compa, *The Multilateral Agreement on Investment and International Labor Rights: A Failed Connection*, 31 CORNELL INT'L L.J. 683, 684 (1998) (describing MAI's failure as a result of heavy public criticism); *see also* Jan McDonald, T*he Multilateral Agreement on Investment: Heyday or MAI-day for Ecologically Sustainable Development?*, 22 MELB. U. L. REV. 617, 655–56 (1998) (explaining that the OECD decided to postpone future negotiations in 1998 amid growing disapproval from nations concerned with state sovereignty, and disapproval from environmental and labor groups).

211. *See* Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization*, 12 AM. U. J. INT'L & POL'Y 1015, 1044–45 (1997) (stating that bilateral investment treaties are so prevalent that they became the basis of the MAI treaty); *see also* Jeffrey Lang, *The International Regulation of Foreign Direct Investment: Obstacles & Evolution*, 31 CORNELL INT'L L.J. 455, 457 (1998) (pointing out that the U.S. has signed over forty BIT's with foreign nations, making it a vital tool in American international trade).

tent requirements and performance requirements. It can be stated that the TRIMs Agreement is the best multilateral agreement that could be achieved so far since other efforts to achieve further liberalization of the FDI régime (by OECD in the form of MAI) eventually failed due to an inability of the parties to reconcile their differences.

## III. Ukraine and its Accession to the WTO: Impact on the Investment Regulation

### 1. Ukraine and the WTO

The Ukraine is currently experiencing an extremely harsh period of its post-independence history.[212] Since the breakup of the Soviet Union in 1991, the Ukraine has suffered a tremendous economic decline.[213] Its 1999 per capita GDP was $750,[214] with an annual decline of 0.4%.[215] The current setback in the Ukrainian economy is a direct consequence of the sudden and haphazard severance of economic ties with the republics of the former Soviet Union that became sovereign nations nearly overnight.[216] As a result, the gross domestic product has

212. According to the recent World Bank Report, Ukraine, from 1990 to 1999, had an average annual decline in GDP amounting to 10.8%—the greatest in the world for the surveyed period of time. World Bank, WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 8 (2001). *See* Anka Feldhusen, *The "Russian Factor" in Ukrainian Foreign Policy*, 23 FLETCHER F. WORLD AFF. 119, 125 (1999) (commenting that the Ukrainian economy is "faltering"); John Moroz Smith, *The Icon and the Tracts: A Restrained Renaissance of Religious Liberty in Ukraine*, 2001 BYU L. REV. 815, 842 (2001) (noting that Ukraine's economy is "defunct").

213. *See* World Bank, WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 8 (2001) (stating that "expanding into international markets promotes economic growth in the developing countries"); *Economic Conditions*, THE PRS GROUP, Jan. 1, 1998, *available at* LEXIS (stating that the Ukraine's economic decline rate has actually decreased from a high of 23.7% in 1994 to 5% in 1997); *see also Ukraine Update*, THE PRS GROUP, Dec. 1, 1999, *available at* LEXIS (noting that the Ukraine's GDP declined an average of 5.7% a year from 1995 to 1999).

214. *See Ukraine-Building Materials*, National Trade Desk Data Bank, Dec. 1, 1998, *available at* LEXIS (noting that the low level of purchase power in the Ukraine greatly affects pricing policy of companies doing business there); *see also Economic & Social Data*, THE PRS GROUP, Jan 1, 2000, *available at* LEXIS (confirming that original estimates had the Ukraine's Per Capital GDP at $725 in 1999); *Ukrainian Industrial Production up 17.4% in Q1*, INTERFAX NEWS AGENCY, Apr. 13, 2001, *available at* LEXIS (offering that despite Ukraine's low ranking, it could strengthen its position within just five years).

215. *See Banking and Finance Report*, INTERFAX NEWS AGENCY, May 16, 2001, *available at* LEXIS (confirming that the Ukraine's GDP decreased by .4% in 1999); *see also* Elizabeth Brainerd, *Women In Transition: Changes in Gender Wage Differentials in Eastern Europe and the Former Soviet Union*, 54 IND. & LAB. REL. REV. 138, 142 (2000) (offering that the huge decline in the Ukraine's GDP is due to inaccurate measuring); *Fitch Assigns Ratings to Ukraine*, INTERFAX NEWS AGENCY, June 15, 2001, *available at* LEXIS (stating that just one year later, the Ukraine's GDP increased by 5.8%).

216. *See* Susan Tiefenbrun, *Piracy of Intellectual Property in China and the Former Soviet Union and its Effects Upon International Trade: A Comparison*, 46 BUFF. L. REV. 1, 65 (1998) (pointing out how all of the former Republics of the Soviet Union have had difficulty making the transition into global trading as independent entities); *see also* Andrew M. Beato, *Newly Independent and Separating States' Succession to Treaties: Considerations on the Hybrid Dependency of the Republics of the Former Soviet Union*, 9 AM. U. J. INT'L & POL'Y 525, 558 (1994) (stating that the economic climate in all of the former Soviet republics is in such turmoil that it may create an international crisis); Note, *Conflict in the Crimea: An Examination of Ethnic Conflict under the Contemporary Model of Sovereignty*, 34 COLUM. J. TRANSNAT'L L. 219, 224 (1995) (offering that the internal conflict in the Ukraine with Crimea, which could not be resolved in the rush to declare independence from the former Soviet Union, is costing the Ukraine considerably, exacerbating the economic crisis).

dropped dramatically from $91,327 million in 1990 to an estimated $42,415 million in 1999.[217] At the same time, the Ukraine, lacking its own sufficient oil and gas supplies, appeared to be fully dependent on Russia's energy resources.[218] The Ukraine's constant indebtedness gave Russia an opportunity to hold a grip on the Ukrainian economy.[219] These factors urged the Ukraine to struggle for new external financial resources, notably in the form of FDI.[220] The country, lacking internal resources for revitalization, has been in desperate need for capital.[221] However, the situation with FDI is very unstable and changes considerably every year.[222] According to the UNCTAD, in 1999 FDI inflows to the Ukraine constituted $496 million, which was only about 66% of the 1998 FDI ($743 million).[223] However, according to the Ukrainian State Committee on Statistics (*Derzhkomstat*), in 2000, FDI increased by 20% and reached $584 million.[224]

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217. See World Bank's WORLD DEVELOPMENT REPORT 2000/2001: ATTACKING POVERTY, at 8 (2001) (stating that "expanding into international markets promotes economic growth in the developing countries"). *See generally Ukrainian GDP Down 3% in Seven Months*, INTERFAX RUSSIAN NEWS, Aug. 17, 1999, *available at* LEXIS (during the first seven months of 1999 the Ukraine's Gross Domestic Product decreased 3%); Stefan Korshak, *Hryvna Solid Until Fall*, KYIV POST, May 7, 1999, *available at* LEXIS (finding the Ukrainian Gross Domestic Product continues to drop during 1999).

218. *See* Robert H. Donaldson, *Boris Yeltsin's Foreign Policy Legacy*, 7 TULSA J. COMP. & INT'L L. 285, 303–04 (2000) (explaining that bitter feelings between Russia and the Ukraine still exist despite, or even because of, the forgiveness of the Ukraine's large oil debt); Pamela Bickford Sak, *Environmental Law in Ukraine: From the Roots to the Bud*, 11 UCLA J. ENVTL. L. & POL'Y 203, 206 (1993) (pointing out that the Ukraine faces an energy crisis despite having sufficient natural resources). *See generally Belarussian Bullying*, TIMES (LONDON), Sept. 10, 2001, *available at* LEXIS (noting that Russia provides the Ukraine with 70% of its energy). *But see* Scott Peterson, *Diplomatic Tug-of-War Has Ukraine Playing Both Sides*, CHRISTIAN SCI. MONITOR, July 11, 2001, at 7 (citing that the Ukraine is currently entering into agreements with other nations in order to lessen its dependence upon Russia for energy).

219. *See* Anka Feldhusen, *Geography and the Boundaries of Confidence: The "Russian Factor" in Ukrainian Foreign Policy*, 23 FLETCHER F. WORLD AFF. 119, 129 (1999) (citing that Russia heavily influences the Ukrainian economy); *see also* Anatoliy M. Zlenko, *Foreign Policy Interests of Ukraine and Problems of European Security*, 21 FORDHAM INT'L L.J. 45, 60–61 (1997) (remarking that Russia is the main economic partner for Ukraine). *See generally Russian, Ukrainian Presidents to Hold Talks in Moscow*, ITAR-TASS, June 21, 2000, *available at* LEXIS (noting that in 2000 Ukraine's debt to Russia equaled $3 billion dollars).

220. *See* Vladimir V. Sytin, *When Partners Become Slippery Customers*, UKRAINIAN TIMES, Sept. 4, 2001, *available at* LEXIS (noting that the Ukrainian economy is dependant upon foreign investment); *see also* Jenik Radon, *Permitted Unless Prohibited: The Changed Soviet Mentality*, 20 FORDHAM INT'L L.J. 365, 367–68 (1996) (citing that countries who enact favorable FDI legislation have more investors despite other generally unfavorable conditions). *See generally Ukraine: Country Profile*, EUROPE REVIEW WORLD OF INFORMATION, Sept. 13, 2001, at 1 (stating that Ukraine has a disproportionately low level of FDI).

221. *See Ukraine: Review 1999*, EUROPE REVIEW WORLD OF INFORMATION, Nov. 11, 1999, at 1 (noting that Ukrainian industry needed both reform and capital); *see also* Doyle McManus, *Clinton Sales Pitch Aimed at Ukraine Lawmakers*, LA TIMES, Jan. 12, 1994, at A8 (citing that former President Clinton relied on the Ukraine's desperate need for financial aid in his foreign policy); Jeff Sommer, *Dreams of Independence as the Ukrainians Toil*, NEWSDAY, Oct. 20, 1991, at 7 (finding that Ukrainian agriculture in particular was in desperate need of financial aid).

222. *See* DeAnne Julius, *Global Companies & Public Policy. The Growing Challenge of Foreign Direct Investment*, 86 A.J.I.L. 434, 434 (1992) (discussing the fact that FDI has undergone drastic changes over the past several decades); *Ensure you gain from FDI*, NEW STRAITS TIMES (MALAYSIA), Aug. 21, 2001, at 2 (noting that FDI has changed in "size, form, and impact"); Kieran Cooke, *Survey—Business Locations In Europe*, FINANCIAL TIMES (LONDON), at 4 (discussing the "changing nature of FDI").

223. UNCTAD Press Release TAD/INF/2859, Foreign Investment Increases in Central and Eastern Europe, Topped by Poland and Czech Republic (Oct. 3, 2000).

224. MONTHLY ECONOMIC MONITOR UKRAINE, No. 2(4) February 2001, *available at* <http://www.ier.kiev.ua/Down/MEMU_ 4%20February%200l%20EN.pdf> (last accessed July 19, 2001).

As it is noted in a recent OECD Policy Review, "economic decline of Ukraine cannot be attributed merely to economic fundamentals, but is mainly due to difficult conditions for business activity in Ukraine that deter investors, foreign and domestic alike, drive Ukrainian entrepreneurs underground and encourage domestic capital to flee the country."[225]

Undoubtedly, the FDI inflow is hampered by the fact that Ukraine is not a member of the WTO and therefore not entitled to (or bound by) the WTO framework agreements' provisions on national treatment, MFN treatment and elimination of quantitative restrictions.[226] As commentators note, the existence of a treaty between the investor's home country and the host country of the investment gives the investor much more confidence because a breach of a treaty is a violation of the universally recognized rule *pacta sunt servanda*.[227] Unlike an FDI protective régime, which can easily be revoked or limited through the exercise of legislative power and would not be actionable due to the concept of sovereign immunity,[228] or the act of state doctrine,[229] states are generally much less willing to violate treaty obligations specifically owed to

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225. UKRAINE INVESTMENT POLICY REVIEW. THE LEGAL AND INSTITUTIONAL REGIME FOR INVESTMENT: ASSESSMENT AND POLICY RECOMMENDATIONS. EXECUTIVE SUMMARY AND RECOMMENDATIONS. OECD DIRECTORATE FOR FINANCIAL, FISCAL, AND ENTERPRISE AFFAIRS, at 6 (March 2001).

226. *See* William J. Kovatch, Jr., *Joining the Club: Assessing Russia's Application for Accession to the World Trade Organization*, 71 TEMP. L. REV. 995, 999 (stating that members of the WTO enjoy numerous economic and trade advantages); *see also* Mikhail Melnik, *Canada Ready to Support Ukraine's Drive for Joining WTO*, ITAR-TASS, Aug. 27, 2001, *available at* LEXIS (noting that by joining the WTO there would be an increase in employment in Ukraine). *See generally Ukraine: Review 1997*, EUROPE REVIEW WORLD OF INFORMATION, April 1997, at 241 (noting that in 1997 Ukraine had a relatively low inflow of foreign direct investment).

227. "Foreign markets are being re-opened to Western investment in many parts of the world, and this tendency is expected to grow," PAUL E. COMEAUX & N. STEPHEN KINSELLA, PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW 99 (1997). *See* Detlev F. Vagts, *The United States and Its Treaties: Observance and Breach*, 95 A.J.I.L. 313, 326 (2001) (citing that the breach of treaties has been historically seen as "fundamentally wrong"). *See generally* Gabe Shawn Varges, Book Note, 86 AM. J. INT'L L. 841, (1992) (reviewing J. F. O'CONNOR, GOOD FAITH IN INTERNATIONAL LAW (1991)) (defining *pacta sunt servanda* as international good faith and honesty).

228. The doctrine of sovereign immunity is based on the premise that the sovereign state is immune from suit in the court of another state and constitutes a long-recognized development of the international law principle of comity among nations. In the U.S., it was first spelled out by the U.S. Supreme Court in 1812 in The Schooner Exchange v. McFaddon, 11 U.S. 116, 3 L. Ed. 287 (1812), where the court stated:

> [The] perfect equality and absolute independence of sovereigns, and this common interest impelling them to mutual intercourse, and an exchange of good office with each other, have given rise to a class of cases in which every sovereign is understood to wave [sic] the exercise of a part of that complete exclusive territorial jurisdiction, which has been stated to be the attribute of every nation.

*Id*. at 137. *See also* Texas Trading v. Federal Republic of Nigeria, 647 F.2d 300 (2d Cir. 1981), *cert. denied*, 454 U.S. 1148 (1982). *See generally* RONALD A. BRAND, FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS 775–832 (2000).

229. The act of state doctrine is a U.S. judicially created concept that is based on the theories of sovereignty and separation of powers. The leading state-doctrine case is Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 84 S. Ct. 923, 11 L. Ed. 2d 804 (1964), where the court in the oft-cited paragraph stated:

> the Judicial Branch will not examine the validity of a taking of property within its own territory by a foreign sovereign government, extant and recognized by this country at the time of a suit, in the absence of a treaty or other unambiguous agreement regarding controlling legal principles, even if the complaint alleges that the taking violates international customary law.

*Id.* at 428.

other states.[230] The reason for this is that the political repercussions of violating a treaty are usually worse than a breach of contractual obligations toward individual private investors.[231]

In Ukraine, accession to the WTO was considered from the outset as an important step in the country's path toward the effective market economy and integration into the world economic community.[232] Unlike Poland and Hungary, the Soviet Union, and later Ukraine as its successor, has never been a party to the GATT, and therefore could not qualify for the original membership in the WTO.[233] On the other hand, Ukraine's accession to the WTO through a 2/3 majority vote of the members will commit Ukraine to further reforms in the economic sphere; such as an increase in the transparency of governmental regulation of the economy, submission to monitoring by other WTO member countries and decision making within the confines of WTO policies.[234] This requires an overview of the current foreign investment legislation as well as an analysis of the possible impact of WTO membership on the Ukrainian domestic FDI régime.

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230. *See* Scott McBride, *Dispute Settlement in the WTO: Backbone of the Global Trading System or Delegation of Awesome Power?*, 32 LAW & POL'Y INT'L BUS. 643, 664 (2001) (noting the binding nature of treaties, and that international law requires a nation to respect its treaty obligations); Claudia Fox, Article, *The UNIDROIT Convention On Stolen Or Illegally Exported Cultural Objects: An Answer To The World Problem Of Illicit Trade In Cultural Property*, 9 AM. U. J. INT'L L. & POL'Y 225, 253 (1993) (commenting that nations are unwilling to enforce another nation's laws and obligations absent a binding treaty); Jelena Pejic, *Creating A Permanent International Criminal Court: The Obstacles To Independence And Effectiveness*, 29 COLUM. HUM. RTS. L. REV. 291, 301 (1998) (stating that "treaties are the most reliable source of international law because the binding nature of their norms is beyond dispute").

231. *See* PAUL E. COMEAUX & N. STEPHEN KINSELLA, PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW 100 (1997).

232. *See* Mikhail Melnik, *Canada Ready to Support Ukraine's Drive for Joining WTO*, ITAR-TASS, Aug. 27, 2001, *available at* LEXIS (noting that by joining the WTO there would be an increase in employment in Ukraine); *see also Ukraine Hopes to Match Euro Standards*, E. ECONOMIST DAILY, July 4, 2001 (finding Ukraine seeks to improve its economy in hopes of gaining membership in the WTO).

233. The WTO Agreement provides for two kinds of participation in the Organization: original membership and membership by accession. See WTO Agreement, Arts. XI and XII. Article XI addresses original membership:

> The contracting parties to GATT 1947 as of the date of entry into force of this Agreement, and the European Communities, which accept this Agreement and the Multilateral Trade Agreement and for which Schedules of Concessions and Commitments are annexed to GATT 1947 and for which Schedules of Concessions are annexed to GATS shall become original Members of the WTO.

WTO Agreement, art. XI. Article XII addresses membership by accession:

> Any state or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto.

WTO Agreement, art. XII.

234. *See* Clyde Summers, *The Battle in Seattle: Free Trade, Labor Rights, and Societal Values*, 22 U. PA. J. INT'L ECON. L. 61, 70–71 (2001) (remarking that member nations must abide by stringent policies or face WTO sanctions); *see also* Kristin Weldon, *Piercing the Silence or Lulling You to Sleep: The Sounds of Child Labor*, 7 WIDENER L. SYMP. J. 227, 235–36 (2001) (citing that nations who enjoy membership in the WTO must assent to, and comply with, all international agreements that were discussed at the Uruguay Round).

### 2. Legal Régime of FDI in Ukraine

#### (a) Constitutional Background for Protection of Foreign Investment

In the Ukraine, foreign investment is regulated by a complicated system of legislative and administrative regulations.[235] The fundamental principles are embodied in the 1996 Constitution that provides for the protection of private property from expropriation by the government and guarantees the right to compensation.[236] Another provision sets forth the régime of natural resources, which are declared the property of the people of the Ukraine.[237] Another issue that is very sensitive, and at the same time, of potential great interest to foreign investors, is ownership of land.[238] Many of the so-called countries in transition (former socialist countries of Europe) have resisted the conveyance of land to foreigners and foreign companies, since it is often associated with dilution of national wealth and even with selling-off the motherland to aliens.[239] The Ukraine is not an exception.[240] Article 14 declares land as "the fundamental national wealth that is under special state protection."[241] The Constitution guarantees the right of private property, but the language of that provision is not free from ambiguity.[242] Article 14(2)

235. *See* Mikhail Albuseiri, *U.S.-Ukraine Tax Treaty v. Cyprus' Offshore Enterprise Alternative*, 4 D.C.L. J. INT'L L. & PRAC. 359, 362 (1995) (noting that the Ukraine and the U.S. have extensive international regulations concerning double income taxation); Kevin P. Block, *Ukrainian Bankruptcy Law*, 20 LOY. L.A. INT'L & COMP. L.J. 97, 98 (1997) (noting extensive Ukrainian bankruptcy laws which are applicable to foreign investors); *see also* Wolfgang Freiherr von Marschall, *Creating the Necessary Instruments for a Market Economy in the Post-Communist Countries of Eastern Europe: Policies and Problems*, 39 ST. LOUIS U. L.J. 951, 953 (1995) (finding that Ukraine has numerous financial and trade policies).

236. UKR. CONST., art. 41.

237. UKR. CONST., art. 13, pt. 1.

238. *See* Joseph A. Laroski, Jr., *NMES: A Love Story Nonmarket and Market Economy Status Under U.S. Antidumping Law*, 30 LAW & POL'Y INT'L BUS. 369, 388 (1999) (stating that the Ukraine prohibits foreign ownership of land); *see also* William E. Kovacic, *Designing and Implementing Competition and Consumer Protection Reforms in Transitional Economies: Perspectives from Mongolia, Nepal, Ukraine, and Zimbabwe*, 44 DEPAUL L. REV. 1197, 1201 (1995) (stating that Ukraine has generally unfavorable land ownership laws); *Week in Brief*, INTERFAX RUSSIAN NEWS, July 18, 2000, *available at* LEXIS (citing that foreign entities cannot purchase land in the Ukraine for farming purposes).

239. *See* Christopher Costa, *The Tie That Binds: The Story of Foreign Investment Law in Romania*, 4 J. INT'L LEGAL STUD. 105, 107–26 (1998) (discussing Romania's painful pace toward market relations through their gradual liberalization of policies and rules on FDI); *see also* Andrei A. Baev, *Emerging Capital Markets: Implications of Emerging Legal Structures for Capital Markets in Russia*, 2 STAN. J.L. BUS. & FIN. 211, 228 (1996) (citing that foreign ownership of land is prohibited in Russia). *See generally* David A. Levy, *Bulgarian Trade and Investment: A Realistic Assessment*, 27 CASE W. RES. J. INT'L L. 203, 207–9, (1995) (noting that Bulgaria limits foreign ownership of property).

240. During the negotiations over the draft Constitution in 1996, the provisions on the property of land raised heated debates, with Communist and Socialist factions fiercely backing the concept of land in state ownership; the final version of the Constitution seems to represent a consensus. *See* John Moroz Smith, *The Icon and the Tracts: A Restrained Renaissance of Religious Liberty in Ukraine*, 2001 BYU L. REV. 815, 830 (2001) (discussing the rights to property as it relates to the Ukrainian Constitution).

241. UKR. CONST., art. 14.

242. *See Ukraine Could Get a Very Good Constitution*, THE CURRENT DIGEST OF THE SOVIET PRESS, Jan. 3, 1996, at 24 (citing political uncertainty concerning property ownership as provided by the Ukrainian Constitution). *See generally Ukraine: Politics*, WORLD OF INFORMATION COUNTRY REPORT, July 1999, at 12 (citing that there are numerous uncertainties within the Ukrainian Constitution); Briefing, Arms Control Ass'n, *Major Leader Special Transcript*, FED. NEWS SERVICE, Nov. 23, 1993, *available at* LEXIS (noting that the Ukrainian Constitution is an "unclear instrument").

provides that the right of property may be acquired by citizens, legal persons and the state.[243] The current Land Code of Ukraine prohibits conveyance of land to foreigners and *apatrides*.[244] However, it does not mean that foreigners will always be barred from acquiring title to land in Ukraine. First, the effective Land Code was adopted in 1990 and now clearly contravenes the Constitution on many issues.[245] Second, Article 14(2) does not limit the right of enterprises with foreign capital to own land.[246] Finally, even foreign nationals potentially may be granted the right to acquire land ownership by virtue of the broad constitutional interpretation of the word "citizen."[247]

**(b) The FIRL**

**(1) Definition of Investment**

The main piece of legislation on FDI in Ukraine is the Law "On the Régime of Foreign Investment" ("FIRL").[248] FIRL establishes a number of modes for carrying on FDI, such as part ownership of the joint venture, established by Ukrainian nationals or legal persons, or acquisition of an interest in an already existing enterprise; establishing wholly owned enterprises, branches and subsidiaries, or acquisition of real property through direct purchase or through acquisition of shares, stock or other securities; and acquisition of the rights to use land or develop mineral resources.[249] Foreign investment is defined in FIRL very broadly and rather ambiguously: "assets transferred by foreign investors in the objects of investment activity according to the laws of Ukraine with a purpose of gaining profits or reaching social effect."[250] An enterprise with foreign investment is defined as an "entity of any form of legal organization, if its equity capital has at least 10 percent of foreign investment."[251] According to FIRL, a company acquires the rights of the enterprise with foreign investment from the day of transferring investment on its balance sheet.[252]

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243. UKR. CONST. art. 14(2) ("The right of property to land is guaranteed. This right is acquired and realised by citizens, legal persons and the state, exclusively in accordance with the law").

244. LAND CODE OF UKR., art. 6(13); *See Investment Restrictions: Political Support and Opposition*, POL. RISK SERVICES, Jan. 1, 1998, *available at* LEXIS (providing a number of problems hindering "private foreign investment" in the Ukraine); *Ukraine—Investment Climate*, MKT. REP., Jan. 16, 1997, *available at* LEXIS (stating that "foreigners cannot acquire privatization certificates directly").

245. *See Ukraine—Investment Climate*, MKT. REP., Jan. 16, 1997, *available at* LEXIS (acknowledging that the 1996 constitution recognizes the right to private ownership of land even for foreigners); *World Bank Ready to Finance Land Reform in Ukraine*, BUS. REP., June 14, 2001, *available at* LEXIS (noting that adoption of the new Land Code would probably lead to improvements "in a system for registering land ownership rights"). *See generally Review of Laws Passed in CIS: Ukraine*, INTERFAX RUSSIAN NEWS, Mar. 14, 2000, *available at* LEXIS (stating that "the adoption of a new Land Code is one of the agriculture-related requirements of the International Monetary Fund for restarting the release of loans to Ukraine").

246. *See* UKR. CONST., art. 14.

247. *See* UKR. CONST., art. 14. The issue is that in the Constitution and Ukrainian statutes, the word "citizen" is used not only in the meaning of a national but also as a term synonymous to the word "individual," depending on the context. Therefore, it may be suggested that the provision of Article 14(2) of the Constitution is a potential target for the Constitutional Court's ruling, which has already proven to be the fastest way of modifying statutory norms. *Id.*

248. LAW ON THE REGIME OF FOREIGN INVESTMENT (1996) (as amended 1999, 2000).

249. FIRL, art. 3.

250. FIRL, art. 1.

251. FIRL, art. 1.

252. FIRL, art. 18.

As to the definition of the term "object of foreign investment," here FIRL follows the best traditions of Ukrainian law in defining concepts as obscurely as possible.[253] Article 4 provides that "foreign investment can be placed into any object, investing in which is not prohibited by the laws of Ukraine."[254]

**(2) National Treatment**

Article 7 lays down a very important principle of national treatment of foreign investors, subject however, to the exceptions, which are "provided for in the laws of Ukraine."[255] The law further spells out that certain groups of foreign investors, in particular, those carrying on projects under the governmental programs of development, may be granted preferential treatment.[256] However, similar to GATT and other trade-related agreements, FIRL stipulates that foreign investment may be limited or even prohibited within certain territories on the grounds of national security considerations.[257]

**(3) Protection Against Expropriation and Nationalization**

Article 9 provides that foreign investment in Ukraine is not subject to nationalization.[258] Governmental authorities may requisite foreign investment only in the course of rescue and emergency operations or under other similar circumstances.[259] One of the shortcomings of FIRL is that it does not address expropriation *per se*, but if such situation emerges, investors will be able to invoke directly the relevant provision of the Constitution.[260] The FIRL also contains an elaborate provision on compensation in the case of requisition, as well as recovery of damages incurred as a result of unlawful acts of government authorities: Compensation must be prompt, adequate, effective and in the currency of investment.[261]

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253. FIRL, art. 1. *See also Investment Climate Report for 1999*, MRT. REP., June 28, 1999 (listing some of the factors responsible for "creating an environment of uncertainty and ambiguity among would-be foreign investors"); *NIS-Trade & Investment Obstacles*, MRT. REP., Aug. 17, 1993 (noting that there is "instability and uncertainty in regulations and laws, especially huge and unpredictable changes in tax rates").

254. FIRL, art. 4.

255. FIRL, art. 7(2).

256. *Id.*

257. FIRL, art. 7(3).

258. FIRL, art. 9.

259. FIRL, art. 9. *See Hi Tech, Industrial Conversion Guarantee Program*, MARKETING SURVEY, *available at* <http://www.bisnis.doc.gov/bisnis/country/990515ukhi.htm> (proffering the situations when Ukrainian government may requisite foreign investment). *See generally New Foreign Investment Law: Two Steps Forward*, EAST/WEST EXECUTIVE GUIDE, Jan. 1, 1997, *available at* LEXIS (reassuring that protection of foreign investment is provided by the Ukrainian Law).

260. UKR. CONST., art. 41. *See* FIRL, art. 18. *See generally New Foreign Investment Law: Two Steps Forward*, EAST/WEST EXECUTIVE GUIDE, Jan. 1, 1997 (stating the premises of the "Expropriation Provisions" of FIRL).

261. FIRL, art. 10.

**(4) Right of Repatriation**

Article 11 of the FIRL provides that upon termination of foreign investment, the investor is entitled to the prompt (within 6 months) withdrawal of his or her investment in kind or in cash exempt from any duties.[262] The right of repatriation of profits abroad is guaranteed, but is made subject to deduction of all relevant taxes, duties and other mandatory levies.[263]

**(5) Protection Against Changing Laws**

As a safeguard against unexpected changes in legislation, FIRL provides that if laws on the protection of foreign investors change, investors during the next 10 years are nevertheless entitled to treatment under the rules that were effective on the moment of their entering the market.[264] However, the applicability of this provision is questionable following the ruling of the Constitutional Court, and in light of recent legislative developments (see *Tax Holiday*s case *infra*, 3.(a)).[265]

**(6) Market Access Rules**

FIRL makes foreign investment subject to mandatory registration in the local state administration offices within three days of listing the investment on the balance sheet of the corporation.[266] However, registration may be denied only for non-compliance with the procedural rules.[267] Such a denial may be challenged in court.[268] FIRL lays down the very foundation and principles of foreign investment in Ukraine, and its provisions are further developed in other laws and administrative acts, especially in the field of taxation and customs regulation.[269]

*Prima facie*, FIRL provides an adequate framework for FDI in Ukraine: the principal standards of national treatment, appropriate compensation in case of requisition and administrative non-review of investment are addressed.[270] However, several defects exist: first, the excessively

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262. FIRL, art. 11.

263. *Id.*

264. FIRL, art. 8.

265. *See Ukraine Cancels Rules of Taxing Joint Ventures*, INTERFAX RUSSIAN NEWS, Aug. 24, 1999, *available at* LEXIS (illustrating the relationship of Constitutional Court and regulation of foreign investment); *New Corporate Profits Tax Law,* MONDAQ BUS. BRIEFING, July 25, 1997, *available at* LEXIS (detailing the provisions on guarantees of foreign investment protection afforded by the new tax law—the Law "On Corporate Profit Tax"). *See generally Ukraine 2000 Investment Climate Statement*, Aug. 22, 2000, *available at* <http://www.bisnis.doc.gov/bisnis/country/000828investment_ua.htm> (providing general description of Ukraine's legal system and it's relation to foreign investment).

266. FIRL, art. 13.

267. FIRL, art. 14.

268. FIRL, art. 14.

269. *See Ukraine-Consulting on Management of Industrial Enterprises/Kiev*, MKT. REP., Mar. 1992, *available at* LEXIS (noting that the Law "On Foreign Investment" granted a "favorable climate" to many foreign investors); *see also* Lesia Polyshchuk, *Ukraine-Building Materials*, MKT. REP., Dec. 1, 1998, *available at* LEXIS (stating that the Law "On Foreign Investment" regulated the foreign "investment activity" in the Ukraine). *See generally* FIRL.

270. *See Investment Opportunities Surface in the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996, *available at* LEXIS (stating that "[t]he main legislation governing foreign investment in Ukraine is the Law 'On the Regime of Foreign Investment'").

broad language of definitions raise the potential for disputes over interpretation; second, there is overly broad legislative discretion in cases of national treatment and restricted industries ("objects of investment activity"); finally, and most significantly, is the absence of any limitation on governmental authority to impose restrictive investment requirements (such as TRIMs). Such an uncertainty in legal standards could enable the government to change investment rules in a haphazard fashion.[271]

### 3. Examples of Restrictive Investment Practices

#### (a) *Tax Holidays* Case

A case involving the alteration of tax legislation is an illustration of the Ukrainian investment law's unpredictability. Moreover, it provides an overview of the development of the relevant legislation. In the *Tax Holidays* case, aggrieved foreign investors seeking relief went as far as the Constitutional Court of Ukraine, however, without any particular success.[272]

The first investment law package was adopted in Ukraine in 1991 and included, *inter alia*, Law No. 1540a-II, "On Protection of Foreign Investment in Ukraine," which established basic principles and guarantees of protection of foreign investment.[273] In 1992, the Ukrainian Parliament—Supreme Rada (Council)—adopted the Law "On Foreign Investment," which introduced a 10-year "grandfathering" clause,[274] and granted very generous tax holidays to foreign investors.[275] One year later, in 1993, Decree No. 55 was promulgated with the purpose of encouraging large-scale foreign investment.[276] It repealed the Law "On Foreign Investment"

271. As the Department of State 2000 Country Commercial Guide on Ukraine warns, "Ukrainian laws and regulations are vague and open to considerable leeway in interpretation, providing ample corruption opportunities for officials at every bureaucratic level." U.S. Department of State, *FY 2000 Country Commercial Guide: Ukraine*, at 16, *available at* <http://www.state.gov/www/about_state/business/com_guides/2000/europe/ukraine_CCG2000.pdf>(last accessed at July 19, 2001); *see also Investment Climate Report for 1999*, MRT. REP., June 28, 1999, available at LEXIS (listing some of the factors responsible for "creating an environment of uncertainty and ambiguity among would-be foreign investors"); *NIS-Trade & Investment Obstacles*, MRT. REP., Aug. 17, 1993 *available at* LEXIS (noting that there is "instability and uncertainty in regulations and laws, especially huge and unpredictable changes in tax rates").

272. *See Ukraine—Grain Storage and Processing Equipment*, MRT. REP., May 19, 1992 (promoting the passage of the Law on the Promotions of Foreign Investment as advantageous for U.S. investors); *see also Ukraine: International Business Practices, Trade and Investment*, *available at* <http://strategis.ic.gc.ca/SSG dc91952e.html> (last accessed Nov. 1, 2001) (noting the importance of foreign investment in the Ukrainian economy).

273. UKR. LAW NO. 1540a-II. The law provided, *inter alia*, for protection against requisitions, unless in cases of natural disasters, calamities etc., where the investor was entitled to the "adequate and effective" compensation. UKR. LAW NO. 1540a-II, art. 3.

274. UKR. LAW NO. 1540a-II, art. 9.

275. UKR. LAW NO. 1540a-II, art. 32. Subject to some limited exception, the Law exempted companies with foreign investment from payment of corporate tax for the term of 5 years. *Id. See also Ukraine—Consulting on Management of Industrial Enterprises/Kiev*, MKT. REP., Mar. 1, 1992, *available at* LEXIS (noting that the Law "On Foreign Investment" granted a "favorable climate" to many foreign investors).

276. *See* Ukraine-Investment Incentives, MKT. REP., Mar. 21, 1995, *available at* LEXIS (discussing new investment incentives in Ukraine provided by the Decree No. 55); *see also Ukrainian Government on Measures Against Hyperinflation*, TASS, Dec. 18, 1993 (noting that the Ukrainian Cabinet of Ministers encourage foreign investment in order to improve the "social and economic situation in Ukraine"). *See generally Ukrainian Program Seeks to Lure Investors, But Main Concern is Still Political, Economic Climate*, RUSSIA & COMMONWEALTH BUS. L. REP., May 30, 1994, *available at* LEXIS (stating that the Ukrainian government enacts programs that offer "attractive tax . . . benefits" to foreign investors).

and replaced it with a new set of rules.[277] The Decree, one of the most favorable decrees to foreign investments in Ukrainian history, reaffirmed the existing grandfathering period of 10 years, and at the same time extended the tax holiday period to the retail trade companies and agencies, which had not been exempt under the preceding Law.[278] In 1996, the Parliament adopted FIRL, which expressly introduced a national régime for foreign investors, but was silent on the issue of tax holidays, granting no new privileges to the investors.[279] Also, FIRL repealed Decree No. 55.[280]

Parliament continued to look for a way to place Ukrainian and foreign investors on an "equal footing" and to increase the state budget.[281] On May 22, 1997, it enacted the new version of the Law "On Corporate Profit Tax" which was silent on any tax privileges for foreign investment altogether.[282] It enabled the tax authorities to demand payment of corporate tax by those investors who believed they had been securely exempt from those assessments until

277. *See Ukraine—Investment Incentives*, MKT. REP., Mar. 21, 1995, *available at* LEXIS (explaining a new set of rules of the Decree No. 55); *see also Ukraine-Country Marketing Plan FY '94*, MKT. REP., June 20, 1994, *available at* LEXIS (stating that the problems associated with implementation of the Law "On Foreign Investment" resulted in "a number of subsequent amendments and changes"). *See generally Ukraine: Economy Sags as State Reasserts Powers*, CURRENT DIG. OF THE POST-SOVIET PRESS, Nov. 24, 1993, at 12 (noting that "Ukraine's law on foreign investments was at first acknowledged by international experts to be one of the most liberal laws of its kind").

278. DECREE OF THE CABINET OF MINISTERS ON REGIME OF FOREIGN INVESTMENTS [DECREE NO. 55] art. 31, May 20, 1994 (Ukraine).

279. *See Change of the Rules on Foreign Investments*, MONDAQ BUS. BRIEFING, July 19, 1996, (stating that the "law 'On the Regime of Foreign Investment' . . . does not provide for any profit tax privileges for newly established companies with foreign investment"); *see also Investment Opportunities Surface in the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996 (stating that the Law "On the Regime of Foreign Investment" does not afford "special privileges for foreign investors and/or enterprises with foreign investment"). *See generally Securities Regulation in Ukraine*, EAST/WEST EXECUTIVE GUIDE, Dec. 1, 1996 (noting that the "Law 'On the Regime of Foreign Investment' . . . has added some needed clarity to the legal status and rights pertaining to international investment activity in Ukraine").

280. *See New Foreign Investment Law: Two Steps Forward*, EAST/WEST EXECUTIVE GUIDE, Jan. 1, 1997 (stating that the Law "On the Regime of Foreign Investment" provides that the Law "On Foreign Investment" and the Decree No. 55 "have lost their force and effect"); *see also Investment Opportunities Surface in the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996 (noting that the Law "On the Regime of Foreign Investment," unlike the two previous "investment law[s] that it replaced," contains "elaborated structure and clear definitions"). *See generally Change of the Rules on Foreign Investments*, MONDAQ BUS. BRIEFING, July 19, 1996 (stating that the "law 'On the Regime of Foreign Investment'" replaced "previous. . . foreign investment" laws).

281. Alex Frishberg, Ukraine's Foreign Investment Law Sets New Rules With Big Exceptions, RUSSIA & COMMONWEALTH BUS. L. REP., March 11, 1998.

282. *See New Corporate Profits Tax Law*, MONDAQ BUS. BRIEFING, July 25, 1997 (noting that the new version of the Law "On Corporate Profit Tax" requires "non-residents and permanent establishments of non-residents which receive income from Ukrainian sources . . . to pay corporate profits tax in Ukraine"); *see also Ukraine Revises Profits Tax Law*, EAST EUR. BUS. L., Aug. 1, 1997 (illustrating that the new Law "On Corporate Profit Tax" provides that foreign investors "are subject to Ukrainian taxation"). *See generally Ukraine Streamlines Government Bond Regime*, EAST EUR. BUS. L., Oct.1, 1997 (stating that the Law "On Corporate Profit Tax" of 1997 replaced the Law "On Corporate Profit Tax" of 1994).

1999.[283] In 1997, a group of foreign investors lodged a petition with the Constitutional Court of Ukraine requesting the official interpretation of the legislative provisions on guarantees of foreign investment protection, as well as interpretation of the allegedly *nunc pro tunc* provisions of the last tax law.[284] The Court dismissed the petition on the ground that it had become moot after adoption of certain laws interpreting the investment guarantee provisions—in particular, the Legislative Order "On Coming Into Force of the Law on Régime of Foreign Investment" ("Order") and after the Constitutional Court's ruling on the *nunc pro tunc* laws.[285] Paragraph 5 of the 1996 Order provided that the new rules of FIRL would not apply to foreign investment registered under the precedent laws and thereby guaranteed the grandfathering period and tax holidays which had been granted to foreign investors before 1996.[286] The next year, the Parliament took the last shot in the "battle" against aliens and adopted a new law "On Elimination of Discrimination in Taxation of Business Undertakings Incorporated with the Use of Assets and Cash of Domestic Origin."[287] This law completely repealed Paragraph 5 of the Order and therefore abolished all the remaining guarantees of protection of foreign investors in Ukraine.[288] This case proved that absent strict and rigid standards of treating foreign investors, the state authorities have *carte blanche* in enacting, amending and abolishing any guarantees

283. *See* LAW ON CORPORATE PROFITS TAX, May 22, 1997 (Ukraine) (providing that the Ukrainian government has the authority to tax foreign investors); *see also Ukraine Revises Profits Tax Law*, EAST EUR. BUS. L., Aug. 1, 1997, (illustrating that the new Law "On Corporate Profit Tax" states "that all entities . . . with a source of income on the territory of Ukraine . . . are subject to Ukrainian taxation . . . at a rate of 30% of profit"). *See generally New Corporate Profits Tax Law*, MONDAQ BUS. BRIEFING, July 25, 1997 (noting that the Law "On Corporate Profit Tax" requires all foreign enterprises that derive income from Ukrainian business dealings to "pay corporate profits tax").

284. For a general overview of Ukrainian foreign investment law *see* <http://brama.com/ua-trademission/tradelaw.htm>. Foreign InvestmentRegime> (last visited on October 5, 2001); *see also New Corporate Profits Tax Law*, MONDAQ BUS. BRIEFING, July 25, 1997 (detailing the provisions on guarantees of foreign investment protection afforded by the new tax law—the Law "On Corporate Profit Tax"); *See generally Investment Opportunities Surface in the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996 (noting that "[t]he main legislation governing foreign investment in Ukraine is the Law On the Regime of Foreign Investment").

285. *See generally* unofficial translation of the Law "On the Regime of Foreign Investment," *available at* <http://brama.com> (last visited on October 2, 2001).

286. *See* unofficial translation of the Law "On the Regime of Foreign Investment," available at: <http:// brama.com> (last visited on October 2, 2001); *see also New Corporate Profits Tax Law*, MONDAQ BUS. BRIEFING, July 25, 1997 (detailing the provisions on guarantees of foreign investment protection afforded by the new tax law—the Law "On Corporate Profit Tax"). *See generally Investment Opportunities Surface in the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996 (noting that the Law "On the Regime of Foreign Investment" provides many advantages to foreign investors).

287. *See* unofficial translation of the Law "On the Regime of Foreign Investment," *available at* <http:// brama.com>. (last visited on October 2, 2001).

288. *See* unofficial translation of the Law "On the Regime of Foreign Investment," *available at* <http:// brama.com>. (last visited on October 2, 2001); *see also* New Corporate Profits Tax Law, Mondaq Bus. Briefing, July 25, 1997 (detailing the provisions on guarantees of foreign investment protection afforded by the new tax law—the Law "On Corporate Profit Tax"). *See generally Investment Opportunities Surface in the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996 (noting that the Law "On the Regime of Foreign Investment" provides many advantages to foreign investors).

previously granted.[289] Undoubtedly, it adds significantly to the uncertainty foreign investors face in the unpredictable Ukrainian market.[290]

At the same time, this example provides an illustration of the flaws pertinent to the TRIMs Agreement of the WTO. Since 1991, when the foreign investment legislative package was first introduced, there has been a consistent and virtually annual reduction of the MFN standard of treatment (generous tax exemptions, 10-year protection against changing laws) to national treatment, however poor it is.[291] Foreign investors now operate in the same atmosphere of unpredictability and uncertainty as their domestic counterparts.[292] Even if the Ukraine had become a member of the WTO at that time, these clearly confusing practices could hardly have qualified for prohibited TRIMs within the meaning of the TRIMs Agreement, which precludes the member states only from introduction of restrictions incompatible with national treatment provision of the 1994 GATT, such as performance requirements and local content requirements.[293] Foreign investors could claim frustration of legitimate expectations due to legislative acts, but at the same time it could be considered a normal risk any investor should undertake when entering foreign markets.[294]

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289. *See* Lesia Polyshchuk, *Ukraine-Building Materials*, MKT. REP., Dec. 1, 1998 (noting that the Ukrainian government eliminated "the five-year tax exemption for all companies registered after [October 23, 1997]"); *see also Ukraine-Investment Incentives*, MKT. REP., Mar. 21, 1995 (providing an example of the preferential treatment given to some foreign investors). *See generally Ukraine: Economy Sags as State Reasserts Powers*, CURRENT DIG. OF THE POST-SOVIET PRESS, Nov. 24, 1993, at 12 (stating that "after a series of modifications by government decrees," guarantees previously granted to foreign investors have been abolished).

290. This uncertainty is still in place. In the beginning of January, 2001, the last international investment bank operating in Ukraine, Wood & Co., announced the withdrawal of its investment in the Ukrainian market and the closure of its Kiev office. *See* Foreign Policy of Ukraine, U.N. Press-release #59, Newsletter Dec. 23, 2000, *available at* <http://www.un.int/ukraine/pres-rel/2000/pr-r-2912.htm> (last visited April 24, 2001); *see also Investment Climate Report for 1999*, MKT. REP., June 28, 1999 (listing some of the factors that are responsible for "creating an environment of uncertainty and ambiguity among would-be foreign investors"); *NIS-Trade & Investment Obstacles*, MKT. REP., Aug. 17, 1993 (noting that there is "instability and uncertainty in regulations and laws, especially huge and unpredictable changes in tax rates").

291. *See Equity Restrictions*, Ukraine Country Files, Sept. 1, 2000, *available at* LEXIS (stating that "some tax concessions previously available [to foreign investors] have been eliminated"); *see also Change of the Rules on Foreign Investments*, MONDAQ BUS. BRIEFING, July 19, 1996 (stating that the Law "On the Regime of Foreign Investment" does not contain "tax privileges for newly established companies with foreign investment"); *Investment Opportunities Surface In the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996 (stating that the Law "On the Regime of Foreign Investment" does not provide "special privileges for foreign investors and/or enterprises with foreign investment").

292. *See* Matthew Kaminski, *Scramble for Ukraine Phone Partners*, FIN. TIMES (London), Apr. 2, 1997, at 2 (discussing that both the weak economy and the political uncertainty of the Ukraine have contributed to minimal foreign investment); Matthew Kaminski, *Waiting Game Paying Off in Ukraine*, FIN. TIMES (LONDON), July 25, 1995, at 19 (discussing how the uncertainty of the Ukrainian economic climate, including an unstable currency and hyperinflation, has affected foreign investors like S.C. Johnson & Son); *see also* William Gruber, *Harassment Suit Stings Prudential*, CHI. TRIB., Nov. 29, 1993, at 3C (stating that the desire to form a partnership and build a milk plant in Kiev, the capital of Ukraine, has been curtailed due to the country's economic uncertainty).

293. TRIMs, art. 2.

294. Traditionally, the primary political risk foreign investors were facing abroad was considered to be the risk of expropriation or nationalization. "Political risk" in general is the risk faced by an investor that a host country will confiscate all or a portion of the investor's property rights located in the host country. *See* PAUL E. COMEAUX & N. STEPHEN KINSELLA, PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW 1 (1997). At present, writers agree that the risk of expropriation has been significantly diminished through the set of guarantees provided by domestic legislation, bilateral investment treaties and insurance. *See* Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 29–31 (1995). *See generally* RONALD A. BRAND, FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS 975–76 (2000).

### (b) *Daewoo* Case

After the petition was filed with the Constitutional Court, the Ukrainian Prime Minister promised foreign investors that although the government was unable to overcome the parliament's resistance and return general tax exemptions, it would provide large investors with tax privileges on a case-by-case basis.[295] The *Daewoo* case provides a good example.[296] In 1997, the Ukrainian Parliament enacted a new law "On Stimulating of Automobile Production in Ukraine" ("SAPUL") which offered tremendous market advantages to a company that would establish a joint venture with the Ukrainian national motor vehicle manufacturer AutoZaZ.[297] Article 1 of the SAPUL defined investment for the purposes of the law as "investment in cash amounting to at least $150 million only."[298] SAPUL guaranteed various tax and duty exemptions for a period till 2008 to a qualifying investor who could raise $150 million in cash.[299] Those exemptions included (1) exemption from import tax on equipment; (2) the privilege to sell motor vehicles in Ukraine VAT-free; (3) land tax exemption; (4) provision that gross income and gross expenses are subject to indexation on inflation rate; (5) provision on lowering

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295. *See* Alex Frishberg, *Ukraine's Foreign Investment Law Sets New Rules With Big Exceptions*, RUSSIA & COMMONWEALTH BUS. L. REP., March 11, 1998. *See generally* Kevin P. Block, *Ukrainian Bankruptcy Law*, 20 LOY. L.A. INT'L & COMP. L. REV. 97, 98 (1997) (discussing the process of Ukrainian tax proceedings); Craig Ehrlich Daesob Kang, *U.S. Style Corporate Governance in Korea's Largest Companies*, 18 UCLA PAC. BASIN L.J. 1, 59 (2000) (discussing the Korean government's policy on investments in affiliate companies).

296. *See* Charles Clover, *Daewoo Sells Part of 40% Kazakh State*, FIN. TIMES (LONDON), Mar. 25, 1998, at 45 (discussing how restrictions the Ukraine placed on imported cars upset the European Commission). *See generally* Eric Phillips, *World Trade and the Environment: The Café Case*, 17 MICH. J. INT'L L. 827, 861 (1996) (noting that the European Commission opposes protectionist practices by individual states); Kevin Done, *A New Wave of 'Transplants'—Cars*, FIN. TIMES (LONDON), Jan. 8, 1990, at IV (examining how the European Commission has made one of its aims to do away with restrictions on imported cars).

297. *See* John H. Friedland, *The Law and Structure of the International Financial System: Regulation in the United States, EEC, and Japan*, 28 GW J. INT'L L. & ECON. 549, 559 (1994) (highlighting the excessive costs of present protectionist policies particularly in the automobile and steel industries); *see also* David M. Haug, *The International Transfer of Technology: Lessons That East Europe Can Learn From the Failed Third World Experience*, 5 HARV. J. LAW & TECH. 209, 234 (1992) (discussing the success of governmental intervention into technology importation with reference to the G.M. joint venture in Hungary); Thomas M. Reiter, *The Feasibility of Debt-Equity Swaps in Russia*, 15 MICH. J. INT'L L. 909, 923–24 (1994) (discussing the popularity of debt-equity swaps with multinational corporations particularly in the tourism and automobile sectors).

