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PRIVATE v PUBLIC AUTHORITY IN NAFTA: THE PROCYCLICALITY OF INVESTOR PROTECTIONS AND GLOBAL GOVERNANCE ISSUES

by

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ABSTRACT OF THE DISSERTATION

Private v Public Authority in NAFTA: The Procyclicality of Investor Protections and Global Governance Issues

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As states fiercely compete for international trade, there is growing concern about the emergence of private authority in global governance systems. States have delegated various aspects of their regulatory authority to private actors to facilitate the expansion of free trade in the global markets. This delegation of authority has generated the expansion of private international administrative law involving states. An unintentional, or perhaps intentional, consequence of this change in authority is the empowerment of private actors over states.

When states seek to compete in a globalized financial market and increase foreign investment flows, investors demand protection from "unfair" state actions in exchange for their investments. As regulatory activities and investment transactions increase so often does the volume of disputes between public and private actors. The result can be the development of an effective investor-state dispute settlement mechanism. This study examines the procyclicality of investor protections and global governance issues, with particular attention to the North American Free Trade Agreement's (NAFTA) Chapter 11

on investments.

The current literature on global political economy has not yet fully explored the complex interdependency between states and private actors. NAFTA established an investor-to-state dispute arbitration mechanism to deter states from unfair national treatment and even expropriation. Under this structure, private investors may file claims directly against a state for monetary damages. Unlike national courts presided over by publicly appointed or elected judges, these tribunals consist of private individuals selected by the investors and member states.

This dissertation examines the expansion of private authority through NAFTA tribunals, as a case study of the accommodation accorded to firms in evolving patterns of global governance. The analysis also includes a review of relevant global political economy literature; a comprehensive analysis of newly released U.S. National Archives and White House documents related to NAFTA; an overview of the U.S.-Mexican Claims Commissions (1838-1946); and key information obtained through candid interviews with former senior U.S. and Mexican officials regarding NAFTA and its Chapter 11 tribunals.

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This research contains the views of many individuals who were, and some still

are, major players in the development, expansion, and study of free trade and international arbitrations. I would like to express my gratitude to the many terrific people who contributed to this scholarship. The following individuals were generous with their time and assisted me to learn more about the White House and legislative decision-making process related to trade issues, the negotiation and implementation of NAFTA, and NAFTA's investor-state dispute settlement mechanism: General Brent Scowcroft, Ambassador Carla A. Hills, Ambassador Andrés Rozental, Dr. Robert A. Pastor, Ph.D., Professor Andreas F. Lowenfeld, Professor Andrea K. Bjorklund, Jon E. Huenemann, James W. Cicconi, Guillermo Aguilar-Alvarez, Charles (Chip) Roh, Nicholas E. Calio, Warren H. Maruyama, Mélida N. Hodgson, J. French Hill, Frederick D. McClure, Stephen P. Farrar, Ari Fleischer, and Daniel M. Price.

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Finally, I would like to thank my family for their patience and support. I could not have completed this thesis without the loving support of my wife and children. This manuscript is dedicated to my father, Hugh Rosero, whose selfless devotion to his family and endless pursuit of knowledge inspired me to achieve higher goals in life.

TABLE OF CONTENTS

CHAPTER 1

INTRODUCTION

As states fiercely compete for global trade, there is growing concern about the emergence of private authority in global governance systems. States have partly delegated their regulatory authority to private actors to facilitate the expansion of free trade in the global markets.[1] This delegation of authority has generated the expansion of private international law involving states. An unintentional, or perhaps intentional, consequence of this change in authority is the empowerment of private actors over states.

As part of global governance systems, regional trade agreements were created with the intent to foster free trade by deterring states from implementing nationalistic and anti-competitive commercial trade policies.[2] A potent mechanism of deterrence is the investor-to-state dispute arbitration process developed under Chapter 11 of the North American Free Trade Agreement (NAFTA).[3] Chapter 11 provides private investors with a legal right to bring claims directly against a member state for economic loss to the

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[1] Shara L. Aranoff, *Regional Trade Organizations: Strengthening or Weakening Global Trade?*, 88 Am. Soc'y Int'l L. Proc. 309 (1994). Professor Frederick M. Abbott believes "a regional trading arrangement by definition involves a concession of sovereignty, because it limits the freedom of action of the contracting states." Id at 322. Charles (Chip) Roh, former Assistant U.S. Trade Representative and Deputy Chief U.S. Negotiator of NAFTA, agrees with Abbott's position and acknowledges there is some "degree of transfer of a sovereignty entailed in [a treaty] like NAFTA." Id.

[2] Emmanual Gaillard, *Loewen Group v U.S.A.: New Ground in NAFTA/ICSID Arbitration*, N.Y.L.J. (Apr. 5, 2001).

[3] North American Free Trade Agreement (pts. 1 & 2), U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 & 605; North American Free Trade Implementation Act, 19 U.S.C.A. §§ 3314 *et seq*., Pub. L. No. 103-182, 107 Stat. 2057 (1993) [hereinafter NAFTA].

investor's investment caused by the state. Unlike traditional judicial hearings presided over by appointed or elected judges, these tribunals consist of private individuals selected by the investors and member states. The arbitrators evaluate the member states' laws, public policy, and decision-making that allegedly aggrieved the investor. Although arbitrators have limited authority to render only monetary awards, their decisions are final, and are generally not subject to review by any of the states' national courts.[4] Moreover, the decisions have a broader implication for laws and public policy that are at the center of the dispute.

During the past two years, the U.S. economy has spiraled into a major recession after the stock market peaked in October 2007. At its peak, the Dow Jones Industrial Average (the "Dow Jones" or DJIA), which averages the stock prices of thirty of the largest and most widely held U.S. public companies, reached an all-time high of over 14,100 points, and large companies such as AIG, Citigroup and General Motors were listed on the index. By late 2008, the extraordinarily high rate of mortgage defaults and foreclosures, a crippling credit crunch, and the unraveling of derivative investment products contributed to one of the most significant declines in the American economy since the Great Depression. In September 2008, the decline was marked by the Lehman Brothers' bankruptcy filing that caused the Dow Jones to tumble more than 500 points in one day for only the sixth time in its history. Shortly thereafter, the Dow Jones experienced nine of its largest intraday swings since 1987 (and sixteen of the top twenty)

[4] See Henry Paul Monaghan, *Article III and Supranational Judicial Review*, 107 Colum. L. Rev. 833 (2007).

had occurred between the period of September 29, 2008 through November 21, 2008.[5] Further, the largest intra-day point swing resulted in a decline of more than 1,000 points from 8,901 to a low of 7,882 on October 10.[6]

Some commentators contend the current global economic turmoil has tempered the emergence of private authority in global markets. They also argue that the proposed revamping of the regulatory framework for the financial markets and corporate structures of U.S. financial institutions is a strong indicator that states are still exercising their power and influence over private actors, including financial institutions and other types of firms. Although a major restructuring of the U.S. regulatory framework is inevitable within the next few years, there is still ample space for private actors to exercise significant influence over states and their laws and public policies, especially in international trade matters through private arbitrations.

When states seek to compete in a globalized financial market and increase foreign investment flows, investors demand protection from "unfair" state action in exchange for making investments within the states. This series of events results in the procyclicality of investor protections and global governance issues.[7] As regulatory activities and investment transactions increase so often does the volume of disputes between public and private actors.[8] The result is the need for a strong and effective investor-state dispute

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[5] Wall Street Journal, Dow Jones Industrial Average Largest Intraday Point Swings, Since 1987, online at http://online.wsj.com/mdc/public/page/2_3047-djia_intraday.html (visited on June 19, 2009).

[6] Id.

[7] For purposes of this thesis, the term "procyclicality" is defined as a sequence of changes in regulatory policy that magnifies the fluctuations of investor claims against states.

[8] United Nations Conference on Trade and Development, *Investor-State Dispute Settlement and Impact on Investment Rulemaking 2007*, Geneva UNCTAD/ITE/IIA/2007/3.

settlement mechanism. Since these events impact perceived state sovereignty and the regulation of global trade and financial markets, the interaction between public authority and private authority in this space is a vitally important area for research.

In addition, as states continue to delegate components of their regulatory function to private actors, we must consider how this shift from public authority to private authority has reconfigured the traditional notions of global governance. How is this reconfigured system impacting the public, multinational corporations (MNCs) and regulatory institutions? In light of the current global economic turbulence, what strategic changes have states and MNCs taken to manage this shift in authority?

Hansen and Salskov-Iverson note the disaggregation and entanglement of authority leads us to consider the multi-faceted dynamics of key actors within a wider process.[9] Underlying the ambiguities produced by disaggregation, they raise the question of accountability and the role of the private actors in global governance as the subject of future research. The purpose of this study is to investigate the development of private authority within a regional arena of global trade. NAFTA, a trilateral free trade treaty between the United States, Mexico and Canada, provides a primary case study with potentially broader implications.

Complex relationships between business and regulatory institutions are inherent in cross-border trade transactions. The intersection between business concerns and government regulation has important consequences for both the present and future viability of a business's product development, marketing and distribution, and also for

[9] Hans Krause Hansen and Dorte Salskov-Iverson, eds., *Critical Perspectives on Private Authority in Global Politics* (Palgrave Macmillan, 2008).

societies within which that business has, of necessity, to operate. This study concerns the degree to which private actors are not only central to global trade politics, but also directly impacting public law and policy through private international regimes such as NAFTA's Chapter 11 arbitrations.

There exists extensive literature and research on NAFTA.[10] While this literature primarily focuses on NAFTA's economic benefits, legal interpretations, and effects on specific public policy issues, there is little research on NAFTA as a global governance sub-system, and the balance between public and private authority as a result of this system. The following analysis explores the type of authority asserted by firms through NAFTA's arbitration tribunals from three key perspectives: (1) as a response to a growing global trend toward developing free-trade zones between states within regions; (2) as a continuity of joint U.S. and Mexican arbitration systems over the past 170 years; (3) and as an effective investor protection mechanism to deter or change state behavior toward free trade and foreign investments.

In their attempt to foster free trade, we have noted states have delegated various degrees of authority to private actors and fora. States create mechanisms such as Chapter 11 to regulate the conduct of other states, but these mechanisms have also led to the development of a new legal norm based on private administrative law by which private

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[10] See generally Frederick W. Mayer, *Interpreting NAFTA: The Science and Art of Political Analysis* (Columbia University 1998); Joseph A. McKinney, *Created from NAFTA:The structure, Function, and Significance of theTtreaty's Related Institutions* (M.E. Sharpe 2000); Ralph H. Folsom and W. Davis Folsom, eds., *NAFTA Law and Business* (Kluwer Law International 1999); Alan Rugman et al., *Environmental Regulations and Corporate Strategy : a NAFTA Perspective* (Oxford University 1999); Alejandro Posadas, *Closer Borders: Investment and Law in Mexico After the NAFTA*, 6 Duke J. Comp. & Int'l L. 371 (1996); Carolyn L. Deere and Daniel C. Esty, eds., *Greening the Americas: NAFTA's Lessons for Hemispheric Trade* (MIT 2002), Sidney Weintraub, ed., *NAFTA's Impact on North America: The First Decade* (Center for Strategic and International Studies 2004); and David Bacon, *The Children of NAFTA* (University of California 2004).

actors, such as firms, are empowered over states. Chapter One examines the current debate on the theoretical and normative changes caused by firms on global governance systems, and suggests the significance of NAFTA's tribunals as a case study.

Chapter Two reviews the current literature on private authority in global governance. The first half of this section highlights scholarly articles that speak to the "emergence of private authority in the international system, and the extent to which this phenomenon is significant … to international political economy."[11] In the second half of this chapter the argument is the lack of effective regulation, or the increased delegation of regulatory authority to private actors by states has resulted in what Saskia Sassen calls a "new geography of power."[12] This area of power is the development of private administrative law involving states. An example of this development is the establishment of the investor-to-state dispute resolution mechanism under Chapter 11 of NAFTA. This mechanism subjects states to substantially the same arbitration rules utilized by private actors in resolving their commercial disputes. It is, in actuality, a supranational institution that empowers private actors over states. Chapter Two also provides a general overview of the impact globalization has had in promoting the current global financial markets and focuses on Susan Strange's perspective on the volatility of the markets and the inability of states to regulate them. This section explains what "globalization" is as it relates to these markets, but is not intended to, nor could it possibly provide a

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[11] R.Bruce Hall and Thomas J. Biersteker, eds., *The Emergence of Private Authority in Global Governance*, xv (Cambridge University 2002).

[12] Saskia Sassen, *Embedding the Global in the National: Implications for the Role of the State*, in *State and Sovereignty in the Global Economy* in *States and Sovereignty in the Global Economy*, David Smith, Dorothy Solinger and Steven Topik, eds., 158,160 (Routledge 1999)[hereinafter *Embedding the Global*].

comprehensive review of all the potential political and economic issues related to globalization.

Since NAFTA is central to this, it is important for background to understand the complex history and often complicated relationship between the United States and Mexico related to the resolution of monetary claims of its citizens against the other state. Chapter Three provides an overview of the precursor to NAFTA's investor-state dispute settlement mechanism that was developed and utilized by these two neighboring states dating back to the early days of Mexico's independence from Spain in the 1820s. Between 1838 and 1945, these states entered into several treaties establishing claims commissions comprised of government representatives who were charged to review thousands of claims, evaluate evidence submitted by claimants and the respondent state, issue an opinion whether to approve or deny the claim, and, if approved, to determine the amount of damages to be paid by the offending state. Under this claims commission structure, any claim that resulted in a deadlock decision between the national arbitrators was eligible for appeal to an impartial umpire who was usually a national from a third state.

The U.S.-Mexican claims commissions have significant historical value not only as the precursor to NAFTA's Chapter 11 dispute settlement mechanism, but also as a pioneer framework for international arbitration. Chapter Four provides a summary of selected claims arising from the war between the two states, U.S. territorial expansion, and Mexican expropriation and nationalization movements. A substantial portion of this information was taken directly from primary source documents maintained by the U.S. National Archives. They describe in detail how the arbitrators: (1) reviewed a myriad of

claims with limited authority; (2) handled political interference from each of their countries; (3) managed unreasonable expectations of their national governments and fellow citizens; (4) identified fraudulent claims typically based upon minimal information; and (5) dealt with an overwhelming docket in a short time period with rudimentary communication methods. Original written decisions of the Mexican arbitrators were translated from the Spanish by the author. The global political economy literature related to the impact of the U.S.-Mexican Claims Commissions is sparse, so this dissertation helps to demonstrate a continuity of an arbitration system between the U.S. and Mexico that has existed since the 1830s.

National Archives records shed light on the strengths and weaknesses of the claims commission structure that led to its failure to resolve investor-state disputes effectively within a reasonable time period. The commissions and NAFTA tribunals were both established and empowered by states, but the results of these dispute settlement mechanisms differ drastically from each other. The claims commissions rarely completed their review of thousands of claims within the short time frames imposed by the governments. Even when the commissioners adjudicated a claim in favor of a claimant, the likelihood of successfully enforcing or collecting the awards was extremely low. The result was a huge docket of open claims that kept rolling over to new commissions for several decades without any hope of a closure, let alone a timely closure.