298. SAPUL, art. 1.

299. *See* Lan Cao, *Public Perspectives on Privatization: Chinese Privatization: Between Plan and Market*, 63 LAW & CONTEMP. PROB. 13, 33 n. 101 (2000) (explaining China's efforts to promote development through relaxed price controls on various industries including automobile manufacturing). *See generally* David P. Fidler, *Foreign Private Investment in Palestine: An Analysis of the Law on the Encouragement of Investment in Palestine*, 19 FORDHAM INT'L L.J. 529, 587 (1995) (discussing Palestinian policy of encouraging foreign investment through various fiscal incentives such as tax exemptions); Zhaodong Jiang, *China's Tax Preferences to Foreign Investment: Policy, Culture and Modern Concepts*, 18 NW. J. INT'L L. BUS. 549, 581 (1998) (discussing China's tax exemptions to encourage investments not only in wealthy regions, but also in underdeveloped areas).

annual income tax dependent upon the amount of money reinvested.[300] In turn, the qualified investor was required to promise (1) to reinvest the full amount of received profits into development of production of materials and parts for the automotive industry; (2) to not require payment of royalties for transferred technologies; (3) to preserve the number of AutoZaZ employees within 3 years; and (4) to fulfill all requirements of the investment program.[301] The only company that qualified for the project was Daewoo Motors.[302]

The enactment of SAPUL coincided with the increase of tariffs on all other imported motor vehicles.[303] All other interested parties, primarily automotive manufacturers trading on the Ukrainian market, as well as the European Commission, protested, claiming that the law was discriminatory and favored one party to the detriment of all others as it imposed indirect subsidies and restrictive investment requirements.[304] The European Union also alleged viola-

300. *See Making Sense of Ukraine's Investment Laws*, EAST EUROPEAN BUSINESS LAW, March 1, 1998 (detailing various exemptions granted to eligible investors, including exemption from import taxes on equipment, ability to sell cars in the Ukraine free of any value-added tax, all providing certain investors with market advantages); Alex Frishberg, *Ukraine's Foreign Investment Law Sets New Rules With Big Exceptions*, 8 RUSSIA AND COMMONWEALTH BUSINESS LAW REPORT 21, March 11, 1998 (discussing the SAPUL Law's exemptions and incentives for companies whose investment in the automotive industry exceeds $150 million; such as providing for lower annual income taxes—depending upon the amount of money reinvested—and subjecting gross income and gross expenses to indexation based on the rate of inflation). *See generally EU/Ukraine: Kiev Steps Up Pre-Summit Preparations*, EUROPEAN REPORT, Sept. 2, 2000 (stating that the European Union has long protested the 1997 SAPUL Law).

301. *See Making Sense of Ukraine's Investment Laws*, EAST EUROPEAN BUSINESS LAW, March 1, 1998 (detailing various requirements of qualified investors); *see also* Alex Frishberg, *Ukraine's Foreign Investment Law Sets New Rules With Big Exceptions*, 8 RUSSIA AND COMMONWEALTH BUSINESS LAW REPORT 21, March 11, 1998 (discussing SAPUL). *See generally EU/Ukraine: Kiev Steps Up Pre-Summit Preparations*, EUROPEAN REPORT, Sept. 2, 2000 (discussing the EU's stance on SAPUL).

302. *See Foreign Investments Pruned by Half*, THE UKRAINIAN TIMES, December 30, 1997 (discussing how laws were enacted because of the anticipated creation of a joint venture between AutoZaZ and Daewoo); *see also GM, Daewoo In Ukraine Deal*, AUTOMOTIVE NEWS, May 12, 1997, at 8 (noting the announcement of a joint venture involving both General Motors and Daewoo with AutoZaZ to produce cars in the Ukraine).

303. *See* Alex Frishberg, *Ukraine's Foreign Investment Law Sets New Rules With Big Exceptions*, RUSSIA & COMMONWEALTH BUS. L. REP., March 11, 1998; *see also Making Sense of Ukraine's Investment Laws,* EAST EUROPEAN BUSINESS LAW, March 1, 1998 (discussing the enactment of Stimulating Automobile Production in Ukraine and how it is an attempt to bridge the gap between local and foreign investors).

304. *See* Charles Clover, *Daewoo Sells Part of 40% Kazakh State*, FIN. TIMES (LONDON), Mar. 25, 1998, at 45 (discussing how restrictions the Ukraine placed on imported cars upset the European Commission and may affect the Ukraine's chance of being admitted to the World Trade Organization); *see also* Kevin Done, *A New Wave of 'Transplants'—Cars*, FIN. TIMES (LONDON), Jan. 8, 1990, at IV (examining how the European Commission has made one of its aims to do away with restrictions on imported cars); Eric Phillips, *World Trade and the Environment: The Café Case*, 17 MICH. J. INT'L L. 827, 861 (1996) (noting that the European Commission opposes protectionist practices by individual states).

tion of Article 15 of the Partnership and Co-Operation Agreement between the EU and Ukraine on national treatment.[305] Finally, there were allegations of corruption and bias on the part of Ukrainian officials.[306]

The *Daewoo* case is an analogy to Indonesia's Pioneer Timor Car Campaign.[307] Ukraine might have been in violation of national treatment and MFN treatment by imposing explicit performance requirements, equity requirements and individual tax exemptions on a single company.[308] However, the fact that Ukraine was not a member of the WTO precluded the affected countries from bringing the claim to the panel under the WTO Dispute Resolution Rule.[309] Furthermore, at that time the Ukraine was not yet a member of the ICSID Conven-

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305. Partnership and Co-Operation Agreement Between the European Communities and Their Member States and Ukraine ("PCA") (Mar. 1, 1998). Article 15 of PCA provides:

> The products of the territory of one Party imported into the territory of the other Party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products…Moreover, these products shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provision of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

*PCA*, art. 15.

*See Ukraine Eliminates Minimal Customs Value for Imported Home Appliances*, UNIAN NEWS AGENCY, January 29, 2000, *available at* LEXIS. *See generally* Roger J. Goebel, *The European Union Grows: The Constitutional Impact of the Accession of Austria, Finland, and Sweden*, 18 FORDHAM INT'L L.J. 1092, 1181–82 (1995) (discussing the status of possible European Union membership of the Ukraine in light of the Partnership and Cooperation Agreement).

306. *See Foreign Investment in Ukraine: Competition and Deals on the Rise*, in EAST/WEST EXECUTIVE GUIDE, April 1, 1997; *see also* Roger Alan Boner & William E. Kovacic, *Antitrust Policy in Ukraine*, 31 GEO. WASH. J. INT'L L. & ECON. 1, 16–17 (1997) (illustrating a situation where the Anti-Monopoly Commission has a resource problem and as a result cannot function as well as desired; and the Commissioners only earn $100 per month, yet the chairman is provided with an apartment and use of a state car); *Other Post-Soviet States*, THE NEWS OF THE WEEK (THE CURRENT DIGEST OF THE SOVIET PRESS), July 23, 1997, *available at* LEXIS (stating that Prime Minister Pavel Lazarenko has often been a target of allegations of corruption).

307. *See* John H. Friedland, *The Law and Structure of the International Financial System: Regulation in the United States, EEC, and Japan*, 28 GW J. INT'L L. & ECON. 549, 559 (1994) (highlighting the excessive costs of present protectionist policies particularly in the automobile and steel industries); *see also* David M. Haug, *The International Transfer of Technology: Lessons That East Europe Can Learn From the Failed Third World Experience*, 5 HARV. J. LAW & TEC 209, 234 (1992) (discussing the success of governmental intervention into technology importation with reference to the G.M. joint venture in Hungary); Thomas M. Reiter, *The Feasibility of Debt-Equity Swaps in Russia*, 15 MICH. J. INT'L L. 909, 923–24 (1994) (discussing the popularity of debt-equity swaps with multinational corporations particularly in the tourism and automobile sectors).

308. *See Change of the Rules on Foreign Investment*, MONDAQ BUS. BRIEFING, July 19, 1996 (stating that the "Law 'On the Regime of Foreign Investment' does not provide for any profit tax privileges for newly established companies with foreign investment"); *see also Investment Opportunities Surface in the Ukrainian Oil and Gas Industry*, RUSSIA & COMMONWEALTH BUS. L. REP., Nov. 18, 1996 (stating that the Law "On the Regime of Foreign Investment" does not afford "special privileges for foreign investors and/or enterprises with foreign investment"). *See generally Securities Regulation in the Ukraine*, EAST/WEST EXECUTIVE GUIDE, Dec. 1, 1996 (noting that the "Law 'On the Regime of Foreign Investment' places no special restrictions on foreign investors").

309. *See* Carol J. Miller, *WTO Scrutiny v. Environmental Objectives: Assessment of the International Dolphin Conservation Program Act*, 37 AM. BUS. L.J. 73, 80 (1999) (stating that "member nations must sponsor the case submissions"). *See generally* INTRODUCTION TO DISPUTE SETTLEMENT IN THE WTO, *available at* <http://www.wto.org/english/tratop_e/disp_e/disp_e.htm> (last visited on October 1, 2001).

tion, so private parties could not seek redress in the impartial arbitration tribunal.[310] At the same time, it is asserted that Ukraine failed to comply with its obligations under the Schedule of Concessions and Commitments, which is currently being negotiated with the WTO.[311] Moreover, it is clear that the introduction of violative measures will in no way facilitate the country's process of accession to the WTO.

#### 4. The Ukraine and the ICSID

Before the Ukraine's ratification of the ICSID Convention,[312] the process of dispute settlement for foreign investors in the country remained rather vague and unreliable.[313] As the U.S. State Department's 1999 Country Commercial Guide for Ukraine noted, the only partially successful method of settlement of investment dispute involved intervention at the highest levels of the government through the Embassy's Appeal.[314] However, since 1999 things have slightly improved.

The Convention established the International Centre for Settlement of Investment Disputes (ICSID), which operates under the auspices of the World Bank, the successor to the International Bank for Reconstruction and Development,[315] with the purpose of promoting settlement of investment disputes involving a host government and a private investor.[316] As commentators point out, although the ICSID has been used only infrequently for its quarter-century history,[317] "it nevertheless represents a central part of the international régime for the settlement of investment disputes."[318] The Centre is usually referred to by the BITs in dispute

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310. *See Ukraine-United States: Treaty Concerning The Encouragement and Reciprocal Protection of Investment*, 1995 BDIEL AD LEXIS 28 (discussing the choices available for dispute resolution under ICSID); *see also Ukraine-United States: Treaty Concerning The Encouragement and Reciprocal Protection of Investment*, Art. VI, 1994 BDIEL AD LEXIS 22 (providing general guidelines for dispute resolution under ICSID Convention).

311. Ukraine's Working Party in the WTO was established on 17 December 1994. Bilateral market access negotiations are continuing on the basis of revised offers in goods and services. *See* WTO Official Website, *available at* <http://www.wto.org/english/thewto_e/acc_e/status_e.htm>; GATT, Part IX, art. 15.

312. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 4 I.L.M. 532, (1965) ("ICSID Convention"). Ukraine signed the Convention on April 3, 1998; ratified on July 7, 2000.

313. *See* Mikhail Albseiri, Comment, *U.S.-Ukraine Tax Treaty v. Cyprus' Offshore Enterprise Alternative*, 4 J. INT'L L. & PRAC. 359, 359–60 (1995) (stating that because Ukraine does not have much experience in the area of commercial law, U.S. investors must be cautious in their dealings in the country). *See generally* Daniel A. Bilak, *Promethus Unbound or Achilles' Heel?: Implications of Emerging Legal Structures in Ukraine for Foreign Investment*, 654 PLI/COMM 459, 480 (1993) (discussing the Foreign Investment Law in Ukraine and the process by which disputes between foreign investors and authorities were to be settled); Survey, 2001, *Annual Survey of International & Comparative Law*, 7 ANN. SURV. INT'L & COMP. L. 21, 23–24 (2001) (discussing that the main goal of ICSID was "to assure foreign investors of protection under international law").

314. U.S. STATE DEPARTMENT. COUNTRY COMMERCIAL GUIDES. FY 1999: UKRAINE, *available at* <http://www.state.gov/www/about_state/bisiness/com_guides/1999/europe/ukraine99_07.html> (last visited on April 21, 2001).

315. ICSID Convention, art. 2.

316. ICSID Convention, art 25.

317. Since its establishment in 1965, the ICSID has resolved 52 cases with 35 more cases currently pending, which proves increasing popularity of this device of investment dispute resolution. Statistics and reports of selected cases available on the ICSID OFFICIAL WEB SITE, <http://www.worldbank.org/icsid/cases/main.htm> (last accessed Oct. 20, 2001).

318. *See* Thomas L. Brewer, *International Investment Dispute Settlement Procedures: The Evolving Regime for Foreign Direct Investment*, 26 L. & POL'Y INT'L BUS. 633, 655 (1995).

settlement provisions,[319] and has already become an important arbitration forum in the area of FDI.[320] To date, 148 countries have signed the Convention, which is evidence of the worldwide recognition of the Centre.[321] Commentators predict further development and enhancement of the role of ICSID in international investment transactions in the future, which will probably make it the universally accepted investment dispute settlement body for FDI.[322] In fact, jurisdiction of the Centre is gradually expanding, which is leading to change in the role of the ICSID.[323] Until the mid-1980s, jurisdiction was based on the consent of the parties, fixed in the investment contract or similar document. However, increasingly more cases arise where the parties do not have such contractual relations, and investors seeking to establish the state's consent rely solely on the provision in an investment law.[324] Moreover, the operation of the Additional Facility allows dispute settlement procedures when a dispute involves a country—not a signatory of the Convention—and the Centre itself is not available, provided the country in question expressly consented to such jurisdiction.[325]

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319. *See, e.g.*, U.S. Model Bilateral Treaty, Article IX. in FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS—DOCUMENTS 129–30 (Ronald A. Brand ed., 2000).

320. *See* Thomas L. Brewer, *International Investment Dispute Settlement Procedures: The Evolving Regime for Foreign Direct Investment*, 26 L. & POL'Y INT'L BUS. 633, 656 (1995).

321. *See* ICSID OFFICIAL WEB SITE *available at* <http://www.worldbank.org/icsid/cases/awards.htm> (last accessed Oct. 20, 2001).

322. *See* Thomas L. Brewer, *International Investment Dispute Settlement Procedures: The Evolving Regime for Foreign Direct Investment*, 26 L. & POL'Y INT'L BUS. 633, 659 (1995); Bernard Kishoiyian, *The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law*, 14 NW. J. INT'L. L. & B. 327, 368 (1994) (stating that ICSID arbitration is becoming the accepted method of settling foreign investment disputes); *see also* Don Greenfield and Bob Rooney, *Aspects of International Petroleum Agreements*, 37 ALBERTA L. REV. 352, 380 (1999) (describing the ICSID convention as a success, with over 100 countries already accepting it, due partially to the confidence it promotes in international investment).

323. *See* W. Michael Reisman, *The Breakdown of the Control Mechanism in ICSID Arbitration*, 1989 DUKE L.J. 739, 785, (1989) (noting the "far-reaching qualitative change" that could come about in ICSID). *See generally Colloquium, Regulating the Global Banking Network—What Role (If Any) For the IMF?,* 62 FORDHAM L. REV. 1953–54 (1994) (discussing the "propensity of international organizations to expand their jurisdiction"); Jasmine Jordaan, Note, *Proposal of Dispute Resolution Mechanisms for the Israeli/Palestinian Interim Agreement: A Crucial Step in Establishing Long-Term Economic Stability in Palestine and a Lasting Peace*, 23 BROOK. J. INT'L L. 555, 595 (1997) (noting that if jurisdiction under ICSID existed, foreign investors would be able to claim damages against Israel for border closings).

324. *See* Symposium, *Symposium on Energy and International Law: Development, Litigation, and Regulation*, 36 TEX. INT'L L.J. 1, 3, 9 (2001) (discussing how governments consent to international arbitration through local investment laws of the country); *see also* Moshe Hirsch, Book Review, *The Arbitration Mechanism of the International Center for the Settlement of Investment Disputes*, 88 AM. J. INT'L L. 572, 572–73, (1994) (noting that the Centre's jurisdiction is based on the consent of the parties).

325. *See* Gregory W. MacKenzie, *ICSID Arbitration as a Strategy for Leveling the Playing Field Between International Non-Governmental Organizations and Host States*, 19 SYRACUSE J. INT'L & COM. 197, 220 (1993) (noting that only those states that are part of the Convention are eligible to use the facilities of the Convention); *see also* Clyde C. Pearce and Jack Coe, Jr., *Arbitration Under NAFTA Chapter Eleven: Some Pragmatic Reflections Upon the First Case Filed Against Mexico*, 23 HASTINGS INT'L & COMP. L. REV. 311, FN36 (2000) (discussing dispute resolution of a non-member state and how a choice available is to arbitrate under Additional Facility of ISCID); William Rand, Robert N. Hornick, and Paul Friedland, *ICSID's Emerging Jurisprudence: The Scope of ICSID's Jurisdiction*, 19 N.Y.U. J. INT'L & POL. 33, 57 (1986) (noting the emergence or jurisdiction over non-signatory parties).

Any investment disputes arising in Ukraine between the government and foreign investors now may be brought before the ICSID.[326] Within a short period of time, there have been at least two cases lodged with the Centre involving Ukraine as a party. The first of them, *Joseph Charles Lemire v. Ukraine*,[327] involved the government's revocation of a broadcast license for the Kiev radio broadcasting station, Gala Radio. The complaint brought by an American businessman, Mr. Lemire, the shareholder of the radio station, was registered with the ICSID on January 16, 1998.[328] At that time, Ukraine was not yet a party to the Convention, so the complaint was filed under the ICSID Additional Facility Arbitration Rules, according to Article VI(4) of the U.S.-Ukraine Bilateral Investment Treaty.[329] The complaint was dismissed upon the rendering of a settlement agreement on September 18, 2000.[330]

The second case, *Generation Ukraine, Inc. v. Ukraine* involved a dispute over the construction of an office building and is still pending before the ICSID.[331] These latest trends show some development in the area of protection of foreign investors in Ukraine: the Ukraine has willingly availed itself to the worldwide-recognized system of the settlement of disputes with foreign investors.

One of the positive features of the current Ukrainian law is constitutional protection of investors against nationalization and provision for the full compensation in case of requisition. At the same time, whether foreign investors are restricted by the current land legislation from acquiring real property is unclear since the Constitution is rather vague on this point. On the other hand, although FIRL provides some legal framework and sets forth the national treatment standard, it contains numerous reservations allowing the government to limit this standard and restrict areas open for investment by enacting other legislation.[332] Furthermore, even the observance of the national treatment régime cannot be considered satisfactory as long as both domestic and foreign investors are subject to unpredictable changes in investment and investment-related legislation. This situation can by no means be called attractive for the foreign capital that first looks for the certainty and predictability of the investment rules in a new market.

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326. *See* MOSHE HIRSCH, THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTER FOR THE SETTLEMENT OF INVESTMENT DISPUTES 19–20 (1993) (noting that one of the goals of ICSID is to settle disputes between foreign investors and the host nation). *See generally* George W. Coombe, Jr., *The Resolution of Transnational Commercial Disputes: A Perspective from North America*, 5 ANN. SURV. INT'L & COMP. L. 13, 18 (1999) (discussing the importance of alternative dispute resolution in attracting foreign investment to Ukraine); Carolyn M. Penna, *Dispute Resolution Laws of 1993*, N.Y. L.J., Mar. 3, 1994, at 3 (noting the measures the ICSID will take in order to provide dispute resolution to disputing parties).

327. Case No. ARB(AF)/98/1 (2000).

328. Case No. ARB(AF)/98/1 (2000).

329. Treaty Between the United States and Ukraine Concerning the Encouragement and Reciprocal Protection of Investment, Doc. No. 103–37 (Mar. 4, 1994).

330. Case No. ARB(AF)/98/1 (2000).

331. Case No. ARB/00/9 (outcome still pending).

332. *See* OECD Directorate for Financial, Fiscal, and Enterprise Affairs (March 2001), at 6, 11.

## Conclusion

It can be predicted that FDI will play an increasingly important role in the world economic system. The globalization process and cross-border expansion has begun and will likely escalate in the future. However, the lack of a single agreement on FDI hampers economic development and adds to uncertainty for investors.

The TRIMs Agreement of the WTO can be considered inadequate and redundant because it is not capable of being invoked independently of the GATT provisions. Nevertheless, despite all its flaws and shortcomings, it still provides for a degree of protection and reflects the principles of national treatment. Moreover, it sets forth internationally recognized standards of treatment that are not subject to unilateral changes by the state, absent compelling reasons enumerated in the GATT. All in all, the TRIMs Agreement may be viewed as the best achievement reached on a multilateral level in the area of direct foreign investment so far.

Ukraine has declared adherence to world-recognized standards in the protection of foreign investment but has allowed numerous exceptions to those standards. Moreover, it has discriminated against foreign investors. However, not being a party to a binding international agreement, such governmental acts can be justified on grounds of sovereign immunity. The *Daewoo* case was very illustrative of what restrictive measures the host government can undertake to favor one investor over all others for certain reasons. Leaving numerous provisos in the investment legislation and making the declared principle of national treatment subject to further alterations in general legislation gives the government virtually unlimited discretion in introducing discriminatory rules under the pretext of national economy protection.

On the other hand, the régime of national treatment cannot be viewed as satisfactory and attractive either. As in the case with tax holidays and other privileges and guarantees granted by the first investment laws and later reduced virtually to nothing by subsequent legislation, national treatment in this context means treating foreign investors as poorly as domestic ones, ruining any reasonable and legitimate expectations of both groups of entrepreneurs.

The possible membership of Ukraine in the WTO would mean automatic accession to all trade-related agreements (in particular, the TRIMs Agreement), since the WTO does not allow "opt-outs."[333] Accession to the WTO would bring the Ukraine in line with the generally accepted standards of national treatment[334] and MFN treatment,[335] as well as with the prohibition of quantitative restrictions.[336] Bound by the TRIMs Agreement, the Ukraine would be precluded from introduction in the future of such restrictive measures as local content requirements and performance requirements, so the *Daewoo* case would be a clear violation or impairment of Ukraine's WTO obligations. Furthermore, such measures would be actionable under the rules of DSU, despite the fact that the procedure of initiating proceedings under those rules is rather complicated and unavailable to private parties.

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333. WTO Agreement, art. XVI (5).

334. GATT, art. III; GATS, art. II; TRIMs, art. 2.

335. GATT, art. II; GATS, art. XVII.

336. GATT, art. XI; TRIMs, art. 2.

The very significant flaw of Ukrainian market regulation was the lack of reliable dispute resolution procedures on the domestic level. However, one of the greatest steps toward attracting foreign capital in the Ukraine was the ratification of the ICSID Convention—a very effective tool in the hands of aggrieved foreign investors. It can be predicted that this dispute settlement facility will be used more frequently in the future. But even now, the fact that there are already two cases with foreign investors being brought before the tribunal is encouraging: the ICSID has proven its availability and efficiency free from governmental influence.

On the other hand, Ukraine's membership in the WTO would not preclude the government from reducing previously granted privileges to merely national treatment régime in breach of its guarantees and promises, because the TRIMs Agreement requires no more than national treatment, while the provisions of the GATT and GATS on MFN treatment relate only to trade in goods and services, but not to foreign investment *per se*. And if the national régime of foreign investor treatment is rather poor, it seems to be a more internal problem of the state in question rather than non compliance with one's international obligations. The only guarantee against such a problem seems to be to enter into a carefully drafted and negotiated investment contract with the host government, containing elaborate *force-majeure* and hardship clauses, which would allow termination or non performance of the contract or even capital withdrawal and an escape route out of the market in case of a significant increase of business costs and risks in the host country.

# Bank Holiday: The Constitutionality of President Mahuad's Freezing of Accounts and the Closing of Ecuador's Banks

**Jorge J. Pozo**

## Introduction

In 1999, the President of the Republic of Ecuador, Jamil Mahuad, closed over 9 major banks and froze their customers' assets, which totaled more than $3 billion in deposits.[1] The decision was in response to the severe economic crisis that had shaken the nation. Agricultural shortages due to the extreme weather caused by *El Niño*, diminished exportation of petroleum, and high inflation had crippled the Ecuadorian economy to the extent that Mahuad felt such drastic measures were necessary.[2]

The severe economic conditions caused many Ecuadorians to panic.[3] Millions raced to their banks to withdraw their entire life savings in fear that the money would disappear.[4] In

1. *See* Geoffrey Mohan, *The Americas: A Weekly Look at People and Issues in Latin America: Policy of Death in Fiscal Crisis: Ecuador Austerity Hits its Citizens Hard*, NEWSDAY, Mar. 21, 1999, at A26 (discussing the trouble of the citizens of Ecuador who had accounts frozen); Charles A. Radin and Jonathan Franklin, *Ecuador Issues Warrant for Arrest of Ex-President Now Teaching at Harvard*, THE BOSTON GLOBE, July 15, 2000, at A2 (explaining the decision to freeze thousands of bank accounts); *see also New Government Pledges Reform Programme*, FT ENERGY NEWSLETTERS—POWER IN LATIN AMERICA, Feb. 1, 2000, at 10 (discussing the actions of ex-President Mahuad in closing banks and freezing accounts and the new government's commitment to dollarization).

2. *See* Justine Newsome, *Ecuador President Struggles to Fulfill His Promise: Jamil Mahuad's Efforts to Restore Stability have Failed and Economic Difficulties are Looming Large*, FIN. TIMES (LONDON), Feb. 26, 1999 at 3 (discussing the impact of El Niño and the plummeting price of oil on Ecuador's economy); *America's Conference Concludes with Keynote Address by Ecuador's President Jamil Mahuad*, BUSINESSWIRE, Sept. 21, 1998, *available at* LEXIS (explaining the effects of El Niño and a drastic drop in the price of oil on the economy); *see also* Jim Wyss Quito, *Does Jamil Know?: With Ecuador's Economy Crumbling, Everyone is Blaming the Year-old Administration of President Jamil Mahuad*, LATIN TRADE, July 1999, *available at* LEXIS (discussing the inflation problem and the plan to freeze bank accounts).

3. *See* Larry Rohter, *Accord in Ecuador Can't Hide Woes*, N.Y. TIMES, Mar. 21, 1999, at 3 (discussing the frustrations of Ecuadorian citizens trying to withdraw funds from frozen accounts); Kevin G. Hall, *Ecuador Readies Export Boost*, JOURNAL OF COMMERCE, Mar. 15, 1999, at 14A (recounting the panic of Ecuadorians that stemmed from the banking crisis); Nicole Veash, *Police Fire Tear Gas at Protestors as Ecuador Teeters on the Brink of Collapse*, THE IRISH TIMES, Jan. 10, 2000 at 12 (describing public reaction to the freezing of bank accounts).

4. *See* Larry Rohter, *Accord in Ecuador Can't Hide Woes*, N.Y. TIMES, Mar. 21, 1999, at 3 (discussing the fear of the Ecuadorians as they flocked to their banks); *see also* ORG. OF THE AM. STATES, ANN. REP. OF THE INTER-AM. COMM'N ON HUMAN RIGHTS 1999, CHAPTER IV: HUMAN RIGHTS DEVELOPMENTS IN THE REGION OF ECUADOR (1999) (discussing the financial hardships of citizens with frozen bank accounts); Nicole Veash, *Police Fire Tear Gas at Protestors as Ecuador Teeters on the Brink of Collapse*, THE IRISH TIMES, Jan. 10, 2000 at 12 (describing public reaction to the freezing of bank accounts).

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response, President Mahuad ordered the closure of banks and freezing of their assets. President Mahuad's rationale for such a move was based on his proclaimed "war against poverty."[5]

Nevertheless, his decision caused chaos and protests all over the major cities of Ecuador, including Quito and Guayaquil.[6] Many people did in fact end up losing their life savings.[7] Ultimately, Mahuad's attempt to stabilize the economy ended in utter failure.[8] The following year, Mahuad was ousted from the presidency by a military coup,[9] and the *sucre* (Ecuador's national currency) was replaced by the U.S. dollar.[10]

President Mahuad's decision to close banks and freeze assets may have been constitutionally illegal. It has been argued that Mahuad's actions exceeded his executive powers. The four members of the board of directors of the Central Bank of Ecuador resigned due to differences

5. *See* Stephen Buckley, *'We Lost Democracy'; Ecuadoran Coup Highlights Basic Problems and Reflects Shift to Oil-Based Economy*, THE WASH. POST, Jan. 26, 2000, at A17 (noting that the measures taken by President Mahuad were done in response to the failing economy); *cf*., David Talbot, *Rioters, Soldiers Clash as Ecuador Labor Unions Call National Strike*, THE BOSTON HERALD, Mar. 11, 1999, at 7 (reporting on the government's order to close banks to prevent withdrawals). *See generally* ORG. OF THE AM. STATES, ANN. REP. OF THE INTER-AM. COMM'N ON HUMAN RIGHTS 1999, CHAPTER IV: HUMAN RIGHTS DEVELOPMENTS IN THE REGION OF ECUADOR (1999) (stating the government's plan to close banks in response to people's attempt to withdraw funds).

6. *See* Larry Rohter, *Dollar May be a Reprieve in Ecuador*, N.Y. TIMES, Jan. 16, 2000, at 6 (illustrating the campaign of civil disobedience in response to the plan to convert the *sucre* to the U.S. dollar); Sebastion Rotella, *Ecuador's Military Says 'Junta' is in Charge; Latin America: Defense Chair Announces New Government*, L.A. TIMES, Jan. 22, 2000, at 1 (reporting on the protests which led to the ousting of Jamil Mahuad's); *Ecuador Riot Police Break up Protests*, NEWSDAY, Jan. 7, 2000, at A16 (discussing the protests by students and the blocking of roads by workers).

7. *See* Nicole Veash, *Ecuador Moves to Halt Fall of Currency*, THE BOSTON GLOBE, Jan. 10, 2000, at A1 (discussing the collapse of several banks and the loss of life savings by "thousands" of people); *see also* Nicole Veash, *Police Fire Tear Gas at Protestors as Ecuador Teeters on the Brink of Collapse*, THE IRISH TIMES, Jan. 10, 2000, at 12 (describing the effects of the devaluation of the sucre). *See generally* David Talbot, *Rioters, Soldiers Clash as Ecuador Labor Unions Call National Strike*, THE BOSTON HERALD, Mar. 11, 1999, at 7 (quoting an Ecuadorian as commenting that the economy was in the worst condition of the century).

8. *See* David Adams, *Ecuador Bets Future on the Dollar*, ST. PETERSBURG TIMES, Feb. 15, 2000, at 1A (noting the freezing of assets and devaluation of currency has brought Ecuador "to its knees."); Nicole Veash, *Ecuador Moves to Halt Fall of Currency*, THE BOSTON GLOBE, Jan. 10, 2000, at A1 (discussing the collapse of the Ecuadorian economy); *see also Day of Rebellion Ends with Ouster of Ecuador Leader*, N.Y. TIMES, Jan. 22, 2000, at 1 (recounting the collapse of Mahuad's rule).

9. *See Day of Rebellion Ends with Ouster of Ecuador Leader*, N.Y. TIMES, Jan. 22, 2000, at 1 (reporting on the overthrow of President Mahuad's government by 120 military officers); Savita Iyer, *Political Risk—Ecuador Unclear; Nigeria, Kazakhstan Slide Downwards*, EMERGING MARKETS DEBT REPORT, Feb. 28, 2000 (discussing the removal of Ex-President Mahuad and the installation of Vice-President Gustavo Noboa); Charles A. Radin and Jonathan Franklin, *Ecuador Issues Warrant for Arrest of Ex-President Now Teaching at Harvard*, THE BOSTON GLOBE, July 15, 2000, at A2 (describing Jamil Mahuad's ouster and the subsequent issuance of a warrant for his arrest).

10. *See* Larry Rohter, *Ecuador's Top Three Central Bankers Quit over Dollarization*, N.Y. TIMES, Jan. 12, 2000, at C4 (discussing President Mahuad's victory for dollarization over the protests of bank officials); *see also Ecuador Inches Closer to Replacing Currency With Dollar*, AGENCE FRANCE PRESSE, Feb. 3, 2000, *available at* LEXIS (detailing the government's proposal to continue Ex-President Mahuad's quest for dollarization); *see also* FT ENERGY NEWSLETTERS—POWER IN LATIN AMERICA, Feb. 1, 2000, at 10 (discussing the new government's commitment to dollarization).

with banking policies implemented by the executive; suggesting that his actions were unconstitutional. It may also be argued that Mahuad did not even have the constitutional authority to take the actions he did. Indeed, Mahaud's attorneys argued that his decision to freeze assets was "not a crime on the country's statute books" in support of their request that the court revoke Mahuad's sentence.[11] Nevertheless, the traditional role of Ecuador's Executive Branch allows it to exercise great power irrespective of the language or text of the constitution.[12]

In this article, it will be argued that due to the vague separation of powers between the executive and the other branches of government resulting from distinctive historical circumstances, the president is legally enabled to exercise authority that is both overbroad and arguably unconstitutional. The vague separation of powers is especially apparent in the area of banking regulations. During the banking crisis, neither the Judiciary, the National Congress, the Ecuadorian Private Banks Association nor the Central Bank of Ecuador had the power to stop the President from exercising his authority.

A comparison with the United States' banking laws will assist in evaluating areas within Ecuador's regulatory banking framework that fail to provide adequate protection for investors and banks alike. An evaluation of U.S. laws will also demonstrate what safeguards are in place within the United States to adequately determine whether the executive's power to close banks and freeze assets are constitutionally legal. This comparison will be essential in understanding how to prevent the draconian measures taken in Ecuador to save the economy. It will highlight the need for Ecuador's banking regulatory system to be re-worked and continue to be developed. An attempt, however, to distribute power away from the executive may be difficult, given the historical circumstances surrounding the executive's traditional powers. Ultimately it is hoped that a clearer picture of Ecuador's executive powers and a modernized system of banking laws will emerge in order to prevent or deal with future economic crises in an efficient manner.

## I. Overview of Executive Power

Article II of the United States Constitution and Article 164 of the Ecuadorian Constitution create and give legal authority to their respective executive branches.[13] Both nations' con-

11. *See* Nicholas Moore, *World News: Latin America and Caribbean: Court Asked to Revoke Ecuador President's Sentence*, FIN. TIMES (London), July 26, 2000, at 5 (quoting Jamil Mahuad's attorney in defense of the crimes charged).

12. *See* Judith Kimerling, *Rights, Responsibilities, And Realities: Environmental Protection Law In Ecuador's Amazon Oil Fields*, 2 SW. J. OF L. & TRADE AM. 293, 295 (1995) (noting that the executive has traditionally had broad and expansive powers in Ecuador); *see also* Robert Kilborn et al., *News in Brief: World,* THE CHRISTIAN SCIENCE MONITOR, Jan. 11, 2000, at 20 (discussing President Mahuad's threat to fire central bank officials who try to block the move to replace the *sucre* with the U.S. Dollar); David Talbot, *Rioters, Soldiers Clash as Ecuador Labor Unions Call National Strike*, THE BOSTON HERALD, Mar. 11, 1999, at 7 (describing the President's order to partially suspend civil rights).

13. U.S. CONST. art. II, §1, cl. 1; CONSTITUCION POLITICA DE LA REPUBLICA DEL ECUADOR (Ecuador Constitution) art. 164 (1998).

stitutions define the various obligations and duties of the executive branch.[14] To a certain degree, they also define the powers that the executive has to carry out the laws.[15]

### A. Powers of the Executive in Ecuador

#### 1. Constitutional Basis

The president in Ecuador is the Chief of State and Government.[16] He is responsible for all public administration.[17] His duties require that he fulfill all the laws of the constitution.[18] The president also has the power to convene the National Congress in "extraordinary situations."[19]

The Constitution gives the president broad power to declare a state of emergency.[20] It allows the president to declare such a state of emergency during times of imminent external aggression, international war, grave civil disorder and natural catastrophes.[21] In such emergencies, the president may suspend or limit some or all of the established rights of the Constitution.[22] The president has the obligation to notify the National Congress within 48 hours of issuing the executive order.[23] However, the Congress, at its discretion and under reasonable justification, may override the president's declaration.[24]

#### 2. Latin American Democracy

The strength of the executive branch in Latin American democracies (including Ecuador) in wielding authority can be attributed to the distinct type of democracy that has developed in

14. *Id*.

15. *Id*.

16. CONSTITUCION POLITICA DE LA REPUBLICA DEL ECUADOR (Ecuador Constitution) art. 164 (1998).

17. CONSTITUCION POLITICA DE LA REPUBLICA DEL ECUADOR (Ecuador Constitution) art. 171(1) (1998).

18. *Id*. art. 171(1).

19. *Id*. art. 171(8).

20. *Id*. art. 180.

21. *Id*.

22. *Id*. art 180(6). This provision allows the President to suspend or limit, *inter alia*: the right of citizenship upon marriage (art. 9); the rights of foreigners within Ecuador (art. 13); fundamental civil rights such as right to life (art. 23(1)), freedom from torture, equality under the law (art. 23(3)), liberty (art. 23(4)), freedom of expression (art. 23(9)), right to privacy (art. 23(13)), the right to work (art. 23(17)), the right of access to the courts (art. 23(26)), right of due process (art. 23(27)). It should be noted that Ecuador is a party to the International Covenant on Civil and Political Rights, which provides that all persons have "the right to liberty." Nonetheless, the Covenant also allows parties to "take measures derogating form their obligations under the present Covenant" in times of public emergency. *See* International Covenant on Civil and Political Rights, Dec. 16, 1966, 999 U.N.T.S., 6 I.L.M. 369, art. 4 and 9.

23. *Id*. art 180(6).

24. *Id*. art 182.

Latin America.[25] Developing democracies, such as the one in Ecuador, often consist of political institutions that are too weak to ensure the representation of diverse interests, constitutional supremacy, the rule of law and the constraint of executive authority.[26] Latin American presidents are often granted sweeping and largely unaccountable authority.[27]

One author has analyzed various Latin American constitutions (including Ecuador) and concluded that presidential dominance is manifest and common in each.[28] First, the appointive powers of Latin American presidents are extensive.[29] The president may appoint high officials

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25. *See* LARRY DIAMOND, DEVELOPING DEMOCRACY: TOWARD CONSOLIDATION 34 (1999); Gabriel L. Negretto & Jose Antonio Aguilar Rivera, *Exception and Emergency Powers: Liberalism and Emergency Powers in Latin America: Reflections on Carl Schmitt and the Theory of Constitutional Dictatorship*, 21 CARDOZO L. REV. 1797, 1798 (2000) (noting that the powers of Latin American presidents are not subject to any checks); Luis Carlos Ugalde, *The Transformation of Mexican Presidentialism*, 1929–2000, 25 FLETCHER F. WORLD AFF. 115, 117 (2001) (discussing the Mexican executive's ability to rule with "considerable authority"); *see also* Maria Dakolias, *A Strategy for Judicial Reform: The Experience in Latin America*, 36 VA. J. INT'L L. 167, 174 (1995) (noting the prevalent interference by the executive branch is a function of sociopolitical factors such as the unique history of Latin American countries).

26. *See* LARRY DIAMOND, DEVELOPING DEMOCRACY: TOWARD CONSOLIDATION 34 (1999). *See generally* Larry Diamond, *NAFTA Revisited: Expectations and Realities: Consolidating Democracy in the Americas*, 550 ANNALS 12, 16 (1997) (discussing the state of democracy in the Americas and the inherent "weak political institutions"); Vedat Milor, *The Promotion of Economic Development through Conflict and Dispute Resolution: Examples from Mexico and Malaysia*, 35 STAN. J. INT'L L. 169, 170 (1999) (noting the political weakness of parties and the existence of "systematic corruption" in Latin American governments).

27. *See* LARRY DIAMOND, DEVELOPING DEMOCRACY: TOWARD CONSOLIDATION 34 (1999); Gabriel L. Negretto & Jose Antonio Aguilar Rivera, *Exception and Emergency Powers: Liberalism and Emergency Powers in Latin America: Reflections on Carl Schmitt and the Theory of Constitutional Dictatorship*, 21 CARDOZO L. REV. 1797, 1798 (2000) (noting that the powers of Latin American Presidents are not subject to any checks); Luis Carlos Ugalde, *The Transformation of Mexican Presidentialism*, *1929–2000*, 25 FLETCHER F. WORLD AFF. 115, 117 (2001) (discussing the Mexican executive's ability to rule with "considerable authority"); *see also* Maria Dakolias, *A Strategy for Judicial Reform: The Experience in Latin America*, 36 VA. J. INT'L L. 167, 174 (1995) (noting the prevalent interference by the executive branch is a function of sociopolitical factors such as the unique history of Latin American countries).

28. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Gabriel L. Negretto & Jose Antonio Aguilar Rivera, *Exception and Emergency Powers: Liberalism and Emergency Powers in Latin America: Reflections on Carl Schmitt and the Theory of Constitutional Dictatorship*, 21 CARDOZO L. REV. 1797, 1798 (2000) (noting the president's ability to declare emergencies is not subject to many restrictions). *See generally* Maria Dakolias & Kim Thachuk, *The Problem of Eradicating Corruption from the Judiciary: Attacking Corruption in the Judiciary: A Critical Process in Judicial Reform*, 18 WIS. INT'L L.J. 353, 362 (2000) (discussing the failure of the judiciary and the legislature in Latin American countries to act as an effective deterrent to executive power and its abuse).

29. *See* Luis Carlos Ugalde, *The Transformation of Mexican Presidentialism*, 1929–2000, 25 FLETCHER F. WORLD AFF. 115, 117 (2001) (discussing the powers of the Mexican president to appoint high-ranking officials without the approval of the Congress); William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L. 1, 7 (1993) (discussing the power of the Argentinean president in appointing high ranking officials is immense). *See generally* T. Leigh Anenson, *For Whom the Bell Tolls . . . Judicial Selection by Election in Latin America*, 4 SW. J. OF L. & TRADE AM. 261, 297 (1997) (noting how introduction of the "retention election scheme" would curtail the executive's power).

without approval of the congress.[30] For instance, the president of Ecuador can freely appoint and remove Ministers of State and Provincial Governors.[31] Second, state intervention in the economy is extensive.[32] Article 244 of the Ecuador Constitution gives the State power to regulate the "development of all economic activities."[33] Third, the authority to issue decree laws, or decrees with force of law is considerable.[34] Fourth, the constitutions of most Latin American nations share a provision for presidential assumption of extraordinary powers in crisis situations.[35]

The president's power to suspend basic fundamental rights during a state of emergency gives the president enormous power to implement his personal agenda.[36] In areas such as appointments, decree laws, the budget and emergency powers, the Latin American president

30. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Luis Carlos Ugalde, *The Transformation of Mexican Presidentialism*, 1929–2000, 25 FLETCHER F. WORLD AFF. 115, 117–18 (2001) (discussing the constitutional authority of the President to appoint high-ranking officials under article 89); T. Leigh Anenson, *For Whom the Bell Tolls . . . Judicial Selection by Election in Latin America*, 4 SW. J. OF L. & TRADE AM. 261, 297 (1997) (discussing the appointive powers of the Latin American president); William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 69 (1993) (noting the "unfettered" power of the Argentinean president in appointing high ranking officials).

31. *See* MANUAL DE GOBIERNO DE LA REPUBLICA DEL ECUADOR 22 (Universidad Central del Ecuador, 1962) (Article 171(10) of the Ecuador Constitution allows the president to "name and remove freely the Ministers of State." It does not require that the President consult with Congress).

32. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Emilio J. Cardenas, *The Regional Approach to Hemispheric Integration: A Modular Road Towards Free Trade*, 1 SW. J. OF L. & TRADE AM. 49, 52 (1994) (discussing state intervention and its recent deterioration in most economic sectors); Anthony M. Vernava, *Latin American Finance: A Financial, Economic and Legal Synopsis of Debt Swaps, Privatizations, Foreign Direct Investment Law Revisions and International Securities Issues*, 15 WIS. INT'L L.J. 89, 92 n.2 (1996) (discussing the opposition of the new economic model to state intervention).

33. CONSTITUCION, *supra* note 13, art. 244.

34. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Paul A. O'Hop, Jr., *Hemispheric Integration and the Elimination of Legal Obstacles Under a NAFTA-Based System*, 36 HARV. INT'L L.J. 127, n.190 (1995) (discussing the power of the president to issue decrees without the legislature); Carlos Santiago Nino, Essay, *The Debate Over Constitutional Reform in Latin America*, (Michael E. Roll trans.), 16 FORDHAM INT'L L.J. 635, 641 (1993) (discussing the Latin American presidential power to issue decrees).

35. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Carlos Santiago Nino, Essay, *The Debate over Constitutional Reform in Latin America* (Michael E. Roll trans.)16 FORDHAM INT'L L.J. 635, 641 (1993) (discussing the powers of the president for calling new elections and the dissolution of congress that would be desirable under a "mixed system" in Latin America). *See generally* Gabriel L. Negretto & Jose Antonio Aguilar Rivera, *Exception and Emergency Powers: Liberalism and Emergency Powers in Latin America: Reflections on Carl Schmitt and the Theory of Constitutional Dictatorship*, 21 CARDOZO L. REV. 1797, 1798 (2000) (noting that presidential use of authority during emergencies was self-imposed).

36. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Paul A. O'Hop, Jr., *Hemispheric Integration and the Elimination of Legal Obstacles Under a NAFTA-Based System*, 36 HARV. INT'L L.J. 127, 156 n.190 (1995) (discussing the power of the president to issue decrees despite the legislature); Carlos Santiago Nino, Essay, *The Debate Over Constitutional Reform in Latin America*, (Michael E. Roll trans.), 16 FORDHAM INT'L L.J. 635, 641 (1993) (discussing the Latin American presidential power to issue decrees).

clearly has greater authority within his political system than that of the U.S. president.[37] In cases of national emergency, the president of Ecuador can act in a dictatorial manner.[38] These extensive presidential powers in Latin American nations are a consequence of unique historical, legal and cultural circumstances of the region.[39]

### B. Sources of Executive Power in Ecuador

While the Constitution defines the textual authority for executive power, deeper cultural influences are primarily responsible for defining the president's scope of power.[40] *Caudillismo* and the Civil Law Tradition have heavily influenced and defined the expectations of executive accountability and scope of power.[41]

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37. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Carlos Santiago Nino, Essay, *The Debate over Constitutional Reform in Latin America* (Michael E. Roll trans.)16 FORDHAM INT'L L.J. 635, 640–41 (1993) (discussing the differences between the constitutional powers of the Argentinean president and the constitutional powers of the U.S. president); William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 69 (1993) (noting the influence of cultural factors in the development of constitutional government in Argentina).

38. *See* CLINTON L. ROSSITER, CONSTITUTIONAL DICTATORSHIP: CRISIS GOVERNMENT IN THE MODERN DEMOCRACIES 5 (1948). A hallmark of modern democracies (France, U.K., Germany and U.S.) is an alteration of normal constitutional government in times of crisis, such as war, rebellion and economic depression. *See* Gabriel L. Negretto & Jose Antonio Aguilar Rivera, *Exception and Emergency Powers: Liberalism and Emergency Powers in Latin America: Reflections on Carl Schmitt and the Theory of Constitutional Dictatorship*, 21 CARDOZO L. REV. 1797, 1798 (2000) (noting the extensive powers of the president stemming from emergency provisions). *See generally* Carlos Santiago Nino, Essay: *The Debate over Constitutional Reform in Latin America* (Michael E. Roll, trans. 1993), 16 FORDHAM INT'L L.J. 635, 641 (1993) (discussing the ability of a Latin American president to call new elections and dissolve Parliament as part of a "mixed system" to combat the nuisances of the presidential system).

39. *See* William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 69 (1993) (noting that the failure of Constitutional government in Argentina is due to a combination of historic and economic problems); Luz Estella Nagle, *The Cinderella of Government: Judicial Reform in Latin America*, 30 CAL.W. INT'L L.J. 345, 347 (2000) (discussing the colonial Spanish cultural influences that are "embedded" in Latin American countries). *See generally* Gabriel L. Negretto & Jose Antonio Aguilar Rivera, *Exception and Emergency Powers: Liberalism and Emergency Powers in Latin America: Reflections on Carl Schmitt and the Theory of Constitutional Dictatorship*, 21 CARDOZO L. REV. 1797, 1797 (2000) (noting how "established political traditions" serve as an impediment to the growth of democracy).

40. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1998) (noting the *caudillo* tradition in Latin America and the ensuing oppression of individual rights that followed); Luz Estella Nagle, *The Cinderella of Government: Judicial Reform in Latin America*, 30 CAL. W. INT'L L.J. 345, 347 (2000) (discussing the colonial Spanish cultural influences in Latin American countries). *See generally* Note, *Liberalismo Contra Democracis: Recent Judicial Reform in Mexico*, 108 HARV. L. REV. 1919, 1923–24 (1995) (describing the failure of the liberals in sustaining democracy, giving rise to the *caudillos*).

41. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1998) (noting how the *caudillos* ruled after the collapse of the democratic governments); *Liberalism Contra Democracis: Recent Judicial Reform in Mexico*, 108 HARV. L. REV. 1919,1924 (1995) (noting the emergence of *caudillos* into the political life); Luz Estella Nagle, *The Cinderella of Government: Judicial Reform in Latin America*, 30 CAL. W. INT'L L.J. 345, 347 (2000) (discussing the cultural influences in Latin America that are a result of Spanish colonization).

### 1. The Tradition of the *Caudillo in Latin American Presidencies*

The colonists that rose to power in Spanish America have been termed *caudillos*.[42] A *caudillo* is a military or civilian strongman who ruled in dictatorial fashion.[43] He routinely exceeded constitutional limitations on his powers and disregarded the rights of others.[44]

Economic distress, including social and political chaos, was rampant after the Spanish-American War of Independence.[45] In addition, U.S. intervention played no small role in ensuring the underdevelopment of Latin America.[46] As the lawlessness increased, effective political

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42. *See* M.C. Mirow, *Borrowing Private Law in Latin America: Andre Bello's Use of The Code Napoleon in Drafting the Chilean Civil Code*, 61 LA. L. REV. 291, 326 (2001) (noting that Argentina fell into the control of *caudillos* after independence); Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1998) (noting the birth of *caudillos* into Latin American political life after a brief experiment with democratic governments); William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L.1, 8 (1993) (discussing the birth of the *caudillo* in Latin American countries).

43. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1998) (defining *caudillo* as "military and civilian strongmen who ruled in dictatorial fashion"); *Liberalismo Contra Democracis: Recent Judicial Reform in Mexico*, 108 HARV. L. REV. 1919, 1924 (1995) (noting that a *caudillo* was a military strongman); William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L.1, 8 (1993) (defining the *caudillo* as the "provincial leader of the common people who ruled by physical and psychological prowess").

44. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1988) (stating that Antonio Lopez de Santa Anna ruled Mexico in a "crude and capricious fashion" often without regard to individual rights and with disregard to constitutional guarantees of rights); *see also Liberalismo Contra Democracis: Recent Judicial Reform in Mexico*, 108 HARV. L. REV. 1919, 1924 (1995) (noting that a *caudillo* was in a sense a dictator). *See generally* Christopher M. Nelson, Comment, *An Opportunity for Constitutional Reform in Argentina: Re-Election 1995*, 25 U. MIAMI INTER-AM. L. REV. 283, 306 (1993–94) (discussing how the federalist nature of the government was perpetuated by the presidential modifications to constitutional provisions).

45. *See* GEORGE PENDLE, A HISTORY OF LATIN AMERICA 125 (1976). *See generally* Gloria Sandrion, *Los Confundidos: De-Conflating Latinos/as: Race and Ethnicity*, 19 CHICANO-LATINO L. REV. 69, 86 (1998) (discussing political turmoil during the Spanish-American war). *See generally* Carlos Ortiz Miranda, *Haiti and the United States During the 1980s and 1990s: Refugees, Immigration, and Foreign Policy*, 32 SAN DIEGO L. REV. 673, 674 n.4 (1995) (discussing the prevalent political chaos used as a pretext by the United States to invade Haiti after the Spanish-American War).

46. *See* GEORGE PENDLE, A HISTORY OF LATIN AMERICA 172–75 (1967) (arguing that U.S. military intervention and economic domination contributed to the succession of dictators in Latin America); Leo Gross & Ann Van Wynen Thomas, *Le Principe de Non-Intervention: Theorie et Pratiques dans les Relations Inter-Americaines*, 78 AM. J. INT'L ARB. 261, 262 (1984) (stating that the U.S. interventionary activities with the elites in Latin America have been exploitive of the country and have therefore contributed to underdevelopment in the region). *See generally* Max J. Castro, Ph.D., *Democracy in Anti-Subordination Perspective: Local/Global Intersections*, 53 U. MIAMI L. REV. 863, 867 (1999) (arguing that an analysis of the relations between the U.S. and Latin America reveals a perception of Latin inferiority on the part of the U.S.).

power went into the hands of personal leaders.[47] These personal leaders retained a charismatic personality and a loyal following.[48] Of course, most, if not all, of these leaders came from the military. Because of the lack of autonomous rule and the inability to establish self-government, military leadership became highly regarded.[49] It was under these circumstances that the *caudillo*'s power evolved and was defined.

*Caudillos* enjoyed large popular support not only from the newly born elite, but also from the working classes in Latin America.[50] Yet their form of rule differed little from that of Colonial Spanish rule.[51] As was done in Europe, they centralized power and shared it with no one.[52] Partly as a consequence of their military background, *caudillos* commonly used this as a means

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47. *See* GEORGE PENDLE, A HISTORY OF LATIN AMERICA 125 (1976); Tom Farer, *Consolidating Democracy in Latin America: Law, Legal Institutions and Constitutional Structure*, 10 AM. U. J. INT'L. L. & POL. 1295, 1301 (1995) ("Latin American political parties have served as vehicles for personalistic, paternalistic rule, in the first place by the chief executive and secondarily by local bosses, or 'Caciques,' dispensing government favors"); *see also* Symposium, *Challenges to the Fragile Democracies in the Americas: Legitimacy and Accountability*, 36 TEX. INT'L. L.J. 319, 325–26 (2001) (discussing the dictatorial nature of the Peruvian government).

48. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Symposium, *Challenges to the Fragile Democracies in the Americas: Legitimacy and Accountability*, 36 TEX. INT'L. L.J. 319, 324 (2001) (stating that as a ruler, the *caudillo* is more like a spokesperson for the people than any legal government representative could be); *see also* William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L. L. 1, 8 (1993) (describing the *caudillos* as provincial leaders "of the common people who ruled by physical and psychological prowess").

49. *See* PRESIDENTIAL POWER IN LATIN AMERICAN POLITICS 73 (Thomas V. DiBacco ed., 1977); Rafael X. Zahralddin-Aravena, *Chile and Singapore: The Individual and the Collective, A Comparison*, 12 EMORY INT'L L. REV. 739, 750–52 (1998) (relating the continuing presence of military leadership in Chile as an alternative to economic, political and social chaos); *see also* Thomas C. Wright, *Human Rights in Latin America: History and Projections for the Twenty-First Century*, 30 CAL. W. INT'L. L.J. 303, 305 (2000) (explaining how the desire not to upset the political and economic conditions strengthened the support for the current governments and steered away from Western democracies).

50. *See* M.C. Mirow, *Borrowing Private Law in Latin America: Andrea Bello's Use of the Code Napoleon in Drafting the Chilean Civil Code*, 61 LA. L. REV. 291, 326–27 (2001) (discussing how the conditions in the trade industry in the 1840's led the merchant class to support the rule of *caudillos*). *See generally* Robert S. Barker, *Constitutional in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1988) (stating that when the *caudillos* took power they were able to calm the reigning chaos that resulted from the fact that the government in power was unable to enforce the constitutions as adopted); Tim Dockery, *The Rule of Law Over the Law of Rulers: The Treatment of De Facto Laws in Argentina*, 19 FORDHAM INT'L. L.J. 1578, 1586 (1996) (discussing the political history of Argentina including the movement towards independence from Spain and the effects of the rise to power of the *caudillos*).

51. Ruben M. Saenz, *When Justice Shrinks: Impunity as Means of Democracy* (1998) (unpublished paper, Utica College of Syracuse University) (on file with author). *See generally* Luz Estella Nagle, *The Cinderella of Government: Judicial Reform in Latin America*, 30 CAL. W. INT'L. L.J. 345, 347 (2000) (discussing "the historical, political, and cultural factors inherited from colonial Spanish domination which are still embedded in Latin American countries").

52. *See* Luz Estella Nagle, *The Cinderella of Government: Judicial Reform in Latin America*, 30 CAL. W. INT'L. L.J. 345, 369 n.134 (2000) (noting that *caudillos* "held control over regional commerce, politics, and societal affairs"); Lauren Benton, *"The Laws of This Country": Foreigners and the Legal Construction of Sovereignty in Uruguay, 1830–1875*, 19 LAW & HIST. REV. 479, 484 (2001) (commenting that *caudillos* maintained control that could not be restricted by the legal system); *see also* M. C. Mirow, *Borrowing Private Law in Latin America: Andrea Bello's Use of the Code Napoleon in Drafting the Chilean Civil Code*, 61 LA. L. REV. 291, 326 (2001) (noting that the *caudillo*'s power stemmed from their ownership of property).

to exercise their authority.[53] This included imprisonment, death, financial abuse and dishonesty.[54] They commanded the armed forces for maintaining order and power.[55]

The legacy of continuous military involvement left by *caudillismo* permitted the executive branches of Latin American governments to wield tremendous authority, power and force.[56] With its military style of executive power, the *caudillo* contributed to a form of government far different than the one evolving in the United States.[57] As such, Latin American republics did

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53. Ruben M. Saenz, *When Justice Shrinks: Impunity as Means of Democracy* (1998) (unpublished paper, Utica College of Syracuse University) (on file with author). Robert S. Barker, *Constitutional in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1988) (noting that "[t]he ensuing chaos was halted only by the emergence, almost everywhere, of the caudillos . . . who ruled in dictatorial fashion, routinely exceeding constitutional limitations on their own power and disregarding the constitutional guarantees of the rights of others"). *See generally* Christopher M. Nelson, Comment, *An Opportunity for Constitutional Reform in Argentina: Re-election 1995*, 25 U. MIAMI INTER-AM. L. REV. 283, 299 (1993–94) (explaining that the caudillos often fought each other for power and in the process, destroyed their surroundings).

54. *See* M.C. Mirow, *Borrowing Private Law in Latin America: Andrea Bello's Use of the Code Napoleon in Drafting the Chilean Civil Code*, 61 LA. L. REV. 291, 326 (2001) (discussing the "quasi-law" rule under which the *caudillos* governed); *see also* Jonathan M. Miller, *Courts and the Creation of a "Spirit of Modernation": Judicial Protection of Revolutionaries in Argentina, 1863–1929*, 20 HASTINGS INT'L & COMP. L. REV. 231, 238–39 (1997) (stating that Rosas "used terror as a weapon, acted as his own judiciary, and intimidated his political adversaries through a murder squad known as the Mazorca, a group that openly brandished long knives that it used to cut the throats of its opponents"); William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 8 (1993) (discussing an example of a typical *caudillo* in Juan Manuel de Rosas).

55. *See* Ruben M. Saenz, *When Justice Shrinks: Impunity as Means of Democracy* (1998) (unpublished paper, Utica College of Syracuse University) (on file with author); Jonathan M. Miller, *The Authority of a Foreign Talisman: A Study of U.S. Constitutional Practice as Authority in Nineteenth Century Argentine and the Argentine Elite's Leap of Faith*, 46 AM. U. L. REV. 1483, 1496 (1997) ("Local caudillos—ranch owners who formed mounted militia with their own peons and those of allied or client ranch owners—seized power in the interior and acted as warlords over as much territory as their militia could control."); *see also* Jonathan M. Miller, *Courts and the Creation of a "Spirit of Modernation": Judicial Protection of Revolutionaries in Argentina*, 1863–1929, 20 HASTINGS INT'L & COMP. L. REV. 231, 238–39 (1997) (discussing the practices used by Rosas to stay in power).

56. *See* Stefanie Ricarda Roos, *Democracy and Elections in Guatemala*, 21-SPG FLETCHER F. WORLD AFF. 97, 100 (1997) (discussing the government of Guatemala, the author states that "[t]he past three civilian governments were only a façade for the de facto rule of the military and the traditional economic elite"); Bruce Ackerman, *The New Separation of Powers*, 113 HARV. L. REV. 633, 645–46 (2000) (discussing how democracies in Latin America often crumble at the whim of the executive in power who seizes "*caudillo*-like" control of the government); Jonathan M. Miller, *The Authority of a Foreign Talisman: A Study of U.S. Constitutional Practice as Authority in Nineteenth Century Argentina and the Argentine Elite's Leap of Faith*, 46 AM. U. L. REV. 1483, 1497 (1997) (discussing Rosas' methods for getting and keeping the grant of absolute power in the government). *See generally* Christopher M. Nelson, Comment, *An Opportunity for Constitutional Reform in Argentina: Re-Election 1995*, 25 U. MIAMI INTER-AM. L. REV. 283, 301 (1993–94) (discussing the extensive powers of the president under the Argentine constitution and "hyper-presidentialism").

57. *Compare* William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 5–6 (1993) (discussing how the differences in development in the history and tradition of United States and Argentina have impacted the powers and roles of the presidents in these countries); *with* T. Leigh Anenson, *For Whom the Bell Tolls . . . Judicial Selection by Election in Latin America*, 4 SW. J. L. & TRADE AM. 261 (1997) (discussing the development of the legal system in Latin America); *with* Erwin Chemerinsky, *Losing Faith: America without Judicial Review,* 98 MICH. L. REV. 1416, 1416 (2000) (discussing the importance of judicial review to government in the United States).

not develop naturally into parliamentary democracies.[58] The early constitutions promulgated in the 19th century placed few restrictions on the exercise of executive authority.[59] A *de facto* supremacy of executive power was implicitly acknowledged.[60] The legacy of the *caudillo* is therefore an important aspect of the executive branch in Ecuador. Its circumstances define the way the executive is to rule, even if contradicted or limited by the Constitution.

### 2. The Influence of the Civil Law Tradition on the Executive

Ecuador's government and legal system is based upon civil law tradition, which has influenced its structure.[61] In the United States, constitutional provisions presuppose the existence of common law rules and practices, such as the power of judicial review as established in *Marbury v. Madison*.[62] However, this approach did not fit within the civil law systems of Latin America. From Roman times until the 18th century, this system had little tradition of judicial control over government action.[63]

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58. *See* GEORGE PENDLE, A HISTORY OF LATIN AMERICA 125 (1976); Bruce Ackerman, *The New Separation of Powers*, 113 HARV. L. REV 633, 728–29 (2000) (stating that most of the aspirant democracies in Latin America have chosen pure presidentialism instead of pure parliamentarian); Tim Dockery, *The Rule of Law Over the Law of Rulers: The Treatment of De Facto Laws in Argentina*, 19 FORDHAM INT'L L.J. 1578, 1586 (1996) (discussing decentralization of government in Buenos Aires "characterized by the regional authoritarian rule" of the *caudillos*).

59. *See* LAURA CHINCHILLA, THE ADMINISTRATION OF JUSTICE IN ECUADOR 20 (1993); Jonathan M. Miller, *Courts and the Creation of a "Spirit of Modernation": Judicial Protection of Revolutionaries in Argentina, 1863–1929*, 20 HASTINGS INT'L & COMP. L. REV. 231, 234–35 (1997) (noting that "[w]hile the Constitution provided for a federal system with substantial provincial autonomy, in practice much of what happened in provincial politics was controlled by the President"). *See generally* Tim Dockery, *The Rule of Law Over the Law of Rulers: The Treatment of De Facto Laws in Argentina*, 19 FORDHAM INT'L L.J. 1578, 1588 (1996) (discussing the division of powers in the Argentinian Constitution).

60. *See* LAURA CHINCHILLA, THE ADMINISTRATION OF JUSTICE IN ECUADOR 20 (1993).

61. *See* Lila Katz de Barrera-Hernandez & Alastair R. Lucas, *Environmental Law in Latin America and the Caribbean: Overview and Assessment*, 12 GEO. INT'L ENVTL. L. REV. 207, 228 (1999) (stating that Ecuador is a civil law country); T. Leigh Anenson, *For Whom the Bell Tolls . . . Judicial Selection by Election in Latin America*, 4 SW. J. L. & TRADE AM. 261, 267 (1997) (detailing the formation of the civil law system in Latin American countries); Bruce M. Wilson & Roger Handberg, *From Judicial Passivity to Judicial Activism: Explaining the Change within Costa Rica's Supreme Court*, 5 NAFTA. L. & BUS. REV. AM. 522, 524 (1999) (discussing civil law traditions in Latin American countries).

62. 5 U.S. 137, 177–78 (1803). *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1988). *See generally* Justice Robert F. Utter & David C. Lundsgaard, *Judicial Review in the New Nations of Central and Eastern Europe: Some Thoughts From a Comparative Perspective*, 54 OHIO ST. L.J. 559, 563–77 (1993) (discussing the role of judicial review in the U.S. as compared with judiciaries in civil law countries).

63. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1988); Bruce M. Wilson & Roger Handberg, *From Judicial Passivity to Judicial Activism: Explaining the Change Within Costa Rica's Supreme Court*, 5 NAFTA. L. & BUS. REV. AM. 522, 524 (1999) (stating that the courts tended to be viewed as politically neutral because of their tendency to remain neutral during hectic political times). *See generally* Frederick R. Anderson & Claudio Grossman, *Lawyers and the Rule of Law in the Western Hemisphere*, 643 PLI COMMERCIAL LAW AND PRACTICE COURSE HANDBOOK SERIES 191, 195–200 (1998) (discussing the lack of authority of civil law judges in Latin America and that the doctrine of judicial review is not followed in most Latin American countries).

During the 19th century, the civil law tradition had a profound anti-judicial bias that became manifest in a number of important and interrelated doctrines.[64] First, judicial decisions were not considered a source of law.[65] Second, the judiciary could not assume legislative functions.[66] Third, judges could not decide a case by following the decision of other judges (i.e., *stare decisis*).[67] As a result, the American doctrine of judicial review is alien to the central tenets of the civil law.[68]

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64. *See* Jeffrey Waggoner, Comment, *Discretion and Valor at the Russian Constitutional Court: Adjudicating the Russian Constitutions in the Civil-Law Tradition*, 8 IND. INT'L & COMP. L. REV. 189, 214 (1997) (noting the anti-judicial bias of the civil law tradition); Brian Pearce, *The Comity Doctrine as a Barrier to Judicial Jurisdiction: A U.S.-E.U. Comparison*, 30 STAN. J. INT'L L. 525, 569 (1994) (discussing the anti-judicial bias of various civil law countries). *See generally* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 902–03 (1988) (discussing the practice of the civil law tradition of shunning judicial precedent).

65. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 902–03 (1988) (detailing the civil law practice of seeking justice rather than blindly following precedent); *see also* Hunter R. Clark & Amanda Velazquez, *Foreign Direct Investment in Latin America: Nicaragua—A Case Study*, 16 AM. U. INT'L L. REV. 743, 761–62 (2001) (differentiating between *stare decisis* based on common law principles, and a civil law jurisdiction's reliance on legislative code); Lila Katz de Barrera-Hernandez & Alastair R. Lucas, *Environmental Law in Latin America and the Caribbean: Overview and Assessment*, 12 GEO. INT'L ENVTL. L. REV. 207, 228 (1999) (emphasizing Ecuador's strict adherence to written statutes).

66. *See* Luz Estella Nagle, *Latin America in the Twenty-first Century: The Cinderella of Government: Judicial Reform in Latin America*, 30 CAL. W. INT'l L.J. 345, 371 (2000) (highlighting the Latin American judiciary's lack of power to review constitutional questions). *See generally* Hunter R. Clark & Amanda Velazquez, *Foreign Direct Investment in Latin America: Nicaragua—A Case Study*, 16 AM. U. INT'L L. REV. 743, 761–62 (2001) (describing the inability of Civil Law judiciaries to rely on prior decisions thereby forming a common law); Hector Fix-Fierro & Sergio Lopez-Ayllon, *International Law in the Americas: Rethinking National Sovereignty in an Age of Regional Integration: The Impact of Globalization on the Reform of the State and the Law in Latin America*, 19 HOUS. J. INT'L L 785, 800 n.45 (1997) (discussing the legislature in Ecuador's power to appoint members of the Supreme Court).

67. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 902 (1988) (explaining civil law tradition's absence of the doctrine of *stare decisis*); *see also* Lila Katz de Barrera-Hernandez & Alastair R. Lucas, *Environmental Law in Latin America and the Caribbean: Overview and Assessment*, 12 GEO. INT'L ENVTL. L. REV. 207, 228 (1999) (comparing Ecuador's civil law system with Jamaica's common law system as well as the lack of power of Ecuadorian judges to decide cases upon prior precedent); Ewell E. Murphy, Jr., *The Andean Decisions on Foreign Investment: An International Matrix of National Law*, 24 INT'L LAW. 643, 643 (1990) (explaining the civil law process of rationalizing and refining judicial principles to reach the intended result).

68. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 902 (1988) (highlighting the absence of a doctrine in civil law, parallel to the American doctrine of judicial review); Martin A. Geer, *Foreigners in their Own Land: Cultural Land and Transnational Corporations—Emergent International Rights and Wrongs*, 38 VA. J. INT'L L. 331, 390 n.247 (1998) (listing Ecuador among developing nations with civil law traditions having problems with weak judicial review). *See generally* Ewell E. Murphy, Jr., *The Andean Decisions on Foreign Investment: An International Matrix of National Law*, 24 INT'L LAW. 643, 643 (1990) (identifying the central tenants of the civil law).

The civil law tradition in Ecuador therefore prevented the judiciary branch from exercising any type of check or limit on executive authority.[69] Worse, escalating conflict between the legislature and the executive contributed to the ensuing politicization of Ecuador's Supreme Court and the loss of judicial independence.[70]

Thus, the legacy of the *caudillo* and the distinctive traditions of the civil law contributed greatly to the consolidation of power within the executive branch in Ecuador.[71] Because of these particular circumstances, a check or effective limit on executive power has been absent. It is put forth that this absence allowed President Mahuad to exercise his authority to freeze bank accounts all over the country.

### C. Powers of the Executive in the United States

The United States Constitution lists the various functions of the presidency.[72] Relative to the powers granted to Congress, the executive branch appears limited in scope.[73] However, the

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69. *See* T. Leigh Anenson, F*or Whom the Bell Tolls . . . Judicial Selection by Election in Latin America*, 4 SW. J. of L. & TRADE AM. 261, 265 n.21 (1997) (detailing the selection process of Supreme Court Justices in Latin America by the executive branch); David Boyce, *Foreign Plaintiffs and Forum Non Conveniens: Going Beyond* Reyno, 64 TEX. L. REV. 193, 210 (1985) (citing a plaintiff's affidavit which stated that the military in Ecuador regularly intervened in judicial proceedings). *See generally* Hector Fix-Fierro & Sergio Lopez-Ayllon, Symposium: *International Law in the Americas: Rethinking National Sovereignty in an Age of Regional Integration: The Impact of Globalization on the Reform of the State and the Law in Latin America*, 19 HOUS. J. INT'L L. 785, 265 n.21 (1997) (describing the executive's role in the selection of the members of the Supreme Court).

70. *See* LAURA CHINCHILLA, THE ADMINISTRATION OF JUSTICE IN ECUADOR 26 (1993); Judith Kimerling, R*ecent Development: The Environmental Audit of Texaco's Amazon Oil Fields: Environmental Justice or Business as Usual?*, 7 HARV. HUM. RTS. J. 199, 202 (1994) (explaining the politicization of the courts in Ecuador due to the executive's strong role in selecting members of the Ecuador's Supreme Court); *see also* T. Leigh Anenson, *For Whom the Bell Tolls. . .Judicial Selection by Election in Latin America*, 4 SW. J. of L. & TRADE AM. 261, 278 (1997) (explaining the inability of Ecuador's judiciary to become impartial while they remain controlled by politicians).

71. *See* Robert S. Barker, *Constitutionalism in the Americas: A Bicentennial Perspective*, 49 U. PITT. L. REV. 891, 901 (1988) (reviewing the history of Latin American independence and the collapse of democratic governments where the military routinely exceeded constitutional limitations of their own power and disregarded the constitutional rights of others); *see also* Peggy Rodgers Kalas, The Implications of Jota v. Texaco and the Accountability of Transnational Corporations, 12 PACE INT'L L. REV. 47, 63 (2000) (identifying the biased nature of the judiciary in Ecuador since it's controlled by the military); David Boyce, *Foreign Plaintiffs and Forum Non Conveniens: Going Beyond* Reyno, 64 TEX. L. REV. 193, 210 (1985) (stating that the military in Ecuador assumed the role of the executive).

72. *See* U.S. Const. art. II, § 1–4.

73. *See* David A. Strauss, *Presidential Interpretation of the Constitution*, 15 CARDOZO L. REV. 113, 113 (1993) (explaining the executive branch's limitation to the interpretation of statutes); Aaron Paul Arnzen, United States v. Dickerson: A Case Study in Executive Constitutional Interpretation, 78 N.C. L. REV. 1153, 1175 (2000) (discussing Congress' ability to prevent an overly powerful executive branch through its right to impeachment, power of the purse and rights to use necessary and proper means to carry out its will). *See generally* Lee C. Weingart, *Who Keeps the Secrets?:* A Framework and Analysis of the Separation of Powers Dispute in American Foreign Service Association v. Garfinkel, 59 GEO. WASH. L. REV. 193, 207 (1990) ("[w]here Congress has power to legislate, the executive branch must enforce the laws as written").

scope of executive power has been an ongoing debate within the judiciary and legislative branches.[74]

The Supreme Court has repeatedly been asked to define the scope of the president's inherent powers.[75] Such questions have included the president's power to freeze Iranian assets in the U.S.[76] or impound funds allocated and appropriated by Congress.[77] In all instances, the question was whether the president could act without express constitutional or statutory authority.[78]

While the specific issues continue to arise, the Court has resolved the validity of presidential actions that are made "on an ad-hoc basis, without resort to fundamental principle."[79] Most doctrines on presidential authority stem from the Supreme Court's analysis in *Youngstown Sheet and Tube Co. v. Sawyer*.[80] First, presidential actions are presumptively valid if done pursu-

74. *See* Thomas O. Sargentich, Symposium, Bowsher v. Synar: The Contemporary Debate about Legislative-Executive Separation of Powers, 72 CORNELL L. REV. 430, 471 (1987) (discussing the scope of the power of the executive); Abner S. Greene, *Checks and Balances in an Era of Presidential Lawmaking*, 61 U. CHI. L. REV. 123, 127 (1994) (indicating the relevance of the "Executive Power Vesting Clause," the "Take Care Clause," and the second half of the "Necessary and Proper Clause"); *see also* Lawrence Lessig & Cass R. Sunstein, *The President and the Administration*, 94 COLUM. L. REV. 1, 5 (1994) (discussing the intent of the framers of the Constitution).

75. *See, e.g.*, Humphrey's Executor v. United States, 295 U.S. 602, 632 (1935) (holding that the provisions of the Federal Trade Commission Act restricted the President's power to remove a commissioner upon only one or more of the causes named in the Act); *see also* Erwin Chemerinsky, *Controlling Inherent Presidential Power: Providing a Framework for Judical Review*, 56 S. CAL. L. REV. 863, 863 (1983) (discussing the Supreme Court's power to define the scope of the President's inherent powers); Wiener v. United States, 357 U.S. 349, 356 (1958) (deciding the extent of the President's authority to remove petitioner from War Claims Commission).

76. Dames & Moore v. Regan, 453 U.S. 654, 669–74 (1981) (holding that the International Emergency Economic Powers Act and congressional approval of claims settlement procedures authorize presidential orders to freeze Iranian assets). *See generally* Minnesota v. Mille Lacs Band of Chippewa Indians, 526 U.S. 172, 194 n.5 (1999) (challenging the inherent power of the president to order the removal of Native Americans from public lands). Loving v. United States, 517 U.S. 748, 776 (1996) (describing the extent of the president's inherent powers under the Constitution).

77. Train v. City of New York, 420 U.S. 35, 49 (1975) (holding that the Administrator could not allot to the states less than the entire amounts authorized to be appropriated, but was obligated to allot the full amounts authorized for appropriation). *See generally* Minnesota, et al. v. Mille Lacs Band of Chippewa Indians, 526 U.S. 172, 194 at n.5 (1999) (discussing the president's inherent power to order the removal of Chippewa Indians from public lands); Loving v. United States, 517 U.S. 748, 776 (1996) (detailing presidential powers inherent under the Constitution).

78. *See* Erwin Chemerinsky, *Controlling Inherent Presidential Power: Providing a Framework for Judicial Review*, 56 S. CAL. L. REV. 863, 864–65 (1983) (providing examples of situations in which the Supreme Court has been asked to review the scope of the president's inherent powers); Erwin Chemerinsky, *Wrong Questions Get Wrong Answers: An Analysis of Professor Carter's Approach to Judicial Review*, 66 B.U. L. REV. 47, 56 (1986) (discussing the general importance of the president's inherent powers). *See generally* John D. Leshy, *Shaping the Modern West: The Role of the Executive Branch*, 72 U. COLO. L. REV. 287, 296 (2001) (discussing the extent of the president's rights to act without express authority from Congress in preserving federal lands).

79. Erwin Chemerinsky, *Controlling Inherent Presidential Power: Providing a Framework for Judicial Review*, 56 S. CAL. L. REV. 863, 865, n.12 (1983) (*citing* George Winterton, *The Concept of Extraconstitutional Executive Power in Domestic Affairs*, 7 HASTINGS CONST. L.Q. 1, 20 (1979)).

80. 343 U.S. 579, 634 (1952).

ant to an express or implied congressional authorization.[81] Second, in the absence of such authorization, the president can rely upon his own independent powers subject to the "imperatives of events and contemporary imponderables."[82] Finally, where presidential actions are incompatible with the express or implied will of Congress, they will be sustained only if they are in an area where Congress cannot lawfully act.[83]

However, *Youngstown* failed to provide guidance on how future cases are to be decided.[84] Thus, because the Supreme Court has not provided a proper framework for judicial review of the scope of executive power, it is asserted that the Court has contributed to the "ever increasing accumulation of power in the White House."[85]

In times of national emergency, it is submitted, the U.S. executive has exercised extremely broad powers that cannot, with certainty, be construed as constitutional. This increasing accumulation of power was evident when a similar banking crisis occurred in the United States during the Great Depression.

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81. *Id*. at 635. *See* Youngstown Sheet & Tube Co. et al. v. Sawyer, 343 U.S. 579, 700–01 (1952) (determining the contention that the President was acting within the implied authorization of Congress); *see also* Minnesota, et al., v. Mille Lacs Band of Chippewa Indians et al., 526 U.S. 172, 303 (1999) (confirming the traditional holding that where a president acts pursuant to authorization from Congress, his actions are presumed valid); Dames & Moore v. Regan, 453 U.S. 654, 669 (1981) (noting that the president's power to issue an order must stem either from an act of Congress or from the Constitution itself).

82. *Id*. at 637. *See* Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 637 (1952) (detailing a portion of the court's analysis developed for determining the validity of presidential authority); *see also* Under 21 v. Koch, 108 A.D.2d 250, 261 (1985) (indicating that a test of power is likely dependent upon essential events as opposed to theories of law). *See generally* Chas. T. Main International v. Khuzestan Water & Power Authority, 651 F.2d 800, 806 (1981) (discussing the measures of independent presidential responsibility).

83. *Id*. at 637–38. *See* Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 637–38 (1952) (describing three situations from which to determine the validity of presidential authority); Weber v. Kaiser Aluminum, 563 F.2d 216, 227 (1977) (summarizing the rule used to determine whether presidential actions are compatible with the express or implied will of Congress); *see also* U.S. v. Mississippi Power & Light Company, 638 F.2d 899, 906 n.12 (1981) (reiterating categories of presidential authority, where the president is at his strongest acting with express or implied approval of Congress and weakest acting contrary to some express or implied will of Congress).

84. *See* Erwin Chemerinsky, *Controlling Inherent Presidential Power: Providing a Framework for Judicial Review*, 56 S. CAL. L. REV. 863, 870 (1983) (emphasizing *Youngstown*'s failure to articulate a standard for when the president may act without express constitutional or statutory authority); *see also* Aaron v. Cooper, 163 F.Supp. 13, 30 (1958) (restricting the application of the criteria in *Youngstown* to like cases); Independent Meat Packers v. Butz, 395 F. Supp. 923, 932 (1975) (limiting the application of *Youngstown* to cases involving conflicts with constitutional principles respecting private property).

85. Erwin Chemerinsky, *Controlling Inherent Presidential Power: Providing a Framework for Judicial Review*, 56 S. CAL. L. REV. 863, 866 (1983) (implying that *Youngstown* failed to indicate where the president may act without express constitutional or statutory authority). *See generally* David A. Strauss, Presidential Interpretation of the Constitution, 15 CARDOZO L. REV. 113, 129 (1993) ("In defining its power over foreign and military affairs . . . executive autonomy in constitutional interpretation, should lead to less power for the executive branch"); Margaret A. Garvin, Book Reviews, *Civil Liberties During War: History's Institutional Lessons All the Laws But One: Civil Liberties in Wartime*, 16 CONST. COMMENTARY 691, 706 (1999) ("The long term impact of blindly upholding executive action . . . is the creation of a questionable line of precedents").

### 1. Trading with the Enemy Act of 1917

The Trading with the Enemy Act of 1917 (TWEA) represents an example of the difficulties in defining the scope of presidential powers.[86] Section 5(b) of the TWEA gave the president extraordinary powers during times of declared national emergency.[87] This Act provided the president with broad regulatory power (without explicit limit) over banking transfers, possession of gold and silver bullion and the power to import and export currency and securities.[88] Indeed, President Franklin Roosevelt invoked the powers of this Act during the Banking Emergency of 1933.[89]

### 2. FDR's Broad Executive Powers During the Banking Crisis of 1933

The United States suffered a banking crisis in 1933 not unlike the recent Ecuadorian crisis.[90] One of the roots of the U.S. crisis was the historical development of the American bank-

86. Trading with the Enemy Act of 1917, 50 U.S.C. Appx. §5(b)(1) (2001) (providing for the limits of Presidential authority in trade during times of war). *See generally* Berta Esperanza Hernandez Truyol, *Fifth Annual Philip D. Reed Memorial Issue: Article: Out in Left Field: Cuba's Post-Cold War Strikeout*, 18 FORDHAM INT'L L.J. 15, 17 n.6 (1994) (describing the various changing circumstances under which the Act may be used); Pamela S. Falk, *Broadcasting from Enemy Territory and the First Amendment: The Importation of Informational Materials from Cuba Under the Trading with the Enemy Act*, 92 COLUM. L. REV. 165, 171–72 (1992) (discussing the Berman Amendment and its effect on the scope of TWEA, by excluding the president's authority to embargo the importation).

87. Trading with the Enemy Act of 1917, 50 U.S.C. Appx. §5 (b)(1) (2001) (providing the president with extraordinary powers during national emergencies); *see also* Michael P. Malloy, *Economic Sanctions and Retention of Counsel*, 9 ADMIN. L.J. AM. U. 515, 518–19 (1995) (describing the president's powers during times of declared national emergency); *The International Emergency Economic Powers Act: A Congressional Attempt to Control Presidential Emergency Power*, 96 HARV. L. REV. 1102, 1104 (1983) (outlining the various sets of powers provided to the president by the TWEA).

88. Trading with the Enemy Act of 1917, 50 U.S.C. app. § 5(b)(1) (1976 & Supp. IV 1980). *See* United States v. Zavala, 139 F.2d 830, 832 (2d Cir. 1944) (stating that the President is authorized to regulate or prohibit the importation of currency); Alexewicz v. General Aniline & Film Corp., 181 Misc. 181, 184 (N.Y. Sup. Ct. 1943) (stating that under § 5(b), the president has the power to regulate currency and bank transfers).

89. *See* Hardee v. Washington Loan & Trust Co., 91 F.2d 314, 315–17 (D.C. Cir. 1937) (holding that the President's proclamation invoking a bank holiday under § 5(b) was valid); Vidal v. Backs, 21 F.2d 952, 953–54 (1933) (stating that the President, during a time of national emergency, issued a proclamation, pursuant to his powers under Section 5(b), declaring a bank holiday and closing banks).

90. *See* Hale E. Sheppard, *Dollarization of Ecuador: Sound Policy Dictates U.S. Assistance to this Economic Guinea Pig of Latin America*, 11 IND. INT'L. & COMP. L. REV. 79, 85 (2000) (discussing how the instability of Ecuador's economy has caused the worst economic crisis in its history); *see also Ecuador: Politics*, PRS GROUP/INTERNATIONAL COUNTRY RISK GUIDE, Apr. 1, 1999, *available at* LEXIS, (reporting how Ecuadorian President Mahuad froze bank accounts during its economic emergency); Mario Naranjo, *Ecuador Banks Bracing Monday for Panic Run*, THE NEWS, Mar. 15, 1999 (stating that the closing of the banks during the banking emergency has sparked a number of bank runs).

ing system, which developed in a haphazard manner.[91] There was no consensus on the formal banking system and a minimum of restraint put on the banking industry.[92] As a result, banks collapsed.[93] The reaction to this mismanagement was a large scale of "heavy and unwarranted withdrawals of gold and currency from . . . banking institutions."[94] In order to halt this massive withdrawal, the President invoked his powers under Section 5(b) of the TWEA to prohibit any transactions of currency.[95] In his autobiography, President Roosevelt defended his decision to freeze and close the banks because he felt it was "imperatively necessary to do so even *if* he could not find some specific authorization to do it."[96] Indeed, the courts buttressed this belief when they ruled that presidential proclamations relating to banking emergencies and ordering

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91. *See* Edward L. Symons, Jr., *The "Banking of Business" in Historical Perspective* 51 GEO. WASH. L. REV. 676, 677 (1983) (discussing the shaky historical beginnings of the first banks); Charlotte L. Tart, *Expansion of the Banking Industry under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Is the Banking Industry Headed in the Right Direction?*, 30 WAKE FOREST L. REV. 915, 916–20 (Winter 1995) (tracing the history of bank formation and regulation); Robert G. Ballen and Joseph P. Savage, *Interstate Bank Branching: Are the Walls Starting to Crumble?*, 111 BANKING L.J. 149, 150–51 (1994) (explaining how the National Bank Act did not provide for bank branch offices and this raised questions of bank regulation between the federal and state governments).

92. *See* Edward L. Symons, Jr., *The United States Banking System*, 19 BROOK. J. INT'L. L. 1, 4–7 (1993) (explaining how bank power was undefined and compromised stability in the banking system); Charlotte L. Tart, *Expansion of the Banking Industry under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Is the Banking Industry Headed in the Right Direction?*, 30 WAKE FOREST L. REV. 915, 921 (Winter 1995) (discussing how the imbalance of power in favor of states over the federal government to create bank branching powers caused little restraint on banks). *See generally* Michael P. Battin, *Bank Director Liability under FIRREA*, 63 FORDHAM L. REV. 2347, 2371–72 (1995) (stating how bank failures throughout the country due to an informal banking system led to reform in the regulation of the bank system).

93. *See* SUSAN ESTABROOK KENNEDY, THE BANKING CRISIS OF 1933 5 (1973); Curtis J. Polk, *Banking and Securities Law: The Glass-Steagall Act—Has it Outlived its Usefulness?*, 55 GEO. WASH. L. REV. 812, 812 (May 1987) (discussing how the stock market crash of 1929 caused the banks to collapse); Michael P. Battin, *Bank Director Liability under FIRREA*, 63 FORDHAM L. REV. 2347, 2372 (1995) (explaining how lack of confidence in the banking system caused runs on the bank that caused their final collapse); *see also* Timothy A. Canova, *Transformation of U.S. Banking and Finance: From Regulated Competition to Free-Market Receivership*, 60 BROOK. L. REV. 1295, 1297 (1995) (stating how public distrust of the banking system led to financial instability).

94. Proclamation No. 2038, 48 Stat. 1689 (1933). *See* Gail Otsuka Ayabe, *"Brokered Deposit" Regulation: A Response to the FDIC's and FHLBB's Efforts to Limit Deposit Insurance*, 33 UCLA L. REV. 594, 596 (Dec. 1985) (explaining how lack of public confidence and uncertainty of the future caused depositors to withdraw all of their money out of banks); Brian Arthur Pomper, *Japanese Financial Reform of 1993: Will Reform Speak Innovation?* 28 CORNELL INT'L. L.J. 525, 537 (1995) (stating how people withdrew their money "in droves" after buying unmarketable securities from banks leading to the collapse of the stock market and ultimately many banks).

95. Proclamation No. 2038, 48 Stat. 1689 (1933); 12 U.S.C. § 95 (2001) (Congress' codification of the President's authority to impose banking restrictions during an emergency, granted to him under the TWEA). *See also* Uebersee Finanz v. Rosen, 83 F.2d 225, 228–29 (2d Cir. 1936), *cer't den*. 298 U.S. 679 (1937) (affirming the constitutionality of the Emergency Banking Act of 1933).

96. EDWARD S. CORWIN, THE PRESIDENT: OFFICE AND POWERS 131 (1940) (emphasis added) (stating that it was not until 1936 that the constitutionality of the President's use of his powers under TWEA was resolved, even though he had previously been exercising those powers). *See* Hanley v. Corwin, 15 F. Supp. 396, 397 (E.D.N.Y. 1936) (holding that the emergency legislation passed was constitutional and the acts of the Comptroller of the Currency, under the authority of this act, was legal); *see also* Smith v. Witherow, 102 F.2d 638, 641 (3d Cir. 1939) (holding that President Roosevelt's Proclamation No. 2039, which ordered the closing of a national bank, was a reasonable step taken in a financial emergency).

the closure of banks were valid.[97] In addition, the president has the statutory authority to designate a legal holiday for national banking associations during emergencies.[98]

## II. Evaluation of the Limits on Executive Power

The limits on executive power have evolved through different traditions. In the United States, the framers sought to eradicate any resemblance of a king to its government.[99] The framers granted the bulk of the power to the legislature, which they considered to be the branch closest to the will of the people.[100] In addition, the judiciary's power of review served as a check on presidential power.[101] In Ecuador, the civil law tradition and the legacy of the *caudillo* were responsible for shaping the limitations (or absence thereof) on executive power.[102]

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97. Hanley v. Corwin, 15 F. Supp. 396, 397 (E.D.N.Y. 1936) (affirming the constitutionality of Banking Act of 1933). *See also* Smith v. Witherow, 102 F.2d 638, 641 (3d Cir. 1939) (holding that President Roosevelt's Proclamation No. 2039, which ordered the closing of a national bank, was a reasonable step taken in a financial emergency).

98. *See* BANK AND BANKING ACT, 12 U.S.C. § 95 (2001) (allowing the president to designate bank holidays in times of national emergency); *see also* Norman v. Baltimore & Ohio R.R. Co., 294 U.S. 240, 310–11 (1935) (holding that the president had statutory authorization to impose a bank holiday); Trading with the Enemy Act of 1917, 50 U.S.C. app. § 5(b)(1) (1976 & Supp. IV 1980) (authorizing the president to regulate or prohibit the transfer of currency).

99. *See* U.S. CONST. amend. X, § 2 ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people"); Myers v. U.S., 272 U.S. 52, 293 (1926) (Brandeis, J., dissenting) (arguing that the Framers instituted a government with the doctrine of separation of powers in order to "save the people from autocracy"); THE FEDERALIST PAPERS: NO. 77 (A. Hamilton) (stating the importance of the Senate is to check the actions of the Executive in order to prevent the government from becoming an aristocracy or oligarchy).

100. *See* U.S. CONST. art. I, § 2, cl. 1 (states that the House of Representatives will be composed of members chosen by the people); CONSTITUTIONAL LAW, (Gunther & Sullivan, ed., 14th ed. 2000) (quoting Wechsler, *Political Safeguards of Federalism—The Law of the States in the Composition and Selection of National Government*, 54 COLUM. L. REV. 543, 546 (1954)) (arguing that the Legislature is closest to the will of the people because the people have the power to elect those whom will represent them); THE FEDERALIST PAPERS: NO. 48 (J. Madison) (asserting that the legislative branch's constitutional powers are greater than those of the other departments because it was the only branch that has access to the people).

101. *See* U.S. CONST. art. III, § 2, cl. 1 (stating that the power of the judicial branch extends to all cases that arise under the Constitution); Marbury v. Madison, 5 U.S. 137, 178–180 (1803) (setting the precedent for judicial review by holding that the judiciary has the power, designated by the Constitution, to review the actions of the president); THE FEDERALIST PAPERS: NO. 78 (A. Hamilton) (supports the notion of judicial review to check to the actions of both the legislative and executive branches of government).

102. *See* Aleeze Sattar, *To Kill a Cacique: Caciques, Communities, State Formation: Chimborazo, Ecuador: 1830–1845, available at* <*http:*//www.yachana.org/research/ confs/lasa2000/satter.html> (last visited Sept. 9, 2001) (discussing how military president and famous Ecuadorian *caudillo*, Juan Jose Flores, created a new constitution that provided unlimited presidential power and supremacy over the administration of Ecuadorian affairs); *see also* The Columbia Electronic Encyclopedia, *Caudillo, available at* <http://www.factmonster.com/ce6/history/A0810917.html> (last visited Sept. 9, 2001) (defining *caudillo* as a "military strongman" and political leader who ultimately became an oligarch with unchecked power over the country). *See generally Ecuador: Second and Third Most Likely Regime Scenarios*, PRS GROUP/POLITICAL RISK SERVICES, July 1, 2001, *available at* LEXIS, Ecuador's Country Files (alluding to the notion that with military support, current Ecuadorian president, Noboa, has unquestionable power to run the affairs of the country).

### A. Limits on the Executive Power of the President in Ecuador

While the National Congress has some constitutional power to check the president's actions, the weakness of the party system in Ecuador has contributed to reducing the effectiveness of the legislature.[103] Its political character fragments the Congress and stifles any chance at reaching a consensus to check the president's actions.[104] Moreover, the executive carries out a major share of the legislative action through the adoption of executive decrees, just like President Mahuad did when he issued the *Decreto No. 685* (freezing of assets and closing banks).[105] Combining these factors, it is easy to see how the limits on executive power are ineffective or weak at best.

### B. Limits on the Executive Power of the President of the United States

Various features including the legislature and judicial review check the power of U.S. presidents.[106] Nonetheless, in times of emergencies, the president can exercise broad powers.[107]

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103. *See* LAURA CHINCHILLA, THE ADMINISTRATION OF JUSTICE IN ECUADOR 26 (1993); John Linarelli, *Anglo-American Jurisprudence and Latin America*, 20 FORDHAM INT'L L.J. 50, 51, 63 (1996) (stating how the powerful executive branch controls a weak and ineffective legislature by stripping its power through executive decrees); David Swafford, *Help Wanted*, LATIN FINANCE, May, 1999 at 17 (discussing how President Mahuad decreed an economic state of emergency to implement his new economic policy after Congress failed to approve his financial plan); Pasisley Dodds, *Ecuador Pres.: Push through Reform*, Associated Press, Sept. 6, 2000 (reporting that Ecuadorian President Noboa stated that he would dissolve Congress if they did not approve his reform bills).

104. *See* James F. Smith, *Ecuador Presidential Race Won by Social Democrat*, L.A. TIMES, May 9, 1988 at 10 (stating how political parties in Ecuador have traditionally been weak and as a result, have caused constant political battles between the executive and legislative branches of government); *see also* Judith Kimerling, *Rights, Responsibilities, and Realities: Environmental Protection Law in Ecuador's Amazon Oil Fields*, 2 SW. J. OF L. & TRADE AM. 293, 301 (1995) (discussing how patronage by political parties dominates the judicial system, contributing to the corruption and constant branch battles that is prevalent in the Ecuadorian political arena).

105. *See* Alan Riding, *International Report; Oil Weaker, Ecuador Tougher*, N.Y. TIMES, JUNE 23, 1986, at D8 (noting the wide power of the executive branch to issue executive decrees). *See generally* Enrique R. Carrasco, *Law, Hierarchy, and Vulnerable Groups in Latin America: Towards a Communal Model of Development in a Neoliberal World*, 30 STAN. J INT'L L. 221, 253 (1994) (noting the widespread use of executive decrees in Latin American nations); Symposium: *Challenges to Fragile Democracies in the Americas: Legitimacy and Accountability*, 36 TEX. INT'L L.J. 319, 340 (2001) (noting the same).

106. *See* Norman v. Baltimore & Or. Co., 294 U.S. 240, 310–11 (1935) (holding the Emergency Banking Act of 1933 was constitutional); Marbury v. Madison, 5 U.S. 137, 178–180 (1803) (establishing the judiciary power to check the president's power); Hardee v. Washington Loan & Trust Co., 91 F.2d 314, 315–17 (App. D.C. 1937) (discussing how President Roosevelt needed the statutory approval of Congress before declaring a bank holiday during the Banking Crisis).

107. *See* Jeffrey P. Bialos & Joel B. Harris, *The Strange New World of United States Export Controls Under the International Emergency Economic Powers Act*, 18 VAND. J. TRANSNAT'L L. 71, 92 (1985) (relating that should a President promulgate any regulations during an emergency, those promulgations will likely pass scrutiny without a veto from Congress); *see also* David Cole, *The National Security Constitution: Sharing Power After the Iran-Contra Affair. Harold Hongju Koh*, 99 YALE L.J. 2063, 2079 (1990) (discussing how presidents can effect major change during an emergency without fear of opposition by Congress); Harold Hongju Koh & John Choon Yoo, *Dollar Diplomacy/Dollar Defense: The Fabric of Economics and National Security Law*, 26 INT'L LAW. 715, 725 (1992) (discussing how presidents, in emergency situations, may make decisions without being opposed in large part by Congress).

The ability of the executive to exercise such powers can pose great dangers to the rule of law.[108] Yet it is difficult for the legislature to contain such powers in emergencies because "unforeseen dangers that are endemic to crisis require the availability of great discretionary power."[109] Because Congress believed the President had overreached his Constitutional powers during the Great Depression, Congress passed the International Emergency Economic Powers Act (and later the War Powers Resolution) in an effort to limit presidential power.[110] But, it is argued, the actions President Roosevelt took were within his constitutional authority.

## III. Banking Law in the United States

### A. Regulatory Framework

Congress has the power, under the United States Constitution, to borrow money, regulate commerce and coin money.[111] In addition, Congress has the power to incorporate a bank.[112]

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108. *See* ROSSITER, *supra* note 38, at 61–73; William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 73–4 (1993) (relating that the power of the executive during emergencies should not go unchecked); *see also* Martin S. Sheffer, *Does Absolute Power Corrupt Absolutely?* 24 OKLA. CITY U. L. REV. 233, 287 (1999) (discussing the danger to the prosperity of limited government if the president is allowed unlimited power); *The International Emergency Economic Powers Act: A Congressional Attempt to Control Presidential Emergency Power*, 26 HARV. L REV. 1102, 1112 (1983) (detailing that despite the danger of blanket presidential authority, the alternative of requiring the president to be authorized to act by Congress in a state of emergency is more dangerous).

109. Note, *The International Emergency Economic Powers Act: A Congressional Attempt to Control Presidential Emergency Power*, 96 HARV. L. REV. 1102, 1103 (1983). *See* Developments in the Law—The National Security Interest and Civil Liberties v. The Exercise of Emergency Powers, 85 HARV. L. REV. 1284, 1293 (1972) (discussing that while legislative checks on the president's power during an emergency might be an attractive possibility, the legislature cannot keep the president from having any emergency powers, since the very nature of an emergency makes that an impossibility); William C. Banks & Alejandro D. Carrio, *Presidential Systems in Stress: Emergency Powers in Argentina and the United States*, 15 MICH. J. INT'L L. 1, 73–75 (1993) (referring to the legislature's inability to stop or impede the president's powers during an emergency, specifically because of the deliberate nature of Congress).

110. *See* Note, *The International Emergency Economic Powers Act: A Congressional Attempt to Control Presidential Emergency Power*, 96 HARV. L. REV. 1102, 1102 (1983) (discussing how Congress enacted the IEEPA in order to limit the President's powers in peacetime emergencies); Jeffrey P. Bialos & Joseph B. Harris, *The Strange New World of United States Export Controls Under the International Emergency Economic Powers Act*, 18 VAND. J. TRANSNAT'L L. 71, 91 (1985) (discussing Congress's desire to limit presidential power and the ways in which the IEEPA sets limits on presidential power); *see also* Barry E. Carter, *International Economic Sanctions: Improving the Haphazard U.S. Legal Regime*, 75 CAL. L. R. 1159, 1239 (1987) (discussing the threefold system of the IEEPA used to limit the president's emergency powers).