On the other hand, NAFTA's Chapter 11 dispute settlement mechanism has so far proved to be effective structure to adjudicate claims within a relatively short period of time. The power bestowed on the private arbitrators who preside over the tribunals is

greater because of their independence from government interference. More importantly, NAFTA clearly makes the tribunals' awards final and generally not subject to the jurisdiction of the members' national courts. There is thus a significant contrast to the historical pattern.

Chapter Four provides an overview of key international trade and foreign affairs issues that influenced the United States' decision to enter into NAFTA. By the late 1980s, there was a growing trend toward multilateral and bilateral free trade agreements throughout the world. In 1988 the United States and Canada finalized a major free trade agreement between the two neighboring states. The concept of free-trade zones had also become popular with proposals such as the Andean Trade Initiative and Japan-U.S. Free-trade zone. In addition, the United States was in the midst of intense negotiations with over one hundred countries in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). These events laid the foundation for the United States to become receptive to Mexico's proposal in 1990 to negotiate a free trade agreement, which was later expanded to include Canada.

Chapters Five and Six detail the basic structure of the investor-state arbitration tribunal system under NAFTA. They also explain the political and historical influences on the development and negotiations of NAFTA's arbitration process. This research is the first known to discuss and analyze recently released declassified White House, Central Intelligence Agency, and National Security Council documents.[13] It is also the

[13] The author was the original submitter of Freedom of Information Act (FOIA) and Presidential Records Act Mandatory Review (MR) requests for the release of numerous classified White House, Central Intelligence Agency, and National Security Council records that were finally released in late 2009, after five years of navigating through a complex regulatory structure and the bureaucracy of several federal agencies.

first to analyze internal decision memos, strategy books, electronic communications, and handwritten notes of key governmental decision-makers concerning NAFTA and the need to prevent expropriation of American investments in Mexico. Furthermore, this study contains unpublished information from candid interviews with former senior U.S. and Mexican officials who participated in the drafting and negotiations of the trade agreement.

Chapter Seven discusses three significant NAFTA claims that have impacted public policy and laws through the resolution of private claims in the confidential investor-state arbitration tribunal system. The first claim involves the *Ethyl Corporation v Canada* in which the latter agreed to settle the claim after the tribunal issued several rulings in favor of the investor.[14] This settlement consisted of monetary compensation and resulted in significant changes to government regulations that benefited private actors. The second claim involving the *Loewen Group* highlighted the flaws of one American state court system and the vulnerability that national court decisions can later be scrutinized by an arbitration panel consisting of private actors.[15] The third claim, *Fireman's Fund Insurance Co. v United Mexican States*, pertains to the damages allegedly incurred by a major U.S. insurance firm against the Mexican government based, in part, on a claim for expropriation.[16] This chapter also discusses whether NAFTA's investor-to-state dispute resolution mechanism has caused states to diminish their control

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[14] *Ethyl Corp. v Canada*, 38 I.L.M. 708, 709 (Jurisdiction Phase, 1999).

[15] *Loewen Group, Inc. v United States,* Award, 42 I.L.M. 811 (NAFTA Arb. Trib. 2003).

[16] *Fireman's Fund Ins. Co. v United Mexican States*, ICSID Case No. ARB(AF)/02/1ARB(AF)/02/1, Award, P 157 (NAFTA Arb. Trib. July 17, 2006).

inherent in sovereignty. Here, the argument is states have delegated some of their control but have strengthened it in other areas.

The final chapter concludes that states have partially delegated their regulatory authority to private actors to facilitate the expansion of free trade in the global markets. States create mechanisms, such as NAFTA's investor-state arbitration tribunal system, to protect investors, but the de facto result is a reverse regulation of state conduct. These mechanisms have also led to the development of an expanded legal norm based on private administrative law by which private actors are empowered over states. In this evolving sphere of influence, private actors have achieved a win-win situation. They benefit from having direct access to states related to their investments, for which states compete, while maintaining an effective method of recourse against states for any economic harm they may suffer related to those investments.

CHAPTER 2

LITERATURE REVIEW

2.1 Key Concepts of the Firm and the Law

At the core of this study lies the intimate relationship between the firm and the law. "The firm" may be defined as a legal entity with its primary objective to create wealth for its owners through the management of capital, labor, and other types of resources.[1] The law may be defined as the "legislative pronouncement of the rules which should guide one's actions in society" and is considered to be "derived from a combination of the divine or moral laws, the laws of nature, and human experience."[2] Hence, the law is an embodiment of values and norms of a society to regulate conduct of individuals and entities. It is intended to establish order within society and to foster stability of government of various societal members and transactions. Some believe that humans create laws based on some form of internal value system. Others attribute these values to divine intervention innate to the human beings, including beliefs in natural rights and a basic sense of justice.

States use laws to control, regulate, or prohibit conduct of individuals and entities

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[1] Margaret M. Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* 203, 241 (Brookings Institute 1995).

[2] *Barron's Law Dictionary* (1984).

such as firms. The struggle between states and firms for control of the business environment provokes a significant amount of tension. In a democratic society, people express their views on issues, individually, collectively or through their public representatives, that may lead to the development of laws and regulations. Nevertheless, firms exert discernible amounts of influence on lawmakers in the development of laws to the extent it can be said that these laws embody, in part, the values espoused by the firms.

2.2 Private Authority as Global Governance

Global politics literature related to private authority has focused on the implications of private actor conduct to influence global governance, and the resulting theoretical and normative changes.[3] Thomas Biersteker and Rodney Bruce Hall argue that "authoritative actors are not only important players in the international political economy; they are increasingly beginning to play a critical role in the governance of other important spheres of social and political life."[4] A few things these actors have affected in these spheres include "the establishment of standards, the provision of social welfare, the enforcement of contracts, and the maintenance of security."[5] They note the

[3] Hans Krause Hansen and Dorte Salskov-Iverson, eds., *Critical Perspectives on Private Authority in Global Politics* (Palgrave Macmillan 2008); Rodney Bruce Hall, *Private Authority*, 27 Harvard International Review 66-70 (2005); and Timothy Sinclair, *A Private Authority Perspective on Global Governance* in Alice D. Ba and Matthew J. Hoffman, eds., *Contending Perspectives on Global Governance* (Routledge 2005).

[4] Thomas J. Biersteker and Rodney Bruce Hall, eds., *The Emergence of Private Authority in Global Governance* 203(Cambridge University Press 2002).

[5] Id.

traditional conception of authority has centered on the state and its ability to control behavior through different means including coercion. It is "during the latter decades of the twentieth century," they argue, "that there were a growing number of theoretical and empirical challenges to these traditional conceptions about authority and the international system."[6] These challenges have facilitated the "growing recognition of degrees of order and institutionalized, patterned interaction within the international system."[7] Thus, the scope of this authority has transcended national borders, domestic policies and law politics, to the extent they are "influenced by, and increasingly affect international law and politics."[8]

Another dimension of this private authority concept is the development of private international regimes. Claire Cutler defines "private international regimes" as "'an integrated complex of formal and informal institution that is a source of governance for an economic issue area as a whole.'"[9] As she sees it, these regimes "may be created by 'negotiation and interaction among firms within a particular industry sector or issue area, and generally incorporate a number of business associations, both national and international. They formulate rules and procedures for dealing with conflicts among

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[6] Id at 3. For example, Yale Ferguson and Richard Mansbach published an empirical study in 1976 regarding the significance of nonstate actors in world politics. One of the main events that they identified was the integration of international trade. Their research showed that private actors such as the Economic Commission for Latin America was influential in the United States' decision to adopt parts of the Commission's trade policy recommendations. Richard Mansbach and Yale H. Ferguson, The *Web of World Politics: Nonstate Actors in the Global System* 151 (Prentice-Hall 1976).

[7] Biersteker and Hall, *The Emergence of Private Authority* at 4 (cited in note 4).

[8] Id.

[9] A. Claire Cutler, *Private International Regimes and Interfirm Cooperation* in Biersteker and Hall, eds., *The Emergence of Private Authority* at 29 (cited in note 4), quoting Claire Cutler, Virginia Haufler, and Tony Porter, *Private Authority and International Affairs* 13 (State University of New York 1999).

participants and between participants and their customers."[10] Cutler notes NAFTA is an example of private international regimes because "privatized international commercial arbitration has replaced the adjudication of international commercial disputes in national courts of law."[11] She also writes that these regimes are becoming the "institutionalized manifestation of private authority."[12] The study of these regimes, she argues, is important because "interfirm cooperation is increasingly 'taking on the mantle of authority'" and "are basically functioning like governments."[13]

2.3 Private International Regimes-Cutler's Perspective

Claire Cutler is one of the preeminent scholars who has written extensively on expansion of private authority within global systems governance systems.[14] She has analyzed the various aspects of private authority through the lens of private international law versus public international law. She also compares the effect and impact private authority and actors have within this realm. In Cutler's opinion, there is a sense of

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[10] Id.

[11] Id at 31.

[12] Id at 23.

[13] Cutler, *Private International Regimes* at 32 (cited in note 9).

[14] Claire Cutler is a Professor of International Law and Relations in the Political Science Department at the University of Victoria in Canada. Her publications include *Private Authority and International Affairs*, edited with Virginia Haufler and Tony Porter (State University of New York 1999), *Private Power and Global Authority: Transnational Merchant Law in the Global Political Economy* (Cambridge University 2003), and *International Economic Regimes and Canadian Foreign Policy* edited with Mark W. Zacher, (UBC 1992).

dichotomy between public and private authority.[15] A change is occurring within the systems, she observes, and it is necessary to better understand the impact of the overall expansion of this authority. Her writings examine the effect private authority has especially on the field of international commercial law. As Cutler sees it, "[t]ransnational commercial law or the new law merchant is an integral component of this emerging transnational legal order."[16] Her writings on the law merchant are a very fascinating study regarding the use of private international trade and national law, and the intersection between the two. Cutler argues that "the analytical theoretical challenges posed by this emergent order resonate powerfully in its description as a 'twilight zone' of international law."[17]

She believes conventional theories fail to thoroughly analyze the impact that private authority has had on the "transformation of world order."[18] Since these theories use a formalistic conceptual framework, they are incapable, she maintains, of fully describing the role of law in different areas such as "economic, social and political practices."[19] "As a consequence," Cutler explains, "neither law nor politics produces meaningful understandings of how law empowers actors as legal subjects or identifies legitimate sources and voices of the law or confers the authority and legitimacy to resolve disputes and determine outcomes or 'who gets what' in Harold Lasswell's famous

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[15] A. Claire Cutler, *Private Power and Global Authority: Transnational Merchant Law in the Global Political Economy* 1 (Cambridge University 2003).

[16] Id.

[17] Id.

[18] Id at 3.

[19] Cutler, *Private Power* at 3 (cited in note 15).

phrase."[20] She sees there is a historical problem regarding the recognition of private authority within a state centric system. As she notes, "these theories are faced with a legitimacy crises for they are unable to theorize their subject-matter in any but the most formalistic way, thus obscuring the fundamental transformations in world order that are occurring."[21]

According to Cutler, the development of private international regimes has demonstrated the "institutionalized manifestations of private authority" or private power, which involve a multitude of nonstate actors.[22] For example, there is increasing trend toward privatization of governmental functions throughout the world. In those cases, private actors have assumed specific authoritative roles that were historically reserved for states. Moreover, the role of corporations has increased within private international regimes. As she states, "corporations, seemingly and jointly, construct a rich variety of institutional arrangements that structure their behavior."[23] "Through these arrangements, Cutler argues, "they can deploy a form of *private authority* whose effects are important for understanding not just the behavior of firms, but also for analyzing the state and its policies."[24] (Emphasis in original)

Cutler is intrigued by the development of private international regimes as a component of a global governance system. In her writings, she explains that private

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[20] Id.

[21] Id at 4.

[22] Cutler, *Private International Regimes* at 23 (cited in note 9).

[23] Id (quoting A. Claire Cutler, Virginia Haufler, and Tony Porter, *The Contours and Significance of Private Authority in International Affairs*, in Cutler, Haufler, and Porter, eds., *Private Authority and Internationals Affairs* 333(State University of New York 1999)).

[24] Cutler, *Private International Regimes* at 23 (cited in note 9).

international regimes "raises three sets of consideration: analytical, theoretical, and normative."[25] The first set is the analytical process to identify private international regimes as a subset of private authority. As part of this process, it is critical to take an inventory of the various types of those regimes and to understand their scope and nature of authority. The other two sets of considerations deal with the "theoretical and normative dimensions of private international regimes."[26] These dimensions are challenging to conceptualize as the manifestation of those regimes. From a theoretical perspective, the concept of private authority expanding its power and influence challenges the traditional role of the state, pushes the existing theoretical framework for authority, and strikes at the heart of the state-centric perspective that emphasizes public authority.

The potential threat posed by private authority has normative implications. The expansion of private authority is disconcerting to those scholars who study private authority within the current models of global governance systems. Some view it as an undetected movement gradually taking root in key aspects of governance systems. Cutler points out, "as a consequence [of this shift in authority], efforts to hold private institutions accountable in any democratic way are bound to flounder, for that which goes unrecognized is difficult to regulate."[27] Private authority is able to thrive unencumbered by the common obstacles that hinder states, including political impasse and partiality toward certain special interest groups. In the process, private authority has gained

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[25] Id.

[26] Id at 24.

[27] Id.

momentum as a legitimate authority.

The analytical development of private international regimes raises a fundamental question of the relationship of private authority to the evolving theoretical concept of international regimes developed over the past three decades in the field of global political economy. Some of the prominent scholars who have developed this concept include Stephen Krasner, Joseph Nye, Robert Keohane, and Mark Zacher.[28] There are different definitions of the term "regime," but Krasner simply views them as "sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations."[29] Historically, the international relations literature tended to ignore the role of non-state actors because of its state-centric paradigm. The concept was, as Cutler explains, adopted "as a useful corrective to studies that neglected the role of non-state actors in international relations."[30]

The research and writing of various scholars, such as Zacher, helped to highlight the roles especially of international governmental actors (IGOs). Nevertheless, Cutler reminds us "the promise of broadening the analytical net to include non-state actors, particularly of the corporate kind, was not fulfilled."[31] The study of regimes tended to remain anchored in state centric perspectives. For example, Robert Keohane's definition

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[28] See generally Stephen D. Krasner, ed., *International Regimes* 2 (Cornell University 1983); Robert O. Keohane and Joseph S. Nye, *Power and Interdependence* 19 (Little, Brown 1977); and Mark W. Zacher and Brent Sutton, *Governing Global Networks: International Regimes for Transportation and Communications* (Cambridge University 1996).

[29] Krasner, *International Regimes* at 2.

[30] Cutler, *Private International Regimes* at 26 (cited in note 9).

[31] Id.

of regimes focused on states and their explicit rules to govern its nationals and matters within their borders. This analysis would gradually expand to international law, which includes rules on the requirements of non-compliance with regimes.