111. U.S. CONST. art. I, § 8, cl.2, 3 and 5. (giving Congress the right to tax, borrow money and regulate commerce). *See*, *e.g.*, Kenneth W. Dam, *From the Gold Clause Cases to the Gold Commission: A Half Century of American Monetary Law*, 50 U. CHI. L. REV. 504, 515 (1983) (detailing that Congress has the power to tax, borrow money and regulate commerce); Joshua B. Konvisser, *Coins, Notes, and Bits: The Case for Legal Tender on the Internet*, 10 HARV. J.L. & TECH. 321, 331 (1997) (discussing that one of the enumerated powers of Congress is that of collecting taxes, borrowing money and regulating commerce).

112. McCulloch v. Maryland, 4 Wheat. 316, 325 (1819) (discussing the right of Congress to incorporate a bank). *See also* Bret Boyce, *Originalism and the Fourteenth Amendment*, 33 WAKE FOREST L. REV. 909, 961 (1998) (discussing the court's decision in McCulloch v. Maryland to allow for Congressional power to incorporate banks despite the fact that such power had been unsupported by the Philadelphia Convention); Keith Werhan, *Checking Congress and Balancing Federalism: A Lesson From Separation-of-Powers Jurisprudence*, 57 WASH. & LEE L. REV. 1213, 1226 (2000) (discussing the Supreme Court's decision to support Congress's authority to incorporate a bank).

Banking law in the United States consists of a system of statutes and regulatory agencies.[113] Title 12 of the United States Code governs Federal Banking laws.[114] It includes, *inter alia*, the National Bank Act, which authorizes the establishment of national banks to engage in "all such incidental powers as shall be necessary to carry on the business of banking."[115]

### 1. Dual Banking System

The United States has a dual banking system.[116] This system gives power to a state or the federal government to charter a bank or depository institution.[117] The dual system allows for powers and functions to be decentralized.[118] It also establishes a stable and uniform system of

113. *See* Stanley I. Langbein, *The Thrift Crisis and the Constitution*, 53 WASH. & LEE L. REV 159, 174 n.58 (1996) (discussing the regulatory bodies of the banking system as well as the statutory enactments governing the banking system); *see also* Michael P. Malloy, *Balancing Public Confidence and Confidentiality: Adjudication Practices and Procedures of the Federal Bank Regulatory Agencies*, 61 TEMP. L. REV. 723, 729 (1988) (discussing the Federal Reserve System's statutory power and the FDIC's regulatory power); Symposium, *Regulation in a Multisectored Financial Services Industry: Professor Howell E. Jackson*, 77 WASH. U. L.Q. 319, 365 (1999) (detailing the statutory and regulatory powers of the federal government in banking).

114. 12 U.S.C. §1 *et seq.* (1988). *See* Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 25–26 (1996) (discussing the limits placed by Congress on banking through Title 12); Landy v. Federal Deposit Ins. Corp., 486 F.2d 139, 149 (3rd Cir. 1973) (detailing the rights of the FDIC under Title 12).

115. 1 ANN GRAHAM, BANKING LAW §1.03[2] (1999), *citing* 12 U.S.C. § 24(7) (1988) (referring to 12 U.S.C. § 24(7) (1988) governing the banking industry and dividing regulation power between both federal and state governments). *See* Carol Conjura, *Independent Bankers Association v. Conover: Nonbank Banks are not in the Business of Banking*, 35 AM. U. L. REV. 429, 437–38 (1986) (stating that the National Banking Act essentially authorizes people to be involved in the business of banking); Jeffrey D. Dunn, *Expansion of National Bank Powers: Regulatory and Judicial Precedent under the National Bank Act, Glass-Steagall Act, and Bank Holding Company Act*, 36 SW. L.J. 765, 774 (1982) (discussing the power granted by the National Bank Act and how state law may govern in certain instances).

116. 1 ANN GRAHAM, BANKING LAW § 1.03[2] (1999) *citing* 12 U.S.C. § 24(7) (1988) (referring to 12 U.S.C. § 24(7) (1988 allowing both federal and state governments to charter banks). *See* Geoffrey P. Miller, *The Future of the Dual Banking System*, 53 BROOK. L. REV. 1, 14 (1987) (discussing the dual banking system made up of state-chartered banks and federally-chartered banks); *see also* David B. Ripsom, and David S. Swayze, *The Delaware Banking Revolution: Are Expanded Powers Next?* 13 DEL. J. CORP. L. 27, 28–29 (1988) (stating that the National Banking Act gave power to the national government as well as the dual banking system).

117. 1 ANN GRAHAM, BANKING LAW § 1.03[2] (1999), *citing* 12 U.S.C. § 24(7) (1988) (referring to 12 U.S.C. § 24(7) (1988) (allowing both federal and state governments to charter banks). *See* David. B. Ripsom and David S. Swayze, *The Delaware Banking Revolution: Are Expanded Powers Next?* 13 DEL. J. CORP. L. 27, 28–29 (1988) (stating that banks in the United States can be chartered under federal or state law); Heidi Mandanis Schooner, *Recent Challenges to the Persistent Dual Banking System*, 41 ST. LOUIS. U. L.J. 263, 264 (1996) (discussing that however unconventional and possibly dysfunctional the dual banking system is, it seems to be a permanent fixture in United States banking).

118. 1 ANN GRAHAM, BANKING LAW § 1.03[2] (1999), *citing* 12 U.S.C. § 24(7) (1988) (referring to 12 U.S.C. § 24(7) (1988) (placing restrictions on the federal government's power to regulate the banking industry by allowing for states to legislate in areas where there is no federal regulation). *See* Robert F. Roach, *Bank Mergers and the Antitrust Laws: The Case for Dual State and Federal Enforcement*, 36 WM. & MARY. L. REV. 95, 118 (1994) (discussing that the passage of banking laws in the 1800's developed the decentralized banking system enjoyed in the United States today); Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers, The Federal Response, and the Case for Preserving the Dual Banking System*, 58 FORDHAM L. REV. 1133, 1153 (1990) (discussing the laws which established the development of decentralized banking in the United States).

currency.[119] Nevertheless, considerable overlap exists between the federal and state regulatory systems.[120] This overlap is permissible, so long as federal regulatory banking laws do not preempt state laws.[121]

Both the federal government and states have the authority to charter banks.[122] The ability of a state to regulate its banking industry is essential to the protection of consumers.[123] State charters provide local regulatory access and responsiveness in comparison to the time and expense spent in dealing with federal regulatory bureaucracy.[124]

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119. *See* ALFRED M. POLLARD ET AL., BANKING LAW IN THE UNITED STATES 45 (1988); Emeric Fischer, *Banking and Insurance-Should Ever the Twain Meet*? 71 NEB. L. REV. 726, 734–35 (1992) (discussing the National Bank Act and its goal to have a single form of currency and how that goal has been achieved); *see also* Connie M. Friesen, *A New Paradigm for Financial Regulation: Getting from Here to There*, 43 MD. L. REV. 413, 419–20 (1984) (discussing the passage of the Currency Act known today as the National Banking Act and the promotion of one form of currency).

120. *See* Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 682 (1988) (discussing the overlap in state and federal chartering in the United States banking system); *see also* Geoffrey P. Miller, *The Future of the Dual Banking System*, 53 BROOK. L. REV. 1, 14 (1987) (discussing the dual banking system and its overlapping as not being a planned byproduct of careful planning); Heidi Mandanis Schooner, *Recent Challenges to the Persistent Dual Banking System*, 41 ST. LOUIS. U. L.J. 263, 267 (1996) (noting that the overlapping in the United States banking system is sometimes criticized as being costly).

121. *See* Davis v. Elmira Savings Bank, 161 U.S. 275, 283 (1896) (Court stating that any attempt made by a state to exercise authority is subject to being preempted by the laws of the United States); McClellan v. Chipman, 164 U.S. 347, 356 (1896) (court discussing the supremacy of federal law over state law); *see also* Franklin Nat. Bank of Franklin Square v. People, 347 U.S. 373, 378 (1954) (noting that as long as state laws do not conflict with federal laws, such state laws will govern).

122. *See* Keith R. Fisher, *Federalism Contra Federal Reservism: Bank Holding Companies and State Bank Powers*, 23 U.S.F. L. REV. 317, 364 (1989) (discussing the authority of the federal government to establish the power of U.S. national banks); Briscoe v. Kentucky, 36 U.S. 257, 301 (1837) (stating that states have been free to charter banks in times of economic crisis); *see also* Keith R. Fisher, *Federalism Contra Federal Reservism: Bank Holding Companies and State Bank Powers*, 23 U.S.F. L. REV. 317, 364 (1989) (discussing the authority of the state government to charter state banks); Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 357 (1995) (discussing the authority of states by virtue of their individual state banking acts to charter state banks).

123. *See* Hayley M. Brady & Mark V. Purpura, The Riegle-Neal Amendments Act of 1997: The Impact of Interstate Branching on the Dual Banking System, 2 N.C. BANKING INST. 230, 247–48 (1998) (discussing the importance of state banks and the service provided to its customers); Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 710 (1988) (discussing the potential benefits to consumers of state-regulated state banks); Charlotte L. Tart, *Expansion of the Banking Industry Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994: Is the Banking Industry Headed in the Right Direction?* 30 WAKE FOREST L. REV. 915, 948 (1995) (discussing the need for competition among banks for the benefit of consumers).

124. *See* POLLARD ET AL., *supra* note 119; Matthew D. Alman, *Developments in Banking Law: 1996 III. Interstate Banking and Branching*, 16 ANN. REV. BANKING L. 27, 34–35 (1997) (discussing the role of community banks and the interaction between local banks and the local market); B. Lebrecht, *Regulatory Agency Action Banking Department*, 14 CAL. REG. L. REP. 119, 120 (1994) (discussing the positive possibilities of maintaining state chartered banks).

### 2. Regulatory Agencies

Regulatory agencies are responsible for carrying out banking laws, including the extensive authority to interpret and enforce those laws.[125] Bank regulators oversee all banking matters and other activities engaged in by banks (such as sales of securities and consumer relations). At the federal level, the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (The "Board") and the Federal Deposit Insurance Corporation (FDIC) are the fundamental regulatory agencies.[126]

The OCC is responsible for the chartering and regulatory supervision of national banks.[127] These duties may be judicial in character, with the power to take possession of the assets of a bank and assume control of its operations.[128] Supervision includes the "careful examination into the condition of the association, including the amount of the capital stock actually paid in."[129]

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125. *See* Susan M. Golden, *Collateralized Mortgage Obligations: Probing the Limits of National Bank Powers Under the Glass-Steagall Act*, 36 CATH. U. L. REV. 1025, 1025 n.1 (1987) (detailing that national banks must apply to regulatory agencies to be insured); Heidi Mandanis Schooner, *Regulating Risk Not Function*, 66 U. CIN. L. REV. 441, 464 n.149 (1998) (discussing the various regulatory agencies involved in the banking system).

126. *See* POLLARD ET AL., *supra* note 119, at 47; Susan M. Golden, *Collateralized Mortgage Obligations: Probing the Limits of National Bank Powers Under the Glass-Steagall Act*, 36 CATH. U. L. REV. 1025, 1025 n.1 (1987) (detailing that national banks must apply to the OCC for charter and insure themselves with the FDIC); *see also* Heidi Mandanis Schooner, *Regulating Risk Not Function*, 66 U. CIN. L. REV. 441, 464 n.149 (1998) (stating that while the OCC regulates all national banks, the FDIC shares regulation of state banks with the Fed).

127. *See* Steven P. Croley, *Public Interested Regulation*, 28 FLA. ST. U. L. REV. 7, 76 (2000) (discussing the regulatory authority of the OCC and its duty to enforce the National Bank Act of 1864); Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 358 (1995) (stating the difference between the regulatory powers of the OCC and the FDIC); Mitchel Mick, *Personal Liability for Bank Directors Who Violate Lending Statutes: Has Indiana Followed Congress' Lead?* 26 IND. L. REV. 387, 390 (1993) (stating that a national bank is under the supervisory authority of the OCC).

128. Cooper v. O'Connor, 99 F.2d 135, 139 (D.C. Cir. 1938) (discussing the scope of authority of the Comptroller). *See* United States v. Weitzel, 246 U.S. 533, 540 (1918) (describing the duties of the Comptroller which includes taking possession of the assets of a bank and assuming control of its operations); *see also* Altman v. McClintock, 20 F.2d 226, 231 (D. Wyo. 1927), *appeal dismissed*, 28 F.2d 1007 (8th Cir. Wyo. 1928) (noting that the Comptroller is charged with the general administration of the national banking laws even though they may be judicial in character).

129. McCormick v. Market Nat. Bank, 165 U.S. 538, 548 (1897) (noting that the comptroller is required to make a careful examination into the condition of the association to ascertain and determine that the association has in all respects complied with the provisions of the National Bank Act). *See* Casey v. Galli, 94 U.S. 673, 678 (1876) (describing how the comptroller is required to make a careful examination in all cases of original bank applications to make sure that they are entitled to commence business); Kennedy v. Gibson, 75 U.S. 498, 504 (1868) (noting that the comptroller has the authority to take possession of the books and assets of every description of the association).

The Board functions to regulate and supervise Federal Reserve banks and implement monetary policy.[130] The regulation and supervision of banks consists of examining the accounts and affairs of banks to determine their overall viability.[131] Monetary policy refers to government actions that influence or control the cost and availability of money and credit. To effectuate such policy, the Board is authorized to, *inter alia*, permit or require the discounting of the rate of interest on paper (bonds), regulate the issue and retirement of notes, liquidate and reorganize banks and fix the amount of capital and surplus which may be represented by loans secured through stocks or bonds.[132]

The Board is also authorized to determine reserve requirements.[133] Reserves are funds that a bank must set aside, primarily in the form of vault cash.[134] By placing these reserve requirements, the Board affects the volume of loans that investment banks may support.[135] These reserve requirements also place a protective restriction on the amount of credit a banking institution may extend to its customers.[136]

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130. *See* GRAHAM, *supra* note 118, at § 1.06[2][a]; *see also* Joseph G. Fallon, *The Government Securities Act of 1986: Balancing Investor Protection with Market Liquidity,* 36 CATH. U. L. REV. 999, 999–1000 (1987) (discussing how the government securities market has a place among world securities markets because of its role in effecting monetary policy as determined by the Federal Reserve Board); Christian A. Johnson, *Wild Card Statutes, Parity, and National Banks—The Renascence of State Banking Powers*, 26 LOY. U. CHI. L.J. 351, 359 (1995) (discussing how Congress has empowered the Federal Reserve Board to both manage the money supply and supervise State Banks which are members of the federal reserve system).

131. 12 U.S.C. § 248 (1988). *See* Dimuzio v. Resolution Trust Corp., 68 F.3d 777, 780 (3rd Cir. 1985) (stating that one of the purposes of 12 U.S.C.S. § 1823(e) is to allow bank examiners a quick and accurate way of assessing the financial condition of a bank); *see also* Adams v. Bd. of Governors of the Fed. Reserve Bd., 659 F. Supp. 948, 956 (D. Minn. 1987) (stating that the purpose of the supervisory examinations by the Federal Reserve Board is to ensure the financial health and stability of banks).

132. 12 U.S.C. § 248 (1988). *See* Gunter v. Hutheson, 674 F.2d 862, 865 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982), *overruled on other grounds* by Langley v. FDIC, 484 U.S. 86 (1987) (explaining the liquidation and 'purchase and assumption' processes used by the FDIC in an attempt to accomplish its duty as insuror); *see also* Samantha Evans, *An FDIC Priority of Claims Over Depository Institution Shareholders,* 1991 DUKE L.J. 329, 330 (1991) (noting that the FDIC manages a failed insured institution in preparation for its liquidation or sale).

133. 12 U.S.C. § 461 (1988).

134. *Id*.

135. *See* 12 U.S.C.S. § 461(b) (2001); Kolb v. Naylor, 658 F. Supp. 520, 522 (N.D. Iowa 1987) (noting that determining reserve requirements enables the Federal Reserve Board to regulate the ability of member banks to lend money); William F. Jung, *Banking Mergers and "Line of Commerce" After the Monetary Control Act: A Submarket Approach*, 1982 U. ILL. L. REV. 731, 732 n.1 (1982) (noting that manipulating the reserve requirements is one tool that the Federal Reserve Board uses to control the money supply and loan amounts).

136. *See* Rachel R. Gerstenhaber, *Freezer Burn: United States Extraterritorial Freeze Orders and the Case For Efficient Risk Allocation*, 140 U. PA. L. REV. 2333, 2373 (1992) (describing how reserve requirements are one way of reducing the credit risk that might be associated with foreign deposits); Robert F. Kornegay, Jr., *Bank Loans as Securities: A Legal and Financial Economic Analysis of the Treatment of Marketable Bank Assets Under the Securities Acts*, 40 UCLA L. REV. 799, 846 n.167 (1993) (noting that depositors interests are protected from credit risk by reserve requirements); *see also* Charles R. McGuire, *Should Banks Sell Insurance? The Relationship of Section 92 of the Banking Act, the McCarran-Ferguson Act and State Law Restricting Bank Activity,* 22 J. LEGIS. 19, 37 (1996) (noting that reserve requirements are imposed to provide protection for bank customers).

The FDIC is another fundamental regulatory agency within the banking laws framework.[137] It was established by the Banking Act of 1933 in response to the Banking Crisis of 1933.[138] It is currently encoded within statutory law, as the Federal Deposit Insurance Act.[139] The primary function of the FDIC was to restore the public's confidence by establishing a sound, stable and safe banking system through insurance of bank deposits and increased supervision.[140] The FDIC therefore insures deposits up to $100,000.[141]

Thus in order for a bank to operate, it must first be chartered either by the federal or state government. It is then scrutinized and supervised by various regulatory agencies. Finally, the bank must seek a certificate of insurance from the FDIC and demonstrate the history and skills of its management, the ability to meet community needs and its future prospects.[142] If not issued insurance by the FDIC, the bank may not begin operations.[143]

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137. *See* Tenkku v. Normandy Bank, 218 F.3d 926, 927 (8th Cir. 2000) (referring to the FDIC as a federal bank regulatory agency); *see also* Proffitt v. FDIC, 200 F.3d 855, 864 (D.C. Cir. 2000) (describing the authority and enforcement options available to the FDIC and other banking regulatory agencies); America's Cmty. Bankers v. FDIC, 200 F.3d 822, 824 (D.C. Cir. 2000) ("Congress enacted more sweeping legislation to increase the supervisory authority of the FDIC and other regulatory agencies").

138. *See* American Nat'l Red Cross v. S.G., 505 U.S. 247, 255 (1992) (citing the Banking Act of 1933 as the statute creating the FDIC); FDIC v. Philadelphia Gear Corp., 476 U.S. 426, 436 (1986) (referring to the Banking Act of 1933 and how Congress amended the Federal Reserve Act to authorize the creation of the FDIC); Massachusetts v. FDIC, 102 F.3d 615, 617 (1st Cir. 1996) (noting that the FDIC was created by the Banking Act of 1933 to help alleviate the hardships caused by bank failures).

139. 12 U.S.C. § 1811 (1988). *See* Arkansas State Bank Comm'r v. Resolution Trust Corp., 911 F.2d 161, 174 (8th Cir. 1990) (referring to the Federal Deposit Insurance Act as other statutory law having banking authority); *see also* Wiggins v. Philip Morris, Inc., 853 F. Supp. 470, 482 (D. D.C. 1994) (referring to various enforcement provisions imposed by the Federal Deposit Insurance Act and other federal statutes).

140. POLLARD ET AL., *supra* note 119, at 52. *See FDIC v. Philadelphia Gear Corp.,* 476 U.S. 426, 437 (1986) (stating that the purpose of the insurance of deposits is the protection of assets and earnings entrusted to a bank); Rauscher Pierce Refsnes v. FDIC, 789 F.2d 313, 315 (5th Cir. 1986) (noting that the function of the FDIC is to provide regulatory supervision over banks by providing deposit insurance in order to achieve the goal of providing a safe and sound banking system to foster a healthy economic environment).

141. 12 U.S.C. § 1813(l) (1988). *See* FDIC v. Philadelphia Gear Corp., 476 U.S. 426, 429 (1986) (noting that $100,000 is the maximum amount generally insured by the FDIC for single deposits); FAIC Sec., Inc., v. United States, 768 F.2d 352, 355 (D.C. Cir. 1985) (explaining that the statutory limit on federal deposit insurance is $100,000).

142. 12 U.S.C. § 1813(l) (1988). *See* Bank of Commerce of Laredo v. City Nat'l Bank of Laredo, 484 F.2d 284, 286 (5th Cir. 1973) (affirming the comptroller's decision to grant a certificate of authority after he had investigated the new bank's management and operations, the proposed new service area and an economic profile of the area's prospects); City Nat'l Bank v. Smith, 513 F.2d 479, 480 (D.C. Cir 1975) (setting out objectives for the comptroller to follow including convenience and needs of the community and skills and experience of the officers).

143. 12 U.S.C. § 1813(l) (1988). *See* 12 U.S.C.S. §§ 27, 28; Jennifer A. Marler, Recent Development: American Deposit Corp. v. Schacht: Yet Another Attempt to Limit National Banks' Powers to Sell Nondeposit Investment Products, 74 WASH. U. L.Q. 841, 846 (1996) (explaining that when the Comptroller grants a bank a charter, it must join the Federal Reserve Board and obtain FDIC insurance before opening its doors).

The FDIC provides protection for the depositor when an insured institution fails.[144] The FDIC will pay the depositors of that institution either in cash or by making available to each depositor a transferred deposit in a new bank or savings association in another insured bank.[145]

## IV. Banking Law in the Republic of Ecuador

### A. Regulatory Framework

The Constitution of the Republic of Ecuador sets the regulatory framework that governs Ecuador's banking industry.[146] Specifically, article 261 creates the Central Bank of Ecuador (BCE) and gives it extensive power to "establish control and apply monetary, financial, credit and lending policies."[147] Furthermore, the BCE is charged with the responsibility of monitoring the stability of the country's currency.[148] Another fundamental regulatory agency within Ecuador's banking framework is the Superintendent of Banks (SB).[149] The National Congress of Ecuador has codified the office of the SB through the General Law of Institutions of the Financial System (General Law).[150] The General Law defines the powers, duties and responsibilities of the Superintendent of Banks.[151] However, its constitutional authority lies in the General Banking Law of Ecuador's 1945 Constitution.[152] Finally, the Agency for the Guarantee of Deposits (AGD) was recently created as part of an overall plan to revitalize the Ecuador economy.[153]

#### 1. Central Bank of Ecuador (BCE)

The BCE is an agency with the autonomy to make administrative decisions.[154] All five members of the BCE are appointed by the president with the approval of the National Con-

144. *See* Gunter v. Hutheson, 674 F.2d 862, 865 (11th Cir. 1982), *cert. denied*, 459 U.S. 826 (1982), (noting that the FDIC insures bank deposits and one of its duties as insuror is to pay the depositors of a failed bank); Marie T. Reilly, *The FDIC as Holder in Due Course: Some Law and Economics*, 1992 COLUM. BUS. L. REV. 165, 165 (1992) (noting that the FDIC intervenes when a federally insured bank fails).

145. GRAHAM, *supra* note 115, at § 1.06[3], *citing* 12 U.S.C. § 1821(f) (1988). *See* FDIC v. First Mortgage Investors, 485 F. Supp. 445, 451 (E.D. Wis. 1980) (noting that the FDIC is empowered to take steps to ensure the liquidity of a closed bank by either transferring the assets and liabilities to another bank or purchasing certain assets of the defunct institution).

146. CONSTITUCION, *supra* note 2, at art. 261.

147. *Id*.

148. *Id*.

149. Ley General de Instituciones del Sistema Financiero, REGISTRO OFICIAL NO. 250 (2001) (Ecuador).

150. *Id*.

151. *Id*.

152. MANUAL, *supra* note 14, at 316.

153. MANUAL, *supra* note 14, at 316.

154. CONSTITUCION, *supra* note 2, at art. 262.

gress.[155] The director of the BCE promulgates regulations and is responsible for informing the president and the National Congress of the current level of public debt.[156]

The BCE has extensive power to implement monetary policy.[157] The BCE has exclusive power to regulate the issue of currency notes. Moreover, this power is "liberal and unlimited."[158] It also has full discretion to regulate credit and lending policies. Article 265 gives the BCE discretion to extend credit to the public. Yet it also prohibits the BCE from acquiring bonds or other financial instruments issued by such public institutions, except in situations of states of emergency or "litigious conflicts."[159] The BCE is also prohibited from extending credit to private financial institutions. An exception would be for short-term loans that have been determined to be necessary to prevent or overcome temporary periods of illiquidity.[160]

The BCE uses "open market operations" to regulate the amount of money within the Ecuador economy.[161] These operations give the BCE greater flexibility to manage monetary policy. Under this operation, the BCE purchases bonds with cash, thereby adding to the amount of currency in circulation. Conversely, the BCE will sell bonds in exchange for cash, thereby reducing the amount of currency in circulation.[162]

### 2. Superintendent of Banks

While the BCE is responsible for handling the nation's monetary policies, the SB is responsible for managing the health of all financial institutions. Its authority is derived from the General Banking Law and codified in the General Law of Institutions of the Financial System (General Law). The main duty of the SB is overseeing the functioning of banking institutions throughout the nation.[163] It also presents the legislature with recommendations on legal reforms that will serve the public interest.

The SB is also empowered to establish and maintain a minimum level of liquidity requirement that all banking institutions must follow.[164] The SB is also authorized to impose sanctions on those banks that do not meet the statutory and legal requirements or regulations

155. *Id*.

156. CONSTITUCION, *supra* note 2, at art. 263.

157. CONSTITUCION, *supra* note 2, at art. 264.

158. *Id*.

159. CONSTITUCION, *supra* note 2, at art. 265.

160. *Id*.

161. Operaciones de Mercado Abierto, BANCO CENTRAL DEL ECUADOR, Econ. Rep., *at* <http://www.bce.fin.ec/avisos/omas.html>. Despite converting to the dollar from the *sucre*, the BCE will continue with this monetary policy as part of its aggressive economic recovery project.

162. Operaciones de Mercado Abierto, BANCO CENTRAL DEL ECUADOR, Econ. Rep., *at* <http://www.bce.fin.ec/avisos/omas.html>.

163. MANUAL, *supra* note 14, at 317.

164. *Id*.

promulgated by the SB. The SB can seize the business and property of any bank when it appears that there are reasons to justify its liquidation.[165]

The duties and powers are codified within the General Law. Article 6 governs the minimum level of capital reserves a banking institution must have prior to initiating operations.[166] Currently, a bank must have capital reserves totaling at least $2,628,940.[167] Banking institutions are required to provide the SB full access to all of their records and files in order for the SB to determine their financial viability.[168] In order to win public trust and keep the public informed of an institution's viability, the General Law recommends that banks publish reports of earnings and losses and make them freely available to all depositors.[169]

The General Law also provides mechanisms to determine whether a bank must be shut down. Several bases for liquidating a bank are listed as causes of action. These include: failure to pay a depositor his or her money, breaches of fiduciary duties and failure to follow minimum capital reserve requirements.[170] When a bank is liquidated, all depositors are entitled to retrieve a portion of their deposits. Currently, the amount that may be immediately retrieved in the event of a bank collapse is capped at $8,000.[171]

### 3. Agency for the Guarantee of Deposits

Article 5 of the Financial Reform Law created the Agency for the Guarantee of Deposits (AGD).[172] Interestingly, the AGD was created in response to the severe financial crisis of 1998. It was initially drafted as an amendment to the Law for the Reorganization of Economic Matters.[173] It was later codified in the Law for the Economic Transformation of Ecuador under article 38.[174]

In order to reform the financial system during the crisis of 1998, the AGD was formed to "protect the interests of the depositors."[175] The goal of insuring the interests of depositors is accomplished through the rigorous and permanent supervision of all financial institutions.[176] The AGD has the authority to directly intervene in the administration of any financial institution in the event the institution faces serious risks. It can evaluate the information it receives from the BCE and SB to determine preventive measures.

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165. *Id*.

166. Ley General, *supra* note 85, at art. 6.

167. Ley General, *supra* note 85, at art. 37.

168. Ley General, *supra* note 85, at art. 77.

169. Ley General, *supra* note 85, at art. 81.

170. Ley General, *supra* note 85, at art. 148.

171. Ley General, *supra* note 85, at art. 168.

172. Ley de Reforma Tributaria y Financiera, art. 5, REGISTRO OFICIAL NO. 373 (1998) (Ecuador).

173. Reformas de La Ley de Reordenamiento en Materia Economica, REGISTRO OFICIAL NO. 78 (1998) (Ecuador).

174. Ley Para La Transformacion Economica del Ecuador, art. 38, REGISTRO OFICIAL NO. 33 (2000) (Ecuador).

175. *Plan de Reactivacion—Reforma Tributaria*, HOY, Nov. 12, 1998, *available at* <http://www.hoy.com.ec/especial/tribu05.htm>.

176. *Id*.

The AGD operates a policy of unlimited deposit guarantee. In order to capitalize the AGD program, the government issued $900 million in domestic bonds to the agency.[177] It has also been funded through a $300 million loan package from various creditors, including the International Monetary Fund.[178] While the guarantee is unlimited, the payments of depositors' funds are to be incremental over a period of three years.[179]

Thus, the regulatory framework of Ecuador's banking laws is quite developed. It is spearheaded by the Central Bank of Ecuador, which monitors overall monetary policy. The Superintendent of Banks is responsible for overseeing the health and viability of banking institutions. Finally, the Agency for the Guarantee of Deposits was recently created in response to the financial crisis of 1998. These three mechanisms have been codified within the laws of Ecuador.

## V. Comparative Analysis of Both Nations' Banking Laws

At first glance, the regulatory frameworks of the United States and Ecuador seem to be quite similar. Both systems, for example, were designed in a hierarchical structure.[180] In the United States, the Office of the Comptroller resides at the head of the banking regulatory system.[181] It is then followed by the Federal Reserve Board and the FDIC.[182] Similarly, Ecuador's framework includes the Central Bank of Ecuador,[183] the Superintendent of Banks[184] and the

177. *Number of Banks Reduced After Audit*, ECONOMIST INTELLIGENCE UNIT BRIEFS, Aug. 31 1999, *available at* <http://biz.yahoo.com/ifc/ec/news/83199-1.html>. *IMF, World Bank, IDB and CAF Prepared to Support Ecuador*, Mar. 9, 2000, *at* <http://www.imf.org/external/np/sec/nb/2000/nb0014.htm>.

178. *Plan de Reactivacion*, *supra* note 175.

179. *Id.*

180. *See* Mark E. Van Der Weide & Satish M. Kini, *Subordinated Debt: A Capital Markets Approach to Bank Regulation*, 41 B.C. L. REV 195, 209 n.52 (2000) (explaining that there are three federal bank regulatory agencies); Calvin Cunningham, *How Banks can Benefit from Partnership with Community Development Financial Institutions: The Bank Enterprise Awards Program*, 3 N.C. BANKING INST. 261, 280 n.118 (1999) (noting the regulatory sections controlling each of the regulation agencies); *see also* Steven A. Ramirez, *Depoliticizing Financial Regulation*, 41 WM. & MARY L. REV. 503, 523 n.83 (2000) (stating how the government's regulatory authority is circumscribed because the Office of the Comptroller carries the regulatory authority over national banks).

181. *See* Susan M. Golden, *Collateralized Mortgage Obligations: Probing the Limits of National Bank Powers Under the Glass-Steagall*, 36 CATH. U. L. REV. 1025, 1035 (1987) (noting that the Office of the Comptroller is the federal regulatory agency that supervises national banks); Lawrence K. Banks & Paula S. Hoskins, *Liability and Responsibility of Bank Directors: Being Alert to Troubled Times*, 72 KY. L.J. 639, 651 n.64 (1984) (noting that the Comptroller is the primary regulator of banks); Charles C. Boettcher, *Taking Texas Home Equity for a Walk, but Keeping it on a Short Leash*, 30 TEX. TECH L. REV. 197, 242 (1999) (noting that the comptroller is vested with regulatory authority over national banks).

182. *See* Andrea D. Roller, *Thailand's Banking Crises and Subsequent Reform: Could Thailand Benefit from an International Standard?*, 24 SUFFOLK TRANSNAT'L L. REV. 411, 445 n.188 (2001) (noting that the Office of the Comptroller examines the national institutions while the FDIC and Federal Reserve Board examine state institutions); Ramirez, *supra* note 180 (noting that the authority of the Federal Reserve Board is limited by that of the Comptroller); Elizabeth Tibbals, *ATM Networks Under the McFadden Act: Independent Bankers Association of New York v. Marine Midland Bank*, N.A., 35 AM. U.L. REV. 27, 273 n.22 (1985) (noting that a bank with a national charter chooses the comptroller as its primary regulator and the FDIC and Federal Reserve Board as its secondary (citing 53 VA. L. REV. 1091, 1093 (1967)).

183. *See* Ortega Trujillo v. Banco Cent. del Ecuador, 17 F. Supp.2d 1340, 1342 (S.D. Fla. 1998) (noting that the central bank is an agency of the government).

184. Ley General de Instituciones del Sistema Financiero, REGISTRO OFICIAL NO. 250 (2001) (Ecuador).

Agency for the Guarantee of Deposits.[185] However, an examination of the interrelationships of these institutions reveals a tremendous difference. While the interrelationships of the United States agencies operate in a relatively efficient manner, the agencies of Ecuador are rife with conflict.[186]

### A. U.S. Agencies Retain High Level of Insulation from Political Pressure

Autonomy of the various banking regulatory agencies is considered good economics and necessary to ensure that monetary policy is pursued in a socially and politically neutral fashion.[187] To ensure autonomy and to insulate the central bank from short-term partisan political pressures, the founders of the Federal Reserve System stipulated that the agency would be financed from its own resources.[188] In addition, the term of office for each member of the Board of Governors was made long enough (14 years) to prevent day-to-day political pressures from influencing the formulation of monetary policy.[189]

While the U.S. Congress created the Federal Reserve System through the Federal Reserve Act,[190] it intended the regional reserve banks to be non-governmental entities.[191] These separate and distinct entities were to be owned by commercial banks and designed to function essentially for private purposes. As the court stated in *Arney v. U.S.*,[192] these entities were "not

185. *See Ecuador: Country Profile*, AM. REV. OF WORLD INFO., Sept. 4, 2000, at 1 (stating that Ecuador's largest bank became the thirteenth bank to hand over its administration to the state-run Agency for the Guarantee of Deposits (AGD)).

186. *See Most Likely Regime Scenario*, PRS GROUP/ POL. RISK SERVICES, Jan 1, 2001, at 1 (explaining that policy making in Ecuador will fall into a pattern common to their politics. Policy making will be characterized by a series of struggles for power between the executive and legislative branches); *see also* Paul Kilby, *Defensive Moves*, LATIN FIN., Oct. 1998, at 37 (discussing that Latin American banks are going to be on the defensive going forward, and relating that a contraction in credit everywhere will be the result). *See generally* Joachim Bamrud & Mike Zellner, *Free to Fail*, LATIN TRADE, March 1999 (discussing that while the current financial difficulties in Ecuador are a result of poor management and political instability, government intervention may alleviate the financial situation).

187. *See* THE ART OF MONETARY POLICY 75–84 (D. Colander & D. Daane, eds., 1994); Timothy A. Canova, *Banking and Financial Reform at the Crossroads of the Neoliberal Contagion*, 14 AM. U. INT'L REV. 1571, 1610 (1999) (noting that the Federal Reserve's autonomous central bank structure has been the model for central bank independence around the world).

188. 12 U.S.C. § 289 (1988). *See* The Federal Reserve System in Brief, Federal Reserve Bank of San Francisco, at <http://www.frbsf.org/publications/federalreserve/fedinbrief/central.html>; *see also* Michael A. Fletcher, *Criminal Justice Disparities Cited*, WASH. POST, May 4, 2000, at A2 (reporting that central bank autonomy means the privatization instead of a mobilization of the nation's credit).

189. 12 U.S.C. § 289 (1988) (noting that, like the Federal Reserve, the independence of the judiciary is also a function of term of office or life tenure). *See* Jack M. Beermann, *Privatization and Political Accountability*, 28 FORDHAM URB. L.J. 1507, 1552 (2001) (discussing how the appearance and reality of political accountability are placed in doubt when government power is wielded by entities that are either outside government or only loosely connected to government); *see also* 12 U.S.C.S. § 263 (2001) (describing that each board of directors has one vote and that elections are governed by regulations prescribed by the committee).

190. 12 U.S.C.S. § 221 (2001).

191. Arney v. United States, No. 77-3503-NA-CV, 1979 U.S. Dist. Lexis 8212, at 8 (M.D.Tenn. 1979) (noting that the legislative history of the Federal Reserve Act demonstrates that Congress intended the regional Reserve Banks to be nongovernmental entities, separate and distinct from the United States). *See also* 12 U.S.C.S. § 391 (2001) (stating that Reserve Banks are depositaries of funds of the Treasury and may serve as fiscal agents of the Treasury); 12 U.S.C.S. § 341 (2001) (noting that each of the twelve Federal Reserve Banks is a nongovernmental corporation.).

192. Arney v. United States, No. 77-3503-NA-CV, 1979 U.S. Dist. Lexis 8212, at 8 (M.D.Tenn. 1979).

designed to be primarily arms or instrumentalities of the federal government."[193] Thus, the U.S. banking regulatory agencies are able to effectively carry out their duties without difficulties from political pressures.[194]

### B. Political Pressure Dominates Decision Making in Ecuador Agencies

Political pressure presents a serious problem to the smooth functioning of the banking regulatory system in Ecuador.[195] Such political pressure puts a strain on the relationships between the executive branch, the BCE, the SB and financial institutions.[196]

To begin with, the executive branch's decision to freeze assets and close banks was harshly criticized by the BCE and the SB.[197] These parties had reached no consensus over the decision

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193. *Id*. *See* Jack M. Beermann, *Privatization and Political Accountability*, 28 FORDHAM URB. L. J. 1507, 1552 (2001) (discussing how the Federal Reserve System is not primarily an instrumentality of the federal government); *see also* 12 U.S.C.S. § 263 (2001) (explaining that with the creation of the Federal Open Market Committee, the members of the Board of Governors of the Federal Reserve System were appointed from cities nationwide).

194. *See* Jack M. Beermann, *Privatization and Political Accountability*, 28 FORDHAM URB. L.J. 1507, 1552 (2001) (noting that the chairman is appointed pursuant to the Appointment Clause, so his/her lack of accountability is a function of the independence of his agency and his insulation from presidential removal). *But see* Electronic Data Systems Corp. Iran v. Social Sec. Organization, 508 F. Supp. 1350 (N.D.Tex. 1981) (holding valid an executive order directing the Federal Reserve Bank of New York to transfer $2.5 billion from U.S. funds). It is asserted that this case may hint at the possibility that the Executive could interfere at some level with the monetary policies of the Federal Reserve. Indeed, President Reagan once hinted at the possibility of intervening in currency trading when the strength of the U.S. dollar plunged in 1985. *See* Nicholas D. Kristof, *Dollar Plunges in Late U.S. Trading*, N.Y. TIMES, Feb. 27, 1985, at D1; *see also* 12 U.S.C.S. § 263 (2001) (stating that the appointed members are representative of cities nationwide and from the private sector and are governed with a view accommodating commerce and business and with regard to their bearing upon the general credit situation of the country).

195. *See Most Likely Regime Scenario*, PRS GROUP/ POL. RISK SERVICES, Jan 1, 2001, at 1 (stating that political battles are bound to make policies increasingly fragmented and incoherent); *see also Mahuad Proposes 'Dollarization' Plan; Other Developments*, FACTS ON FILE, WORLD NEWS DIGEST, Jan. 13, 2000, at 23 (noting that in order for President Mahuad to push though his currency plan, he would need approval from an opposition-controlled congress); *see also* Dan Krishock, Chris Humphrey, Mark Mulligan, Jonathon Wheatley, *A New Attitude*, LATIN FIN., May 2000, at 39 (explaining the importance of sound banking regulation, using Ecuador as an example of where weak banking regulation was one of the causes of the country's crippling economic problems).

196. *See Most Likely Regime Scenario*, PRS GROUP/ POL. RISK SERVICES, Jan 1, 2001, at 1 (stating the banking crisis of 1998–99 intensified regional tensions between the coast and the highland-dominated government; the crisis also had the hardest impact on banks along the coast); *A New Attitude*, LATIN FIN., May 1, 2000, at 39 (explaining how the idea of setting up specialized supervisory agencies, separating this responsibility from central banks and a proliferation of other departments, in order to create synergy between the three regulators); Monte Hayes, *Ecuador to Adopt Dollar as Currency*, ASS. PRESS, Jan. 10, 2000, *available at* LEXIS (reporting how President Mahuad planned to fire Central Bank executives who opposed his plan to replace the *sucre* with the dollar during the banking crisis).

197. *See Ecuador: Review 1999*, AM. REV. OF WORLD INFO., Dec. 20, 1999, at 1 (discussing, as a result of depositors withdrawing funds from banks, the Ecuadorian Government declared a state of emergency and closed all banks); *see also* Robert Taylor, *Ecuador: The Harvest Is Still To Come*, THE BANKER, Jan. 1, 2001, at 104 (stating that the dollarization launch came in tandem with regulatory measures to end an unpopular year-long freeze on deposits held in the Ecuadorian banking system); *Water Supply & Distribution Equip*., NAT'L TRADE DATA BANK, May 1, 1999, at 2 (reasoning that due to Ecuador's banking crisis, imports during 1999 will be negatively affected by the lack of liquidity, absence of credit lines, and non-issuance of letters of credit).

to freeze bank accounts.[198] In fact, four key members of the Central Bank of Ecuador resigned due to differences with the banking policies implemented by the executive branch.[199] When the president of the BCE recommended to President Mahuad that all failing banks be closed permanently, the President responded that it was "not within his political agenda to close down banks."[200] Relations between Mahuad and the BCE had deteriorated since the first months he took office.[201]

The executive's ability to decide whether to rescue or close a bank is heavily influenced by political pressures. For example, President Mahuad's desire to close down Banco de Progresso, was stymied by the Social Christian Party, who was a huge supporter of the bank (the largest

198. *See* Charles A. Radin, Jonathon Franklin, *Ecuador Issues a Warrant For Arrest of Ex-President Now Teaching at Harvard*, BOSTON GLOBE, July 15, 2000, at A2 (remarking how Jamil Mahuad is now teaching at Harvard sharing his experiences to freeze thousands of bank accounts and bail out 18 failed banks); *see also* Lohn Barham, *The Credibility Conundrum*, LATIN FIN., May 1, 2000, at 10 (stating that Ecuador has made two enormous errors. The first one was to freeze bank accounts, to put the hand of the state in the pocket of the people); Justine Newsome and Richard Lapper, *Ecuador Keeps Banks Closed Another Day Amid Economic Turbulence*, FIN. TIMES, March 10, 1999, *available at* 1999 WL 3449999 (reporting that bankers expressed opposition to the forced holiday, and how the president of the private banks' association said confidence has been weakened by the closure and concluding that the government has lost control of the country).

199. *See Four Central Bank Board Members Resign Over Differences with President*, BRITISH BROADCASTING CORPORATION, Mar. 23, 1999, at 20 (discussing that the resignation of four of the five members of the board of directors of the Central Bank of Ecuador (BCE) was due to difference with the banking policies implemented by the executive branch (Jamil Mahuad); *see also Most Likely Regime Scenario*, PRS GROUP/ POL. RISK SERVICES, Jan 1, 2001, at 1 (noting that the central bank's role had been in decline since Ecuador had adopted the dollar as its principle currency, thus ceding much control to the U.S. Federal Reserve); *see also Ecuador: Review 1999*, AM. REV. OF WORLD INFO., Dec. 20, 1999, at 1 (discussing how the day after President Mahuad declared a state of emergency, Ecuador's central bank president Luis Jacome and three of the four board members handed in their resignations).

200. *El Congelamiento Que Sorprendio a Los Clientes*, EL COMERCIO, Mar. 10, 2001, at <http://www.elcomercio.com/crisis_bancos/crisis_bancos.html>. *See President Mahuad Announces Petrol Price Increase, Plans to Raise Taxes*, BRIT. BROADCASTING CORP., Mar. 16, 1999, at 20 (statement of President Mahuad) (noting that "the second step is being taken in the financial sector. Mahuad spoke of the need for a serious and solvent banking that the country can support"); *see also Politics*, PRS GROUP/ POL. RISK SERVICES, Oct. 1, 1999, at 1 (noting Mahuad's agenda as being predominately economic in nature).

201. *See El congelamiento que sorprendio a los clientes*, EL COMERCIO, Mar. 10, 2001, *available at* <http://www.elcomercio.com/crisis_bancos/crisis_bancos.html>; Monte Hayes, *Cabinet Quits in Ecuador Finance Crisis*, THE INDEP., Jan. 11, 2000, at 16 (describing how President Mahuad, a political centrist and Harvard-educated, has faced increasing calls to step down from political rivals on the left and right); *see also Ecuador: Review 1999*, AM. REV. OF WORLD INFO., Dec. 20, 1999, at 1 (noting Mahuad came under fire from all sides: labor unions, the Social Christian Party (SCP) and center-left parties—and elements within his own DP).

opposition group in the National Congress).[202] Thus, the government was reluctant to offend political allies by closing some banks that were near collapse.[203]

The BCE also faced internal and external difficulties in exercising its duties and obligations. The BCE has admitted that their own agency is to blame for many of the problems. Since 1992, the organization has been in the process of restructuring. It cited an "excess in various departments doing the same jobs without any cooperation among them" thereby leading to the "duplication of functions and activities."[204] External market forces also dictate how the BCE should react. The BCE's decision to bail out floundering banks would cause a collapse in currency valuation and higher inflation.[205] The BCE also faced problems with the Superintendent of Banks. When the BCE attempted to contact the SB to discuss the SB's authority to determine whether banks were viable or not, the SB failed to respond. The BCE made two failed attempts to reach the SB.[206]

Banking institutions also faced political pressures. Bankers have complained that politicized regulators protect weak institutions, with the SB being a "negative rather than neutral

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202. *See* Politics, PRS GROUP/INT'L COUNTRY RISK GUIDE, Oct. 1, 1999, at 3 (noting that as a result of the state of emergency in March, the Social Christian Party (SCP) withdrew from Mahuad's coalition government); Robert Taylor, *Ecuador: The Harvest is Still To Come*, THE BANKER, Jan. 1, 2001, at 104 (explaining that it quickly became apparent that the SCP, having maneuvered itself into a position where it could effectively veto policy initiatives from Mahuad, had no wish to share in unpopular policies.); *see also Latin America and the Caribbean*, THE FIN. TIMES, Jan. 6, 1999, at 6 (noting that Mr. Mahuad's center-right Popular Democracy party is the largest in Congress and has allied itself with the market-oriented but populist Social Christian Party (SCP) to form a majority).

203. *See Ecuador Chaos, Continued*, ECONOMIST, Mar. 20, 1999, at 39; Samantha Newport, *Another Ecuadorian Bank Given over to State Control*, FIN. TIMES, Oct. 6, 1999 *available at* 1999 WL 21148201 (reporting that Ecuador's largest bank has been handed over to state-owned Filabanco); *see also*, Samantha Newport and Richard Lapper, *Ecuador Cracks Down On Protests Over Depressed Economy*, FIN. TIMES, Jan. 7, 2000, *available at* 2000 WL 3287402 (reporting that Jamil Mahuad declared a state of emergency in an a attempt to stem protests over depressed economic conditions).

204. BANCO CENTRAL DEL ECUADOR, EXPOSICION DE MOTIVOS (1992), *available at* <http://www.bce.fin.ec/bce/motivos.htm>. *See* Charles A. Radin and Jonathon Franklin, *Ecuador Issues a Warrant For Arrest of Ex-President Now Teaching at Harvard*, THE BOSTON GLOBE, July 15, 2000, at A2 (reporting that Mahuad speaks about how his proposal for dollarization contains views from all sectors); *see also* Lohn Barham, *The Credibility Conundrum*, LATIN FIN., May 1, 2000, at 10 (explaining that the dollarization measures scarcely began to address the underlying problems of illiquidity and undercapitalization that unleashed a wave of official intervention).

205. *See Desperation in Ecuador*, ECONOMIST, Jan. 15, 2000, *available at* LEXIS (stating that adding liquidity causes a collapsing currency and higher inflation); *Ecuador's Taxi Drivers Win Gas Hike Concessions*, CHICAGO TRIBUNE, Mar. 19, 1999, at 22 (noting that when banks were bailed out in 1999, the currency lost forty percent of its value and inflation was the highest in Latin America); Samantha Newport, *Ecuador President Imposes State of Emergency*, FINANCIAL TIMES (LONDON), Jan. 7, 2000, at 7 (stating that bailout efforts have contributed to rising inflation).

206. *See El congelamiento que sorprendio a los clientes*, EL COMERCIO, Mar. 10, 2001, *available at* <http://www.elcomercio.com/crisis_bancos/crisis_bancos.html>. *See generally* Nicholas Moss, *Anger at Reprimand for Quito Finance Minister*, FIN. TIMES, Feb. 15, 2000, at 7 (stating that four former Bank Superintendants were fired for, among other reasons, negligence in operating the banks); *Letter from Jorge Guzman, Minister of Finance and Public Credit, and Modesto Correa, President of the Board Central Bank of Ecuador to Stanley Fischer, Acting Managing Director International Monetary Fund*, Apr. 4, 2000, *available at* <http://www.bce.fin.ec/avisos/intent_fmi.html>. (last visited Nov. 1, 2001) (describing the intent of Ecuador's government).

force."[207] Nonetheless, many bankers are more than happy with the cushion of liquidity that the BCE injects into their failing institutions.[208]

The creation of the AGD demonstrates the strength of political pressure being exerted on the various regulatory agencies. The creation of the AGD was a compromise reached by the National Congress and the Executive. In November of 1998, the National Congress agreed to give the government draconian intervention powers in return for the establishment of a deposit guarantee agency.[209] Nevertheless, the creation of the AGD came too little to late. Most important, the exchange gave the President all the power he needed to freeze the assets of banking institutions in March of 1999.