At the turn of the twenty-first century, the global political economy literature began to truly explore the manifestations of private authority. At that time, scholars such as Tony Porter, Virginia Haufler and Claire Cutler, among others, developed the analytical framework to explain the development of private authority. In their seminal book titled *Private Authority and Internationals Affairs*, these three authors set forth a persuasive case regarding the changing role of business in contemporary global affairs. This scholarship is premised on the concept "firms do not simply compete in world markets, they also cooperate among themselves in ways that have ramifications." Building upon this framework, Rodney Bruce Hall and Thomas J. Biersteker have continued to expand the literature by emphasizing the importance of private actors in today's global governance system.[32]

Another aspect of private authority is the differentiation between cooperation and authority. As Cutler sees it, "there is evidence to suggest that corporations often will operate, but without a sense of obligation or duty."[33] "Authority requires a basis," she explains, "in trust rather than calculation of immediate benefit, and therefore cooperation must involve the development of habits, norms, rules, and shared expectations—cooperation must be institutionalized."[34] Cutler notes "the acceptance of the legitimacy

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[32] See Hall, *Private Authority* at 66-70 (cited in note 3) and Biersteker and Hall, *The Emergence of Private Authority* (cited in note 4).

[33] Cutler, *Private International Regimes* at 27 (cited in note 9).

[34] Id at 28.

of an authority, as well as, a general sense of the efficacy of authority" are major components of authority.[35] She further explains that "[L]egitimacy involves the respect accorded 'an authority,' such as a specialist, a scholar, or an expert whose authority derives from specialized knowledge and practices that render such knowledge acceptable, and appropriate, as authoritative."[36] Another component of legitimacy includes recognition and respect by institutions and individuals such as public officials and government agencies who are empowered by the state. Beyond recognition, another critical aspect of authority is the adherence of systems and individuals to its rules and practices.

In the business world, Cutler divides the ability of private authority into several categories of cooperative arrangements between firms, and firms with states. These arrangements include: (1) informal industry norms and practices; (2) coordination service firms; (3) production alliances, subcontractor relationships, and complementary activities; (4) cartels; (5) business associations; and (6) private international regimes.[37] The arrangement most relevant to this study is a private international regime.[38] This regime is characteristically adept at obtaining broader recognition through negotiations with other private actors and state institutions. Through these negotiations, the various stakeholders develop rules and procedures to guide them. Moreover, private international regimes have greater influence due to the "pervasiveness and breadth of their activities."[39]

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[35] Id.

[36] Id.

[37] Cutler, *Private International Regimes* at 28-29 (cited in note 9).

[38] Id at 29.

[39] Id.

When private international regimes are established they tend to give their participants more structure and allow them to conduct themselves in a more effective and efficient manner. In Cutler's words: "private international regimes are thus important forms of interfirm cooperation, embodying the most extensive institutionalization of rules and procedures governing regime members and, in some instances, nonmembers as well."[40] This "interfirm cooperation represented in international regimes," she explains, "operates on multiple levels in complex ways, and often involves extensive interaction and cooperation with state."[41] In her view, "one of the important analytical goals in studying private international regimes is to understand the degree to which the private actors in a regime are independent of the public ones."[42]

As described above, private international regimes play an important role in the current global governance systems, including those related to international trade and investments. For example, Cutler finds these regimes in the dispute settlement mechanisms emerging under the General Agreement on Tariffs and Trade (GATT), World Trade Organization (WTO), and NAFTA.[43] These types of organizations or structures have privatized international commercial arbitration, and displaced national courts of law as the primary venue for the adjudication of international commercial disputes. In her writings, Cutler argues that "multinational law firms, which as 'merchants of norms,' exercise profound moral authority, in addition to market authority

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[40] Id.

[41] Cutler, *Private International Regimes* at 29 (cited in note 9)(quoting Cutler in Cutler, Haufler, and Porter, eds., *Private Authority and Internationals Affairs* at 14 (cited in note 9)).

[42] Id.

[43] Id at 31.

through the monopoly of privatized dispute settlement processes."[44] These actors, she states, operate "like a 'private club,' the entry to which is limited to those schooled in Western legal science and which perpetuates a normative regulatory order that privileges neoliberal market discipline."[45] As firms exercise increased influence in global transactions and interfirm cooperation is further developed, Cutler believes this type of cooperation takes on the "mantle of authority" as states delegate more authority to private actors, and private authority is increasingly generally accepted within states.[46]

What is the consequence of this activity? When private actors take on the "mantle of authority," Cutler argues that these actors begin to act and function like governments, which raise theoretical normative as well as potential policy concerns.[47] Under a state-centric theoretical framework, states establish and maintain public authority responsible for managing the traditional roles of public entities and officials. Presumably, the state, especially those with democratic governments, reflect the policies of representatives who are supported by, and sometimes elected by, their constituencies. Legitimate authority to make decisions that impact the state, including any of its subdivisions, are generally expected to be reserved for public actors not private actors. This is where private international regimes turn the state-centric paradigm on its head; as private actors assume authority that directly impacts states and leaves them without effective recourse to overturn such decisions.

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[44] Id.

[45] Cutler, *Private International Regimes* at 29 (cited in note 9).

[46] Id.

[47] Id at 32.

The evolving private authority can also be viewed from the perspective that they are still subject to public authority because states create some of these private international regimes and delegate certain authority to private actors.[48] Hence, private actors are not totally independent of states, nor are they self-created spheres of authority without any accountability to states. Cutler recognizes that the liberal theories of international law view is "the only legitimate 'subjects' of the law are states and their designated representatives." Under these theories, the state determines exclusively when claims can be initiated, and who may initiate them under international law and be subject to legal rights and duties. In this regard several scholars, among them, Andrea K. Bjorklund and Maureen Appel Molot, emphasize that private actors in international arbitrations are not omnipotent, nor do they operate without restraints imposed by states.[49] As Bjorklund sees it, the news media and critics "periodically draw public attention to the 'secret' threat to democracy and popular sovereignty suppose to inhere whenever an international tribunal purports to pass judgment on a U.S. court decision or

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[48] See Stephen D. Krasner, *Power Politics, Institutions, and Transnational Relations, in Bringing Transnational Relations Back*, in Thomas Risse-Kappen, ed., *Nonstate Actors, Domestic Structures and International Institutions* (Cambridge University 1995). Krasner states "Private and public actors are locked in a bargaining relationship. State may be indifferent, encouraging, or antipathetic to the activities of transnationals. When there are conflicts between the state, comprehended as a set of central decision-making organizations and personnel, and transnationals, outcomes will depend upon power." Id at 277. He also believes that "more powerful states (with the state understood as an institution structure or polity) set the basic rules and define the environment within which transnationals must function." Id at 279.

[49] Andrea K. Bjorklund, *Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims*, 45 Va. J. Int'l L. 810 (2005). Professor Bjorklund has written extensively about NAFTA and she is a former Attorney-Adviser for the U.S. Department of State (1999-2001). In her former position, she defended the U.S. Government in investor-state arbitrations brought under Chapter Eleven of the NAFTA. Bjorklund litigated significant NAFTA cases such as *The Loewen Group, Inc. v United States*, Case No. ARB(AF)/98/3 and *Mondev Int'l Ltd. v United States*, 6 ICSID (W. Bank) 181 (NAFTA Ch. 11 Arb. Trib. 2002). See also Maureen Appel Molot, *NAFTA Chapter 11: An Evolving Regime*" in Laura Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Centre for Trade Policy and Law 2002).

government regulation."[50] Yet, she notes "there is nothing secret about a nation's offering such a remedy to foreign investors … [and] a nation's conferring such authority on international tribunals is the very essence of a sovereign act."[51]

2.4 Overview of the Current Globalization Era of Financial Markets

There is a substantial amount of literature that recognizes the impact today's globalization process has had on the financial markets and governance systems.[52] The term "globalization" has actually become an elusive term in the global affairs and international relations literature.[53] Although there is no definitive definition of globalization, there are several key elements that are associated with the term.[54] References to globalization in this thesis will be based on the definitions provided by Langhorne and Held. Langhorne describes globalization as "the latest stage in a long accumulation of technological advances which has given human beings the ability to conduct their affairs across the world without reference to nationality, government authority, time of day or physical environment."[55] He views these technological

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[50] Bjorklund, *Reconciling State Sovereignty* at 815-816 (cited in note 49).