### C. Early Legislation for Banking Institutions Was Too Liberal

This problem became clearly evident during the economic and banking crisis in 1998–1999 but the crisis had its seeds in the events of early 1994.[210] The laws that controlled monetary policy failed to adequately regulate the amount of capital banking institutions could keep or lend.[211] The National Congress created legislation that virtually gave a green light to banking institutions to freely give out loans to its employees. The legislation also gave too much freedom for banking institutions to decide which sectors of the economy could be recipients of loans. Ultimately, banks extended loans to certain limited sectors in the economy.[212]

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207. Justine Newsome & Richard Lapper, *Accountants Vie for Chance to Bring Ecuador's Troubled Banks to Account*, FIN. TIMES, Apr. 20, 1999, at 7. See also Samantha Newport, *Ecuador Bank Absorbed by State*, FIN. TIMES, Oct. 19, 1999, at 8 (stating that the administration of the country's fourth largest bank was taken over by the state). *See generally* Nicholas Moss, *Anger at Reprimand for Quito Finance Minister*, FIN. TIMES, Feb. 15, 2000, at 7 (noting the political pressures that Superintendent of Banks go through).

208. *See Ecuador Chaos, continued*, ECONOMIST, Mar. 20, 1999, at 39 (noting that even though bank closings undermined the public's confidence in these institutions, the closings were nevertheless a welcomed event for the banks).

209. *See* Justine Newsome & Richard Lapper, *Accountants Vie for Chance to Bring Ecuador's Troubled Banks to Account*, FIN. TIMES, Apr. 20, 1999, at 7 (discussing how President Mahuad received greater power over the banking system in its compromise with the National Congress to establish the AGD); *see also* Samantha Newport, *Big Ecuador Bank Handed Over to State*, FIN. TIMES, Sept. 29, 1999, at 7 (stating that the AGD was established in 1998 to regulate the banking sector); Nicholas Moss, *Quito Moves Nearer to IMF Accord*, FIN. TIMES, June 8, 1999, at 7 (reporting that AGD was established by President Mahuad to restructure the fragile banking system caused by the economic crisis in Ecuador).

210. *See* Lenin Guerra, *The Use of Fast Track Authority in the Negotiations of the Free Trade Area of the Americas*, 8 KAN. J. L. & PUB. POL'Y 172, 173, 178-80 (1999) (stating that a small country, such as Ecuador, would financially suffer if the United States did not have fast-track authority to negotiate trade agreements, which authority expired in early 1994).

211. *See* Steve H. Hanke, *Americas: Ecuador Needs More Than a Dollars-for-Sucres Exchange*, WALL ST. J., Mar. 31, 2000, at A19 (attributing the banking crisis to bad loans to weak banks by the Central Bank). *See generally Ecuador: Keeping "Greenbacks" in a Hothouse*, W. MERCH. BANK INV. REV., Feb. 14, 2000, at 156 (reporting that the vulnerability of the banking system can be attributed to its control by the Central Bank); Nicolas Landes, *Ecuador: Commercial Banking Profile*, LATIN FINANCE, October 1993, at S68 (stating that the Central Bank has implemented contradictory legislation creating instability in the banking system).

212. *See Asi se Hundio la Banca*, EL COMERCIO, Mar. 8, 2001, at A1. (discussing how banks concentrated their lending especially on the agricultural sector but unfortunately, this sector was devastated by *El Niño*, which caused a sharp decline in agricultural production); *Historical Timeline*, THE PRS GROUP/POLITICAL RISK SERICES, Oct. 1, 2000, *available at* LEXIS, (discussing the damage and devastation caused by *El Niño* in Ecuador and how the reconstruction will be funded); *see also Chronology of Events*, THE PRS GROUP, Oct. 1, 1998, *available at* LEXIS Ec (stating that Ecuador received millions of dollars in loans from The World Bank to use towards repairing damage done by *El Niño*).

The laws also curtailed the power of the agencies to act in a preventive manner. For instance, the Law of Financial Institutions (1994) removed much of the power that the Superintendent of Banks had to examine the viability of the banking institutions.[213] To no one's surprise, the Superintendent of Banks has received the bulk of the blame for the mismanagement of the regulation of the banking industry.[214]

Because of a combination of political pressure and ineffective legislation, the agencies that were designed to regulate the banking industry were stripped of any meaningful power to resolve the financial crisis. While the Ecuador Constitution and other laws codify and define the powers of these agencies, their powers are frustrated by political pressure.[215] As such, the agencies must have a clearly delineated scope of autonomy in order to function effectively.

A comparison of both frameworks reveals similarities in the infrastructure but differences in the effectiveness of implementation. It is asserted that a key advantage that the U.S. framework has is the relative autonomy from political pressures and executive intrusion. The Ecuadorian framework, by contrast, is stifled by internal and external forces crippling its ability to carry out its objectives. Moreover, the creation of the AGD came at a time when the financial crisis had already taken serious hold.[216] Congressional reaction to the absence of this institution

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213. *See Asi se hundio la banca*, EL COMERCIO, Mar. 8, 2001, at A2; *Economic Trends*, MARKET REPORTS, June 26, 1997 at 1 (discussing the deregulated universal banking system created by the 1994 Financial Institutions Law and how the law "[i]nstitutes full consolidated financial disclosures requirements and requires early intervention by an upgraded superintendency of banks in the event of solvency problems"); *see also Political Support and Opposition*, THE PRS GROUP, Oct. 1, 1998 *available at* LEXIS, (stating that the Financial Institution Law of 1994 worked to create a more liberal operation of foreign financial institutions).

214. *See Asi se hundio la banca*, EL COMERCIO, Mar. 8, 2001, at A1; *Investment Climate*, MARKET REPORTS (National Trade Data Bank Market Reports), July 10, 1998, at A8 (discussing the functioning of the regulatory system in Ecuador's economy); *see also Banking Sector Shake-Up*, VIEWS WIRE LATIN AMERICA (July 25, 2001), *available at* <http://biz.yahoo.com/ifc/ec/news/72501-1.html>. (last visited Nov. 1, 2001) (questioning whether or not the new banking superintendent, Miguel Davila, will be able to establish a new regulatory framework and restore confidence in the banking system).

215. *See* Santiago A. Cueto, *Oil's Not Well in Latin America: Curing the Shortcomings of the Current International Environmental Law Regime in Dealing with Industrial Oil Pollution in Latin America Through Codes of Conduct*, 11 FLA. J. INT'L L. 585, 598 (1997) (discussing Ecuador's constitutional guarantee of the right to a clean environment in contrast to the economic problems that have been caused by the economic necessity of oil drilling and the lack of political attention being paid to the damage to the environment as a result); Judith Kimerling, *Rights, Responsibilities, and Realities: Environmental Protection Law in Ecuador's Amazon Oil Fields*, 2 SW. J. OF L. & TRADE A. 293, 295–96 (1995) (stating that Ecuador's government has traditionally been dominated by a strong executive that has affected development of a democracy in the country and further, that attempts have been made to strengthen the weak judiciary but as of yet no independent judiciary has been established); *see also* Peggy Rodgers Kalas, The Implications of Jota v. Texaco and the Accountability of Transnational Corporations, 12 PACE INT'L L. REV. 47, 63–4 (2000) (discussing that the judicial system in Ecuador provides no meaningful forum for the people to address the violation of their constitutional right to a contamination-free environment as the judiciary is controlled by the military which gets its money from oil sales).

216. *See* Hale E. Sheppard, *Dollarization of Ecuador: Sound Policy Dictates U.S. Assistance to this Economic Guinea Pig of Latin America*, 11 IND. INT'L & COMP. L. REV. 79 (2000) (stating that though it was hoped that the new economic market would succeed where the "bloody hand of government had failed" in bringing about prosperity in the country); *see also Ecuador, Main Economic Indicators*, JANE'S SENTINEL SECURITY ASSESSMENT—SOUTH AMERICA, Aug. 24, 2000 *available at* LEXIS (stating that in May 2000 there was further turmoil in Ecuador's financial institutions).

prior to the financial crisis represents an evolution of Ecuador's banking regulatory framework. While its stage of development is still relatively early, the framework is actively responding to increasingly complex economic conditions. As such, its framework should continue to develop and also become increasingly complex. Nonetheless, it will be imperative for the agencies to achieve a higher level of autonomy from political pressure in order to react competently to, or prevent, future financial crises.

## VI. Conclusion: Constitutional Validity of President Mahuad's Actions During the 1999 Banking Crisis

A comparative analysis of the powers of the executive in both the U.S. and Ecuador reveals interesting similarities as well as differences with respect to banking laws. While both nations' constitutions grant extraordinary powers to the President, each is limited or checked by the legal system and other historical circumstances relative to each country. The common law system of American government provides safeguards on executive power through the use of judicial review and an effective legislature. The civil law system of the Ecuador government also provides limits on executive power. However, historical circumstances, *caudillismo* and the civil law tradition have combined to give the executive branch in Ecuador enormous power. The enormous power of the executive is especially present in Ecuador's Constitution.

Nevertheless, the emergency powers provided for by statute or constitution give both nations' executive enormous power and discretion in times of emergency. A case in point was President Roosevelt's use of emergency powers during the Banking Crisis of 1933. Similarly, the Constitution of Ecuador gives the president the power to suspend fundamental rights in times of national emergency.

Because of this evolution of executive power in Ecuador, it is arguable that Mr. Mahuad's actions were legal. While the Constitution may not explicitly provide for the actions that President Mahuad took, the mere fact that history, legal tradition and *caudillismo* play an important role in the executive's power demonstrate that such actions would inevitably be taken. While President Roosevelt used the broad powers of a statute to exercise authority, Mr. Mahuad used his historically privileged position to exercise his powers.

The regulatory framework analysis of each nation's banking laws reveals an interesting scenario. Many of the symptoms leading to Ecuador's eventual banking crisis of 1998 were also shared by U.S. banks in 1933. Like the U.S. banking system of the 1930s, Ecuador's system was hampered by mismanagement and an absence of regulatory agencies to oversee and ensure the proper administration of the banking industry. And, like the U.S., the Ecuador government reacted to the crisis by creating new agencies like the AGD (or the FDIC in the U.S.). What is revealed, then, is the development of Ecuador's banking industry and the role the executive must play in order to ensure both institutions work together.

In sum, analyzing the issue of whether Mr. Mahuad's actions were unconstitutional does not serve to answer the problems associated with the banking crisis. Even if his actions were

unconstitutional, the banking crisis would have occurred anyway. If any positive lesson is learned from this event, it is the need to develop a more integrated and responsible system of regulatory laws to oversee the banking industry. Moreover, the Ecuador Constitution seems to be overshadowed by the unique powers attributed to the president. Since this is a deeply rooted tradition, it will be difficult to distribute power away from the executive and abandon such a tradition in place of a textual document. Thus, Mr. Mahuad's actions may not have been explicitly provided for in Ecuador's Constitution, but they were provided via the historical tradition of the powers of the executive.

# External Competence of the European Community in the Hague Conference on Private International Law: Community Harmonization and Worldwide Unification*

**Charles T. Kotuby, Jr.****

## I. Introduction

The 1957 Treaty of Rome and its successors,[1] which created and expanded the European Community, have developed a legal system distinct from that of its constituent states.[2] "[N]evertheless [the states are] intimately and organically tied to it in such a way that the mutual and constant respect for the respective jurisdictions of the Community and national bodies" is essential for the proper attainment of Community aims.[3] Although this *sui generis* Community structure has limited the sovereign rights of the Member States in ever-widening fields, it operates upon a backdrop of autonomous, self-contained and functionally independent civil codes of national private law.[4] Because the integration envisaged by the original

1. Treaty Establishing the European Economic Community ("EC Treaty"), Nov. 11, 1997, O.J. C 340/1 (as amended).

2. *See* Mark C. Miller, *A Comparison of Two Evolving Courts: The Canadian Supreme Court and the European Court of Justice*, 5 U.C. DAVIS J. INT'L L. & POL'Y 27, 31 (1999) (noting that the European Union has created a distinct legal system, including its own courts for resolving issues of federalism); Sean C. Monaghanm, Comment, *European Union Legal Personality Disorder: The Union's Legal Nature Through the Prism of the German Federal Constitutional Court's Maastricht Decision*, 12 EMORY INT'L L. REV. 1443, 1447 (1998) (referring to the Treaty of Rome as the "constitution" that established "a distinct legal system"); Bozena Ziedalski, *What Does it Mean to be a European Citizen and Why the Concept of European Citizenship is Important to the European Union?*, 6 NEW ENG. INT'L & COMP. L. ANN. 63, 63 (2000) (commenting that the EU has its own legal system).

3. Case 6/64 Costa v. ENEL (1964) E.C.R. 585, 605–606.

4. *See* Daniel W. Simcox, *The Future of Europe Lies in Waste: The Importance of the Proposed Directive on Civil Liability for Damage Caused by Waste to the European Community and its Environmental Policy*, 28 VAND. J. TRANSNAT'L L. 546, 553 (1995) (EU law "penetrates the domestic legal systems of Member States, and creates rights and obligations for individuals enforceable within their national courts"); Bozena Ziedalski, *What Does it Mean to be a European Citizen and Why the Concept of European Citizenship is Important to the European Union?*, 6 NEW ENG. INT'L & COMP. L. ANN. 63, 63 (2000) (noting that the EU's laws are incorporated into the national laws of the Member States); *see also,* Case 26/62, N.V. Algemene Transp. & Expeditie Onderneming Van Gend & Loos v. Nederlandse administratie der belastingen, 1963 E.C.R. 1, 12 (holding that certain provisions of the Treaty of Rome apply directly to individuals within national legal systems).

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Treaty structure relies on market forces and is powered by economic drive, the "four freedoms" guaranteed by this structure—namely, the free trans-border movement of goods, services, people and capital—remain attainable without the complete substantive uniformity of national laws.[5] Still, with further integration encouraging increased interstate transactions, and few substantive matters falling exclusively within the general jurisdiction of the Community, legal dilemmas referencing diverse national laws hinder the operation of the internal market.[6] Rather than erode the sensitive national bulwark of substantive private law, however, the Community often chose to enact common rules on the conflict of law to determine the reach of Community measures and their intersection with national substantive laws.[7]

Periodic Community efforts at harmonizing substantive national laws, usually taken under the auspices of Article 95 EC, have often included scattered conflict rules.[8] These rules purport to protect the legal framework of the internal market against the choice of laws of a third state, and by the wording of Article 95(2), primarily encompass matters pertaining to

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5. *See* Myung Hoon Choo, *Dispute Settlement Mechanisms of Regional Exonomic Arrangements and Their Effects on the World Trade Organization*, 13 TEMP. INT'L & COMP. L.J. 253, 255 (1999) (commenting that the goal of the EU is to remove "physical, fiscal, and technological obstacles, and thereby create a unified economic market in order to achieve a level of productivity and standard of living higher than that of customs union"); Gregory W. Hotaling, Comment, *Ideal Standard v. IHT: In the European Union, Must a Company Surrender its National Trademark Rights When it Assigns its Trademark?*, 19 FORDHAM INT'L L.J. 1178, 1197–99 (1996) (remarking that the EU was created in the "name of free trade"); *see also* Daniela Caruso, *The Missing View of the Cathedral: The Private Law Paradigm of European Legal Integration,* HARVARD JEAN MONNET WORKING PAPER NO. 9/96, *available at* <http://www.law.harvard.edu/programs/JeanMonnet/papers/96/9609ind.html>.

6. *See* Peter L. Lindseth, *Democratic Legitimacy and the Administrative Character of Supranationaism: The Example of the European Community*, 99 COLUM. L. REV. 628, 665–67 (1999) (discussing the various hinderences towards establishing a functioning internal market in the EU); *see also* Alison Harcourt, *The European Commission and Regulation of the Media Industry*, 16 CARDOZO ARTS & ENT. L.J. 425, 436 (1998) (citing the various national laws of the Member States as one reason for the "fragmentation" of the EU's internal market). *See generally* Denis J. Edwards, *Fearing Federalism's Failure: Subsidiarity in the European Union*, 44 AM. J. COMP. L. 537, 574–77 (1996) (discussing the various legal difficulties encountered by the EU's efforts to harmonize national laws).

7. *See* Justin P. Fletcher, *An Argument for Ratification: Some Basic Principles of the 1994 Inter-American Convention on the Law Applicable to International Contracts*, 3 GA. J. INT'L & COMP. L. 477, 494–95 (1999) (discussing the use of conflict-of-law rules to implement goals of the EU); Susanne Knofel, *EC Legislation on Conflict of Laws: Interactions and Incompatibilities Between Conflicts Rules*, 47 INT'L & COMP. L.Q. 439, 439 (1998) (noting that "modern Community legislation . . . increasingly complements the intended substantive law harmonization with provisions on conflict of law"); Hans Kuhn, *Multi-State and International Secured Transactions Under Revised Article 9 of the Uniform Commercial Code*, 40 VA. J. INT'L L. 1009, 1095 (2000) (noting that the EU has attempted to establish uniform conflict-of-law rules).

8. *See* Justin P. Fletcher, *An Argument for Ratification: Some Basic Principles of the 1994 Inter-American Convention on the Law Applicable to International Contracts*, 3 GA. J. INT'L & COMP. L. 477, 494–95 (1999) (discussing the use of conflict-of-law rules to implement goals of the EU); Christian Pitschas, GATT/WTO, *Rules for the Border Tax Adjustment and the Proposed European Directive Introducing a Tax on Carbon Dioxide Emissions and Energy*, 24 GA. J. INT'L & COMP. L. 479, 500 n.41 (1995) (discussing that the European Union uses certain conflict-of-law rules to implement economic policy, such as using Article 95 to expand neutral systems of internal taxation to both domestic and foreign goods). *See e.g.*, Art. 6 of Directive 93/13/EEC of 5 April 1993 on Unfair Terms in Consumer Contracts, O.J. 1993, L 95/29; Article 9 of Directive 94/47/EC on Protection of Purchasers in Timeshare Contracts.

trade in goods.[9] However, as the definition of the internal market enshrined in Article 14(2) states, the full realization of a community "area without internal frontiers" requires not only the free movement of goods, but the inclusion of "persons, services and capital" as well.[10] Thus, the recent Treaty of Amsterdam has broadened the reach of future Community conflict rules by means of Articles 61 and 65, which give the Community power to adopt internal conflict rules, and categorically fall under Title IV relating to the free movement of persons.[11] This "area of freedom, security and justice" established by Article 61 complements the aim of Article 95, doing its part to ensure the "establishment and functioning of the internal market."[12] Accept-

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9. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, art. 95(2), O.J. (C 340):

> No member shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. Member States shall not, later than at the beginning of the second stage, repeal or amend any provisions exisiting when this Treaty enters into force which conflict with the preceding rules.

*See also* Alexander J. Black, *European Law and Public Utility Open Access,* 10 FLA. J. INT'L L. 117, 126–27 (1995) (discussing the European Community's primary goal of establishing a single internal market "without internal frontiers" in goods); Manning Gilbert Warren III, *Global Harmonization of Securities Law: The Achievements of the European Communities,* 31 HARV. INT'L L.J. 185, 195 (1990) (explaining that the establishment of a common market for the European Community replaces the numerous regulations of many states with the uniform standards of one market whose goal is to promote the free movement of goods between Member States).

10. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, O.J. (C 340) (stating in Article 14(2) that "[t]he internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty"). *See* Youri Devuyst, *The European Union's Constitutional Order? Between Community Method and Adhoc Compromise*, 18 BERKELEY J. INT'L LAW 1, 1–2 n.2 (2000) (noting that free movement of persons, services and capital is one pillar of the EU); Susan H. Easton, *Honor Thy Promise: Why the Dutch Drug Policies Should Not Be a Barrier to the Full Implementation of the Schengen Agreement*, 23 B.C. INT'L & COMP. L. REV. 121, 122–23 (1999) (commenting that the EC treaties seek to remove barriers to movement).

11. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, O.J. (C 340) (addressing in Title IV "Visas, Asylum, Immigration and Other Policies Related to Free Movement of Persons"); *see also Nested "Old" and "New" Citizenships in the European Union: Bringing Out the Complexities*, 5 COLUM. J. EUR. L. 389, 412 (1999) (discussing the addition and effect of Title IV); Karoline Kerber, *Temporary Protection in the European Union: A Chronology*, 14 GEO. IMMIGR. L.J. 35, 44–45 (1999) (discussing the fact that Title IV of the Treaty of Amsterdam brought laws "that were previously a matter of intergovernmental cooperation into the framework of the EC").

12. Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, art. 95, O.J. (C 340). Article 95(1) states:

> By way of derogation from Article 94 and save where otherwise provided in this Treaty, the following provisions shall apply for the achievement of the objectives set out in Article 14. The Council shall, acting in accordance with the procedure referred to in Article 251 and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.

Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, art. 95(1), O.J. (C 340). *See* Thomas S. Hornlaker, *The European Union's Deposit Guarantee Directive: A Critical Analysis*, 20 B.C. INT'L & COMP. L. REV. 335, 336 (1997) (noting that a "fundamental objective" of the European Union is to create an economy where factors of production freely move).

ing these legitimate ends in the Treaty, conflict-of-law rules enacted under each article intend to ensure legal certainty over applicable law by jurisdictional rules, and secure the uniformity of decisions over the same transaction.[13] Realization of these goals should advance the free movement of goods, services and especially people, without the legal obstacles presented by divergent national substantive laws.[14]

This implicit recognition, that rules on the conflict of law ensure the free movement of goods, services and persons necessary for the proper functioning of the internal market, must apply equally to multistate transactions involving non-Member States as well as to intra-Community transactions. Although internal Community conflict rules cannot affect the rules applied by non-Member States, in cases involving a third state and at least two Member States, there exists the possibility that contradictory judgments may be passed within the Community through the application of purely national laws.[15]

In this way, the goal of legal certainty and uniformity of decisions cannot be solely an intra-Community objective, but rather a legitimate goal undertaken by the Community on the external plane. The European Court of Justice has "constitutionalized" the EC Treaty to provide for this goal, supplementing explicit internal competences with implied external competences.[16] By this doctrine of implied powers, external competence may arise in the absence of internal rules if the subject matter of an international agreement is inextricably linked to an

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13. *See generally* Vivian Grosswald Curran, *Romantic Common Law, Enlightened Civil Law: Legal Uniformity and the Homogenization of the European Union*, 7 COLUM. J. EUR. L. 63, 65 (2001) (concluding that legal uniformity is both "necessary" and "destructive" due to the diversity of cultures); Hon. David A.O. Edward, *What Kind of Law Does Europe Need? The Role of Law, Lawyers and Judges in Contemporary European Integration,* 5 COLUM. J. EUR. L. 1, 5 (1999) (noting that a free market's existence is dependent on some form of uniformity of laws); Paola Michelle Koo, Note, *The Struggle for Democratic Legitimacy within the European Union,* 19 B.U. INT'L L.J. 111, 120 (2001) (noting that uniformity is a component of integration).

14. Peter Hay, *et al.*, Conflict of Laws as a Technique for Legal Integration, in Integration Through Law, Vol. 1: Methods, Tools and Institutions, Book 2: Political Organs, Integration Techniques, and Judicial Process 161 (Cappelleti, *et al.* ed., 1986); *see also* Terence L. Blackburn, *The Unification of Corporate Laws: The United States, The European Community and the Race to Laxity*, 3 GEO. MASON IND. L. REV. 1, part 1(a)(1)(2), (1994) (discussing the significance of legal uniformity in the European Community pertaining to business operations across jurisdictional boundaries). *See generally* Jennifer Manvell Jeannot, *An International Perspective on Domestic Banking Reform: Could the European Union's Second Banking Directive Revolutionize the Way the United States Regulates its Own Financial Services Industry?*, 14 AM. U. INT'L L. REV. 1715, 1730–34 (1999) (referring to the thwarting of international competition due to the lack of legal harmonization in the European Union's financial services industry).

15. *See* Terence L. Blackburn, *The Societas Europa: The Evolving European Corporation Statute,* 61 FORDHAM L. REV. 695, 703–04 (1993) (discussing that the diverse laws among Member States create potential barriers to economic business and efficiency); s*ee also* Cliona J.M. Kimber, *A Comparison of Environmental Federalism in the United States and the European Union,* 54 MD. L. REV. 1658, 1682 (1995) (stating that the European Court has no jurisdiction over national laws unless they conflict with EC law, thus allowing Member States to disagree without intervention and guidance by the EC).

16. *See* Judith Hippler Bello, *International Decisions*, 89 AM. J. INT'L L. 772, 780 (1995) (noting that the Community's external competences do not necessarily rely on the internal powers granted to it by the Treaty); Donald K. Anton, *et al., Nationalizing Environmental Protection in Australia: The International Dimensions*, 23 ENVTL. L. 763, 772–73 (1993) (discussing the futile effect of inconsistent state legislation and the importance of uniformity in the European Community).

internal Treaty objective.[17] Similarly, once the Community exercises its internal competence, it acquires external competence over the subject matter internally covered; the scope of which is determined by the extent of those internal rules.[18]

This article addresses the new Community competence stemming from Articles 61 and 65, and the approach that the Community has taken to utilize conflict of law as an integrating tool. Illustrating this approach in the recent regulation incorporating the 1968 Brussels Convention into Community law,[19] the Court's case law on external competence will be examined with a view to assessing potential Community competence in future multilateral conventions on matters of private international law. The origin of this case law in the area of goods and services, and the theoretical dilemmas which may arise in transferring this rationale to matters of a purely legal, rather than economic nature, will be examined. Finally, the ongoing negotiations of the Hague Conference on Private International Law Convention on jurisdiction and the recognition and enforcement of judgments will be examined.

## II. *In Foro Interno, In Foro Externo:* The Internal Market and External Community Competence

The external competence of the Community over matters within its internal realm has long been recognized as necessary.[20] Since its creation, the Community has become party to hundreds of international agreements.[21] Nevertheless, the external competence to accede to such agreements, or fully participate in such work, comes largely at the expense of the sovereignty of the Community's Member States.

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17. Opinion 1/76, re: The Draft Agreement for a Laying-up Fund for Inland Waterway Vessels, (1977) E.C.R. 741.

18. Opinion 2/91, re: Convention No. 170 of the ILO, (1993) E.C.R. I 1061.

19. O.J. (27) 1 (1998); replaced by Council Regulation (EC) on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, COM (1999) 348. The recent regulation incorporating the 1968 Brussels Convention into Community Law illustrates this approach. The Court's decisions on external competence will be considered in light of potential Community competence issues in future multilateral conventions regarding issues of private international law.

20. *See* Judith Hippler Bello, *International Decision: Commission of the European Communities v. Council of the European Union*, 91 A.J.I.L. 349, 354 (1997) (recognizing the ECJ's view that external competence of the Community is necessary when its internal powers are ineffective); *see also* Gunnar Schuster, *European Communities—Agreement Between the Commission and the United States on Competition—Power of the Commission to Conclude the Agreement,* 89 A.J.I.L. 136, 138 (1995) (discussing the ECJ's finding of parallels between the Community's internal competences and its external competences); Judith Hippler Bello, *Community Competence to Conclude WTO Agreements Exclusive of Member States*, 89 A.J.I.L. 772, 781 (1995) (illustrating the Community's external competences to further internal policies does not depend on prior exercise of those internal powers, as long as it is conferred in the treaty and is needed to achieve a Community objective).

21. *See Discussion After the Speeches of Richard B. Bilder and Donat Pharand,* 20 CAN.-U.S. L.J. 35, 36 (1994) (discussing that because the Community is party to many international agreements, it could be a model for balancing sovereign independence and state and cultural values); *see also* Christoph Wilhelm Vedder, *Nonappearance and Disappearance Before the International Court of Justice*, 81 A.J.I.L. 293, 293 (1987) (discussing the ability of the Community to enter into international agreements with non-Member States and international organizations as part of its foreign affairs power); John Fitzpatrick, *The Lugano Convention and Western European Integration: A Comparative Analysis of Jurisdiction and Judgments in Europe and the United States,* 32 CORNELL INT'L L.J. 109, 128 (1993) (discussing the ability of Member States to enter into international agreements because they are still sovereign states and subject to international law).

### A. Treaty Provisions and "Inextricable Links": Protecting the Internal Market

The division of competences between the Community and its Member States is governed by two general principles of Treaty interpretation.[22] The first principle limits Community powers to those that are specifically conferred to it in the Treaty.[23] While adhering to this principle, the European Court of Justice has long been diligent in asserting the external element of the common commercial policy for trade in goods,[24] and has broadly construed this policy to ensure uniform conclusion of tariff agreements,[25] export policy[26] and trade liberalization.[27] By this extensive construction of Article 133, the Community has successfully maintained exclusive external power over almost all international agreements relating to trade in goods.[28]

One exception to exclusivity founded upon express Treaty provisions is contained within the Court's doctrine of implied powers. In the role of a constitutional court exercising a purposive approach to treaty interpretation, the European Court as early as 1970 furthered its broad view of Community objectives and held that external powers not only arise from express conferment in the Treaty, but may also be implied by other provisions of the Treaty, Acts of Accession and measures adopted by Community institutions.[29] In Opinion 1/76, the Court held

22. *See* Takis Tridimas and Piet Eeckhout, *The External Competence of the Community and the Case-Law of the Court of Justice: Principle versus Pragmatism*, 14 Y.B. EUR. L. 143, 154–155 (1994); *c.f.* John E. Noyles, *The International Tribunal for the Law of the Sea*, 32 CORNELL INT'L L.J. 109, 128 (1998) (reasoning that whether the International Tribunal for the Law of the Sea will be a respected international court could depend on whether it uses conventional treaty interpretation, such as looking to the intent of the drafters). *See generally* Peter L. Lindseth, *Democratic Legitimacy and the Administrative Character of Supernationalism: The Example of the European Community*, 99 COLUM. L. REV. 628, 704–706 (1999) (discussing, as part of the legal basis of Community competence and internal institutional balance, that the treaty itself may determine whether the power is delegated to the Community itself, or a member state).

23. *See* Takis Tridimas and Piet Eeckhout, *The External Competence of the Community and the Case-Law of the Court of Justice: Principle versus Pragmatism*, 14 Y.B. EUR. L. 143, 154–155 (1994); Anne Peters, *Decision: International Decisions*, 89 A.J.I.L. 376, 381 (1995) (discussing the ability of the court to use parts of the treaty, such as the preamble, as a guideline for its interpretation); *c.f.* Georg Ress, *Decision Concerning the Maastricht Treaty of October 12, 1993*, 88 A.J.I.L. 539, 545 (1994) (stating that acts not covered by the treaty with Germany shall be nonbinding on Germany and disregarded).

24. EC Treaty Article 133(3).

25. Case 45/86, Commission v. Council (Generalised Tariff Preferences), (1987) E.C.R. 1493.

26. Opinion 1/75, re: OECD Local Cost Standard, (1975) E.C.R. 1355.

27. Opinion 1/78, re: International Agreement on Natural Rubber, (1979) E.C.R. 2871; Opinion 1/94, re: The Uruguay Round Treaties, (1995) C.M.L.R. 205.

28. *See* Maria Gavouneli, *International Law Aspects of the European Union*, 8 TUL. J. INT'L & COMP. L. 147, 157 (2000) (stating the express treaty-making power of the Community exists not only in commercial agreements, but also in association agreements); *see also* Juliane Kokott & Rainer Scholch, *International Decision: Dorsch Consult Ingenieurgesellschaft MbH v. Council and Commission. Case T-184/95. Court of First Instance of the European Communities, April 28, 1998,* 93 A.J.I.L. 685, 688 n.5 (1999) (discussing the use of Article 133 of the EC Treaty and its use in trade embargos); Dmitri Sandakov, *The Russian Perspective on the State of European Integration*, 9 MSU-DCL J. INT'L L. 211, 216–17 (2000) (discussing how the Community used its power under Article 133 to impose anti-dumping measures against Russia).

29. *See* Youri Devuyst, *The European Union's Constitutional Order? Between Community Method and Ad Hoc Compromise*, 18 BERKELEY J. INT'L L. 1, 13 (2000) (discussing how the European Court of Justice was able to develop an implied powers doctrine forming parallelism between internal and external competences); Martin Hession and Richard Macrory, *The Legal Framework of European Community Participation in International Environmental Agreements*, 2 NEW EUR. L. REV. 59, 66 (1994) (stating that an influential canon of construction that is referred to as *effet utile* is where implied external power is derived). *See generally,* Case 22/70, *infra* note 39; Joined Cases 3, 4 – 6/76, Cornelius Kramer et al*.,* (1976) E.C.R. 1279.

that external power "flows by implication from the provisions of the Treaty. . .insofar as the participation of the Community in the international agreement is. . .necessary for the attainment of one of the objectives of the Community."[30] Although recognizing that Community competence over transport was non-exclusive, the Court granted exclusive competence to the Community to sign an international agreement regulating river traffic in the Rhine and Moselle basins, premised upon the fact that internal legislation could not be complete without the inclusion of a third country, i.e. Switzerland.[31] Combined, the doctrines of express and implied competence endorse a notion of pragmatic parallelism—external competence arises not only where a Treaty provision expressly notes its existence, but also where an internal provision is "inextricably linked" to unified international action.[32] This notion gives the Court the means to affect the objectives of the Treaty, while ensuring the coherent development of Community policies when the Treaty fails to account for unique factual scenarios.

The second principle of Community competence further expands this constitutional development of the Treaty, and holds that Community competence founded upon Treaty provisions is exclusive and irreversible.[33] Once the Community occupies a certain subject area by express conferment in the founding treaties, the Member States are thereafter unable to enter

30. Opinion 1/76, *supra* note 17 at ¶ 4. *See* Inger Osterdahl, *Bananas and Treaty-Making Powers: Current Issues in the External Trade Law of the European Union*, 6 MINN. J. GLOBAL TRADE 473, 517 (1997) (illustrating a situation where the Community may imply an external power when it is necessary for obtaining a Community objective); J.H.H. Weiler, *The Transformation of Europe*, 100 YALE L.J. 2403, 2416 (1991) (stating that in the 1970's, a landmark decision of the European Court's decision gave the Community the ability to imply powers where they are necessary to attain its objectives).

31. More recent case law has heightened this criteria, precluding both express and implied competence from broadening the substantive scope of the EC Treaty, and conditioning implication only where Community action on the international level is "inextricably linked" to its exercise of attributed internal powers. *See* Opinion 1/94, *supra* note 27 at ¶ 86. *See* Dr. Christoph Henkel, LL.M., *Constitutionalism of the European Union: Judicial Legislation and Political Decision-Making by the European Court of Justice*, 19 WIS. INT'L L.J. 153, 172 (2001) (discussing the equivalent of the American "necessary and Proper clause" in the European Community Treaty and how powers may be implied to achieve necessary objectives). *See generally* Jacques H.J. Bourgeois, *External Relations Powers of the European Community*, 22 FORDHAM INT'L L.J. 149, 161 (1999) (discussing the powers conferred upon the European Community under Opinion 1/94).

32. Opinion 1/94, *supra* note 27 at ¶ 86. *See* Julio A. Baquero Cruz, *Disintegration of the Law of Integration in the External Economic Relations of the European Union*, 3 COLUM. J. EUR. L. 257, 265–66 (1997) (stating that previously while Community competence stemmed solely from means determined necessary to achieve goals of treaties, after Opinion 1/76 it became necessary that the power desired to be exercised be "inextricably linked" to the objective). *See generally* Professor Dr. Torsten Stein, *The Allocation of Competences: Foreign Relations Between the European Union and the Federal Republic of Germany*, 53 SMU L. REV. 505, 509 (2000) (discussing the Inland Waterways Opinion and the decision of the Court that the Community has certain necessary powers by implication).

33. *See* Edward T. Swaine, *Subsidiary and Self-Interest: Federalism at the European Court of Justice*, 41 HARV. INT'L L.J. 1, 71–73 (2000) (outlining three ways of interpreting what it means for the Community to have "exclusive competency" over certain areas under the Treaty); *See generally* Sari K. M. Laitinen-Rawana, *Creating a Unified Europe: Maastricht and Beyond*, 28 INT'L LAW. 973, 985 (1994) (discussing the enumerated powers given to the Community under the Treaty); *See generally* Christian Kirchner, *The Principle of Subsidiary in the Treaty on European Union: A Critique from a Perspective of Constitutional Economics*, 6 TUL. J. INT'L & COMP. L. 291, 297 (1998) (discussing the doctrine of parallelism and the importance of the supremacy of Community law with regard to the competence of the Community as per enumerated powers in the Treaty).

that area without amendment to the Treaty or specific authorization by the Community.[34] This position remains central to the interpretation of Community competence over matters of commercial policy and the internal market in goods.[35] Its theoretical basis in the Treaty has also been extended pragmatically in the case of "inextricably linked" internal and external objectives. In such cases, the practical necessity of including external action alongside certain internal objectives implies an explicit Treaty provision granting exclusive external competence.[36] Because the internal objective cannot be achieved without its external counterpart, exclusivity exists *a priori*.

The reasoning behind these two guiding principles of Treaty interpretation flows from the protection of the internal market in goods. In Opinion 1/75, the Court dealt with the grant of export and upheld a broad interpretation of the Community's exclusive competence over common commercial policy due to a need for uniform rules. Practically speaking, unilateral Member State action "would lead to disparities in the condition for the grant of export credits, calculated to distort competition between the undertaking of the various Member States. Such distortion can only be eliminated by strict uniformity."[37]

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34. *See* Sari K. M. Laitinen-Rawana, *Creating a Unified Europe: Maastricht and Beyond*, 28 INT'L LAW. 973, 987 (1994) (discussing that under the doctrine of supremacy there are certain areas where the Member States have conferred exclusive competency to act to the Community); *See generally* Theodor Schilling, *The Autonomy of the Community Legal Order: An Analysis of Possible Foundations*, 37 HARV. INT'L L.J. 389, 404 (1996) (discussing the Community's autonomy with regard to treaty-making power).

35. *See* Case 804/79, Commission v. United Kingdom, (1981) E.C.R. 1045 (the Court has endorsed this view by characterizing such exclusivity as an *a priori* concept, indefeasible regardless of whether the Community has exercised its internal competence and legislated in the field); Professor Dr. Rainer Arnold, *The Treaty on European Union and German Constitutional Law: The German Constitutional Court's Decision of October 12, 1993, on the Treaty of Maastricht*, 9 TUL. EUR. & CIV. L. F. 91, 132 (1994) (stating that European Court decisions have decided that in external commercial policy-making areas, competence is exclusive to the Community). *See generally* Judith Hippler Bello, *International Decisions*, 89 AM. J. INT'L L. 772, 772–82 (1995) (discussing Opinion 1/94 and the exclusive power of the Community in international agreements such as the WTO and GATTS).

36. *See* A. David Demiray, *Intellectual Property and the External Power of the European Community: The New Extension*, 16 MICH. J. INT'L L. 187, 188–89 (1994) ("Implicit external powers stem from internal Community provisions that necessarily require an external power in order to realize the internal goals. Exclusivity of such external powers depends upon the extent such powers are exclusive internally or, in other words, upon the intensity of the internal arrangement"). *See generally* James J. Callaghan, *Analysis of the European Court of Justice's Decision on Competence in the World Trade Organization: Who Will Call the Shots in the Areas of Services and Intellectual Property in the European Union?*, 18 LOY. L.A. INT'L & COMP. L. REV. 497, 512–16 (1996) (discussing the EJC in International Agreement on Natural Rubber and Article 113 of the Treaty and the competence of the Community in global trade areas); Julio A. Baquero Cruz, *Disintegration of the Law of Integration in the External Economic Relations of the European Union*, 3 COLUM. J. EUR. L. 257, 266–67 (1997) (discussing external competence of the Community through implication and necessity).

37. Opinion 1/75, *supra* note 26 at ¶ 26. *See* Allison S. Russell, *Subsidiarity in European Union Law: Member State Morphine for the Painful Loss of Sovereignty*, 11 INT'L L. PRACTICUM 67, 69 (1998) (stating that a most important goal under Article 100a is to confer upon the Community the power to harmonize the internal market with an eye towards cutting down on inefficiencies in transnational interactions). *See generally* James J. Callaghan, *Analysis of the European Court of Justice's Decision on Competence in the World Trade Organization: Who Will Call the Shots in the Areas of Services and Intellectual Property in the European Union?*, 18 LOY. L.A. INT'L & COMP. L. REV. 497, 502–03 (1996) (discussing the argument prior to the Uruguay Round that the Community should have exclusive competence over any WTO agreements so as to lessen any possible weaknesses in the Community's negotiating positions that could result from an inability on the part of the Member States to come to an agreement on how to proceed).

The Court recognized that allowing the Member States to pursue unilateral measures regarding the international trade in goods could distort the conditions of trade within the internal market, undoing the work of the Community attributed to it in the Treaty. This conclusion is not only based upon these practical considerations, but also finds considerable support in the Treaty. The Court recognized that to accept concurrent external competence over matters expressly reserved for the Community on the internal plane would amount to recognizing that, "in relations with third countries, Member States may adopt positions which differ from those [of] the Community. . . ."[38] Such a position would infringe on the duty of cooperation enshrined in Article 10, which obliges Member States to "abstain from any measure which could jeopardize the attainment" of Community objectives. However, what remains most important is that these considerations remain valid. If an exercise of external power falls within the realm of commercial policy regulated by the Treaty, or if it is "inextricably linked" to the realization of an internal Treaty objective, that power is independently and exclusively reserved to the Community.

### B. Exercise of Internal Competence and "Complete Harmonization": Conflicts Rationale of External Competence

The principles mentioned above are solely Treaty-based rules of interpretation; only upon finding the scope of Community powers expressly within the Treaty may the nature of those powers be measured. The only caveat to that rule is the narrow and fact-specific application of implied powers set out by Opinion 1/76. Moreover, the limitations of those principles remain applicable only to situations where Community competence has not been exercised. However, once the Community passes internal measures under an objective listed in the Treaty, it is no longer limited by express Treaty provisions, nor is it constrained by the narrow interpretation of Opinion 1/76. The doctrine of implied competence becomes an empowering rule, granting external competence over fields covered by that Community measure.

This well-established Community doctrine was first introduced in Case 22/70, *Commission v. Council (ERTA)*,[39] which involved the competence of the Community to enter into an international agreement on road transport. The Court stated that "each time the Community, with a view to implementing a common policy envisaged by the Treaty, adopts provisions laying down common rules. . .the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries."[40] The Court noted the Community's objectives relating to transport, enshrined in Article 3(f) of the Treaty, and the subse-

38. Opinion 1/75, *supra* note 26 at ¶ 28. *See* Dr. Rudolf Geiger, *External Competences of the European Union and the Treaty-Making Power of its Member States*, 14 ARIZ. J. INT'L & COMP. L. 319, 323 (1997) (stating that where the treaty powers of the Community and the Member States are concurrent or parallel, the states may still act autonomously as opposed to parallelism in domestic issues where Community competence is exclusive). *See generally* James J. Callaghan, *Analysis of the European Court of Justice's Decision on Competence in the World Trade Organization: Who Will Call the Shots in the Areas of Services and Intellectual Property in the European Union?*, 18 LOY. L.A. INT'L & COMP. L. REV. 497, 502–03 (1996) (stating that although the Treaty granted the Community exclusive competence over ECSC products, the Member States still retain competence with respect to certain commercial policy matters).

39. Case 22/70, Commission of the European Communities v. Council of the European Communities, (1971) E.C.R. 263, 272.

40. Case 22/70, *supra* note 39, at ¶ 17. *See also* Case 22/70, Commission of the European Communities v. Council of the European Communities, (1971) E.C.R. 263, 273.

quent duty of the Member States to "abstain from any measure which might jeopardize the attainment of the objectives of the Treaty."[41] Thus, "when [internal] rules come into being, the Community alone is in a position to assume and carry out contractual obligations towards third countries affecting the whole sphere of application of the Community legal system."[42] After that time, the "Member States cannot, outside the framework of Community institutions, assume obligations which might affect those rules or alter their scope."[43]

Unlike external competence deriving from explicit Treaty provisions or inseparable internal action, competence derived from internal measures does not flow directly from the Community objective, but rather from the realization of that objective on the internal level. Recognizing that internal Community measures may involve differing levels of that realization, the nature of competence derived from internal measures is more limited. Rather than existing as a *per se* concept, entirely defeating Member States of their ability to legislate in the Community realm, the internal measure operates as a "blocking effect," precluding Member States' action only insofar as that action may "affect Community rules" or "alter their scope."[44]

The Court's interpretation of these conditions recognized the need to protect Community objectives without fully encroaching on Member States' sovereignty. In Opinion 2/91, (Convention No. 170 of the ILO), the Court held that all internal measures, not only those passed as common policies, demand respect from Member State activities.[45] Despite this initially broad stance, the Court interpreted the Community rules covering the subject matter of the proposed international agreement narrowly. Because that particular Treaty only permitted those internal rules to include minimum requirements, the Member States could plausibly abide by Community and international rules simultaneously, without the envisaged agreement affecting the internal Community measures or altering their scope. As a result, the Community and Member States concluded the ILO agreement.[46]

More recently, in the dispute over the Community's competence to conclude the WTO agreements on services (GATS) and intellectual property (TRIPs), this criterion was more precisely defined.[47] In that case, the Court refused to recognize the Community's exclusive treaty-

41. EC Treaty art. 10. *See* Treaty Establishing the European Economic Community (Treaty of Rome), 1994, art. 5, 2 B.D.I.E.L. 45 (outlining the restrictive duty of Member States to avoid imperil of the treaty).

42. *See* Case 22/70, Commission of the European Communities v. Council of the European Communities, (1971) E.C.R. 263 at ¶ 18.

43. Case 22/70, *supra* note 39 at ¶ 18–22. *See also* Case 22/70, Commission of the European Communities v. Council of the European Communities, (1971) E.C.R. 263, 273–74.

44. *See* Opinion 1/94, *supra* note 27 at ¶ 88 (noting that "it is undeniable that, where harmonizing powers have been exercised, the harmonization measures thus adopted may limit, or even remove, the freedom of Member States to negotiate with non-Member countries"); *see also* Tridimas, *supra* note 22 at 165; Opinion 1/94, Competence of the Community to Conclude International Agreements Concerning Services and the Protection of Intellectual Property—Article 228(6) of the EC Treaty, (1994) E.C.R. I-5267.

45. Opinion 2/91, *supra* note 18 at ¶ 10.

46. Opinion 2/91, *supra* note 18 at ¶ 16–18. *See* Opinion 2/91, Opinion Delivered Pursuant to the Second Subparagraph of Article 228 (1) of the EEC Treaty. Convention No. 170 of the International Labor Organization Concerning Safety in the Use of Chemicals at Work, (1993) E.C.R. I-1061.

47. Opinion 1/94, *supra* note 27. *See* Opinion 2/91, Opinion Delivered Pursuant to the Second Subparagraph of Article 228 (1) of the EEC Treaty. Convention No. 170 of the International Labor Organization Concerning Safety in the Use of Chemicals at Work, (1993) E.C.R. I-1061.

making powers over a wide range of service and intellectual property matters because the scheme of internal Community legislation in those areas had not exhaustively harmonized the field. It concluded that only when internal legislation has provided for rules in the sense of "complete harmonization," does the exclusive external competence of the Community need to be realized in order to obviate conflicting Member States' action.[48]

Whereas the principles of competence founded on Treaty provisions form a doctrine on competence *per se*, the notion of implied powers founded on internal measures is a doctrine on conflict.[49] Although the practical effect of exclusive competence under both the Treaty and secondary Community measures is effectively the same—excluding Member States from legislating in the occupied field—the theoretical underpinnings must be distinguished to arrive at that conclusion. Rules on competence have no regard for the scope and nature of Community measures in the field, but rather accept Treaty provisions as fully representative of the Community's exclusive power.[50] However, rules on conflict first depend upon the existence of a Community rule; second, upon an envisaged Member State action; and decisively on a real conflict between the two, a potential interference with Community law operation, or a future impediment to Community decision making.[51] Accepting the Court's consistent case law on the supremacy of Community measures over those national,[52] and the inability of the latter to affect the operation of the former,[53] the rule in *ERTA* becomes operative to exclude national competence

48. Opinion 1/94, *supra* note 27 at ¶ 96. *See* Opinion 1/94, Competence of the Community to Conclude International Agreements Concerning Services and the Protection of Intellectual Property—Article 228(6) of the EC Treaty, (1994) E.C.R. I-5267.

49. *See* John Temple Lang, *The ERTA Judgement and the Court's Case-Law on Competence and Conflict*, 6 Y.B. EUR. L 183, 190 (1987); Opinion 1/94, *Competence of the Community to Conclude International Agreements Concerning Services and the Protection of Intellectual Property—Article 228(6) of the EC Treaty*, (1994) E.C.R. I-5267. *See generally* Inger Osterdah, *Bananas and Treaty-Making Powers: Current Issues in the External Trade Law of the European Union*, 6 MINN. J. GLOBAL TRADE 473, 490 n.50 (1997) (noting that the Community does have implied powers to conclude agreements where it has internal legislative powers).

50. *See* Cliona J. M. Kimber, *Environmental Federalism: A Comparison of Environmental Federalism in the United States and the European Union*, 54 MD. L. REV. 1658, 1672 (1995) (noting that a Member State is unclear about it's competency with respect to community measures); *see also* Eva Brems, *Case Law: Grant: Case C-249/96. Lisa Jacqueline Grant v. South-West Trains Ltd.* (Eur. Ct. J. February 17, 1998), 5 COLUM. J. EUR. L. 141, 149 (1999) (noting the interplay between competence and community measures); J.H.H. Weiler & Ulrich R. Haltern, *The Autonomy of the Community Legal Order—Through the Looking Glass*, 37 HARV. INT'L L.J. 411, 413 (1996) (discussing the European Court of Justice's role in determining soundness of community measures).

51. *See* John Temple Lang, *The ERTA Judgement and the Court's Case-Law on Competence and Conflict*, 6 Y.B. EUR. L 183, 193 (1987); David O'Keeffe, *Judicial Protection of the Individual by the European Court of Justice*, 19 FORDHAM INT'L L.J. 901, 911 (1996) (noting that there is a rejection of a national rule if it would conflict with a Community rule); *see also* Francois Rigaux, *Conflict of Laws, Comparative Law and Civil Law: Codification of Private International Law: Pros and Cons*, 60 LA. L. REV. 1321, 1330 (2000) (stating that the Member States must comply with their own rules and as such these rules will exert influence on the development of conflict of rules).

52. *See* Case 6/64, *supra* note 3 (stating that community law is superior to unilateral measures taken by Member States); Case 106/77, *supra* note 22 (concluding that Community law is supreme over state law because the Member States put limitations on their own sovereignty by consenting to participate in the EC); *see also* Martin Hession and Richard Macrory, *Legal Framework of European Community Participation in International Environmental Agreements*, 2 NEW EUR. L. REV. 59, 72–73 (1994) (stating that the ECJ has consistently ruled in favor of Community supremacy).