[51] Id.

[52] See Susan Strange, *Mad Money: When Markets Outgrow Government* (University of Michigan 1998).

[53] David Held, Anthony McGrew, David Goldblatt, and Jonathan Perraton, *Global Transformations: Politics, Economics and Culture* (Stanford University 1999).

[54] See generally, Geoffrey L. Herrera, *The Politics of Bandwidth: International Political Implication of a Global Digital Information Network*, 28 Rev. Int'l Studies 1, 93 (2002).

[55] Richard Langhorne, *The Coming of Globalization* (Palgrave 2001).

advances as affecting the various aspects of our society, including "commercial, financial, religious, cultural, social or political."[56] Similarly, Held explains that globalization is the "widening, deepening and speeding up of worldwide interconnectedness in all aspects of contemporary social life, from the cultural to the criminal, the financial to the spiritual."[57] Beyond the academic literature, the media and general public routinely use the term to describe broad sweeping changes in the global financial markets, culture, and foreign and domestic policies of states.[58]

There is a constant debate on the effects of globalization on public welfare, environment, financial markets, and local customs. The supporters of globalization contend the high level of connectivity between individuals and institutions throughout the world has made a positive contribution to the various aspects of society.[59] Some of these contributions include the increased volume of financial transactions throughout the world, including underdeveloped nations that are historically excluded from high levels of this activity; the advancement of telecommunications and its impact on individuals, governmental and commercial sectors; the easy accessibility to information via the Internet; and the expansion of democratic principles, especially in Eastern Europe.[60]

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[56] Id.

[57] Held, *Global Transformations* at 2 (cited in note 53).

[58] Thomas Friedman, *The Lexus and the Olive Tree* (Anchor Books 2000).

[59] See generally, Langhorne, *The Coming of Globalization* (cited in note 55);and Ronald Diebert, *Parchment, Printing, and Hypermedia: Communication in World Order Transformation* (Columbia University 1997).

[60] See generally, Risaburo Nezu, *E-Commerce: A Revolution with Power*, 221 Columbia Int'l Affairs Online Journal (2000) ; The Economist, *Knowledge is Power: Do We Need a New Competition Policy for the New Economy*? (Sept. 21, 2000); and Interview by Victor Rivero with David Beier, *Electronically Shaping a New World Order*, Government Technology, eCommerce (August 1999), online at http://www.govtech.net/publications/eCommerce/aug99/newworld.phtml (visited Oct. 12, 2002).

The anti-globalists attribute many of the social problems of states such as poverty, degradation of the environment, unsound immigration policies, and lower labor standards to globalization.[61] They view the expansion of the Internet as creating a massive digital divide between the haves and have-nots.[62] Moreover, they perceive globalization as the cause of an adverse impact on culture with the dominance of Western culture (i.e., American icons such as Hollywood stars and fast food franchises).[63] Regardless of the pros and cons of globalization, it has become clear during the past decade that the governance of international commercial transactions and public policy concerning them is increasingly necessary.

The financial markets are much more globalized today than they were ten or twenty years ago.[64] Whether the current level of globalization of the markets is only a recent phenomenon is the subject of debate among scholars.[65] Some historians assert that the current level of international trade and interconnectedness of the national economies has developed within the past thirty years primarily due to the technological advancement of telecommunications and its expansion to the masses.[66] On the other hand, there is international relations literature that suggests the current levels of global interdependence

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[61] See generally, Saskia Sassen, *Globalization and Its Discontents (*New Press 1998); Craig N. Murphy, *Global Governance: Poorly Done and Poorly Understood*, 76 Int'l Affairs 789 (2000). Contrast John Dunning, Lecture at the Rutgers University, School of Management, Newark, N.J. (April 1, 2002). Professor Dunning rejected the notion that poverty is attributable to globalization.

[62] David Dollar and Aart Kraay, *Spreading the Wealth*, 81 For. Aff. 120 (Jan-Feb 2002). See also, Bruce R. Scott, *The Great Divide in the Global Village*, 80 For. Aff. 160 (Jan-Feb. 2001).

[63] Friedman, *The Lexus and the Olive Tree* at 248-275 (cited in note 57).

[64] Held, *Global Transformations* at 234-35 (cited in note 52).

[65] Id at 11.

[66] Langhorne, *The Coming of Globalization* at 15, 18-19 (cited in note 54).

are comparable to those of the late nineteenth century.[67] Be that as it may, there is now the highest level of connectivity between people regarding political, economic, social, and cultural issues that has ever existed in world history. For example, the modern Internet evolved from a computer network project that was intended primarily for military purposes.[68] The modern use of this technology has expanded to virtually all aspects of society, including business, law, education, science, entertainment, and government.[69]

As Susan Strange's pioneering and prescient analysis expressed it, "the markets 'have simply outgrown governments' ability to regulate them."[70] She compared the markets to a casino that has gone mad.[71] "Why mad?," she explained, "[b]ecause [to her] mind it was, and is, 'wildly foolish'—the dictionary synonym for 'mad'—to let the financial markets run so far ahead, so far beyond the control of state and international authorities."[72]

She believed there were "two serious threats that jeopardize civilization."[73] The first threat is a long-term issue involving environmental concerns over the depletion of

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[67] Held, *Global Transformations* at 14 (cited in note 53).

[68] Robert E. Kahn and Vinton G. Cerf, *What is the Internet (And What Makes it Work)*, Internet Policy Institute (December 1999), online at http://www.policyscience.net/cerf.pdf (visited Feb. 20, 2010); and Diebert, *Parchment, Printing, and Hypermedia* at 131 (cited in note 59).

[69] Id. In 1999 there were an estimated "60 million host computers on the Internet serv[ing] about 200 million users in over 200 countries and territories." Id. According to a recent study, the estimated number of Internet users worldwide is approximately 1.73 billion (as of Mar. 1, 2010). http://www.internetworldstats.com/stats7.html.

[70] Strange, *Mad Money* at 17 (cited in note 52).

[71] Id at 1. See also Susan Strange, *Casino Capitalism* (Oxford University 1986).

[72] Strange, *Mad Money* at 1 (cited in note 52).

[73] Id at 2.

the ozone layer and the build-up of carbon dioxide in the atmosphere that will cause damage to nature, animals, and humans.[74] The more immediate threat to her was the concern that "if confidence in the financial markets were to collapse, causing credit to shrink … [the] world economic growth [would] slow to zero."[75] In her view, the continuous roller coaster cycle of the markets has resulted in one financial crisis followed by another.[76] The end results have been, as Strange saw it, "more volatility, more uncertainty and more anxiety."[77] If we reflect for a moment on what has happened in the financial markets between 2008 and 2010, we see that the latter of Strange's concerns has come to fruition. The enormous credit crunch of the past two years has resulted in the shrinking of economic growth throughout the world today.[78]

One key aspect of the financial markets Strange emphasized in her writings was the interconnectedness of national economies. The volatility she described centered on the frailty of the global markets when one state or region's economy fails.[79] For example, the East Asian financial crisis of 1997 exemplifies the global impact a systemic failure in the financial markets and institutions can have across the globe.[80] Poor government regulation combined with virtually nonexistent or corrupt corporate governance systems facilitated the enormous speculative flows and loss of market

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[74] Id.

[75] Id.

[76] Strange, *Mad Money* at 1 (cited in note 52).

[77] Id at 3.

[78] United Nations, World Economic Situation and Prospects 2009, online at http://www.un.org/esa/policy/wess/wesp2009files/wesp09update.pdf (visited Jan. 24, 2010).