53. *See, e.g.*, Joined Cases 95 and 96/79 *Kefer and Delmelle,* 1980 E.C.R. 103, 113; Cases 223/78 *Grosoli*, 1979 E.C.R. 2621, 2631–32 (stating that even though Member States are able to regulate prices the regulation must not interfere with the goals of the community as a whole); Case 177/78 Pigs and Bacon Commission v. McCarren, (1979) E.C.R. 2161, 2188 (holding that Member State provisions cannot trump Community law).

which may "affect [Community] rules or alter their scope." If that measure completely harmonizes a particular subject matter, determining the nature of Community competence does not demand a searching analysis of the effect of Member State action on the relevant Community rules; such an effect is *a priori* understood. If, however, that subject matter does not completely harmonize the relevant field, such an analysis is necessary to determine the scope of unilateral Member State action prohibited as a matter of conflict with Community law.[54]

As the scope of Community measures continues to widen, the area which is infiltrated by Community competence also continues to follow a course that is parallel to those measures.[55] Nevertheless, with the principles of subsidiarity and proportionality emerging from recent Treaty amendments as an effective check on deepening Community power,[56] the potentiality of "complete harmonization" of the trade in goods becomes increasingly unlikely. Due to these trends, some have remarked that the Court's case law on competence has reached a golden balance: "in effect, it is as difficult to establish that the Community has no competence on a given area as it is to establish that the Community's competence is truly exclusive."[57] Most important, the Court has arrived at that balance, i.e., through the intersecting need to effectively meet its Treaty objectives and exert a coherent external policy, yet ensure the mutual coexistence of functionally independent legal regimes. The determination of Community external competence over these new areas must take due regard of the theoretical underpinnings that have validated this competence.

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54. This two prong test may be derived from the Court's case law in Opinion 1/94, *supra* note 27, and Opinion 2/91, *supra* note 18. The latter case sets forth the principle that areas of "complete harmonization" preclude Member States' action, while the latter case addressed a situation where such harmonization did not prevail, and exclusivity could only be founded on the potential substantive overlap of the international and Community instruments. *See* Mark Miller, *TRIPS Agreement and Direct Effect in European Community Law: You Can Look But Can You Touch?*, 74 NOTRE DAME L. REV. 597, 607 (1999) (discussing how unharmonized fields occur where the Member States have parallel but not exclusive competence); *see also* Cliona J. M. Kimber, *Comparison of Environmental Federalism in the United States and the European Union*, 54 MD. L. REV. 1658, 1671 (1995) (explaining how the scope of Member State measures will determine if national legislation harmonizes with Community law).

55. *See* John Temple Lang, *The ERTA Judgement and the Court's Case-Law on Competence and Conflict*, 6 Y.B. EUR. L 183, 190 (1987) (discussing how the Community has broadened its exclusive jurisdiction into more fields thus limiting the ability of Member States to have true concurrent competency); Rudolf Geiger, *External Competences of the European Union and the Treaty-Making Power of its Member States*, 14 ARIZ. J. INT'L & COMP. L. 319, 324 (1997) (arguing that the Community has gained exclusive competence in areas that were traditionally granted to Member States); Christian Kirchner, *Principle of Subsidiarity in the Treaty on European Union: A Critique from a Perspective of Constitutional Economics*, 6 TUL. J. INT'L & COMP. L. 291, 296–98 (1998) (explaining how even in areas of mixed competency Member States are being deprived of the competency vested in them).

56. Treaty Establishing the European Economic Community, Nov. 11, 1997, art. 5, O.J. (C 340). This treaty requires the Community to take action "only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States," and obliges that such action "shall not go beyond what is necessary to achieve the objectives of this Treaty." *See* PAUL CRAIG & GRAINNE DEBURCA, EU LAW: TEXT, CASES AND MATERIALS 124 (2d ed. 1998); Koen Lenaerts, *Principle of Subsidiarity and the Environment in the European Union: Keeping the Balance of Federalism*, 17 FORDHAM INT'L L.J. 846, 848–49 (1994) (discussing how subsidiary and proportionality principles place limitations on the Community's ability to obtain exclusive competency where no treaty provision specifically provides for it).

57. Tridimas, *supra* note 22 at 172. *See* Isabelle Martin, *Limitations to the Implementation of a Uniform Environmental Policy in the European Union*, 9 CONN. J. INT'L L. 675, 684–85 (1994) (arguing that once the Community occupies a field, the ECJ has basically given it exclusive competency over all areas relating to that field); Piet Van Nuffel, Case Law, *WTO-Agreement*, 1 COLUM. J. EUR. L. 338, 344 (1995) (discussing how the ECJ's judicial opinions allow areas of concurrent jurisdiction to fall within the exclusive competency of the Community).

## III. External Competence and the "European Judicial Area": Taking Article 65 Abroad

The "area of freedom, security and justice"[58] first introduced by the tripartite yet intergovernmental structure of the Maastricht Treaty, and recently "communitarized" by Title IV of the Treaty of Amsterdam, is the most recent attempt to incorporate European conflict rules into the internal market. This envisioned "European judicial area" successively promotes the development of European private law away from its intergovernmental constraints,[59] and supports the further evolution of a completed internal market. First, it shifts responsibility for conflict legislation from the third pillar to the first pillar, i.e., the European Community, through Articles 61 and 65. This development allows for regulations to take the place of intergovernmental conventions; placing harmonizing conflict rules on an equal footing with the pre-existing and self-defined substantive regulations.[60] Second, it augments Article 95 by allowing for private law harmonization in matters pertaining to the free movement of persons; an area previously excluded by Article 95(2),[61] yet essential for the completion of the internal market under Article 14. Because Article 95 is effectively a residual provision, operating "save where otherwise provided in this Treaty," Articles 61 and 65 become the sole legislative basis with regard to harmonizing measures adopted for the free movement of persons.[62]

The precise goals of an "area of freedom, security and justice" include the improvement and simplification of cross-border service of judicial documents, the recognition and enforce-

58. EC Treaty Article 61. *See* Philippe Manin, *Treaty of Amsterdam*, 4 COLUM. J. EUR. L. 1, 4 (1998) (explaining that the Treaty of Amsterdam promotes an "area of freedom, security and justice"); Jean-Claude Piris and Giorgio Maganza, *Amsterdam Treaty: Overview and Institutional Aspects*, 22 FORDHAM INT'L L.J. 32, 37 (1999) (stating that the goals of "freedom, security and justice" fall within the Third Pillar of the TEU).

59. EC Treaty Article 293. Article 293 calls for intergovernmental conventions on private international law, and has been utilized, *inter alia*, as the Treaty basis for the 1968 Brussels Convention on Jurisdiction and the Recognition and Enforcement of Judgments, and the 1998 Rome Convention on the Law applicable to Contractual Obligations. *Id*. *See* Werner F. Ebke, *Centros—Some Realities and Some Mysteries,* 48 AM. J. COMP. L. 623, 638 (2000) (discussing how Member States of the EC Treaty should keep the well-being of their nationals in mind when negotiating with each other); *see also* Eava Kolehmainen, *The Directive Concerning the Posting of Workers: Synchronization of the Functions of National Legal Systems,* 20 COMP. LAB. L. & POL'Y J. 71, 90 (1998) (stating that Article 293 requires the Member States to advance the common Market by a system of "free movement of judgments").

60. Modern Community legislation increasingly utilizes the procedures set forth in Article 95 to issue regulations. *See* Case 106/77, Amministrazione delle Finanze Dello Stato v. Simmental SpA (II*),* (1978) E.C.R. 629. With such regulations directly applicable, independent and supreme over national conflict rules, their scope of application needs to be self-defined, resulting in intended substantive law harmonization complemented by provisions on the conflict of laws; *see, e.g.*, Council Regulation (EEC) No. 295/91, Establishing Common Rules For A Denied-Boarding Compensation System In Scheduled Air Transport, Feb. 4 1991, O.J. 1991, L 36/5.

61. EC Treaty Article 95(2) provides "[Article 95(1)] shall not apply to fiscal provisions, to those relating to the free movement of persons nor those relating to the rights and interests of employed persons." *Id.*

62. Jurgen Basedow, *The Communitarization of the Conflict of Laws Under the Treaty of Amsterdam,* 37 COMMON MKT. L. REV. 687, 697 (2000). *See* EC Treaty, art. 61, 37 I.L.M. 56, 89–90 (addressing what the Council shall adopt to create an area of freedom, security and justice); *see also* EC Treaty, art. 65, 37 I.L.M.56, 91 (addressing the cross-border consequences of judicial collaboration).

ment of judicial decisions and the harmonization of national laws applicable to jurisdiction.[63] The broad inclusion of these matters establishes a more comprehensive "European judicial area,"[64] and inherently regards the inability to effectively assert legal rights across borders as an obstacle to the free movement of persons and the completion of the internal market.[65] The resulting structure of European conflict rules is clearer than its predecessors: regulations replace intergovernmental conventions and situate intra-Community conflict rules on the Community level, vesting the resolution of substantive, national divergences with clear, supranational rules. The justification of this scheme is based on an effective syllogism: Article 61 deeming "freedom, security and justice" essential for the free movement of persons, and Article 14(2) considering free movement essential to the completion of the internal market, conflict rules and measures of judicial cooperation adopted at the Community level, become an operative part of the *aquis communitaire*.

The Community institutions have thus far embraced the opportunity to advance the internal market into the legal arena. As of June 2000, the objectives contained in Article 65 have yielded Community regulations improving and simplifying the cross-border service of judicial documents,[66] and harmonizing the jurisdiction and the recognition and enforcement of judgments.[67]

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63. *See* Marc. L. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity,* 20 MICH. J. INT'L L. 207, 262–63 (1999) (focusing on harmonization and reciprocity between the Member States as being a minimum standard from which Member States may add their own jurisdictional standards); *see also* Rolf Sturner, *Some European Remarks on a New Joint Project of the American Law Institute and UNIDROIT,* 34 INT'L LAW. 1071, 1075–76 (1999) (discussing the benefits of a common civil procedure among states to advance the harmonization of litigation throughout the world, and facilitation of cross-border litigation); Claudia Tobler, Note, *Managing Failure in the New Global Economy: The U.N.C.I.T.R.A.L. Model Law on Cross-Border Insolvency,* 22 B.C. INT'L & COMP. L. REV. 383, 417 (1999) (discussing the UNCITRAL model for cross-border harmonization of insolvency issues and inter-state cooperation on such judicial proceedings).

64. *See* G. Vermeulen & T. Vander Beken, *New Conventions on Extradition in the European Union: Analysis and Evaluation,* 15 DICK. J. INT'L 265, 270 (1997) (discussing the historical background and purpose of a European judicial area); *cf.* Jorg Monar, *Justice and Home Affairs in the Treaty of Amsterdam: Reform at the Price of Fragmentation*, 23 EUR .L. REV. 320, 324 (1998). *See generally* Tamara L. Joseph, *Preaching Heresy: Permitting Member States to Enforce Stricter Environmental Laws Than the European Community*, 20 YALE J. INT'L L. 227, n.13 (1995) (discussing the importance of harmonization in establishing a European judicial area).

65. *See* Wendy Kennett, *Current Developments: Private International Law*, 48 INT'L & COMP. L.Q. 465, 466 (1999); Dr. Barry A. Feinstein & Dr. Mohammed S. Dajani-Daoudi, *Permeable Fences Make Good Neighbors: Improving a Seemingly Intractable Border Conflict Between Israelis and Palestinians*, 16 AM. U. INT'L L. REV. 1, 6–7 (2000) (noting that a goal in setting up a single European Market is to remove any obstacles that may exist with regards to cross-border judicial proceedings and enforcement); *see also* Francis R. Monaco, Comment*, Europol: The Culmination of the European Union's International Police Cooperation Efforts*, 19 FORDHAM INT'L L.J. 247, 248 (1995) (noting the importance of a single financial market in abolishing any restrictions to the free movement of persons across borders for financial and legal transactions).

66. Council Regulation on the Service in the Member States of Judicial and Extrajudicial Documents in Civil or Commercial Matters, COM (2000) 75.

67. Council Regulation (EC) on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, COM (1999) 348.

The Court has propounded coexisting theories of exclusive external competence as well; one a Treaty-based policy to protect its vision of the internal market, the other a conflict-based rule to strengthen the development of further European integration.[68] Both principles are founded upon the unfettered operation of Community powers in the envisaged Community regime, and the necessary complement unified external action gives to the realization of internal objectives. Most of the case law on competence deals with the internal market as a customs union, focusing on external matters solely related to trade in goods, transport and most recently, services.[69] Competence implied from Articles 61 and 65, while implicating the free movement of persons within the internal market, necessitates a transfer of the Court's rationale to a new "European judicial area" rather than the traditional common market. The coherent expansion of Community competence into new areas such as conflict of law and judicial cooperation may require a novel view of external competence, and a new adaptation of the Court's previous case law.

Jurgen Basedow asked whether the Community is now entitled to adopt, for instance, provisions on the recognition and enforcement of judgments taken outside the Community in the form of an international agreement.[70] The approach to this question involves the Treaty analysis taken in the preceding section; by the express wording of Article 65, its scope is restricted to the "proper functioning of the internal market," and is silent on any power to conclude agreements with third countries. Although this fact may preclude exclusive external competence founded upon express provisions in the Treaty, it does imply reference to the caveat illustrated by Opinion 1/76: external competence may be found under Article 65 if the conclu-

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68. *See* Udo Di Fabio, *A European Charter: Towards a Constitution for the Union,* 7 COLUM. J. EUR. L. 159, 160 (2001) (showing that through the Single European Act and the Maastricht Treaty, there has indeed not only been a preservation of the internal market, but a growth of it as well); *see also* Paola Michelle Koo, Note, *The Struggle for Democratic Legitimacy within the European Union,* 19 B.U. INT'L L.J. 111, 116 (2001) (discussing the ways in which European integration has worked not only to the benefit of, but also to the detriment of, certain goals because of the ways in which such integration conflicts with other decision-making policies). *See generally* Patricia Lynch, Susan J. Marsnik & Barbara Crutchfield George, *U.S. Multinational Employers: Navigating Through the "Safe Harbor" Principles to Comply with the EU Data Privacy Directive,* 7 AM. BUS. L.J. 735, 750 (2001) (discussing generally what the goals of the European Union are regarding an internal market and how one could be implemented and protected).

69. Opinion of the Council (EC) Legal Service, Doc. 6683/99, J.U.R. 99, ¶ 15 (1999).

70. Basedow, *supra* note 62 at 704. *See generally* Judith Hippler Bello, *International Decisions*, 89 AM. J. INT'L L. 772, 781 (1995) (noting that the Community could not solve the problems by internal legislation because there was an international agreement involved in the policy); Reiner Schulze, *A Century of the Burgerliches Gesetzbuch: German Legal Uniformity and European Private Law,* 5 Colum. J. Eur. L. 461, 463 (1999) (discussing how many European countries have adopted international agreements as a form of uniform law).

sion of an international agreement is "inextricably linked" to the objective of the internal market in such a way that the adoption of autonomous rules could not suffice. [71]

As previously discussed, the proper functioning of the internal market is dependant upon, *inter alia*, the creation of an "area of freedom, security and justice" to ensure the free movement of people.[72] In establishing this European judicial area, the Community necessarily engages in a common demarcation of competence implying a relationship between the Community as a whole vis-à-vis third states.[73] Within this demarcation, the Treaty permits the Community to engage in the unilateral adoption of conflict rules to improve and simplify intra-Community conflicts, as well as protect the substantive law of the Community in the face of the laws of non-Member States.[74] This application of the same internal law to one and the same transaction by courts of different Member States is intended to increase legal security and uniformity, and promote the legitimate expectations of the parties involved.[75]

Exclusive Community competence in relation to goods is justified by the fact that when intra-Community rules are passed that permit goods to pass freely within the Community's borders, individual Member State policies toward third states significantly disrupt the opera-

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71. *See* Julio A. Baquero Cruz, *Disintegration of the Law of Integration in the External Economic Relations of the European Community*, 3 COLUM. J. EUR. L. 257, 266 (1997) (stating that the agreement has to be "inextricably linked" to the objective); Judith Hippler Bello, *International Decisions,* 89 AM. J. INT'L L. 772, 781 (1995) (noting that external powers can be exercised, but not in the sphere of services because the freedom to provide services for nationals of the Member States is not inextricably linked to the treatment in the Community of non-Member countries); Inger Osterdahl, *Bananas and Treaty-Making Powers: Current Issues in the External Trade Law of the European Union*, 6 MINN. J. GLOBAL TRADE 473, 525 (1997) (noting that the Court used the "inextricably linked" formula in deciding whether the Community has external competence).

72. EC Treaty, art. 61(c).

73. *See* Basedow, *supra* note 62 at 703. *See generally* James E. Hickey, Jr., *The Source of International Legal Personality in the 21st Century*, 2 HOFSTRA L. & POL'Y SYMP. 1, 9 n.21 (1997) (noting that the European Community has the power to bind the Community to international commitments with third states); Eberhard Schollmeyer, *The New European Convention on International Insolvency*, 13 BANKR. DEV. J. 421, 427 (1997) (discussing the recognition of third state proceedings in the European Community Treaty).

74. *See* Eeva Kolehmainen, *The Directive Concerning the Posting of Workers: Synchronization of the Functions of National Legal Systems*, 20 COMP. LAB. L. & POL'Y J. 71, 93–94 (1998) (noting that harmonized conflict rules help govern the operation of divergent substantive laws). *See generally* Ronald A. Brand, *Direct Effect of International Economic Law in the United States and the European Union*, 17 J. INT'L L. BUS. 556, 602 n.239 (1996) (noting that the Treaty authorized the unilateral adoption of safeguard measures); Justin P. Fletcher, *An Argument for Ratification: Some Basic Principles of the 1994 Inter-American Convention on the Law Applicable to International Contracts*, 3 GA. J. INT'L & COMP. L. 477, 494 (1999) (noting that the European Union harmonized the Member States' conflict-of-law rules).

75. *See* Eeva Kolehmainen, *The Directive Concerning the Posting of Workers: Synchronization of the Functions of National Legal Systems*, 20 COMP. LAB. L. & POL'Y J. 71, 94 (1998) (stating that harmonized conflict rules represent a synchronization of different legal systems within the Community). *See generally* Justin P. Fletcher, *An Argument for Ratification: Some Basic Principles of the 1994 Inter-American Convention on the Law Applicable to International Contracts*, 3 GA. J. INT'L & COMP. L. 477, 494 (1999) (noting that the outcome of the harmonization by Member States of their conflict-of-law rules was unification); Daniel W. Simcox, Note, *The Future of Europe Lies in Waste: The Importance of the Proposed Directive on Civil Liability for Damage Caused by Waste to the European Community and its Environmental Policy*, 28 VAND. J. TRANSNAT'L L. 543, 553 (1995) (discussing the different branches of the EC and how the law is enforceable in the national courts).

tion of that scheme.[76] Such divergent policies would give third states the ability to gain access to Member States' markets indirectly, taking advantage of the lack of internal cross-border controls, and giving rise to Member States' interest in maintaining such controls.[77] For this reason, the Court has continually upheld the exclusive external competence of the Community with respect to international agreements on trade in goods.[78]

This reasoning is readily transferable to a European judicial area—itself a component of the internal market to establish the free movement of persons. When a dispute arises that involves a third state and at least two Member States, intra-Community rules need not apply; resulting in the possibility that the courts of the different Member States may apply their own internal law and reach contradictory conclusions.[79] This example is equally valid when applied to relations between a third state and a single Member State, as alternative Community forums may arise with a subsequent change of residence.[80] In either case, the legitimate expectations

76. *See* Reimer von Borries & Malte Hauschild, *Implementing the Subsidiary Principle*, 5 COLUM. J. EUR. L. 369, 376 (1999) (discussing the relationship between the free movement principle and Exclusive Community competence). *See generally* David O'Keeffe, *Blaine Sloan Lecture: Current Issues in European Integration*, 7 PACE INT'L L. REV. 1, 3 (1995) (discussing how the Community provides for the free movement of goods); Kurt Riechenberg, *The Merger of Trading Blocks and the Creation of the European Economic Area: Legal and Judicial Issues*, 4 TUL. J. INT'L & COMP. L. 63, 78 (1995) (discussing the EC and the free movement of goods).

77. *See, e.g.*, Case 41/76, Donckerwolcke (1976) E.C.R. 1936. In *Donckerwolcke*, Belgian merchants importing Lebanese fabric into Belgium, and subsequently introducing that fabric into France as goods of Community origin, could bypass French customs duties. The Court in this situation held that

> the assimilation to products originating within the Member States of goods in free circulation may only take full effect if these goods are subject to the same conditions of importation both with regard to customs and commercial considerations, irrespective of the state in which they were put into free circulation.

*Id*.

78. *See, e.g.,* Case 45/86, Commission v. Council (Generalised Tariff Preferences), (1987) E.C.R. 1493; Opinion 1/75 re: OECD Local Cost Standard, (1975) E.C.R. 1355; Opinion 1/78, re: International Agreement on Natural Rubber, [1979] E.C.R. 2871. *See also* Youri Devuyst, *The European Union's Constitutional Order? Between Community Method and Ad Hoc Compromise,* 18 BERKLEY J. INT'L L. 1, 13 (2000) (discussing the development of an implied powers doctrine by the European Court of Justice that expanded the competence of the European Community in the field of external relations); J.H.H. Weiler, *The Transformation of Europe,* 100 YALE L.J. 2403, 2416 (1991) (noting that the European Court delivered a landmark decision implying that internal competence should be read to imply an external treaty-making power and further suggested that this decision went beyond treaty-making power).

79. Case 2/73, Geddo v. Ente nationale Risi, (1973) E.C.R.. 865 (discussing in relation to creating a single market, the Member States have delegated to the community legislation that will preclude all other and internal law is held invalid because it infringes on the power of prohibition against discrimination). *See also* 48/69, Imperial Chemical Industries Ltd. v. Commission, (1972) E.C.R. 619 (finding that because the laws of the Member States only share a common principle, the disparity that exists is not possible to discern without taking into account Community law); Case 52/69, Geigy AG v. Commission, (1972) E.C.R. 787 (remarking how according to international law the Member States cannot free State to punish an act done by a third State outside its territory).

80. *See* Basedow, *supra* note 62 at 703–704; Dr. Rudolf Geiger, *NAFTA and the Expansion of Free Trade: Current Issues and Future Prospects: Commentary: External Competences of the European Union and the Treaty-Making Power of its Member States*, 14 ARIZ. J. INT'L & COMP. L. 319, 323 (1997) (discussing whether it is the European Union or single Member States that initiate dispute settlement); *see also* John David Donaldson, *Television Without Frontiers: The Continuing Tension Between Liberal Free Trade and European Cultural Integrity*, 20 FORDHAM INT'L L.J. 90, 93 (1996) (discussing the effect of the Directive on free trade and television programming and the relationship between the Directive and the dispute between the United States and the Community).

and legal certainty of the Community party gives way to national law and unilateral international agreements, significantly curtailing their free movement within the Community.[81]

Thus, the purpose of Article 65 to promote the intra-Community free movement of persons would appear to suggest an interpretation which inextricably links an external element to the internal objective. That interpretation may justify the exclusive external competence of the Community to conclude international agreements with third countries over matters of private international law. However, the Court has often narrowly construed the conditions of Opinion 1/76, exercising it as an exception to the rule of Treaty-based exclusivity in only one case.[82] In fact, this narrow view has been advocated by the Council (EC) Legal Service in a 1999 Opinion regarding the external competence resulting from the revision of the Brussels Convention. The Legal Service concluded that the Community could have exclusive competence based upon an "inextricable link" with a Treaty objective over international agreements with those Member States not participating in the adoption of measures under Title VI, i.e., Denmark, Ireland and the United Kingdom. That competence, however, could not extend to non-Member States, as the "proper functioning of the *internal* market (emphasis added)" could be attained through intra-Community agreements and autonomous Community rules.[83]

Despite this outcome, external powers over envisaged international agreements need not be based on the "inextricable link" rationale. Rather, if the Community should take the advice of the Council Legal Service and pursue the objectives of Article 65 with autonomous Com-

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81. For example, a German citizen with an American judgment against him, unenforceable in Germany but enforceable in France, cannot freely change his residence within the Community. That judgment becomes equivalent to an adverse judgment in France unenforceable in Germany; either way, the ability of the Community party to move their residence from one Member State to another might be seriously hampered, and the Community goal of free movement frustrated. By this analogy, foreign judgments are indeed analogous to goods, insofar as they may enter the common judicial area under differing circumstances and act to hinder intra-Community free movement. *See* Karen E. Minehan, *The Public Policy Exception to the Enforcement of Foreign Judgments: Necessary or Nemesis?*, 18 LOY. L.A. INT'L & COMP. L.J. 795, 796–99 (1996) (stating that the existence of multiple laws lends to conflicting and unpredictable rules, but discussing the 1968 Brussels Convention that was intended to aid in the mobility of judgments across borders). *See generally* Peter Gottwald *Principles and Current Problems of Uniform Procedural Law in Europe Under the Brussels Convention*, 1997 ST. LOUIS-WARSAW TRANSATLANTIC L.J. 139, 140–42 (1997) (discussing the Brussels Convention and its introduction of provisions that were intended to bring uniformity to issues of international jurisdiction); Sara L. Uberman, *The Brussels II Convention: A Tool Necessary to Enforce Individual Rights Relating to Matrimonial Matters Within the European Union*, 23 SUFFOLK TRANSNNAT'L L. REV. 157, 168–74 (1999) (discussing the right of free movement of persons as one of the most important aspects of citizenship in the European Union and how non-recognition of divorce judgments hinders that right by restricting mobility of citizens).

82. Opinion 1/76, *supra* note 17. For a recent instance of this narrow interpretation, *see* Opinion 1/94, *supra* note 18 at ¶ 85–86. *See also* Judith Hippler Bello, *International Decisions*, 89 A.J.I.L. 772, 783 (1995) (stating how the European Court did not apply the Opinion 1/76 doctrine to intellectual property rights cases); Jacques H. J. Bourgeois, *External Relations Powers of the European Community*, 22 FORDHAM INT'L L.J. 149, 167 (1999) (noting that the European Court also did not apply the Opinion 1/76 doctrine in situations involving services).

83. Opinion of the Council (EC) Legal Service, *supra* note 69 at ¶ 16–19. *See also*, Paul Beaumont, *A United Kingdom Perspective on the Proposed Hague Judgments Convention*, 24 BROOK. J. INT. L. 75, 81 n.13. *See generally* Peter L. Lindseth, *Democratic Legitimacy and the Administrative Character of Supranationalism: The Example of the European Community*, 99 COLUM. L. REV. 628, 652–53 (1999) (mentioning the role of the competences of the European Community in achieving an integrated internal market among Member States).

munity rules, it could find the external element of Article 65 based upon conflict rather than competence. This functional route has recently been undertaken by the Community, as they have passed new regulations on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters,[84] and the Service of Judicial and Extrajudicial Documents.[85] Invoking the rule in *ERTA*, if an envisioned international agreement corresponding to the Community's internal rules on the conflict of law were to "affect those rules or alter their scope," the blocking effect of Community law would defeat the Member States of their ability to legislate on the matter, thereby transferring external competence to the Community level.

A determination of competence under this rationale obviates the need for theoretical harmonization with the previous case law. In fact, in Opinion 2/91, the Court applied these established principles to an area of social policy with significant repercussions on the free movement of persons rather than goods.[86] The reasoning behind this more extensive application rests upon the origin of the conflict rationale of external competence. Its purpose is to ensure a harmonious coexistence of legal regimes and efficient operation of legislative measures, rather than to empower one system to the exclusion of another.[87] In essence, it is based on a practical need rather than a theoretical justification, referencing rules common to federal states rather than rules aimed to establish a supranational economic regime. As a result, a determination of competence from conflict relies primarily upon a statutory interpretation of the relevant Community measure and its empowering Treaty provision, and second, on a comparative analysis of the envisaged international agreement.

Based upon this rationale and judging by the adoption of internal measures, Community external competence exists, to some degree, over the matters covered by Article 65. This conclusion results from the mere existence of Community legislation in matters of service, jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, as representative of the exercise of competence provided for in the Treaty. What remains to be determined is the nature of that competence over future international agreements. The case law of the Court provides a two-prong analysis for this determination.[88] The first question asks

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84. Council Regulation (EC) on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, *supra* note 19.

85. Council Regulation on the Service in the Member States of Judicial and Extrajudicial Documents in Civil or Commercial Matters, *supra* note 66.

86. Opinion 2/91, *supra* note 18.

87. *See* Treaty Of Amsterdam Amending The Treaty On The European Union, The Treaties Establishing The European Communities And Certain Related Acts, Oct. 2, 1997, O.J. (C 340); *see also* Case C-84/94, U.K. v. Commission, (1996) E.C.R. 877 (noting that the intention of Article 2 of the Treaty is to harmonize development and that Community action has never been geared towards leveling down); Peter L. Lindseth, *Democratic Legitimacy and the Administrative Character of Supranationalism: The Example of the European Community,* 99 COLUM. L. REV. 628, 652 (1999) (stating that the European Community is largely tied to the enforcement of rules of competition and the harmonization of the national legislation that is necessary to achieve an integrated internal market among the European Union's 15 members).

88. *See* Werner F. Ebke, *Centros—Some Realities and Some Mysteries*, 48 AM. J. COMP. L. 623, 660 (2000) (noting the focus on judicial cooperation in Article 65); *see also* Gerhard Walter & Samuel P. Baumgartner, *Utility and Feasibility of Transnational Rules of Civil Procedure: Some German and Swiss Reactions to the Hazard-Taruffo Project*, 33 TEX. INT'L L.J. 463, 474 (1998) (discussing a focus on harmonization and judicial cooperation).

whether the applicable Treaty provision calls for, or even permits, secondary legislation to completely harmonize the field of judicial cooperation. The second inquiry addresses the extent of Community legislation, and asks whether the resulting Community legislative scheme may allow the Member States to adopt broader or more rigorous standards, permitting a mutual coexistence of international and Community obligations.

Determining the area covered by Article 65 implicates an overlap with the previous Treaty provision relating to judicial cooperation. Article 293 EC, which remains within the old third pillar, provided for the "simplification of formalities governing the reciprocal recognition and enforcement of judgments," but left the realization of these ends to intergovernmental negotiations.[89] However, once Article 65(a) found its way into the first pillar of the EC Treaty, the residual power left in the third pillar under Article 293 creates redundancy. While the Dutch Presidency of the Council[90] and the Commission[91] both supported the deletion of this latter provision, the rejection of these proposals seems to indicate the incomplete regime created by Article 65, and the continued validity of intergovernmental action over judicial cooperation in civil matters.

However, by its more precise interpretation, the coexistence of both regimes for rules on the recognition and enforcement of judgments serves to support, rather than limit, the complete harmonization envisaged by Article 65. This interpretation credits Article 293 with broad competence to conclude agreements in areas such as criminal, tax and administrative matters; expressly reserving recognition and enforcement measures in civil matters to Article 65(a) does nothing to exhaust its application. Further, by stating that Community legislation on civil judicial cooperation "shall include" acts related to the subjects listed thereafter, the express reservation of such measures rules out the possibility that other matters of civil judicial cooperation could fall outside of Article 65.[92] This effectively "communitarizes" the entire array of possible measures relating to civil judicial cooperation, permitting an extensive scope of Community measures to harmonize that particular field.

However, determining the potential breadth of Community measures contemplated by the Treaty says nothing of the depth of such legislation necessary to preclude Member State action. Unlike Article 95 of the Treaty, there is no parallel provision in Article 65 permitting Member States to adopt divergent or more rigorous standards, as was argued for in Opinion 2/

89. Treaty Establishing the European Economic Community, Nov. 11, 1997, art. 293, O.J. (C 340). Article 220 of the Treaty of Rome provides, *inter alia,* "Member States shall, so far as it necessary, enter into negotiations with each other with a view to securing for the benefit of their nationals: . . . the simplification of formalties governing the reciprocal recognition and enforcement of judgments or courts or tribunals and of arbitration awards."

*Id.*, art. 293.

90. EC Doc. CONF/2500/96 1, 20.

91. EC Doc. SEC (96) 2004, 14.

92. Treaty Establishing the European Economic Community, Nov. 11, 1997, art. 293, O.J. (C 340). The scope of Article 65 could have been narrowed by stating that measures shall "consist of" those acts listed under Article 65(a). The Dutch Presidency supported this position, which was eventually rejected in favor of the broader approach. *See* EC Doc. CONF/2500/96 1.

91.[93] Nevertheless, commentators have noted that "improving," "simplifying" and "promoting compatibility" as called for by Article 65 does not require the unification of laws under an exclusive Community measure.[94] Rather, the Community could issue recommendations inviting Member States to ratify an international convention in a particular area, directives harmonizing national provisions, or regulations which leave Member States free to retain, for example, more generous rules on recognition or to adopt stricter jurisdictional standards.[95] Under each scenario, the measures adopted would not lead to an exclusive Community competence on the external plane, as Member States' Community obligations could be duly honored while adhering to the commitments derived from unilaterally concluded agreements with third states. This situation was contemplated in the Community's conclusion of Convention No. 170 of the ILO, when the Court ruled that the minimum standards adopted under Article 137 could not lead to exclusive Community competence on the external level.[96]

However, the wording of Article 137 is different than that of Article 65. Article 137 expressly limits the means of Community action to adopting "minimum requirements for gradual implementation." In contrast, Article 65 says nothing to limit the means of Community action, but places an implicit limit on its legitimate end, i.e. "improving," "simplifying" and "promoting compatibility."[97] Thus, it is necessary to distinguish between the Treaty's express limits and its practical limits. Whereas Community action under Article 137 is categorized as minimum requirements no matter how intrusive the actual legislation, action under Article 65 can "block" Member State action depending on its extent. Consequently, the "compatibility" of national rules on private international law can be promoted as long as it is possi-

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93. Opinion 2/91, re: Convention No. 170 of the ILO, (1993) E.C.R. I 1061, ¶ 15–21. Article 95(4) permits Member States to "maintain national provisions on grounds of major needs referred to in Article 30." Treaty Establishing the European Economic Community, Nov. 11, 1997, art. 95(4), O.J. (C 340). These "major needs" may include "public morality, public policy or public security, the protection of health and life of humans, animals or plants; the protection of national treasures. . .; or the protection of industrial and commercial property." Treaty Establishing the European Economic Community, Nov. 11, 1997, art. 30, O.J. (C 340).

94. Jurgen Basedow, *The Communitarization of the Conflict of Laws under the Treaty of Amsterdam*, 37 COMMON MKT. L. REV. 687, 687 (2000); *see* Horatio Muir Watt, *Evidence of an Emergent European Legal Culture: Public Policy Requirements of Procedural Fairness Under the Brussels and Lugano Conventions*, 36 TEX. INT'L L.J. 539, 542 n.11 (2001) (discussing how Article 65 gives the Council the power to improve and simplify the recognition of foreign judgments); *see also* Paul Beaumont, *A United Kingdom Perspective on the Proposed Hague Judgments Convention*, 24 BROOK. J. INT'L L. 75, 82 (1998) (discussing how the power of the Council to regulate comes from Article 65's objective to improve and simplify).

95. *See* Paul Beaumont, *European Court of Justice and Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters*, 48 INT'L & COMP. L.Q. 223, 228 (1999).

96. Opinion 2/91, re: Convention No. 170 of the ILO, (1993) E.C.R. I 1061, ¶ 15–21.

97. *See* Jacqueline Klosek, *The Development of International Police Cooperation Within the EU and Between the EU and Third Party States: A Discussion of the Legal Bases of Such Cooperation and the Problems and Promises Resulting Thereof*, 14 AM. U. INT'L L. REV. 599, 625 (1999) (discussing how the European Community recommends to Member States conventions which should be adopted with particular constitutional requirements); *see also* Tracy A. Kaye, European Tax Harmonization and the Implications for U.S. Tax Policy, 19 B.C. INT'L & COMP. L. REV. 109, 122–23 (1996) (discussing the primary types of secondary community legislation as being regulations, directives, decisions, recommendations and opinions).

ble to conceive cases that would be decided differently in different Member States.[98] Even after full approximation, "compatibility" may still be a legitimate end attained only through a unification that replaces national rules with a Community regulation.[99] As a result, Community action under Article 65 may be as nominal as a non-binding recommendation or as intrusive as a unifying regulation, and exclusive external competence is thus neither excluded nor guaranteed, but derived from a searching examination of the actual extent of Community legislation.

From the preceding analysis, it is certain that the Community has, at a minimum, concurrent or shared external competence over the matters under Article 65. This competence is a direct result of the recent exercise of internal legislative competence, and upholds that "golden balance" which the Court often has sought to preserve;[100] by the nature of the envisaged European judicial area and its efficient operation, and by the express provisions of Article 65.

## V. Community External Competence in the Proposed Hague Convention on Jurisdiction and the Recognition and Enforcement of Judgments

For the last four years, the Hague Conference on Private International Law held special commission meetings in preparation of a proposed convention that would establish international rules governing jurisdiction, and recognition and enforcement of foreign judgments in civil and commercial matters. Because of the recent globalization of business and trade, and the parallel growth of transnational disputes and claims, many see this new convention as the most important convention on rules of private international law ever undertaken by that organiza-

98. *See* Jurgen Basedow, *The Communitarization of the Conflict of Laws under the Treaty of Amsterdam*, 37 COMMON MKT. L. REV. 687, 706 (2000); *see also* Antonio F. Perez, *The International Recognition of Judgments: The Debate Between Private and Public Law Solutions*, 19 BERKELEY J. INT'L LAW 44, 49 (2001) (citing recent developments in the European Union to foster uniformity of law and enforceability of foreign judgments amongst Member States); Catherine Kessedjian, *First Impressions of the Transnational Rules of Civil Procedure From Paris and the Hague*, 33 TEX. INT'L L.J. 477, 479–80 (1998) (noting the difficulties of implementing uniform procedural laws throughout European nations).

99. *See* Jurgen Basedow, *The Communitarization of the Conflict of Laws under the Treaty of Amsterdam*, 37 COMMON MKT. L. REV. 687, 706 (2000); *see also* Antonio F. Perez, *The International Recognition of Judgments: The Debate Between Private and Public Law Solutions*, 19 BERKELEY J. INT'L LAW 44, 48–9 (2001) (citing recent developments in the European Union to foster uniformity of law and enforceability of foreign judgments amongst Member States); John P. Flaherty & Maureen E. Lally-Green, *Fundamental Rights in the European Union*, 36 DUQ. L. REV. 249, 294–300 (1998) (remarking that members of the European Union are required to assent to and comply with Community law).

100. Takis Tridimas and Piet Eeckhout, *The External Competence of the Community and the Case-Law of the Court of Justice: Principle versus Pragmatism*, 14 Y.B. EUR. L. 143, 154–155 (1994). *See generally* Inger Osterdah, *Bananas and Treaty-Making Powers: Current Issues in the External Trade Law of the European Union*, 6 MINN. J. GLOBAL TRADE 473, 490 n.50 (1997) (noting that the Community does have implied powers to conclude agreements where it has internal legislative powers).

tion.[101] The Hague Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters ("Hague Judgments Convention") is intended to create a standard by which countries involved in global commerce can resolve these conflicts in an appropriate forum and whose judgments will be recognized and enforced by courts of other signatory countries.[102] This regime is intended to advance the growth of global business transactions by assuring legal certainty over applicable law through jurisdictional rules, and promoting the enforceability of dispute settlement through uniform recognition procedures.[103]

Inevitably, any attempt to unify such conflict rules on the international level invites comparison with the 1968 Brussels Convention.[104] This convention has succeeded in bringing about legal certainty and uniformity in an area vital to transnational dispute resolution, even if only at the regional level.[105] Negotiated and enacted under Article 293 of the EC Treaty, the

101. *See* Edward C. Y. Lau, *Update on the Hague Convention on the Recognition and Enforcement of Foreign Judgments*, 6 ANN. SURV. INT'L. & COMP. L. 13 (2000); Sean D. Murphy, *Contemporary Practice of the United States Relating to International Law*, 95 A.J.I.L. 387, 418 (2001) (stating that "[i]n 1992, the United States proposed that the Hague Conference on Private International Law undertake the drafting of a convention on the recognition and enforcement of national judgments by foreign courts in civil and commercial matters"); *see also* Peter H. Pfund, Symposium, *The Project of the Hague Conference on Private International Law to Prepare a Convention on Jurisdiction and the Recognition/Enforcement of Judgments in Civil and Commercial Matters*, 24 BROOK. J. INT'L L. 7, 8 (1998) (noting that "the Hague Conference Member States decided in October 1996: 'to include in the Agenda of the Nineteenth Session the question of jurisdiction, and recognition and enforcement of foreign judgments in civil and commercial matters'").

102. *See* Edward C. Y. Lau, *Update on the Hague Convention on the Recognition and the Enforcement of Foreign Judgments*, 6 ANN. SURV. INT'L & COMP. L. 13, 13–14 (2000) (noting that "[t]he Hague Convention intended to create a standard by which countries involved in global commerce can resolve these conflicts in an appropriate forum whose judgments will be recognized and enforced by courts of other signatory countries"); *see also* Khoi D. Nguyen, *Invisibly Radiated: Federalism Principles and the Proposed Hague Convention on Jurisdiction and Foreign Judgments*, 28 HASTINGS CONST. L.Q. 145, 145 (2000) (stating that "[a]ll future members to the Hague Convention will be required to recognize and enforce judgments rendered on approved bases of jurisdiction"). *See generally* Hague Conference on Private International Law, Final Act of the Eighteenth Session, 35 I.L.M. 1391, 1405 (1996) (noting that decision "to include in the Agenda of the Nineteenth Session the question of jurisdiction, and recognition and enforcement of foreign judgments in civil and commercial matters").

103. *See* Edward C. Y. Lau, *Update on the Hague Convention on the Recognition and Enforcement of Foreign Judgments,* 6 ANN. SURV. INT'L. & COMP. L. 13, 14 (2000) (noting that "[the Hague Convention] would hopefully foster more global business transactions by assuring parties that there is a predictable legal system for global disputes and enforcing judgments throughout the world"); *see also* Cooper Dreyfuss, Symposium, *Intellectual Property Challenges in the Next Century: Article an Alert to the Intellectual Property Bar: The Hague Judgments Convention,* 2001 U. ILL. L. REV. 421, 425 (2001) (stating that, as a result of the Hague Convention, "[c]ourts would . . . be forced to choose the law suitable for the case, leading ultimately to the articulation of—and international debate over—choice of law rules and principles, as well as "best law" approaches to uniquely international problems"). *See generally* Preliminary Draft Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters, *available at* <http://www.hcch.net/e/conventions/draft36e.html>.

104. O.J. (27) 1 (1998); replaced by Council Regulation (EC) on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, COM (1999) 348.

105. *See* Friedrich Juenger, *Some Comments on European Procedural Harmonization*, 45 Am. J. Comp. L. 931, 933 (1997); William W. Park, *Symposium on International Commercial Arbitration: Illusion and Reality in International Forum Selection*, 30 TEX. INT'L L.J. 135, 188 (1995) (discussing the Brussels Convention's usefulness in fostering legal certainty in jurisdictional matters); *see also* Friedrich Juenger, *Federalism: Judicial Jurisdiction in the United States and in the European Communities: A Comparison*, 82 MICH. L. REV. 1195, 1212 (1984) (noting the effectiveness of the Brussels Convention in resolving jurisdictional issues).

Brussels Convention is an intra-Community convention concluded for the purpose of harmonizing the national laws of the Member States regarding jurisdiction, recognition and enforcement of foreign judgments. Yet, as a result of this intergovernmental form, the Brussels Convention was not a directly applicable part of Community legislation; its national operation relied upon implementing legislation or an executive order, thus leaving the Member States free to enter into other international negotiations falling within the scope of civil judicial cooperation.

Despite this secondary existence in the scheme of Community law, the Court was given an important role in interpreting the Convention by way of a 1971 protocol.[106] This power contributed to the evolution of the Convention as a defining feature of the still rudimentary European judicial area. One of the most far-reaching pronouncements of the Court, at least for its future development into an instrument capable of conferring implicit external competence, is contained in Case 148/84, *Deutsche Genossenschaftsbank v. SA Brasserie du Pecheur*.[107] In that case, the Court was faced with a contention by the Italian government that the Brussels Convention did not contain the exclusive procedures for challenging the enforcement of a foreign judgment. However, the Court ruled that in order to attain the objective of simplifying enforcement procedures within the Community, the Convention "established an enforcement procedure which constitutes an autonomous and complete system."[108] Moreover, this comprehensive system of enforcement procedures is complemented by exhaustive rules on jurisdiction in civil and commercial matters; Article 3 proscribes certain exorbitant bases, Article 5 provides special jurisdictional bases and Articles 7–16 lay down specific rules for insurance, credit sales and exclusive jurisdiction. This "double convention," which purports to regulate both the assumption of jurisdiction and the subsequent foreign recognition, leaves no room for national authorities of the Member States to autonomously assume jurisdiction and utilize methods of discretionary recognition.[109]

Although the 1971 Protocol substantially improved on the intra-Community regime of judicial cooperation, additional developments in this area depended upon further "communitarization." This process of advancing the "area of freedom, security and justice," which many believe has occurred too slowly,[110] was given a significant boost by the recent Council (EC)

106. Protocol on the Interpretation by the Court of Justice of the Convention of September 27, 1968 on Jurisdiction and the Enforcement of Judgments in Civil and Commerical Matters, June 3, 1971 (entered into force in 1975), 1978 O.J. (L 304).

107. Case 148/84 Deutsche Genossenschaftsbank v. SA Brasserie du Pecheur, 1985 E.C.R. 1981, 2 C.M.L.R. 496.

108. Case 148/84 Deutsche Genossenschaftsbank v. SA Brasserie du Pecheur, 1985 E.C.R. 1981, 2 C.M.L.R. 496, ¶ 17.

109. *See* Peter Hay, *The Case for Federalizing Rules of Civil Jurisdiction in the European Community*, 82 MICH. L. REV. 1323, 1326 (1984); Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, Sept. 27, 1968, 1972 O.J. (L 299) (as amended by 1990 O.J. (C 189) (detailing the jurisdiction and recognition provisions of the Brussels Convention); *see also* Joachim Zekoll, *Could A Treaty Trump Supreme Court Jurisdictional Doctrine?: The Role and Status of American Law in the Hague Judgments Convention Project*, 61 ALB. L. REV. 1283, 1288 (1998) (indicating that the Brussels Convention is considered a "double convention" due to the fact that it regulates jurisdiction and recognition).

110. Proposal for a Council Regulation (EC) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, COM (99) 348 final, ¶ 1.1.

Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters.[111] This new Regulation seeks to obviate the national differences that affect the operation of an intra-Community treaty, and effectively incorporate the 1968 Brussels Convention into a directly applicable Community instrument. Thus, the "autonomous and complete system" established and recognized under the Brussels Convention will now operate within the Member States as a supreme body of conflict laws, independent from pre-existing national rules on jurisdiction and the recognition and enforcement of foreign judgments.

As a result of this development, the ability of the Member States to enter into international agreements with third countries on matters which are currently under negotiation at the Hague Conference seems dubious. Reiterating the principles discussed above, the scope in which the Community replaces the Member States in these negotiations, and the extent to which that replacement occurs, depends upon the interpretation of the relevant Community measure. Foremost to this interpretation is the relation between the regime previously established by the Brussels regulation, and the scope of harmonization established by its successor. The preamble to the new regulation makes explicit reference to its predecessor by noting that "continuity. . .should be ensured"[112]; this recognition of the previous regime presumes the intention to carry over its "autonomous and complete system." Beyond its relation to the Brussels Convention, however, the preamble affirms that its scope "must cover all main civil and commercial matters," making certain that "matters excluded from its scope [will] be as limited as possible."[113] These express declarations in the regulation itself confirm the Community's intention to completely harmonize the field of jurisdiction, recognition and enforcement procedures under Community law.

This conclusion raises the presumption that exclusive external competence could be founded on the new regulation. This result would also depend, however, on whether all the matters covered in the Hague Convention fall within the self-defined, substantive scope of the new regulation. Comparing the new regulation with the Preliminary Draft Convention of October 1999 (hereinafter "Draft Convention"), the scope of both instruments, contained in their respective first articles, reveals an almost identical enumeration. Further, the Draft Convention articles on employment contracts, consumer contracts, and provisional and protective measures and damages all have their parallel counterparts in the new regulation. In fact, in some ways the regulation over-encompasses the Draft Convention, including provisions on insurance contracts that do not find comparison in the convention. This nearly identical substantive overlap effectively brings the Draft Convention under the shadow of the new Community regulation, resulting in a presumption for exclusive external competence to conclude that future agreement.

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111. O.J. (27) 1 (1998); replaced by Council Regulation (EC) on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, COM (1999) 348 final.

112. O.J. (27) 1 (1998); replaced by Council Regulation (EC) on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, COM (1999) 348 final, ¶ 5.

113. O.J. (27) 1 (1998); replaced by Council Regulation (EC) on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, COM (1999) 348 final, ¶ 7.

However, the scope of Community action is silent as to the extent of that action necessary to preclude Member State competence. Paul Beaumont, commenting on potential Community legislation in early 1999, noted that it would be possible for the Community to cover the field of jurisdiction, recognition and enforcement, yet still permit Member States to retain external competence, through a Community measure that leaves national actors free to adopt more generous rules of recognition or stricter jurisdictional standards.[114] This argument is based upon the refusal of exclusive Community competence in Opinion 2/91, where Community legislation covered the subject matter of the international agreement, but in such a way as to allow the Member States to adopt more rigorous rules without compromising their Community obligations.[115] Although Article 65 would have permitted such legislation, the objective of that Treaty provision does not limit Community action to that form.[116] In the case of the new regulation, the Community has chosen to comprehensively regulate the subject matter covered, an option not available in Opinion 2/91 where the relevant Treaty article expressly limited Community legislation to "minimum standards."[117]

Nevertheless, the Court in Opinion 2/91 contemplated a situation more analogous to the current case. Complementing the ability of the Community to legislate only minimally, the Court also noted the possibility that the Community legislation could be more stringent than that of the international agreement, thus allowing the Member States to adhere to their Community obligations, yet still uphold the minimum standard set forth by their international commitments.[118] However, this possibility may also be limited by the facts of Opinion 2/91, as the ILO agreement in that case permitted the signatory states to adopt more stringent measures than that set forth by the agreement.[119] The Draft Convention does not yet contain an analogous provision, nor is there any evidence to believe that one is under consideration; signatory states are bound to apply the convention within its scope of application without derogation, regardless of whether that derogation raises the standard internationally agreed upon. Combining the direct applicability, Community origin and comprehensive nature of the new regulation with the potentially inflexible character of the proposed Hague Convention, the possibility that the Member States of the Community could adhere to their Community obligations yet accede to the Convention seems unlikely.