[79] Strange, *Mad Money* at 4 *(*cited in note 52).

[80] Id.

confidence that led to the flight of substantial amounts of foreign investments from East Asia.[81] In Strange's words:

> One thing that has certainly changed since the mid-1980s is the greater awareness of global interdependence. Even as late as 1986, there were still people who thought in terms of the First World and the Third World. The Second World was the Soviet-dominated world of state-planned command economies. Each had different problems. No longer. Now, as 1997 amply showed us, we are all in the same boat. One financial system dominates from Moscow to Manila, from Tokyo to Texas.[82]

Thus, states can no longer establish significant economic and trade policies in silos without having some global consequence.[83]

Another example of the frailty of the global financial markets is the Mexican peso crisis in 1994-95.[84] There were numerous factors leading to the devaluation of the peso, ranging from excessive loans from the International Monetary Fund (IMF) to highly speculative investments made by foreign investors to unsound government strategy in issuing extraordinary number of *tesobonos*, government bonds, tied to the U.S. dollars, which exceeded the country's foreign reserves.[85] One commentator notes "politicians, the media and market dealers outside Mexico played a large part in encouraging the false optimism that allowed the issue of the tesobonos.[86] The source of "encouragement" included, as Strange suggested, President Clinton's overly optimistic promotion of the

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[81] Held, *Global Transformations* at 228 (cited in note 53). See also World Bank's Report on Corporate Governance (1999), online at www.worldbank.org (visited Sept. 30, 2002).

[82] Strange, *Mad Money* at 4 *(*cited in note 52).

[83] Id.

[84] Id at 101-106.

[85] Id at 102-103. See also Peter Calvocoressi, *World Politics, 1945-2000*, 816 (Longman 2001).

[86] Strange, *Mad Money* at 102-103 *(*cited in note 52).

benefits of NAFTA to Mexico during the 1992 presidential elections.[87] On the political side, "NAFTA and the enlarged market it represented gave Americans," Strange adds, "a new and more powerful weapon when it came to bargaining over trade terms with the both the Japanese and the Europeans."[88] This was evident, as the Japanese feared NAFTA was a potent trade protectionist strategy in building a "Fortress North America" that would discriminate against other countries.[89]

Despite the devaluation of its currency during the 1994-95 crisis, Mexico has rebounded economically and transitioned from a closed economy to the global economy.[90] The government has implemented several economic reforms including deregulation of certain business activity and encouraging foreign investments.[91] Today, Mexico has twelve international free trade agreements and twenty-one bilateral investment agreements that provide preferential treatment in over forty-three countries.[92] Mexico puts more than ninety percent of its trade under these free trade agreements.[93] Its three largest trading partners are the United States, European Union and Canada.[94] Even though the current global economic crisis has severely impacted Mexico, which is

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[87] Id.

[88] Id.

[89] *Fortress North Americas' Feared: Firms Hope NAFTA Bloc Won't*, Japan Times, Jul. 27-Aug. 2, 1992.

[90] Organization of American States, Foreign Trade Information System (SICE), International Trade Report for Mexico. www.sice.oas.org (visited Jan. 24, 2010) ; and Government of Mexico, Ministry of the Economy, Trade Intelligence, online at www.economia-snci.gob.mx (visited Jan. 24, 2010).

[91] Id.

[92] Id.

[93] Central Intelligence Agency Factbook: Mexico, online at https://www.cia.gov/library/publications/the-world-factbook/geos/mx.html (visited Jan. 24, 2010).

[94] Id.

suffering through its worst recession since the 1994 currency crisis, the Organization for Economic Co-operation and Development's (OECD) most recent Economic Outlook Report indicates that "supported by the rebound in oil prices and increasing exports to the United States, the fall in activity [such as oil prices, tourism and worker remittances] slowed down and activity is now starting to recover."[95]

2.5 Sassen on Private Authority and International Arbitrations

Where Cutler emphasizes the development of private international regimes as the "institutionalized manifestations of private authority," Saskia Sassen focuses on the proliferation of private authority through international commercial arbitrations.[96] For Sassen, "[a] critical and growing component of the broader field of forces within which states operate today is the proliferation of specialized types of private authority."[97] As she sees it, the expansion of private authority is a mixture of various old and new systems of authority. Moreover, there is increased preference for self-regulatory organizations (SROs) in specialized sectors.

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[95] Organization of Economic Co-operation and Development (OECD), Economic Outlook no. 86- Mexico (Nov. 2009), online at http://www.oecd.org/dataoecd/6/36/20213236.pdf (visited Jan. 24, 2010).

[96] Saskia Sassen is a professor of sociology at Columbia University. According to her faculty profile, Sassen's "research and writing focuses on globalization (including social, economic and political dimensions), immigration, global cities (including cities and terrorism), the new networked technologies, and changes within the liberal state that result from current transnational conditions." In addition, "she has focused on the unexpected and the counterintuitive as a way to cut through established 'truths.'" Online at http://www.sociology.columbia.edu/fac-bios/sassen/faculty.html (visited Oct. 31, 2009).

[97] Saskia Sassen, *Territory, Authority, Rights: From Medieval to Global Assemblages* 242 (Princeton University 2008).

Sassen views this trend as an indication the "global economic system needs governance, though of a different sort from that associated with the older normativity of the Keynesian state."[98] For example, these assemblages of entities and private authority are "highly specialized and oriented toward specific economic sectors, such as the system of rules governing the international operations of large construction and engineering firms."[99] Older existing systems include debt security, bond-rating agencies and commercial arbitrations.

This dissertation study focuses on the system for international commercial arbitrations. Sassen stresses international commercial arbitrations as one type of private authority. The arbitration process lends itself to the commercial parties' preferences, as she notes, because "each party [can] avoid being forced to submit to the courts of the other and to maintain the secrecy of the process." Although the parties to a commercial arbitration can keep the proceedings private, they generally tend to follow established arbitration rules to govern such proceedings. For example, several common sources of rules include the International Center for Settlement of Investment Disputes (ICSID) and United Nations Commission on International Trade Law (UNCITRAL).[100] "The overall trend," Sassen observes, "has been toward strengthening international arbitration and further freeing it from the regulation of national court systems." Thus, the structure of dispute settlement mechanisms plays a vital role in global governance systems today and for the foreseeable future.

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[98] Id at 243.

[99] Id.

[100] Id at 243-244.

To support her proposition that arbitrations proliferated into a significant source of private authority, Sassen cites several statistics related to the growth of the number of arbitration proceeding and eligible arbitrators. This growth carries over to foras developed to manage arbitrations. The number of arbitration centers has increased significantly from a dozen in the 1970s to over 100 centers in the 1990s.[101] Today, there are over 120 centers throughout the world.[102] Sassen also notes the number of arbitrators has increased from 1,000 in 1990 to more than 9,000 in 2008.[103]

Another important fact for Sassen is the spike in the number of arbitration claims filed during the past decade. Commensurate with the increased number of arbitration centers and claims, there is a competitive edge for other players associated with arbitrations, such as the arbitration centers, who are vying for business, and multinational law firms that represent the parties in theses proceedings.[104] During the last decade, the latter group has experienced a significant increase in the merger of older with new firms, smaller "specialized boutiques shops" with larger firms, and European and U.S.-based firms.[105] This trend has subsided as the recent economic downturn in the global economy has severely impacted the legal community.

Since early 2008, a wide array of multinational corporations have suffered substantial financial losses due to the current global economic crisis. Even major

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[101] Sassen, *Territory, Authority, Rights* at 244 (cited in note 95). See Walter Mattli, *Private Justice in a Global Economy: From Litigation to Arbitration*, 55 Int'l Org. 919, 920 (2001).