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114. *See* Paul Beaumont, *A United Kingdom Perspective on the Proposed Hague Judgments Convention*, 24 BROOK. J. INT'L. 75, 282; Edward T. Swaine, *Subsidiarity and Self-Interest: Federalism at the European Court of Justice*, 41 HARV. INT'L L.J. 1, 57 (2000) (noting the Amsterdam Protocol's use of "Community measures" to allow Member States to attain their goals); *see also* Tracy A. Kaye, *European Tax Harmonization and the Implications for U.S. Tax Policy*, 19 B.C. INT'L & COMP. L. REV. 109, 127 (1996) (discussing the European Court of Justice's use of Community Law to determine rulings when requested by Member States).

115. Opinion 2/91, re: Convention No. 170 of the ILO, (1993) E.C.R. I-1061.

116. *See* Opinion 2/91, re: Convention No. 170 of the ILO, (1993) E.C.R. I-1061; *see also* Peter Hay, *The Case for Federalizing Rules of Civil Jurisdiction in the European Community*, 82 Mich. L. Rev. 1323, 1326 (1984). *See Generally* Philippe Manin, *Treaty of Amsterdam*, 4 COLUM. J. EUR. L. 1, 4 (1998) (explaining that the Treaty of Amsterdam promotes an area of freedom).

117. EC Treaty art. 137.

118. Opinion 2/91, re: Convention No. 170 of the ILO, (1993) E.C.R. I 1061, ¶ 18.

119. ILO CONST., art. 19(8).

This principle of harmonizing Community measures precluding Member State external competence is founded on the *ERTA* doctrine and the assumption that national action in a Community-occupied field necessarily "affects Community measures or alters their scope." Contemplating such a comprehensive measure prior to its adoption, the Council (EC) Legal Service suggested that certain provisions within the Community regulation could effectively safeguard Member State competence.[120] It was suggested that Chapter VII, pertaining to the relationship with other instruments, could expressly preserve the ability of Member States to enter into international agreements with third states.[121] This approach would parallel Article 57 of the old Brussels Convention, which precluded its effect on "any conventions to which the Contracting States are or will be parties and which, in relation to particular matters, govern jurisdiction and the recognition and enforcement of judgments." Moreover, Article 59 of that convention expressly empowered the Member States to enter into such international agreements with third states. However, the Community institutions seem to have had no intention to preserve that right.

Chapter VII of the new regulation orders the coexistence of Community measures and certain international agreements, and notes the displacement of other international agreements covering the field of jurisdiction, recognition and enforcement procedures within the Member States. Whereas Article 57 precluded any effect on international conventions, existing and future, the new Article 63 within that Chapter sets forth a short and exhaustive list of international agreements that the regulation "shall not affect." Contained in the proposal for the Council regulation, it specifically notes that this closed list implicitly precludes the Member States from acceding to "existing or future conventions governing jurisdiction and the recognition and enforcement of judgments."[122] Although this proposal and commentary may have little bearing on the interpretation of the finalized Community instrument, it may serve to highlight the intentional wording of the regulation and the preclusive effect it is intended to achieve.

The Council (EC) Legal Service opined that action might be taken in the Hague Conference negotiations that could ensure against the invocation of the *ERTA* principle, and thereby

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120. Opinion of the Council (EC) Legal Service, Doc. 6683/99, J.U.R. 99, ¶ 15 (1999).

121. *See* Willajeanne F. McLean, *Promises to Keep and Miles to Go: A Look at Europe Poised Between Two Treaties,* 15 MICH. J. INT'L L. 831, 841–42 (1994) (reviewing WILLIAM J. ADAMS ED., SINGULAR EUROPE: ECONOMY AND POLITY OF THE EUROPEAN COMMUNITY AFTER 1992 (1992)) (stating that Member States have not relinquished all of their authority to the European Community; retaining rights to make agreements that fall within the competency of both the Member States and the European Community). *But see* Rudolf Geiger, *External Competences of the European Union and the Treaty-Making Power of its Member States*, 14 ARIZ. J. INT'L & COMP. LAW 319, 324 (1997) (asserting that Member States have lost much of their sovereignty since they are not permitted to enter into international agreements covering areas in which the European Union has competence); Peter L. Lindseth, *Democratic Legitimacy and the Administrative Character of Supranationalism: The Example of the European Community*, 99 COLUM. L. REV. 628, 704–705 (1999) (discussing that Member States have lost the power to negotiate agreements in areas where the European Community has ruled on the particular subject, in the interest of uniformity).

122. Proposal for a Council Regulation (EC) on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, COM (99) 348 final, ¶ 1.1., arts. 62, 63.

preserve Member State competence to conclude the agreement. The Legal Service determined that if

> an unqualified disconnection clause was inserted into the Hague Convention which would safeguard the priority of Community under all circumstances, and would result in a situation where the rules of the convention could not affect in any way the Community measure or its possible future evolution, the Member States would remain competent to conclude the convention.[123]

Such a disconnection clause can be found in Article 19 of the 1973 Hague Convention on the Law Applicable to Maintenance Obligations.[124] Although significantly undermining the authority of the Convention, this addition may allow the Community measure to apply between the Member States without prejudice from their international commitments. Similar in practical effect would be the inclusion of a federal clause, similar to the one included in Article 17 of the 1973 Hague Convention. Such a clause would have less of a detrimental effect on the general and future relevance of the Convention by simply excluding its application from territorial units within a federation. The European Community, which, at least in matters within its exclusive internal competence, acts as a federation with subordinate territorial units, could apply the Convention in cases which involve disputes outside of its borders, but reserves its own autonomous measures for cases which solely involve intra-Community parties. This clause would safeguard national implementation of the Hague Convention without affecting the authority of the Community regulation within its scope of application.

Several proposals of a "disconnection" clause are contained in the Preliminary Draft resulting from the most recent special commission.[125] The first of these proposals is the most encompassing in excluding the effect of the Convention on the Community regulation. It states that the Convention "does not affect. . .uniform laws based on special ties of a regional or other nature between the States concerned and to instruments adopted by a community of States."[126] The second proposal is more limited in its exclusion, and closely parallels a similar clause contained in the Lugano Convention. While providing that "a European State shall apply the

123. Opinion of the Council (EC) Legal Service, Doc. 6683/99, J.U.R. 99, ¶ 15 (1999).

124. Convention on the Recognition and Enforcement of Decisions Relating to Maintenance Obligations, Oct. 2, 1973, art. 19, 1021 U.N.T.S. 209, 11 I.L.M. 1286 ("This Convention shall not affect any other international instrument containing provisions on matters governed by this convention to which a Contracting state is, or becomes, a party").

125. Preliminary Draft Convention On Jurisdiction And Foreign Judgments In Civil And Commercial Matters, adopted by the Special Commission Oct. 30, 1999, *available at* <http://www.hcch.net/e/conventions/draft36e.html>.

126. *Id*. at art. 37, proposal 1. The full text of that proposal provides:

> The Convention does not affect any international instrument to which Contracting States are or become Parties and which contains provisions on matters governed by the Convention, unless a contrary declaration is made by the States Parties to such instrument.
>
> However, the Convention prevails over such instruments to the extent that they provide for fora not authorized under the provisions of Article 18 of the Convention.
>
> The preceding paragraphs also apply to uniform laws based on special ties of a regional or other nature between the States concerned and to instruments adopted by a community of States.

*Id*.

European instruments, and not the Convention," it lists three exceptions where, "even if the defendant is domiciled in a European instrument State, a court of such a State shall apply" the Convention.[127] This format was discussed by the Council (EC) Legal Service, in reference to the revision of the Lugano Convention, where it decided that a disconnection clause that contained such exceptions results in a situation where the application of that Convention "affects the scope" of the Brussels Convention.[128] Thus, in the case of Lugano and the proposed Hague Convention, the Community would still be exclusively competent for the respective revision and conclusion of the international agreement, despite the attempted disconnection.

In spite of these negotiated attempts at preserving Member States' competence, the relevant case law of the Court, seeking to preserve its role as a constitutional institution, may preclude a negotiated disconnection between the Community and international instrument. The opinion of the Council (EC) Legal Service notes that a valid disconnection clause must not only obviate present conflicts, but also the "possible future evolution" between the international agreement and the Community measure.[129] If the Community was found not to have exclusive competence over the Hague Convention, resulting in a situation whereby the convention would be individually enacted in all 15 participating Member States, the Court may condemn the implementing national legislation as it did in the *Variola* case.[130] In that case, a Member State had passed national legislation reproducing the provisions of a directly applicable regulation, taking the Community rules out of their Community environment. Such reenactment of a regulation was deemed impermissible, because citizens within the Community would be misled into thinking that their rights and duties were derived from purely national legislation, and would tend not to realize that they had rights under Community law that the Court had the power to interpret under Article 234.[131] Taking this powerful tool away from the Court, not by express provision but through legal uncertainty, could significantly affect the development of future Community principles.[132]

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127. *Id*. at art. 37, proposal 2.

128. Opinion of the Council (EC) Legal Service, Doc. 6683/99, J.U.R. 99, ¶ 22 (1999).

129. *Id*.

130. Case 34/73 Variola, (1973) E.C.R. 981.

131. Case 34/73 Variola, (1973) E.C.R. 981 ("No procedure is permissible whereby the community nature of a legal rule is concealed from those subject to it"). *See* John Temple Lang, *The ERTA Judgement and the Court's Case-Law on Competence and Conflict*, 6 Y.B. EUR. L. 183, 190 (1987); Christopher Henkel, *Constitutionalism of the European Union: Judicial Legislation and Political Decision-Making by the European Court of Justice*, 19 WIS. INT'L L.J. 153, 157–58 (2001) (explaining that the doctrine of direct applicability allows the European Community to adopt legislation which will automatically be binding on the Member States, without the need to incorporate such legislation into the law of the Member States); *see also* Justice Stephen Breyer, *Constitutionalism, Privatization, and Globalization: Changing Relationships Among European Constitutional Courts,* 21 CARDOZO L. REV. 1045, 1050 (2000) (stating that legislation enacted by the European Community is directly applicable to individuals without further national legislation).

132. Experience shows that many landmark decisions of the Court have been initiated by the procedure set forth under Article 234. *See, e.g.*, Case 26/62 Van Gend en Loos, (1963) E.C.R. 1; Case 6/64 Costa v. ENEL (1964) E.C.R. 585, 605–606; Case 106/77 Amministrazione delle Finanze Dello Stato v. Simmental SpA (II), (1978) E.C.R. 629.

The situation in this case would not be altogether different. Community citizens involved in disputes with parties in other signatory Member States would find themselves bound by provisions of the Hague Convention by way of national law, yet subject to the Community regulation by reason of its superiority in application. Thus, the legal certainty and legitimate expectations of such individuals would be significantly affected by the coexisting measures, especially if a dispute involved the interests of a third, non-Member State. Furthermore, this problem cannot be solved by merely inserting a clause into the international instrument declaring that the Community measure will apply in intra-Community disputes, or that the Community measure will hold priority in cases of conflict; the problem exists not simply because of a potential conflict, but rather because of the interpretive coexistence.[133] The Court made the distinction in *Polydor* that international treaties are interpreted differently than Community legislation, even if they appear to include identical provisions.[134] If the Community is not a party to the Treaty, and the national courts of the Member States hold the exclusive right to interpret a clause meant to obviate conflicts between international and Community rules, the risk of divergent application of both instruments within the "area of freedom, security and justice" is real. In this way, an international convention could "alter the scope" of Community law, as proscribed by the Court in the *ERTA* judgment, without recourse to the European Court to ensure the intended application. With the future judicially promoted development of Community law hampered by legal uncertainty, coherent judicial cooperation within the Community's borders may be once again muddled by the divergent and "impermeable labyrinth" of Community conflict laws.[135]

Regardless of the outcome of this analysis, and despite disagreement among commentators, many have advocated that the Community conduct negotiations at the Hague Conference

133. *See* John Temple Lang, *The ERTA Judgement and the Court's Case-Law on Competence and Conflict*, 6 Y.B. EUR. L. 183, 205 (1987); Youri Devuyst, *The European Union's Constitutional Order? Between Community Method and Ad Hoc Compromise*, 18 BERKELEY J. INT'L L. 1, 45–46 (2000) (explaining that conflicts may arise in Germany between the European Court and the German Constitutional Court in interpretations of European Council law); Dieter Grimm, *The European Court of Justice and National Courts: The German Constitutional Perspective After the Maastricht Decision*, 3 COLUM. J. EUR. L. 229, 236 (1997) (explaining that the German Constitutional Court has not been willing to defer to the European Council of Justice as the final authority on European law).

134. Case 270/80, Polydor v. Harlequin, (1982) E.C.R 329.

135. *See* Jurgen Basedow, *The Communitarization of the Conflict of Laws under the Treaty of Amsterdam*, 37 COMMON MKT. L. REV. 687, 696 (2000). The term "impermeable labyrinth" was coined by Jurgen Basedow when referring to the conflict between nationally implemented, intergovernmental European Conventions and the self-defined scope of Community regulations enacted under Article 95. Modern Community legislation increasingly utilizes the procedures set forth in Article 95 to issue regulations. With such regulations directly applicable, independent and supreme over national conflict rules, their scope of application needs to be self-defined; resulting in intended substantive law harmonization complemented by provisions on the conflict of laws. *See, e.g.*, Council Regulation (EEC) No. 295/91 of 4 Feb. 1991, establishing common rules for a denied-boarding compensation system in scheduled air transport, O.J. 1991, L 36/5. However, these scattered Community conflict rules found themselves coexisting with European conventions negotiated under Article 293 EC; such conventions operate as a part of national law in both monoist and dualist states, and often contradict burgeoning Community integration. *See* Meinhard Hilf, *New Frontiers in International Trade: The Role of National Courts in International Trade Relations*, 18 MICH. J. INT'L L. 321, 322 (1997) (describing how conflicts are possible between dual systems of judicial review on the national level and international level).

concurrently with the Member States.[136] Such a "mixed agreement" has become a distinctive feature of the external relations of the Community.[137] Although in theory there may be no such room for Member State action in the matters to be decided at the Hague Convention, in practice, joint participation may be beneficial and, at least at this point in time, practically necessary. Consequently, the Member States of the Community have decided to coordinate their position with regard to the Hague Convention;[138] this decision will require, at a minimum, that the Member States and the institutions inform one another of their positions, seek to reach a consensus on matters falling within the agreement and proceed by common action within the framework of the Conference.[139]

## V. Conclusion

The speculative result in almost all cases where an envisaged international agreement falls under the new Community competence in private international law, at least where that competence has been exercised in the form of Community legislation, is that the Member States may participate in the agreement only if it deals with an aspect not covered at all by the Community measure. Nevertheless, the practicalities surrounding the negotiation and conclusion of such agreements may warrant a more flexible approach, and call for the Community to authorize Member State involvement regardless of its theoretical conflicts. This conclusion is supported by the *sui generis* nature of the Community regime as a whole. While its coherent legal expansion may require a subordination of its economic origins, the political necessities that still guide Community decision making require continued deference in areas of national sensitivity. As the Community enters the realm of private international law, within the Community and without, "mutual and constant respect for the respective jurisdictions of the Community and national bodies"[140] must continue to be ensured, even in the face of further "communitarization."

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136. *See* Jurgen Basedow, *The Communitarization of the Conflict of Laws under the Treaty of Amsterdam*, 37 COMMON MKT. L. REV. 687, 704 (2000); Stephen B. Burbank, Jurisdictional Equilibrium, the Proposed Hague Convention and Progress in Natural Law, 49 AM. J. COMP. L. 203, 205 (2001) (proposing that the Hague Convention would be an opportunity for nations to share, and thereby improve, lawmaking ideas); *see also* Antonio F. Perez, *The International Recognition of Judgments: The Debate Between Private and Public Law Solutions*, 19 BERKELEY J. INT'L LAW 44, 66 (2001) (stating that scholars are encouraging the United States to push for negotiating at the Hague Conference because it will benefit international trade).

137. *See* IAN MACLEOD ET AL., THE EXTERNAL RELATIONS OF THE EUROPEAN COMMUNITIES 142 (1996); Nanette A. Neuwahl, *Shared Powers or Combined Incompetence? More on Mixity*, 33 COMMON MKT. L. REV. 667 (1996). *See generally Justice and Home Affairs: E-Commerce Dominates Talks on More Legal Co-Operation,* EUR. REP., Feb. 28, 2001, *available at* Lexis (providing general information about the Hague Convention).

138. Conclusions of the Special Commission of May 2000 on General Affairs and Policy of the Conference, Preliminary Document No. 10 of June 2000 for the attention of the Nineteenth Session 23, *available at* <http://www.hcch.net/e/workprog/genaff.html>.

139. *See* IAN MACLEOD, *ET AL.*, THE EXTERNAL RELATIONS OF THE EUROPEAN COMMUNITIES, 142, 148 (1996); Nanette A. Neuwahl, SHARED POWERS OR COMBINED INCOMPETENCE? MORE ON MIXITY, 33 COMMON MKT. L. REV. 667 (1996); Nicholas Emiliou, THE DEATH OF EXCLUSIVE COMPETENCE?, 21 E.L.Rev. 310 (1996); *see also* Prepared Testimony Of Susan A. Freivalds Coordinator, Hague Convention Policy Joint Council On International Children's Services Before The House International Affairs Committee, FED. NEWS SERV., Oct. 20, 1999 (stating that Convention provided "framework" for international adoption process). *See generally* Justice And Home Affairs: E-Commerce Dominates Talks On More Legal Co-Operation, EUR. REP., Feb. 28, 2001 (providing general information about Hague Convention).

140. Case 6/64, Costa v. ENEL (1964) E.C.R. 585, 605–606.

# *Haywin Textile Products, Inc. v. International Finance Investment and Commerce Bank, Ltd.*

2001 U.S. Dist. LEXIS 12895

**United States District Court grants summary judgment to plaintiff, holding defendant to be a successor in interest despite controlling Bangladeshi law denying third-party beneficiaries standing to sue for enforcement of a contract.**

In *Haywin Textile Products, Inc. v. International Finance Investment and Commerce Bank, Ltd.*,[1] Azmat Bangladesh Ltd. (hereinafter "Azmat"), a Bangladesh company, had been unable to pay its debt to International Finance Investment and Commerce Bank Limited (hereinafter "IFIC"). In order to avoid "the rather laborious endeavor of a formal foreclosure proceeding,"[2] IFIC transferred Azmat's shares into its own name.[3] Haywin Textile Products, Inc. (hereinafter "Haywin"), a New York corporation, was another creditor of Azmat with a prior New Jersey judgment against it for $1,089,080.30 plus post-judgment interest.[4] Haywin had been seeking to enforce the judgment against Azmat in Bangladesh when the transfer of shares occurred.[5] IFIC caused Azmat to sell its assets to a third party, Moonavi Textile Complex Limited, and to pay the proceeds to IFIC. In connection with that sale, IFIC, Azmat and several other parties (excluding Haywin) entered into a Deed of Agreement that included the provision that "IFIC Bank and the newly constituted Board of Directors of [Azmat] will assume full responsibility of [Azmat] for all purpose [sic] including towards payment of its past and future liabilities if any till the legal liquidation of [Azmat]."[6] When Haywin brought the present action against IFIC in New York,[7] a legal liquidation of Azmat had not yet occurred, and IFIC remained the owner of Azmat's shares.

Haywin sought reimbursement of the debt which might otherwise have been satisfied by the assets IFIC appropriated to itself.[8] Haywin's complaint asserted two causes of action against IFIC: first, that it was a third-party beneficiary of the above-quoted undertaking in the Deed of Agreement, and second, that IFIC was a successor-in-interest to Azmat. In an earlier order, the court dismissed the first cause of action on the ground that Bangladeshi law does not recognize third-party beneficiaries. As to successor liability, however, it held that IFIC had failed to dem-

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1. 2001 U.S. Dist. LEXIS 12895 (hereinafter "*Haywin Textile*").
2. *Id.* at *5. *See generally* Railroad Company v. Howard, 74 U.S. 392, 410 (1868) (enabling the creditors of a railroad corporation to collect the remaining proceeds of a foreclosure sale on the railroad corporation's property which were held in a trust to pay its debts).
3. *Haywin Textile*, U.S. Dist. LEXIS at *5, *15–*16 (describing this practice as unlawful in its intent to claim all of Azmat's assets for itself while leaving behind a corporation unable to satisfy the debts of other creditors).
4. *Id*. at *3.
5. *Id*.
6. *Id*. at *4.
7. This action was originally filed in New York state court and subsequently removed by IFIC to the Federal District Court for the Southern District of New York. *Id.* at *5–*6.
8. *Id*.

onstrate that Bangladeshi law differed from New York law on this subject and that it would therefore apply New York law to the second cause of action.

In the decision discussed in this note, the district court denied Haywin's motion for reconsideration, which alleged that the federal court ignored the affidavit of Haywin's expert on Bangladeshi law in holding that Bangladeshi law does not recognize third-party beneficiary rights to enforce a contract.[9] Additionally, the court denied IFIC's motion for reconsideration[10] of the federal court's opinion that IFIC failed to demonstrate how Bangladeshi law differed from New York law with respect to successor liability.[11] Finally, the court granted Haywin's motion for summary judgment,[12] holding IFIC to be a successor in interest[13] to a Bangladeshi corporation and thus responsible for the ensuing debt owed to Haywin Textile.[14]

The U.S. District Court denied Haywin's motion for reconsideration, which was based on the assertion that the federal court ignored Haywin's expert on Bangladeshi law in holding that third-party beneficiary rights to enforce a contract are not recognized in Bangladesh.[15] Because the plaintiff's and the defendant's experts differed in opinion as to whether Bangladeshi law would recognize third-party beneficiary rights, the court was left to rely on limited prior authority;[16] specifically, on a case broadly restricting third-party rights.[17]

The court then denied IFIC's motion for reconsideration, which was based on the assertion that the Federal court erred in holding that New York law on successor liability would govern.[18] The court noted that said motion for reconsideration was procedurally defective, as it was not accompanied by a memorandum of law.[19] Nonetheless, the motion would not have succeeded on its merits.[20] IFIC's argument that it could not be found liable under the facts was

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9. *Id.* at *8–*9 (highlighting an opinion reached by the court on June 11, 2001, indicating that Bangladeshi law would not recognize the rights of third-party beneficiaries to enforce a contract).

10. *Id.* at *6–*8.

11. *Id*. at *6, *13.

12. *Id.* at *16 (granting Haywin's motion for summary judgment).

13. *Id*. at *13. In noting that Haywin's failure to demonstrate how Bangladeshi law differs from that of New York's in handling successor liability claims, the court summarized New York's general rule as granting successor liability where "(1) there is an express or implied agreement to assume the other company's debts and obligations; (2) the transaction was fraudulent; (3) there was a de facto merger or consolidation of the companies; or (4) the purchasing company was a mere continuation of the selling company."

14. *Id*.

*Id*. at *15–*16.

15. *Id*. at *8.

16. *Id.* at *9.

17. *Id*. (quoting Trang Ice and Cold Storage Co., Ltd. v. Amin Fish Farm and Indus., Ltd., 46 D.L.R. 42 (1994) (hereinafter "*Trang Ice*")). *See Trang Ice*, 46 D.L.R. at 42 (holding a contract's enforceability to be limited to the contracting parties and not extended to third-party beneficiaries). *But see* Marion E. Seaver v. Matt C. Ransom, 224 N.Y. 233, 237–38 (1918) (hereinafter "*Seaver*") (detailing New York's affirmation of the right of third-party beneficiaries to sue for enforcement of a contract).

18. *Haywin Textile*, 2001 U.S. Dist. LEXIS at *6.

19. *Id*. at *6–*7.

20. *Id.* at *7–*8.

found to be insufficient. The court ruled that the facts referred to were irrelevant in consideration of a motion to dismiss since they went beyond the face of the complaint.[21]

Ultimately the court granted Haywin's motion for summary judgment, holding IFIC to be liable to Haywin under New York's successor liability law.[22] In differentiating between the controlling Bangladeshi law denying standing to third-party beneficiaries and the theory of successor liability, the court emphasized the relationship between Azmat and IFIC at the time the Agreement was signed.[23] As opposed to focusing on Haywin's status as one would if the action were based upon the theory of liability to a third party beneficiary,[24] the successor-in-interest argument is based upon IFIC's relationship with Azmat and its assumption of Azmat's liabilities.[25] The court explained that IFIC could not unilaterally devastate Azmat of all its assets, leaving behind a corporation unable to satisfy the claims of other creditors, while escaping liability.[26] Furthermore, by choosing not to formally foreclose on Azmat's assets, IFIC subjected itself to greater responsibility for Azmat's debts.[27]

Though the district court in this case was accurate in its decision to apply the theory of successor liability, the decision appears to have been rooted primarily in policy considerations, rather than substantive law. The clear and credible distinction drawn by the court between third-party beneficiary theory and successor liability serves as a reminder of the policy embedded behind the theory of successor liability itself. The court recognized the danger in allowing corporations such as IFIC to simply take control of Azmat's shares and property in the hopes of selling them, in order to avoid a lengthy and formal foreclosure proceeding. If the case had been decided differently, certainly other creditors would follow suit in claiming the remaining assets of a company for themselves, while untold creditor debts lingered. It is likely then, that this decision will increase awareness of the court's strict adherence to successor liability theory, resulting in fewer instances of the pillaging of assets of corporations and a greater adherence to traditional methods of formal foreclosures, for fear of being found a successor in interest.

**Ana Cenanovic**

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21. *Id*.
22. *Id*. at *12–*13.
23. *Id*. at *15.
24. *Seaver*, 224 N.Y. at 237–38 (explaining the rights of third-party beneficiaries to sue for enforcement of a contract in New York).
25. *Haywin Textile*, 2001 U.S. Dist. LEXIS at *14–*15.
26. *Id*. (quoting Ladjevardian v. Laidlaw-Coggeshall, Inc., 431 F. Supp. 834, 839–40 (S.D.N.Y. 1977)).
27. *Id*. at *16.

# *United States v. Charles Kim*

246 F.3d 186 (2d Cir. 2001)

**Second Circuit Court holds that jurisdiction over defendant is proper although the act of fraud and conspiracy was not committed within the United States.**

In *United States v. Kim*,[1] the court affirmed a judgment of the Southern District of New York convicting Charles Kim of fraud and conspiracy.[2] Kim, a resident of New York, made travel arrangements for the UN peacekeeping mission in Bosnia-Herzegovina.[3] While stationed in Croatia, Kim inflated baggage charge invoices, and these invoices were paid to Kim's co-conspirators by wire transfer from Chase Manhattan Bank in New York City.[4] The issue before the court was whether jurisdiction and venue were proper under the wire fraud statute[5] relevant to Kim's prosecution.[6] After a complex analysis of the statute and defendant's arguments, the court held that jurisdiction and venue were proper even though neither Kim nor his co-conspirators personally committed the fraudulent and conspiratorial act within the United States.[7]

Kim challenged the jurisdiction and venue of the District Court because the fraudulent and conspiratorial acts were committed outside the United States' borders.[8] The court reviewed the issues of jurisdiction and venue *de novo*.[9]

The court first examined whether the mail fraud statute applied in this case.[10] The wire fraud statute is broad in that it can encompass a wide range of activities with the single use of a wire communication. The court reasoned that there is a presumption recognized by the

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1. 246 F.3d 186 (2d Cir. 2001) (hereinafter "*Kim*").
2. *Kim*, 246 F.3d at 187.
3. *Id.*
4. *Id.*
5. 18 U.S.C. § 1343 (2000). The statute reads:

   > Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communications in interstate or foreign commerce, any writings, signs, signals, pictures or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than five years, or both.

   *Id.*
6. *Kim*, 246 F.3d at 189. The court had to determine whether the wire fraud statute applied to crimes committed abroad.
7. *Id.* at 193.
8. *Id.* at 188.
9. *Id. See* U.S. v. White, 237 F.3d 170, 172 (2d Cir. 2001) (stating that questions of subject matter jurisdiction are to be reviewed *de novo* as a matter of law).
10. *Kim*, 246 F.3d at 188. Kim contended that the statute did not apply to entirely foreign fraud. It was the position of the government that the statute applied to American citizens who committed fraud by wire communications into or out of the United States.

Supreme Court against applying criminal laws to acts committed outside the U.S. to American citizens.[11] However, the presumption can be overcome by proof of the legislative intent of Congress to reach such conduct.[12]

It was evident to the court, after examining the wire fraud statute and its legislative history, that the statute included coverage of foreign wire communications.[13] Kim argued for a narrow interpretation of the legislative history.[14] However, the government claimed not only that an American citizen perpetrated the fraud, but that the victim was headquartered in New York.[15] The court concluded that Kim's conduct fell within the meaning of the statute.[16] However, as the fraud was committed by a state citizen against a state victim, the court failed to consider whether the state's criminal laws on fraud should be applied rather than the federal statute.

The court went on to rationalize the application of the wire fraud statute to fraudulent acts committed outside the United States. The court previously held in *United States v. Gilboe*[17] that wire communications used to commit fraud outside the U.S. clearly fell within the wire fraud statute.[18] Again in *United States v. Trapilo*,[19] the court reasoned that "the identity and location of the victim was irrelevant"[20] and considered only the fact that the perpetrator used telecommunications within the U.S. to carry out his scheme.[21]

The court applied the holdings of *Gilboe* and *Trapilo* to the present case to support jurisdiction over Kim.[22] In examining the statute, the court found Kim's act met the test of "transmits or causes to be transmitted" and concluded that Kim acted within the language of the statute.[23] As further support for this application of the statute to Kim, the court stated that the

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11. *See* Sale v. Haitian Ctrs. Council, Inc., 509 U.S. 155, 173 (1993) (discussing how criminal acts committed abroad should generally not be applied to American citizens).

12. *See* EEOC v. Arabian Am. Oil Co., 499 U.S. 244 (1991) (rebutting the presumption against extraterritorial application of criminal laws where there is specific legislative intent).

13. *Kim*, 246 F.3d at 189. *See* H.R. Rep. No. 2385, 84th Cong., 2d Sess.1 (1956) (stating that the 1956 amendment to § 1343 broadened the scope of the statute to specifically include foreign communications.

14. *Id.* (arguing that the statute did not apply to fraudulent acts committed outside the United States).

15. *Id.*

16. *Id.* The court agreed with the government's application of the statute to Kim's offense.

17. 684 F.2d 235 (2d Cir. 1982).

18. *Id.* at 236–37 (holding that jurisdiction was proper for fraud committed by a nonresident alien).

19. 130 F.3d 547 (2d Cir. 1997).

20. *Id*. at 552 (holding that § 1343 applied to the use of the United States' communications system to further a tax fraud scheme against the Canadian government).

21. *Id. See* Anne S. Dudley and Daniel F. Schubert, *Mail and Wire Fraud*, 38 AM. CRIM. L. REV. 1025, 1043 (2001) (noting that the three elements necessary for a conviction of wire fraud are a scheme to defraud, the intent to defraud and the use of the United States' mail system to further the scheme).

22. *Kim*, 246 F.3d at 190 (distinguishing the holdings of those cases from his own by claiming that the statute was inapplicable as he did not personally send or receive the wires. The court rejected this argument).

23. *Id.* at 190.

jury, after hearing all the evidence, concluded that there was a causal link between Kim and the fraudulent activity.[24] The language of the statute is exceedingly broad but the reasonableness of the court's application of the wire fraud statute to the type of fraud committed by Kim is questionable. It was not Kim's transmittal of the wire communications that was fraudulent but the amount to be transferred. It also appears as though the court stretches the language too far in this case in order to obtain jurisdiction. If jurisdiction is proper in this case, who then is not within the reach of the statute?

Kim argued that two civil wire fraud cases, *North South Finance Corp. v. Al-Turkit*[25] *and Butte Mining PLC v. Smith*,[26] should be applied instead of *Gilboe* and *Trapilo*.[27] The court distinguished these cases by explaining that in *North South Finance* and *Butte Mining* the acts were preparation for fraud, not material to the fraud directly, as in this case.[28] As these cases could not be used to overturn the conviction, jurisdiction was found proper.[29]

The court proceeded to address the issue of venue.[30] The court stated that under the Sixth Amendment and Rule 18 of the Federal Rules of Criminal Procedure, "venue is proper in any district where a crime is 'committed.'"[31] Under 18 U.S.C. § 3237(a),[32] the court found that the wire fraud was a continuing offense and that because the place of transmittal was Chase Manhattan located in the Southern District, venue was proper.[33] The court again compared the facts of the present action to *Gilboe*. It found that like Kim, Gilboe was not present in the Southern District, however, the communications were found to be sufficient to warrant venue in that district.[34]

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24. *Id.* at 190.

25. 100 F.3d 1046 (2d Cir. 1996) (hereinafter "*North South Finance*") (addressing the RICO statute).

26. 76 F.3d 287 (9th Cir. 1996) (hereinafter "*Butte Mining*") (involving foreign citizens and entities in the United States).

27. *Kim*, 246 F.3d at 190 (finding these civil cases irrelevant and insufficient to warrant reversal of Kim's conviction).

28. *Id.* Both *North South Finance* and *Butte Mining* dealt with the application of the RICO Act to foreign defendants. In *North South Finance*, the defendants were foreign companies and nationals who committed fraud by misrepresenting and reporting their net worth to negotiate the sale and reorganization of a French bank. *North South Finance*, 100 F.3d at 1048–50. *Butte Mining* involved a fraudulent stock and security sale by defendants who were not U.S. citizens and the fraud occurred outside of the United States. *Butte Mining*, 76 F.3d at 288–90. The courts in both of those cases held that the defendants' acts were solely in preparation of the fraud. *North South Finance*, 100 F.3d at 1053; *Butte Mining*, 76 F.3d at 292.

29. *Kim*, 246 F.3d at 191.

30. *Id.* Kim claimed that neither he nor his co-conspirators committed fraudulent acts to further their scheme in the Southern District. He further argued that the faxes and wire transfers in and out of Chase Manhattan were not "sufficiently essential conduct" to the wire fraud and, therefore, venue was improper.

31. *See* U.S. v. Saavedra, 223 F.3d 85, 88 (2d Cir. 2000) (concluding that any venue in which a crime was "committed" is proper to try an offense). The court was hesitant to apply the "key verb" test and instead chose to implement the Supreme Court test announced in United States v. Rodriguez-Moreno, 526 U.S.275 (1999): identify the conduct and then determine where it occurred.

32. The statute reads: "Any offense involving the use of the mails [or] transportation in interstate or foreign commerce . . . is a continuing offense." 18 U.S.C. § 3237(a).

33. *Kim*, 246 F.3d at 192.

34. *Id.*

Kim urged that *Gilboe* should not be applied because, unlike *Gilboe*, he did not personally send the communications.[35] The court reiterated its reasoning that there was an established causal link between Kim's acts and the transmissions even though he was not physically in Manhattan.[36] The court determined that the Southern District was the proper venue, and consequently upheld the conviction of Charles Kim.[37]

The wire fraud statute is broad enough to allow the court to use its discretion in applying it to Kim. However, there is an underlying federalism concern the court fails to address. The wire fraud statute is drowning in potential for abuse by federal prosecutors. There are no checks on the power of federal prosecutors to bring federal action against conduct that is traditionally regulated by the states,[38] such as the theft that occurred in this case. Where then can the line be drawn between areas of federal and state jurisdiction in the prosecution of crimes? The court's holding in this case now allows federal prosecutors even more leniency in charging state conduct under statutes, such as the wire fraud statute that was never really intended to target the type of corruption in which Kim was charged.[39] Most important, it takes away the policing power of the states to regulate the conduct of its citizens in the area of criminal law.[40]

The excessively broad wire fraud statute[41] further allows the Second Circuit to confer jurisdiction and venue over actions of fraud perpetrated outside the United States' borders.[42] Federal courts have been more willing to extend jurisdiction over foreign defendants[43] and now over foreign activities affecting American businesses.[44] Although it is good public policy to pro-

35. *Id*. *See* United States v. Sawyer, 85 F.3d 713, 723 (1st Cir. 1996) (holding that the conduct can be a foreseeable part of the scheme to confer jurisdiction).

36. *Kim*, 246 F.3d at 192. Kim contended that the holdings of United States v. Brennan, 183 F.3d 139, 145 (2d Cir. 1999) (hereinafter "*Brennan*") and United States v. Beech-Nut Nutrition Corp., 871 F.2d 1181, 1189 (2d Cir. 1989) (hereinafter "*Beech-Nut*") should control this case. However, the court rejected these cases reasoning that they are not on point. The court reasoned that *Brennan* did not challenge venue under § 3237(a); and the wires were not just "passing through" Manhattan but this was the place where the wires were transmitted. Likewise, it rejected *Beech-Nut* because the fraudulent acts in that case were in preparation for fraud. *Kim*, 246 F.3d at 192–93.

37. *Id.* at 192–93.

38. *See* Sara Sun Beale, *Comparing the Scope of the Federal Government's Authority to Prosecute Federal Corruption and State and Local Corruption*, 51 HASTINGS L.J. 699, 700, 715 (2000) (discussing how allowing federal prosecutors to interfere with the state's interest to prosecute criminal activity is inconsistent with federalism and opens up the potential for abuse).

39. *See* Paul Salvatoriello, *Practical Necessity of Federal Intervention Versus the Ideal of Federalism: An Expansive View of Section 666 in the Prosecution of State and Local Corruption*, 89 GEO. L.J. 2393, 2393 (2001) (questioning the power of federal prosecutors to charge state and local officials in the absence of a generalized federal statute on corruption).

40. *See* Brandon L. Bigelow, *Commerce Clause and Criminal Law*, 41 B.C. L. REV. 913, 939 (2000) (stating how it is the states' sovereign interest to regulate areas of criminal law).

41. *See* Michael McDonough, *Mail Fraud and the Good Faith Defense*, 14 ST. JOHN'S J. LEGAL COMMENT. 279, 290 (1999) (commenting on how the mail fraud statute has enjoyed broad interpretation from federal courts).

42. *Kim*, 246 F.3d at 192, 193.

43. United States v. Bin Laden, 146 F. Supp. 2d 373. (S.D.N.Y. 2000) (holding that the federal court had jurisdiction over foreign defendants who committed terrorist crimes in the United States).

44. *Kim*, 246 F.3d at 192, 193.

tect American citizens from fraudulent acts abroad, there must be an appropriate check on the courts and the federal justice system to ensure that they do not abuse their discretion by stretching the "long arm" too far.[45]

**Rose A. Femia**

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45. *See* H. Lowell Brown, *Extraterritorial Jurisdiction Under the 1998 Amendments to the Foreign Corrupt Practice Act: Does the Government's Reach Now Exceed Its Grasp?*, 26 N.C. J. INT'L & COM. REG. 239, 312 (2001) (discussing how the courts have applied overly broad subject matter jurisdiction over foreign offenses).

# *The European Community v. RJR Nabisco, Inc.*

150 F. Supp. 2d 456 (E.D.N.Y. 2001)

**The revenue rule is a discretionary rule, not a constitutional rule or one imperative under international law, but the European Community lacks standing to sue under RICO for injury to the revenues of its member states.**

In *European Community v. RJR Nabisco, Inc.*,[1] the plaintiffs were the European Community (hereinafter the "EC")[2] and various political groups of the Republic of Colombia.[3] The defendants in the EC case were Philip Morris Companies, Inc. (hereinafter "Philip Morris"), along with several of its affiliates and RJR Nabisco, Inc. (hereinafter "RJR Nabisco").[4] Plaintiffs brought suit against these major tobacco product manufacturers and related entities under the Federal Racketeer Influenced and Corrupt Organizations Act (hereinafter "RICO")[5] and several common law causes of action[6] for damages arising out of three separate conspiracies.[7] Plaintiffs alleged damages in the form of "lost tax revenues," lost money and property, "money spent," "illegal profits" and public nuisance.[8] Following consolidation of the suits for administrative purposes, defendants filed a motion to deconsolidate the cases and to dismiss the complaint.[9] The EC also filed a motion to amend its complaint.[10] The U.S. District Court for the Eastern District of New York granted defendants' motion to deconsolidate the two cases, noting that "continued consolidation . . . [would] delay the resolution of these cases unnecessarily. . . ."[11] The court dismissed the EC's complaint and denied its motion to amend.[12]

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1. 150 F. Supp. 2d 456 (E.D.N.Y. 2001) (hereinafter "*European Community*").
2. "The European Community is 'a governmental body created as a result of collaboration among the majority of the nations of Western Europe, [including] Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom." *Id*. at n.1 460.
3. The actions brought by the Colombian plaintiffs are known as the "*Amazonas*" case. *Id*.
4. The group collectively known as "RJR" includes several companies related to RJ Reynolds Tobacco Company and Japan Tobacco, Inc. *Id*.
5. 18 U.S.C. § 1961 *et seq*. (2001).
6. The causes of action included fraud, public nuisance, unjust enrichment, negligence and negligent misrepresentation. *European Community*, 150 F. Supp. 2d at 461.
7. The first alleged conspiracy involved RJR Nabisco "and various co-conspirators" smuggling tobacco products into various member states of the European Community and the laundering of the proceeds of drug trafficking. *Id*. at 460. The second alleged conspiracy involved Philip Morris and its co-conspirators. Similarly, the defendants are alleged to have conspired to smuggle Philip Morris products into various member states of the European Community and laundered the proceeds of drug trafficking. *Id*. The third alleged conspiracy was between RJR Nabisco and Philip Morris, whereby the defendants are alleged to have "employ[ed] various means, including fixing the price of smuggled cigarettes" to cover up the first two conspiracies. *Id*.
8. *Id*. at 461.
9. *Id*. at 459.
10. *Id*.
11. *Id*. at 461.
12. *Id*. at 459. The court made a special point of noting that this opinion "dispose[d] of the EC Case only." *Id*. at 461.

## I. The Allegations

Plaintiffs alleged that defendants RJR Nabisco and Philip Morris had been "actively involved in smuggling contraband cigarettes into the EC and numerous countries outside of the EC for many years."[13] Specifically, plaintiffs alleged that defendant RJR Nabisco had smuggled cigarettes into Spain through one of its employees,[14] and that both RJR Nabisco and Philip Morris had smuggled cigarettes into the EC through the United Kingdom.[15] Claiming that both defendants had knowledge of the illegal activity,[16] plaintiffs argued that both RJR Nabisco and Philip Morris refused to cease dealing with certain customers despite having clear information that these customers were involved in cigarette smuggling.[17] In addition, Philip Morris was accused of destroying documents which, if left intact, would have revealed that the company was involved in such criminal activity.[18]

Not only were defendants alleged to be aware of such activity, but plaintiffs claimed that both RJR Nabisco and Philip Morris took steps to facilitate cigarette smuggling.[19] RJR Nabisco was purported to have used counterfeit tax stamps in order to allow its cigarettes to be shipped to certain locations, as well as to have invoked the use of Swiss secrecy laws in order to avoid the discovery of its involvement in smuggling cigarettes.[20] Philip Morris allegedly facilitated cigarette smuggling when it held a conference at which the company provided smugglers with information concerning its marketing and "product initiatives."[21] Like RJR Nabisco, Philip Morris was also purported to have attached counterfeit tax stamps and certain labels that would "ensure the value" of the cigarettes.[22] Further, Philip Morris designed its packages in such a way that it was difficult for countries to identify smuggled cigarettes.[23]

The defendants were also alleged to have conspired to frustrate EC efforts to prevent cigarette smuggling[24] through the use of various industry groups whereby EC efforts to deal with cigarette smuggling would be "thwarted."[25] Defendants were said to have created the appear-

13. *Id*. at 462, 466–67.

14. The employee's name was Richard Larocca. He was recruited because he had a working knowledge of the Spanish cigarette market. He provided information to various cigarette smugglers in order to "ensure the efficiency of their operations." *Id*. at 462.

15. *Id*. at 462–64, 468.

16. *Id*. at 464, 469. For example, plaintiff alleges that RJR continues to supply cigarettes to an individual known to be involved in cigarette smuggling. *Id*. at 464.

17. *Id*. at 464, 469.

18. *Id*. at 469.

19. *Id*. at 465, 470.

20. *Id*. at 466.

21. *Id*. at 470.

22. *Id*.

23. *Id*.

24. *Id*. at 465–66, 470.

25. *Id*. at 466, 470.

ance that high taxes were the cause of the black market for cigarettes, when in reality it was the actions of each of the defendants.[26]

In addition to allegations of involvement in cigarette smuggling, plaintiffs asserted that defendants were involved in money laundering. Plaintiffs argued that RJR Nabisco executives traveled to the Caribbean and Central America to meet with individuals whom the executives should have known were money launderers.[27] Philip Morris was said to have sold cigarettes to individuals whom Philip Morris should have known were notorious for drug smuggling.[28] Various distributors of RJR's cigarettes and Philip Morris's cigarettes had their bank accounts frozen in the early 1990's, because there were funds in those accounts that represented laundered drug money.[29] All of the above allegations were said to have resulted in lost tax revenues for the EC.

## II. Analysis

### 1. Subject Matter Jurisdiction and the Revenue Rule

As a threshold matter, the court addressed defendants' argument that the court lacked subject matter jurisdiction, because the revenue rule was implicated. Under the revenue rule, U.S. courts "customarily refuse to enforce the revenue laws of foreign sovereigns."[30] According to defendants, the revenue rule is an "international rule" that is "'absolute,' 'categorical,' and 'jurisdictional.'"[31] Contrarily, plaintiffs argued that the rule is "discretionary and that its application is limited to actions brought by foreign sovereigns seeking to enforce tax judgments entered in foreign tribunals."[32] The Second Circuit has found the revenue rule to be discretionary.[33] The revenue rule, according to the court, is "in the nature of abstention"—namely that it pertains to "juridicial principles" which indicate when it is proper for a court to decline to exercise jurisdiction."[34] Judge Learned Hand explained that it should be beyond the province of

26. *Id*.

27. *Id*. at 466.

28. *Id*. at 470.

29. *Id*. at 466.

30. *Id.* at 472.

31. *Id*.

32. *Id*.

33. *See* United States v. Pierce, 224 F.3d 158 (2d Cir. 2000) (holding that abstention from exercising jurisdiction was not warranted under the revenue rule despite the possibility that a challenge to Canadian revenue laws could arise). *See also* United States v. Trapilo, 130 F.3d 547 (2d Cir. 1997) (holding that the revenue rule was inapplicable because there was no assessment of the validity of Canadian tax laws required, but rather a scheme to defraud the government of tax revenues was the focus).

34. *European Community,* 150 F. Supp. 2d at 477.

any court to make determinations relevant to the very existence of another state.[35] The court held that subject matter jurisdiction existed in this case and proceeded to address the remaining arguments.

### 2. Revenue Rule in Relation to Other Doctrines

#### a. Act of State Doctrine

The Act of State Doctrine holds that "[e]very sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory."[36] Questions of this nature arise only in situations where the outcome rests on the implications of an official act by a sovereign state.[37] Recently, the Second Circuit has explained that under this doctrine, "a court presumes the validity of a foreign state's laws within that state's territory."[38] The policy implications of the revenue rule and the act of state doctrine are similar in that U.S. courts are concerned with preserving separation of powers among the branches of government. The concern stems from the possibility that a court act may implicate policy efforts of the other branches.[39]

#### b. International Comity

The doctrine of international comity "is the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard to both international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws."[40] The court explained that the doctrine serves as a "guide" where issues are interrelated with international relations.[41] Clarifying that the doctrine does not serve as a limitation on the exercise of subject matter jurisdiction by courts, the

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35. *See* Moore v. Mitchell, 30 F.2d 600, 604 (2d Cir. 1929) (Hand, J., concurring), aff'd, 281 U.S. 18 (1930) ("To pass upon the provisions for the public order of another state is, or at any rate should be, beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal, and which are intrusted [sic] to other authorities") *Id*.

36. *Id*. (citing Underhill v. Hernandez, 168 U.S. 250, 252 (1897)); *see also* Russ Schlossbach, Note: *Arguably Commercial, Ergo Adjudicable?: The Validity of a Commercial Activity Exception to the Act of State Doctrine*, 18 B.U. INT'L L.J. 139, 142 (2000) (articulating the definition of the doctrine which dates back to the 19th century). *See generally* Joel Richard Paul, *AEI Conference Trends in Global Governance: Do They Threaten American Sovereignty? Article and Response: Is Global Governance Safe For Democracy?*, 1 CHI. J. INT'L L. 263, 265–66 (2000) (pointing out that the doctrine is derived from separation of powers principles).

37. *European Community*, 150 F. Supp. 2d at 473.

38. *Attorney General of Canada v. R.J. Reynolds Tobacco Holdings, Inc.*, 2001 U.S. App. Lexis 21775 at *63 (2d Cir. Oct. 12, 2001) (affirming district court's dismissal of the Attorney General of Canada's complaint against various cigarette manufacturers and trade associations on the basis that RICO was not intended to nullify the revenue rule where foreign nations brought suit under the statute).

39. *Id*.

40. *European Community*, 150 F. Supp. 2d at 474 (citing Hilton v. Guyot, 159 U.S. 113 (1895)).

41. *Id*. (citing In re Maxwell Communication Corp., 93 F.3d 1036, 1047 (2d Cir. 1996)); *see also* Molly Warner Lien, *The Cooperative and Integrative Models of International Judicial Comity: Two Illustrations Using Transnational Discovery and Breard Scenarios*, 50 CATH. U. L. REV. 591, 591–92, n. 1 (2001) (explaining that international comity operates in a variety of contexts and discussing its meaning); James P. George, *Parallel Litigation*, 51 BAYLOR L. REV. 769, 910 (1999) (defining international comity).

court pointed out that when a court "dismisses a complaint in favor of a foreign forum pursuant to [this doctrine], it declines to exercise jurisdiction it admittedly has."[42]

#### c. Political Question

In *Baker v. Carr*,[43] the Supreme Court articulated six factors to be utilized in determining whether an issue is "non-justiciable" as a political question.[44] The court in the *European Community* case pointed out that each of the six criteria set forth in the *Baker* decision is illustrative of a greater concern to keep the judicial branch at a distance from sensitive areas such as foreign affairs.[45] The court noted that like the doctrine of international comity, political question doctrine "counsels caution in the face of adjudications whose international relations implications are pronounced."[46]

#### d. Interrelationship of the Various Doctrines

The court pointed out that the combination of these three doctrines and the revenue rule provides federal courts with the guidance for determining whether jurisdiction is proper in a case where an area of foreign law may be at issue.[47] In the present case, the court noted that any questions of foreign law would be "ancillary to the domestic causes of action giving rise to liability."[48]

### 3. Standing to Sue

Defendants argued that the European Community lacked standing to sue under 18 U.S.C. § 1964(c).[49] The court stated that in order to satisfy § 1964, the plaintiff would have to

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42. *European Community*, 150 F. Supp. 2d at 474.

43. 369 U.S. 186 (1962) (hereinafter "*Baker*").

44. *European Community*, 150 F. Supp. 2d at 474–75. The six criteria involved in the analysis are:

> (1) a textually demonstrable constitutional commitment of the issue to a coordinate political department; or (2) a lack of judicially discoverable and manageable standards for resolving it; or (3) the impossibility of deciding without an initial policy determination of a kind clearly for nonjudicial discretion; or (4) the impossibility of a court's undertaking independent resolution without expressing lack of the respect due coordinate branches of government; or (5) an unusual need for unquestioning adherence to a political decision already made; or (6) the potentiality of embarrassment from multifarious pronouncements by various departments on one question.

*Id*. (citing *Baker*, 369 U.S. at 217).

45. *Id*.

46. *Id*. at 475.

47. *Id*. *See also* Tapio Puurunen, *The Legislative Jurisdiction of States Over Transactions in International Electronic Commerce*, 18 J. MARSHALL J. COMPUTER & INFO. L. 689, 734–36 (2000) (discussing the difficulty in adjudicating a matter concerning international law with a foreign state due to separation of power concerns); Jonathan Turley, *Dualistic Values in the Age of International Legisprudence*, 44 HASTINGS L.J. 185, 203 (1993) (pointing out that the Supreme Court recognizes that "international law is heavily imbued with political questions").

48. *European Community*, 150 F. Supp. 2d at 475.

49. 18 U.S.C. § 1964 states that "any person injured in his business or property by reason of a violation of section 1962 of this chapter . . . " shall have standing to sue. *Id*. at 486.

prove that "(1) he is a person, (2) he was injured in his business or property, (3) the defendant violated section 1962 and (4) the defendant's violation caused the plaintiff's injury."[50]

**a. Plaintiffs as a "Person"**

Relying on Second Circuit case law, the defendants pressed the argument that the EC was not a person, noting that in *United States v. Bonanno Organized Crime Family of La Cosa Nostra,*[51] the U.S. was not allowed to bring a civil RICO claim under 18 U.S.C. § 1964(c). The court here held the *Bonanno* reasoning to have been specific to the U.S., however, so that the European Community could still be a "person" within the meaning of the statute. The court reasoned that the definition of the term "person" given by Congress in 18 U.S.C. § 1961(3)—"any individual or entity capable of holding a legal or beneficial interest in property"[52]—is controlling. The court declared the EC capable of holding such an interest in property.

**b. Cognizable Injury to Business or Property**

Plaintiffs alleged that as a result of defendants' racketeering activity, the EC had suffered economic losses in the form of lost revenues and heightened security costs.[53] The court noted that whether the member states of the EC are able to collect taxes imposed on cigarettes has no impact on the EC's ability to meet its budgetary requirements.[54] Finding that the EC had not suffered injury to its business or property,[55] the court noted that there was no indication that Congress intended to "append to 18 U.S.C. § 1964(c) a 'commercial injury' requirement for governmental entity standing."[56] The court pointed out the possibility that individual states could suffer a loss, but added that this did not mean that the EC, the party to this action, suffered a loss as required under the statute.[57] Stating that the EC's budget cannot, "as a matter of law," be depleted as a result of this illegal activity, the court held that the plaintiffs failed to show injury to their property[58] and thus lacked standing to sue under the statute.[59]

## III. Conclusion

The U.S. District Court for the Eastern District of New York properly exercised jurisdiction over this matter and appropriately concluded that the revenue rule is discretionary. Whether or not to exercise jurisdiction has been and should remain a matter within the sole

50. *European Community*, 150 F. Supp. 2d at 475 (internal citations omitted).

51. 879 F.2d 20 (2d Cir. 1989).

52. *European Community*, 150 F. Supp. 2d at 488.

53. *Id*. at 492–93.

54. *Id*. at 503.

55. *Id*. at 500–01.

56. *Id*. at 500.

57. *Id*.

58. *Id*.

59. *Id*.

discretion of the court, and rules such as the revenue rule can then serve as a guidepost for when jurisdiction is proper. For U.S. courts to be able to pass upon the legitimacy of the revenue rules from other nations is seemingly an invasion of that nation's sovereignty. Furthermore, U.S. courts are not in the best position to assess the policies of other nations with respect to their tax laws.

In addition, the court's determination that plaintiffs lacked standing to sue was appropriate. The court's resort to Congressional intent was the only sound way to deal with potentially ambiguous statutory language. Despite the fact that the individual member states could suffer harm as a result of cigarette smuggling, the court reached the appropriate conclusion that the organization as a whole did not suffer a harm. It seems as if the harm to the organization as a whole as a result of the smuggling scheme would be far too tenuous to bring this within the confines of 18 U.S.C. § 1964(c). Perhaps this cause of action is one better filed by the individual members of the European Community.

**Michelle Mauro**

# *Fujitsu Ltd. v. Federal Express Corp.*

247 F.3d 423 (2d Cir. 2001)

**Under the Vienna Convention on the Law of Treaties, application of the Warsaw Convention is not terminated by Hague protocol but continues in force until the latter takes effect for the country in question.**

In *Fujitsu Ltd. v. Federal Express Corp.*,[1] the Second Circuit held that the Hague Protocol[2] does not supersede the application of the Warsaw Convention[3] (hereinafter "the Convention"), because the former had not been adopted by the U.S. when the present controversy arose. The holding reiterates the viability of the Vienna Convention on the Law of Treaties[4] as a tool in interpretation of international treaties.[5]

Plaintiff Fujitsu Limited (hereinafter "Fujitsu") shipped a container of silicon wafers from Japan to Ross Technologies, Inc. (hereinafter "Ross") in Austin, Texas, via the defendant, Federal Express Corp. (hereinafter "FedEx").[6] A customs agent for Ross rejected the shipment in Austin.[7] FedEx contacted Fujitsu and Ross to inquire what FedEx should do with respect to the shipment.[8] Ross gave written instructions for the return of the shipment; however, FedEx claimed that a day earlier Fujitsu had given oral instructions for the return shipment.[9]

The shipment was flown, without an air waybill, from Austin to Memphis.[10] In Memphis, an incomplete air waybill was prepared, listing Ross as the shipper.[11] Prior to shipment to Japan, the goods were stored in Memphis for one week.[12] When Fujitsu inspected the shipment upon arrival, it noticed an oily substance covering the broken outer container.[13] The residue of the oily substance had penetrated the boxes, and the sealed aluminum bags containing the wafers had the oily substance on them.[14] The bags containing the wafers were not

1. 247 F.3d 423 (2d Cir. 2001) (hereinafter "*Fujitsu*").
2. Protocol to Amend the Convention for the Unification of Certain Rules Relating to International Carriage By Air, Sept. 28, 1955, 478 U.N.T.S. 371.
3. Convention for the Unification of Certain Rules Relating to International Transportation by Air, opened for signature Oct. 12, 1929, 49 Stat. 3000, 137 U.N.T.S. 11, reprinted in 49 U.S.C. 1143 (1994).
4. May 23, 1969, U.N. Doc. A/Conf. 39/27 (1969), 1155 U.N.T.S. 331.
5. *See* Annick Emmenegger Brunner, *Conflicts Between International Trade and Multilateral Environmental Agreements*, 4 ANN. SURV. INT'L & COMP. L. 74, 86 (1997) (noting that the Vienna Convention on the Law of Treaties and its rules are the "standard tools" in interpreting treaties that conflict).
6. *Fujitsu*, 247 F.3d at 426.
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.* at 427.
11. *Id.*
12. *Id.*
13. *Id.*
14. *Id.*

opened.[15] The damage was promptly reported to FedEx and FedEx acknowledged that the containers had been damaged while in its possession.[16] Fujitsu, following instructions from its insurance carrier, eventually disposed of the containers and wafers.[17] Prior to the disposal of the goods, FedEx had made no attempt to inspect them.[18]

Fujitsu brought an action against FedEx for breach of contract and negligence.[19] FedEx contended that the shipment had a proper air waybill under the Warsaw Convention governing international cargo shipment, which limits the liability of carriers for damaged or lost goods; in this case allegedly to be about $1,200.[20]

The trial court granted partial summary judgment to Fujitsu.[21] The court found that the second air waybill did not comply with the requirements of the treaty, and that the first air waybill did not cover the second shipment.[22] The court found FedEx liable for damages totaling $726,640.[23]

On appeal, the defendant offered four arguments against the ruling of the lower court.[24] Defendant charged error to the trial court finding that under the provisions of the Convention, the original air waybill did not cover the returned shipment.[25] According to article 22 of the

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15. *Id.*
16. *Id*.
17. *Id*.
18. *Id*.
19. *Id*.
20. *Id*. The current limit is $9.07 per pound. *Id*.
21. *Id*.
22. *Id*.
23. *Id.*
24. *Id*. at 427–28. Defendant argued:

> (i) that the trial court erred in finding that the return shipment was not covered by the waybill of the originating shipment; (ii) that the court improperly found that an amendment to the Warsaw Convention known as the Hague Protocol was inapplicable; (iii) that the court's findings regarding damages were incorrect; and (iv) that the court erred in denying FedEx's request for a finding of spoliation relating to Fujitsu's destruction of the container and wafers.

*Id.*

25. *Id.* at 428. The court noted that purpose for the Warsaw Convention is to govern international transportation of persons, baggage and goods by air. The Convention promulgates uniform rules of liability for loss, damage or delay of international shipments. *Id.*

Convention, a carrier has limited liability when it has used an air waybill containing certain information, including the place of the origin, itinerary and destination of the cargo.[26] Article 9 of the treaty states:

> if the carrier accepts goods without an air waybill having been made out, or if the air waybill does not contain all the particulars set out in article 8(a) to (i) . . . the carrier shall not be entitled to avail himself of the provisions of this convention which exclude or limit his liability.[27]

Because the benefit from this provision weighs heavily in favor of carriers, strict compliance with article 8 is required, and any omission on the air waybill will terminate the limited liability of the carrier.[28]

The court found undisputed the fact that the first air waybill from Tokyo to Austin contained all the relevant information required by article 8.[29] The court also found undisputed that the goods were shipped from Austin to Memphis without an air waybill.[30] An air waybill was drawn up in Memphis for the return of the goods to Tokyo; however, the air waybill did not contain the "agreed stopping places" that is required under article 8(c) of the Convention.[31]

FedEx contended that the return shipment did not create a new contract; therefore, the issuance of a new air waybill was not necessary.[32] FedEx argued that it issued the second air waybill simply to comply with its computer tracking system;[33] therefore, the second shipment should have been governed under article 12 of the Convention. The court refused to discuss this matter, because the record did not support FedEx's contention that Fujitsu ordered the return shipment; instead there was support in the record that Ross had instructed FedEx for the

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26. *Id*. at 428–29.Specifically, Article 8 of the treaty states that the [air waybill] shall contain the following particulars:

> (a) the place and date of its execution; (b) the place of departure and of destination; (c) the agreed stopping places, provided that the carrier may reserve the right to alter the stopping places in case of necessity. . .; (d) the name and address of the consignor; (e) the name and address of the first carrier; (f) the name and address of the consignee . . .; (g) the nature of the goods; (h) the number of packages, the method of packing, and the particular marks or numbers upon them; (i) the weight, the quantity, the volume, or dimensions of the goods . . . ; (q) a statement that the transportation is subject to the rules relating to liability established by this convention.

*Id.* (citing the Warsaw Convention art. 8(a)–8(q)).

27. *Id*. at 429.

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id*. at 427. FedEx stated that the issuance of a new air waybill for a returned package is a necessary component of its computerized package tracking system. *Id.*

return of the goods to Japan.[34] The instructions from Ross to FedEx regarding the return shipment created a new contract making articles 8 and 9 of the Convention applicable.[35] In order to have limited liability with respect to the second shipment, FedEx was required to submit a complete air waybill.[36] FedEx's failure to comply with the provisions of Articles 8 and 9 extinguished its limited liability claim.[37]

FedEx further argued that the original acceptance in Japan gave it protection under the Convention and, because Ross never took "custody and control" of the shipment, an acceptance was never formed.[38] The court found no definition for acceptance in the Convention or in any applicable cases,[39] however, the contention by FedEx that acceptance must involve physical delivery was readily rejected.[40] The court saw this requirement as too demanding.[41] Because a new contract had formed between Ross and FedEx, Ross "implicitly assumed authority to direct and control the movement of the goods, and FedEx appeared to have accepted the authority of Ross to do so,"[42] a constructive acceptance had taken place.[43]

Relying on the common law doctrine of abatement, FedEx argued that the adoption of the Hague Protocol[44] amending the Warsaw Convention should guide in this matter and not the provisions of the original Warsaw Convention.[45] FedEx wanted limited liability under the Convention as amended by the Hague Protocol. Fujitsu countered that the facts of this case came into existence two years before the amended Convention took effect in the U.S.[46] Fujitsu further argued that to hold that the amended version governed would conflict with a recent decision "that the Hague Protocol not be given retroactive effect."[47]

In its search for an answer, the court looked at how Congress would address a similar concern regarding a statute that has been repealed. The court found that Congress has sought to

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34. *Id*. at 429–30. Ross had given written instructions, Ross made payment and a service agent for FedEx testified in a deposition that Ross had authorized the return of the shipment. *Id.*

35. *Id.* at 429.

36. *Id*. at 430.

37. *Id*.

38. *Id.*

39. *Id.* at 430. "The Warsaw Convention does not define 'accepts,' and this Court has uncovered no cases interpreting that term in the context it is used in Article 9." *Id.*

40. *Id.* at 430. "[N]othing in that definition [Black's Law Dictionary defining acceptance as contemplating "a receiving of an item"] warrants a conclusion that transfer must involve physical delivery of the property." *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id*. at 431. "The Hague Protocol, which eliminates some of the formalities required under Articles 8 and 9 of the Original Warsaw Convention." *Id.*

45. *Id.*

46. *Id*. at 432.

47. *Id*. (citing Chubb & Son, Inc. v. Asiana Airlines, 214 F.3d 301 (2d Cir. 2000) (hereinafter "*Chubb*")) (holding that the Hague Protocol does not have retroactive effect). *Id.*

deal with this problem by enacting a general savings statute.[48] The general savings statute applies regardless of whether an earlier statute has been amended or repealed.[49] If the Hague Protocol or the Montreal Protocol No. 4[50] were looked upon as statutes, the original Warsaw Convention's provisions would be applicable under the general savings statute.[51] However, neither Protocol (Hague or Montreal) has a savings provision.[52]

FedEx argued that a general savings clause does not apply to treaties.[53] FedEx further asserted that since courts cannot enforce "any statutory or treaty remedy that is no longer in effect and has not been saved," the remedy under Article 9 was "abated and extinguished" by the entry of the Hague Protocol and Montreal Protocols.[54]

The contention, that rights and liabilities under the original Convention were extinguished by the Hague Protocol, was a question of first impression and distinguished this case from *Chubb*.[55] In *Chubb*, the court addressed the retroactivity of the Hague Protocol.[56] FedEx argued that retroactivity is not logically related to rights being extinguished.[57] FedEx urged the court to overrule the recent holding in *Chubb,* by giving limited retroactive effect to the Hague Protocol.[58]

The court, however, applied the "rules of customary international law enunciated in the Vienna Convention on the Laws of Treaties" (Vienna Convention).[59] The Vienna Convention contains its own "distinct set of rules concerning the amendment, modification, suspension, and termination of international agreements."[60] Contrary to common law,[61] there is no pre-

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48. 1 U.S.C. § 109.

49. *Fujitsu*, 427 F.3d at 432.

> [T]he repeal of any statute shall not have the effect to release or extinguish any penalty, forfeiture, or liability incurred under such statute, unless the repealing Act shall so expressly provide, and such statute shall be treated as still remaining in force for the purpose of sustaining any proper action or prosecution for the enforcement of such penalty, forfeiture, or liability.

*Id.* (citing 1 U.S.C. § 109).

50. Protocol on Substances that Deplete the Ozone Layer, Sept. 16, 1987, S. Treaty Doc. No. 10, 100th Cong., 1st Sess. (1987), *reprinted in* 26 I.L.M. Ozone-Depleting Chemicals, FIN. TIMES, Apr. 15, 1992, at 1. 1550 (1987), amended and adjusted, S. Treaty Doc. No. 4, 102d Cong., 1st Sess. (1991), reprinted 30 I.L.M. 539 (1991).

51. *Fujitsu*, 427 F.3d at 432.

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*; *see Chubb*, 214 F.3d at 309–310.

56. *Chubb*, 214 F.3d at 310; *Fujitsu*, 427 F.3d at 432.

57. *Fujitsu*, 427 F.3d at 432.

58. *Id.*

59. *Id.* at 433. "Treaties are governed by the customary international law, as recited by the Vienna Convention." *Id.*

60. *Id.*

61. *Id.* at 433 (citing 1A SUTHERLAND STAT. CONST. § 23.33, at 424–25 (Norman J. Singer ed., 5th ed. 1993)) (stating that "Under common-law principles, all rights, liabilities, penalties, forfeitures and offences which are of purely statutory derivation and unknown to the common law are eliminated by the repeal of the statute which granted them, irrespective of the time of their accrual"). *Id.*

sumption that an amended treaty automatically extinguishes an earlier treaty on the same subject matter.[62]

Customary international law operates on the principle of *pacta sunt servanda*.[63] One of the aspects of this doctrine, which is widely accepted as a test of the rules of international trade, is that the effect of a treaty does not become void simply because a superseding treaty has been adopted.[64] The court found this doctrine particularly relevant to a multilateral treaty such as the Warsaw Convention.[65] In these types of agreements, not all original signatories are signatories to the amended version; hence, one must look to the signatories of the amended version in order to assess the effect of the treaty.[66] It is common for a multilateral treaty to have several versions that coexist, calling for the application of different provisions to different states.[67] Looking at the Vienna Convention, the court held that the evidence supports the conclusion that the Hague Protocol did not "terminate" the original Warsaw Convention.[68] The court also acknowledged that the question of retroactivity has been addressed in *Chubb*.[69]

The fact that the Hague Protocol entered into effect during the pendency of this case did not prevent the application of the original Warsaw Convention to this matter.[70] In giving effect to conduct that took place prior to the amendment of the Warsaw Convention, the court was trying to avoid inconsistency.[71] It was therefore unnecessary to decide whether FedEx would have been able to shield itself from liability under the amended Warsaw Convention.[72] In dictum, however, the court expressed the view that even under the amended Warsaw Convention, FedEx would not prevail.[73] The amended version of article 9 still required FedEx to fill out an

62. *Fujitsu*, 247 F.3d at 433.

63. *Id.* The court stated that a treaty in force is "binding upon the parties to it and must be performed by them in good faith" unless the treaty has been affirmatively terminated or suspended. Vienna Convention art. 26. *Id.*

64. *Id.* at 433. According to the Vienna Convention, an international agreement is terminated by a later treaty "only if all of the parties to the first agreement conclude a later agreement relating to the same subject matter." Article 59. *Id.*

65. *Id.*

66. *Id.*

67. *See* Maria Frankowska, *The Vienna Convention on the Law of Treaties Before United States Courts,* 28 VA. J. INT'L L. 281, 361–62 (1988).

68. *Id.* at 434. The court stated that an international agreement is extinguished by a subsequent treaty:

> only if all of the parties to the first agreement conclude a later agreement relating to the same subject matter and either (a) it appears from the later treaty or is otherwise established that the parties intended that the matter should be governed by that treaty; or (b) the provisions of the later treaty are so far incompatible with those of the earlier one that the two treaties are not capable of being applied at the same time.

*Id.* (citing the Vienna Convention art. 59(1)(b)).

69. *Id.* The court noted that "the Protocol didn't intend for the treaty to govern conduct taking place before entry into force of that agreement." *Id.* (citing Chubb, 214 F.3d at 307 n.4).

70. *Id.*

71. *Id.* ("treaty language is to be interpreted so as to avoid inconsistency.")

72. *Id.*

73. *Id.*

air waybill from Austin to Memphis, which it failed to do.[74] It was only in Memphis that an air waybill was drawn up for the return shipment to Japan.[75]

FedEx's third argument charged error to the trial court for its measure of the damages.[76] The court acknowledged that there was no evidence in the record that the wafers themselves were damaged; however, the evidence supported the court's finding that the shipment was a "total loss,"[77] which was not clearly erroneous.[78] The court held that it was not in a position to "discern" the difference between the categories of damage with respect to the wafers.[79] Whether the wafers could be saved or not was a question for the trial court,[80] and the trial court resolved this conflict by finding Fujitsu's expert more credible than FedEx's expert.[81]

The appeals court held that the trial court used the appropriate measure of damages, namely the value of the shipment at the place of origin minus the value of the shipment as damaged.[82] The value of the goods as damaged was found to be zero, because the shipment was custom-made for Ross.[83] Furthermore, the trial court held that since salvage "would have been prohibitively expensive,"[84] Fujitsu's failure to mitigate was not a factor in the calculation of the damages.[85]

Finally, FedEx argued that sanctions must be applied against Fujitsu for spoliation[86] relating to Fujitsu's destruction of the wafers. This finding was the province of the trial court.[87] The record showed that Fujitsu informed FedEx of the damages immediately.[88] FedEx "admits that it never contacted Fujitsu" to inspect the damaged containers and made no demands that the containers should be retained.[89] The trial court found that FedEx had not shown that Fujitsu

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74. *Id.*

75. *Id.*

76. *Id.* at 434. "[T]rial court incorrectly determined the market value of the wafers to be the equivalent of the invoice price, when the testimony established that there was no real market for the wafers." *Id.*

77. *Id.* at 435. (stating that the bags containing the wafers had to be opened in a "clean room," but the bags themselves were not clean; even if the wafers were not damaged they could not be saved).

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.* at 435.

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* at 436. The litigants have an obligation to preserve relevant evidence or evidence which the litigants should know will be relevant at a future date. *Id.*

87. *Id.* The appropriate sanction to be applied for a spoliation claim is "confined to the sound discretion of the trial judge" and it must be "assessed on a case-by-case basis." *Id.*

88. *Id.* at 435.

89. *Id.* at 436.

intentionally destroyed the evidence.[90] It is also undisputed that FedEx's first attempt to gain access to the evidence was not until the making of the summary judgment motion in August 1999.[91] The court found no abuse of discretion by the trial court in finding that sanctions for spoliation were not warranted.[92]

With this decision, the Court of Appeals sent a signal that some semblance of consistency of laws does exist in international transaction disputes. It is a welcome sign to the community of nations that when international transactions are concerned, the U.S. applies relevant international law. Furthermore, the court has upheld the viability of the Vienna Convention on the Law of Treaties and its use in interpretation of conflicting treaties.

**Ali Nassiripour**

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90. *Id.*

91. *Id.*

92. *Id.*

# Armiliato v. Zaric-Armiliato

2001 U.S. Dist. LEXIS 5658 (S.D.N.Y. 2001)

**United States District Court holds that relief under the Hague Convention on the Civil Aspects of Child Abduction, as implemented by the International Child Abduction Remedies Act, was appropriate once it is determined that the minor child had been wrongfully removed from her habitual residence.**

In *Armiliato v. Zaric-Armiliato ("Armiliato")*,[1] the district court, applying the Hague Convention on the Civil Aspects of Child Abduction, as implemented by the International Child Abduction Remedies Act,[2] properly granted petitioner's motion after it determined the minor child had been wrongfully removed from her habitual residence.[3]

In order to discourage the increase in international parental kidnapping, countries that are signatories to The Hague Convention on the Civil Aspects of International Child Abduction of 1980 drafted a treaty that set the standard in international cases of child custody.[4]

On December 12, 2001, Irene Zaric-Armiliato removed Alessandra, her daughter, from Genoa, Italy to New York without informing Alessandra's father and her husband, Fabio Armiliato.[5] In response, Mr. Armiliato filed a petition pursuant to the Hague Convention on the Civil Aspects of Child Abduction, as implemented by the International Child Abduction Remedies Act, for the return of his daughter.[6] The District Court for the Southern District of New York granted the petition.[7]

Mr. Armiliato is a world-renowned opera tenor and an Italian citizen, born in Genoa, Italy, where most of his family resided at the time of the proceedings.[8] Ms. Zaric-Armiliato, a

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1. 2001 U.S. Dist. LEXIS 5658 (May 3, 2001) (hereinafter "*Armiliato*").

2. 42 U.S.C. § 11601 (2001). § 11601(a)(4) states:

   > [T]he Convention on the Civil Aspects of International Child Abduction, done at The Hague on October 25, 1980, establishes legal rights and procedures for the prompt return of children who have been wrongfully removed or retained, as well as for securing the exercise of visitation rights. Children who are wrongfully removed or retained within the meaning of the Convention are to be promptly returned unless one of the narrow exceptions set forth in the Convention applies. The Convention provides a sound treaty framework to help resolve the problem of international abduction and retention of children and will deter such wrongful removals and retentions.

   42 U.S.C. § 11601(a)(4).

3. *Armiliato*, 2001 U.S. Dist. LEXIS at *29.

4. *See* June Starr, *The Global Battlefield: Culture and International Child Custody Disputes at Century's End*, 15 ARIZ. J. INT'L COMP. L. 791, 791 (1998).

5. *Armiliato*, 2001 U.S. Dist. LEXIS at *10.

6. *Id*. at *12.

7. *Id*. at *2.

8. *Id*.

citizen of the former Yugoslavia, is also an opera singer.[9] Her family resides in Belgrade, Serbia, where she maintains an apartment.[10] Alessandra is the couple's only daughter; she was born in Genoa, Italy on March 25, 1994, and is a citizen of Italy.[11]

From the time Alessandra was born, her parents traveled extensively with her because of Mr. Armiliato's operatic obligations.[12] Until Alessandra turned six, the required legal age in Italy to attend school, the family never stayed longer than a month in one location.[13] As noted by the district court, Alessandra's repeated return to Genoa, Italy was a recurring theme throughout her "peripatetic adventures."[14] In 1997, the Armiliatos began to experience marital difficulties for the first time.[15]

After 1997, Mr. Armiliato performed several times in New York City, and his career began to "blossom."[16] During that time, Mr. Armiliato applied for a green card that would permit him to live abroad but perform in the U.S. without having to apply repeatedly for work visas.[17] Yet, Mr. Armiliato never intended to make the U.S. his permanent residence.[18] Again in 1999, the Armiliatos experienced marital difficulties.[19] Following these difficulties, Mr. Armiliato no longer considered moving to New York, and indefinitely postponed the requisite interview with the American government concerning his application for a green card.[20] Then, in late August 2000, the couple separated, and resided separately in Genoa, Italy.[21]

In October 2000, Mr. Armiliato filed an action in Genoa for a judicial separation under Italian law.[22] He requested joint custody of Alessandra and an order directing Ms. Zaric-Armiliato, who had transferred approximately $20,000 from Mr. Armiliato's account, not to remove their daughter from the country.[23] The Italian court scheduled a hearing for January 17, 2001.[24]

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9. *Id*.
10. *Id*.
11. *Id*. at *3.
12. *Id*.
13. *Id*.
14. *Id*. at *5.
15. *Id*. at *6.
16. *Id*.
17. *Id*. at *7.
18. *Id*.
19. *Id*. at *8.
20. *Id*.
21. *Id*.
22. *Id*. at *9.
23. *Id*.
24. *Id*.

Pursuant to an agreement between the parties, on December 8, 2000, Mr. Armiliato gave Ms. Zaric-Armiliato $1,000 and spent the weekend with his daughter.[25] Mr. Armiliato returned Alessandra to Ms. Zaric-Armiliato in Genoa on December 10, 2001.[26] The next day Ms. Zaric-Armiliato requested Alessandra's future homework assignments, because she was taking her daughter to New York, and asked the school not to disclose the trip to Alessandra, because it was a surprise.[27] On December 12, 2001, Ms. Zaric-Armiliato took her daughter to New York without informing Mr. Armiliato, and entered the United States under a visa waiver program, which permitted them to remain only until March 11, 2001.[28] Ms. Zaric-Armiliato's attorney notified Mr. Armiliato's attorney on December 13, 2001 about their trip to New York, and promised they would return to Genoa by Christmas.[29] On December 19, 2000, Ms. Zaric-Armiliato filed for divorce and custody in New York State Supreme Court, because she believed that New York divorce law would be more favorable to her.[30]

On December 28, 2000, Mr. Armiliato instituted criminal proceedings in Italy against Ms. Zaric-Armiliato for the abduction of their child and her unilateral withdrawal of funds from his account. An arrest warrant was issued in Italy.[31] In order to facilitate Ms. Zaric-Armiliato's appearance at the January 17, 2001 judicial separation hearing in Italy, Mr. Armiliato procured a letter from the Genoa prosecutor agreeing not to arrest her if she returned to Italy for the hearing.[32] However, Ms. Zaric-Armiliato did not appear but her lawyer did, and the Italian court granted Mr. Armiliato temporary custody of Alessandra and adjourned the matter.[33] Thereafter, Mr. Armiliato obtained an advisory opinion from the Juvenile Court of Genoa pursuant to Article 15 of the Convention, declaring that Alessandra's "customary residence" was Genoa, Italy. The court also determined that Ms. Zaric-Armiliato's removal of Alessandra to New York without Mr. Armiliato's consent was illegitimate under Article 316 of the Italian Civil Code, "which provides that parental authority on children shall be exercised by both parents by joint agreement."[34] On March 21, 2001, the N. Y. State Supreme Court, New York County issued a decision and order denying without prejudice Mr. Armiliato's motion to dismiss the New York divorce action.[35]

The district court reviewed the objectives of the Convention, as implemented by 42 U.S.C. § 11601, which are: (1) to secure the prompt return of children wrongfully removed to or retained in any contracting State; and (2) to ensure that rights of custody and of access under

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25. *Id*.
26. *Id*.
27. *Id*. at *10.
28. *Id*.
29. *Id*.
30. *Id*.
31. *Id*. at *11.
32. *Id*.
33. *Id*.
34. *Id*. at *12.
35. *Id*.

the law of one contracting State are effectively respected in the other contracting States.[36] Both the U.S. and Italy are signatories to the Convention, pursuant to which states have agreed that when a child who is habitually residing in one contract state is wrongfully removed to, or retained in, another, the latter state "shall order the return of the child forthwith."[37]

To establish that Alessandra had been wrongfully retained, the district court looked to Article 3 of the Convention, which states that retention is wrongful if:

(a)it is in breach of rights of custody attributed to a person, an institution or any other body, either jointly or alone, under the law of the State in which the child was habitually resident immediately before the removal or retention; and

(b)at the time of removal or retention those rights were actually exercised, either jointly or alone, or would have been so exercised but for the removal or retention.[38]

In *Croll v. Croll*,[39] the Second Circuit held that a petitioner claiming wrongful removal under the Convention bears the burden of proving "wrongful removal" by a preponderance of evidence; it is not the petitioner's burden to prove that the child was wrongfully retained.[40] If the petitioner is able to prove by a preponderance of evidence that the child was wrongfully removed, the court must order the child's return to the country of habitual residence unless the respondent demonstrates that one of the four narrow exceptions apply.[41]

The district court recognized that it must resolve four issues in order to determine whether Alessandra was wrongfully removed.[42] First, the date the removal or retention took place; second, the state in which Alessandra was habitually resident immediately prior to the removal; third, whether the rights of custody attributed to the petitioner were breached by the removal under the law of the placing habitual residence; and fourth, whether the petitioner was exercising his custody rights at the time of the removal.[43]

First, the district court found that Alessandra's removal to be December 12, 2001.[44] There was no evidence that Ms. Zaric-Armiliato's removal of Alessandra was ever discussed with her husband.[45]

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36. *Id*.

37. *Id*. at *13.

38. *Id*.

39. 229 F.3d 133 (2d Cir. 2000) (hereinafter "*Croll*").

40. *Croll,* 229 F.3d at 138 (stating that the standard of proof is a preponderance of evidence by which the petitioner bears that burden).

41. *See* Blondin v. Dubois, 189 F.3d 240, 245 (2d. Cir. 1999) (hereinafter "*Blondin*") (stating that two of the four exceptions, namely grave risk of physical or psychological harm and violation of fundamental principles of human rights, require proof by clear and convincing evidence). *See* 42 U.S.C. § 11603(e)(2)(A).

42. *Armiliato*, 2001 U.S. Dist. LEXIS at *16.

43. *Id*.

44. *Id.* at *10.

45. *Id*.

Next, the district court considered which state was Alessandra's habitual residence.[46] Habitual residence is not specifically defined, however it was a well-established idea used by participants at the Hague Conference. The term "habitual resident" is perceived to be a question of pure fact, and quite different from the legal term domicile.[47] In *Mozes v. Mozes*,[48] the Ninth Circuit pointed out that habitual residence under the Convention is primarily factual, but that does not mean it is left entirely unreviewed.[49] The Ninth Circuit noted that the most straightforward way to determine someone's habitual residence would be to observe his behavior.[50] The district court considered that someone's habitual residence would be based strictly on criteria such as how long the child resided in a state and whether her life was centered around a particular location.[51] The district court also considered the English courts' requirement of a "degree of settled purpose" in order to establish habitual residence.[52] However, the district court recognized that the principle of "settled purpose" is difficult to apply to young children who are not old enough to articulate reasons such as business opportunities that would enable them to habitually reside in a particular place.[53] In light of this, the district court explained that the "settled purpose" of a small child is elusive, and to fix the child's residence it is necessary to look beyond the subjective intent of those entitled to the objective manifestations of the parents.[54]

The first objective factor considered by the court was the relative period of time the parties resided in the alleged habitual residence.[55] In *Feder v. Evans-Feder*,[56] the Third Circuit found that a child's habitual residence is the place where he or she has been physically present for an amount of time sufficient to become accustomed to his or her surroundings.[57] Furthermore, the district court considered whether the parties resided in the residence on a temporary or conditional basis.[58] Lastly, the steps the parents have taken to acclimate their child to her surroundings are another objective manifestation of intent to habitually reside in a location.[59] Those steps may include an attempt to establish a regimen, school attendance and the presence of family, friends and doctors.[60]

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46. *Id.* at *16.
47. *See* Elisa Perez-Vera, Explanatory Report in 3 Hague Conference On Private International Law: Acts And Documents Of The Fourteenth Session, Child Abduction 426 (1982).
48. 239 F.3d 1067, 1070 (9th Cir. 2000).
49. *Id.*
50. *Id.*
51. *Armiliato*, 2001 U.S. Dist. LEXIS at *17.
52. *Id.* at *18.
53. *Id.*
54. *Id.*
55. *Id.*
56. 63 F.3d 217 (3d. Cir. 1995).
57. *Id.* at 224.
58. *Armiliato*, 2001 U.S. Dist. LEXIS at *21.
59. *Id.* at *22.
60. *Id.*

The district court found that Genoa, Italy was Alessandra's habitual residence through the following rationale.[61] Alessandra traveled all around the world but continually returned to Genoa, Italy.[62] Alessandra regularly attended school in Genoa for the first half of the school year and visited with her grandparents most weekends in Genoa.[63] The district court did not find it persuasive that Alessandra was registered in an Italian-American school in New York, interpreting this fact as evidence of her parents not wanting her to miss school on the chance Mr. Armiliato would perform in New York.[64]

Also, the district court pointed to a letter written by Ms. Zaric-Armiliato's attorney, notifying Mr. Armiliato that Alessandra's visit to New York was temporary.[65] Furthermore, Ms. Zaric-Armiliato and Alessandra could not remain in the U.S. indefinitely, because they arrived in New York in the visa waiver program and were permitted to stay only until March 11, 2001.[66] The district court pointed out that the only significant tie the family had to New York was that Mr. Armiliato owned an apartment in Manhattan and that Alessandra had made some friends and occasionally attended a pre-school in New York.[67] The district court stated that the arguments by the respondent did not overcome the evidence that pointed to Genoa, Italy as Alessandra's habitual residence.[68] The district court also noted that Ms. Zaric-Armiliato's personal desire to establish a permanent home in New York as her marriage unraveled was not sufficient to establish Alessandra's habitual residence in New York.[69] This is reinforced in *Friedrich v. Friedrich*, when the Sixth Circuit explained habitual residence could be altered only by a change in geography and the passage of time, meaning that the parent who absconds with the child cannot claim a new habitual residence.[70]

The district court then found that Ms. Zaric-Armiliato's removal of Alessandra breached rights of custody enjoyed by Mr. Armiliato under Italian law and that he was exercising those rights at the time of the removal.[71] The district court looked to Article 14 of the Convention, which allows the court to take judicial notice of the law of habitual residence.[72] This enabled the district court to show that Mr. Armiliato's rights of custody were breached.[73] The court recognized that under Article 3 of the Convention, rights of custody might arise by operation of law or by reason of judicial or administrative decision, or by reason of an agreement having

61. *Id.*
62. *Id.* at *23.
63. *Id.*
64. *Id.*
65. *Id.* at *24.
66. *Id.*
67. *Id.*
68. *Id.* at *25.
69. *Id.*
70. *See* Friedrich v. Friedrich, 983 F.2d 1396 (6th Cir. 1993).
71. *Armiliato*, 2001 U.S. Dist. LEXIS at *25.
72. *Id.*
73. *Id.* at *26.

legal effect under the law of the state.[74] The district court found that Italian law determined Mr. Armiliato's rights of custody, because there were no prior court orders or agreements between the parties with respect to the custody of Alessandra when she was removed from Italy.[75] Thus the district court found that Mr. Armiliato, who was married when Ms. Zaric-Armiliato removed Alessandra from Italy, enjoyed rights of custody as defined by the Convention.[76] The court also found that although Alessandra resided primarily with her mother, Mr. Armiliato was in constant contact with Alessandra, he assisted in determining where she would go to school, he provided her medical needs and he took her on vacation.[77] The district court also noted that immediately prior to her removal, Alessandra spent the weekend with her father at his parents' home.[78] For these reasons, the district court found that Mr. Armiliato was exercising his rights of custody at the time of her removal.[79]

The district court properly found that Ms. Zaric-Armiliato's removal of Alessandra from Genoa breached Mr. Armiliato rights of custody.[80] Because Ms. Zaric-Armiliato was not able to present any evidence that any of the four narrow exceptions set forth in the Convention applied, the district court ordered Alessandra to be returned to her habitual residence, Genoa, Italy.[81] Unlike the case in *Blondin v. Dubois*, Alessandra was in no grave risk of potential physical or psychological harm, and Mr. Armiliato's rights were protected under the Convention as implemented by the International Child Remedies Act.[82] The application of the Convention is just a matter of finding the facts that surround the case, and this analysis by the court gives the correct application of the Convention as implemented by the Child Abduction Remedies Act to return children wrongfully removed from one of their parents.

**Elizabeth M. Stover**

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74. *Id*.
75. *Id*. at *27.
76. *Id*.
77. *Id*.
78. *Id*. at *28.
79. *Id*. at *29.
80. *Id*.
81. *Id*.
82. See *Blondin*, 189 F.3d at 247, *see also* 42 U.S.C. § 11601 (2001).

# *Virtual Countries, Inc. v. Republic of South Africa*

148 F. Supp. 2d 256 (S.D.N.Y. 2001)

**The United States District Court for the Southern District of New York held that plaintiff failed to satisfy the requirements for the "commercial activity" exception to the Foreign Sovereign Immunity Act of 1976 and thus granted defendants' motion to dismiss the case for lack of subject matter jurisdiction.**

In *Virtual Countries, Inc. v. Republic of South Africa*,[1] a private company sought a declaration that it had the right to the Internet domain name, "southafrica.com" and a worldwide injunction forbidding the Republic of South Africa and the South African Tourist Board from seeking a contrary declaration.

The case arose over the issue of control of the Internet domain name.[2] Plaintiff Virtual Countries, Inc. (hereinafter "Virtual")[3] registered the domain name "southafrica.com," which it asserted it had "owned and maintained" since May 13, 1995 and used in commerce since October 1996.[4]

On October 30, 2000, defendant Republic of South Africa (hereinafter "Republic") issued a press release stating that "countries have the first right to own their domain names."[5] The press release further stated that Republic "could be the first country in the world to make a challenge for the right to own its own domain name in the largest of the high-level domain names—dot.com."[6] To this end, the release indicated that Republic intended to file an application with the World Intellectual Property Organization (hereinafter "WIPO")[7] by November 10, 2000, declaring its rights in the "southafrica.com" domain.[8] Republic's intention was to use the domain name to promote trade and tourism.[9] Republic's view was that WIPO should rec-

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1. 148 F. Supp. 2d 256 (S.D.N.Y. 2001) (hereinafter "*Virtual Countries*").
2. "A domain name consists of a second-level domain, freely selected by the individual registering the name, followed by a top-level domain, such as '.com,' '.net,' or '.org'." *Virtual Countries*, 148 F. Supp 2d at 259 n.1 (quoting TCPIP Holding Co., Inc. v. Haar Communications, Inc., 244 F.3d 88, 91 n.3 (2d Cir. 2001)).
3. Virtual is a corporation organized and existing under the laws of the State of Washington, with its principal place of business in Seattle, Washington. Virtual manages "country-specific" Internet domain names. *Virtual Countries*, 148 F. Supp. 2d at 259.
4. *Virtual Countries*, 148 F. Supp. 2d at 259.
5. *Id.* at 261.
6. *Id.*
7. WIPO and the Internet Corporation for Assigned Names and Numbers (ICANN), form the two primary international organizations that set policy in regard to domain name registration. *Virtual Countries*, at 259. WIPO is a United Nations agency, which administers 21 international treaties relating to intellectual property protection. Currently, the organization has 177 members, including Republic. *Id. See generally* Stacey H. King, *The "Law That It Deems Applicable": ICANN, Dispute Resolution and the Problem of Cybersquatting*, 22 HASTINGS COMM. & ENT. L.J. 453 (2000).
8. *Virtual Countries*, 148 F. Supp. 2d at 261.
9. *Id.*

ommend a *per se* exclusion of the registration of country names in the second-level domain.[10] Additionally, Republic also suggested the adoption of a policy subjecting entities that register country names in the second-level domain to binding arbitration.[11] At the time of the press release, Republic was planning to submit these views to WIPO and the Internet Corporation for Assigned Names and Numbers (ICANN);[12] it did so in March, 2001.[13]

In response to the press release, Virtual sued Republic and the South African Tourism Board (SATOUR) on November 3, 2000.[14] Virtual alleged that Republic's announcement of its intention to litigate and assert its rights to the domain name injured Virtual by contesting the ownership of Virtual's underlying assets.[15] Virtual sought declaratory and injunctive relief.[16] Defendants moved to dismiss the action for lack of subject matter jurisdiction under the Foreign Sovereign Immunity Act of 1976 ("FSIA")[17] and to dismiss the action as to SATOUR for failure to state a claim.[18]

In dismissing the action for lack of subject matter jurisdiction, the court first noted that the FSIA provides the sole means of obtaining jurisdiction over a foreign state in the courts of this country.[19] In addition, the term "foreign state" includes an agency or instrumentality of a foreign state.[20] Therefore, SATOUR qualified as a foreign state under the statute as well.[21] Under the FSIA, a foreign state is presumptively immune from the jurisdiction of U.S. courts, unless a specified exception is found to apply.[22] The exception raised by Virtual was the "com-

10. *Id*. at 260.

11. *Id.*

12. ICANN is responsible for setting policy for the assignment of domain names, and for the resolution of Internet domain name conflicts. *Virtual Countries*, F. Supp. 2d at 259. Several committees advise ICANN, including the Governmental Advisory Committee ("ICANN-GAC"), of which Republic is a member. Currently, the international procedure for domain name dispute resolution occurs through ICANN's Uniform Domain Name Dispute Resolution Policy ("UDRP"). This procedure was developed by WIPO and focuses on the registration of domain names in violation of trademark rights. *Id.* at 260. *See generally* Mathew Edward Searing, Note, *"What's In a Domain Name?" A Critical Analysis of the National and International Impact on Domain Name Cybersquatting*, 40 WASHBURN L.J. 110, 131(2000) (discussing the formation of ICANN in 1998 by WIPO).

13. *Virtual Countries*, at 260. In its interim report published April, 2001, WIPO stated that a system of *per se* exclusions would not be a desirable means of protecting countries' names. A final WIPO report, published September 3, 2001, contained WIPO's recommendations to ICANN concerning domain name registration policy. *See Report of the Second WIPO Internet Domain Name Process, at* <http://wipo2.wipo.int>. WIPO offers non-binding recommendations. ICANN and WIPO members may accept or reject the report's conclusions. *Virtual Countries*, 148 F. Supp. 2d at 261.

14. *Virtual Countries*, 148 F. Supp. 2d at 262.

15. *Id.*

16. Virtual sought a declaration that it had the sole right in the southafrica.com domain, and an order enjoining defendants from seeking a declaration of their rights to register the domain name in arbitral or court proceedings worldwide. *Id.*

17. 28 U.S.C. 1330, §§ 1602–11 (1994).

18. *Virtual Countries,* 148 F. Supp. 2d at 262.

19. *Id.* at 263 (citing Saudi Arabia v. Nelson, 507 U.S. 349, 355 (1993)).

20. *Id.* at 262.

21. *Id.*

22. *Id.* at 263.

mercial activity" exception.[23] Virtual claimed that jurisdiction was proper under the third clause of the commercial activity exception.[24] The court's analysis therefore focused on considering whether the lawsuit was "(i) 'based. . .upon an act of Republic outside the territory of the United States'; (ii) that was taken 'in connection with a commercial activity' of Republic outside this country; and (iii) that 'caused a direct effect in the United States.'"[25]

Virtual and Republic primarily disagreed as to whether such acts were taken "in connection with a commercial activity" of Republic, and whether the acts had a "direct effect in the United States."[26] The court answered both questions in the negative.[27] While Virtual maintained that Republic had engaged in commercial activity, the court found that the issuance of the press release did not rise to this level in part because it did not constitute "trade, traffic or commerce" within the marketplace.[28] As the court noted, Republic simply issued a press release stating its intention to file an application with WIPO for the right to own the southafrica.com domain name.[29] In addition, Republic affirmatively represented that it would not begin an arbitration in WIPO or another similar organization under the existing UDRP procedures.[30] Thus, as the court noted, even assuming that the initiation of arbitration would constitute the requisite commercial activity under the FSIA, it appeared that such a filing by Republic was not imminent.[31]

The second prong of the court's analysis indicated that even if Republic's actions were assumed to be "commercial" under the FSIA, they would still be insufficient to trigger the commercial activity exception, because they did not cause a "direct effect" in the U.S.[32]

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23. *Id.* The commercial activity exception is codified in 28 U.S.C. § 1605(a)(2) and provides that:

> [A] foreign state is not immune from suit in any case in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; or upon an act outside the territory of the United States in connection with a commercial activity of the foreign state elsewhere and that act causes a direct effect in the United States.

28 U.S.C. § 1605(a)(2).

24. *Virtual Countries*, 148 F. Supp. 2d at 263.

25. *Id.*

26. *Id.*

27. *Id.*

28. *Virtual Countries*, 148 F. Supp. 2d at 264 (citing Republic of Argentina v. Weltover, 504 U.S. 607, 614 (1992)). The court also noted that in *Weltover*, the Supreme Court set forth the standard by which to judge the existence of commercial activity, which reflected the "restrictive" theory of foreign sovereign immunity. Under the theory, a foreign sovereign's acts are "commercial" within the meaning of the FSIA when the sovereign "acts, not as a regulator of the market, but in the manner of a private player within it." *Id.* (citing to *Weltover*, 504 U.S. at 614).

29. *Virtual Countries*, 148 F. Supp. 2d at 264.

30. *Id.* at 265.

31. *Id.*

32. *Id.* The standard establishing a direct effect is the one enunciated in *Weltover*, which states that "an effect is direct if it follows as an immediate consequence of the defendant's activity," though it need not be substantial or foreseeable. *Id.* at 266 (citing to *Weltover*, at 618).

Virtual claimed that it suffered economic loss as a direct result of Republic's issuance of the press release.[33] Virtual's president and CEO, Gregory Paley, stated that the release had a negative effect on Virtual's business operations, in particular by tarnishing Virtual's image with potential investors.[34] In finding these allegations insufficient to establish the necessary direct effect under the FSIA, the court described such allegations as "entirely conclusory."[35] Furthermore, the court found that Virtual's allegations also failed to meet the direct-effect burden, because an undefined financial loss alone is not sufficient to trigger the commercial activity exception.[36]

In dismissing the action as to SATOUR for failure to state a claim, the court held that because SATOUR is an agency of Republic, the same lack of subject matter jurisdiction under the FSIA would apply.[37] Additionally, SATOUR was not alleged to have performed acts apart from its role as an agency of Republic, or any acts that caused Virtual injury.[38]

The court's decision in this case seems to reflect the fact that the law regarding Internet domain names is still developing. The Executive Summary of the Second WIPO Internet Domain Name Process observes that the registration of domain names by parties without any connection to the name often offends other parties who have a greater association with the name.[39] However, as the Executive Summary suggests, the "international framework in this area needs to be further advanced before an adequate solution is available to the misuse of geographical indications in the DNS [domain name system]."[40]

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33. *Id.* at 266.

34. *Id.*

35. *Id.*

36. *Virtual Countries*, 148 F. Supp. 2d at 267 (citing Antares Aircraft, L.P. v. Fed. Republic of Nigeria, 999 F.2d 33, 34–35 (2d Cir. 1993)). The Second Circuit held in *Antares* that jurisdiction under the FSIA does not lie where all "legally significant acts" occur outside the U.S. *Virtual Countries*, 148 F. Supp. 2d at 267.

37. *Virtual Countries*, 148 F. Supp. 2d at 268–69.

38. *Id.* at 269.

39. *See* Executive Summary, at <http://ecommerce.wipo.int/index-eng.html>; *see also* Report of the Second WIPO Internet Domain Name Process, at <http://wipo2.wipo.int>.

40. Id.