[102] See generally, LLRX.com listing of major international arbitration centers, online at http://www.llrx.com/features/arbitration2.htm#Arbitral%20Institutions (visited Oct. 31, 2009).

[103] Sassen, *Territory, Authority, Rights* at 244 (cited in note 97).

[104] Id.

[105] Id at 244-245.

international law firms have been unable to survive the weak economy as their corporate clients incurred substantial financial losses and a drastic drop in their stock prices. This turbulence has resulted in the demise of several large and prestigious law firms such as Thelen, LLP (formerly Thelen Reid & Priest), Wolf Block, and Heller Ehrman.[106] Other large firms are reportedly teetering as the financial woes of major corporate clients continue during the current crisis.

Also, corporations are carefully evaluating their options, including merger opportunities and bankruptcy. During the last year, we have seen the demise, or shift in ownership of large and venerable U.S. financial institutions such as Lehman Brothers, Merrill Lynch, Washington Mutual, and Wachovia. In addition, even household names such as Chrysler and General Motors (GM) are obviously not immune from the global economic turmoil. GM has incurred billions of dollars in losses, and the U.S. government's investment in this company has resulted in its seventy percent ownership stake. In Europe, major financial institutions such as the Royal Bank of Scotland and ING, a Dutch-based financial services company, have also felt the brunt of the global credit crunch and incurred substantial losses from their investments in derivative investment vehicles. These trends indicate that the number of private actors in international trade and commerce may further shrink, but the survivors will become more influential as competition continues to dwindle at this time.

In light of the expansive shift to public adjudication of commercial disputes away from national court systems, Sassen states "one open-ended question is whether the

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[106] See generally, Katerina E. Milenkovski, *Breaking Up Is Hard to Do: What to Do When Your Firm Implodes*, 34 A.B.A. Litig. News 20 (Winter 2009).

formation of new structures, notably WTO, NAFTA, and the EU, will require some new legal elements in the international arbitration world."[107] A review of international trade systems over the past thirty years indicates a notable shift away from state-centric dispute settlement mechanism of individual investor claims to private arbitrations. As will be discussed in Chapter Six, one of the largest multilateral regional trade governance systems is NAFTA. Under its provisions, the United States, Mexico and Canada have established a separate dispute settlement mechanism using private arbitration for investor claims against the member states. Thus, this trend supports Sassen's proposition that states have shifted certain components of its governance systems to private authority in highly specialized forms, and oriented toward specific economic sectors such as investments and financial services.

2.6 The Expanding Geography of Power

Globalization has caused states to reconfigure their role in the global financial markets.[108] It has also compelled states to restructure existing legal systems to accommodate the increased volume of commercial transactions taking place in the world today. This is not to say governments and markets have not undergone this process in the past, or that the influence of firms on the government or markets is a new phenomenon. As Charles Lindblom wrote:

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[107] Sassen, *Territory, Authority, Rights* at 244 (cited in note 97).

[108] Langhorne, *The Coming of Globalization* at 27 (cited in note 55).

> It has been a curious feature of democratic thought that it has not faced up to the private corporation as a peculiar organization in an ostensible democracy. Enormously large, rich in resources, the big corporations, we have seen, command more resources than do most government units. They can also, over a broad range, insist that government meet their demand, even if these demands run counter to those of its citizens expressed through polyarchal controls.[109]

The past and current influence of firms is well-recognized and this study does not challenge that proposition. However, this research explores the nature and extent private authority has changed within the world of international trade and arbitration.

According to Sassen, "one of the roles of the state *vis-a-vis* today's global economy, unlike earlier phases of the world economy, has been to negotiate the intersection of national law and foreign actors—whether firms, markets or supranational organizations."[110] She notes the terms such as "'deregulation,' 'financial and trade liberalization,' and 'privatization' … describe the outcomes of this negotiation."[111] In 2000, Sassen argued, "[s]tates today confront a new geography of power."[112] This confrontation arises from the transition of certain regulatory functions to transnational private fora.[113] She also asserts these private actors will develop a "new institutional order" and thus, reduce "the scope and exclusivity of international law."[114] Furthermore, the increased role of private actors will result in a "shrinking role [of states] in regulating

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[109] Charles Lindblom, *Politics and Markets: The World's Political-Economic Systems* 356 (Basic Books 1977).

[110] Saskia Sassen, *Embedding the Global in the National: Implications for the Role of the State* in Smith, Solinger, and Topik, eds, *States and Sovereignty in the Global Economy* 158 (Routledge 1999).

[111] Id at 160.

[112] Saskia Sassen, *The State and Economic Globalization: Any Implications for International Law?*, 1 Ch.J. Int'l L. 109 (2000). See also, Saskia Sassen, *Regulating Immigration in a Global Age: A New Policy Landscape*, 570 Annals Am. Acad. Pol. & Soc. Sci. 65 (2000).

[113] Sassen, *The State and Economic Globalization* at 109 (cited in note 112).

[114] Id at 111.

economic transactions."[115] A decade later, Sassen's analysis of this geography of power is still important because technological and communications advances have further expanded the power of private actors over global financial and political matters.

As Sassen sees it, there are three components in this new geography of power.[116] Each of these components relate to a concern regarding: (1) the "actual territories where much of globalization materializes in specific institutions and processes;" (2) the development of a "new legal regime to govern cross-border economic transactions;" and (3) "a growing number of economic activities are taking place in digital space."[117] The second component of Sassen's framework for this new geography of power is extremely relevant for this study in order to explain the shift of power now occurring with the proliferation of trade agreements that started in the early 1990s.[118] According to the United Nations Conference on Trade and Development (UNCTAD), there has been a significant increase in the number of bilateral investment treaties from 300 in 1990 to approximately 2,608 in 2008.[119]

Generally, the World Trade Organization has the responsibility to manage global trade, yet "the most ambitious trade liberalization has not been multilateral, but

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[115] Id at 112.

[116] Sassen, *Embedding the Global* at 163 (cited in note 110).

[117] Id.

[118] Antonio R. Parra, Deputy Secretary-General of the International Centre for Settlement of Investment Disputes, *Applicable Substantive Law in ICSID Initiated Under Investment Treaties*, Paper delivered at the 17th Joint ICSID/American Arbitration Association/ICC Court Colloquium on International Arbitration held in Washington D.C. (Nov. 10, 2000), online at www.worldbank.org/icsid/news/n-17-2-5.htm (visited Nov. 6, 2002).

[119] Id. See also United Nations Conference on Trade and Development, *Recent Developments in International Investment Agreements (2007–June 2008*), online at http://www.unctad.org/en/docs/webdiaeia20081_en.pdf (visited January 3, 2009).

regional."[120] Some scholars argue that regional institutions "foster economic openness and bolster the multilateral system."[121] For example, from a U.S. foreign policy perspective, NAFTA is considered to be highly successful because it "institutionalized" Mexico's shift from "centralized protectionism...toward decentralized, democratic capitalism."[122]

Others on the opposite side of this issue believe the wave of regionalism such as the European Union, Mercosur, and NAFTA, will "erode the multilateral system that has guided economic relations since the end of World War II" and "promot[e] protectionism and conflict."[123] In many respects, both sides of this issue articulate valid points to justify their positions.[124] The more immediate concern should be with the creation of supranational institutions that already allows private actors to exercise broad authority over states in particular issues and areas.[125] Many regional and multilateral agreements have "their own built-in governance structures."[126] For example, NAFTA is a supranational institution with its own governance structure consisting of two types of

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[120] Center for International Development at Harvard University, Global Trade Negotiations, Regionalism Summary, online at www.cid.harvard.edu/cidetrade/issues/regionalism.html (visited Dec. 2, 2002).

[121] Id.

[122] Daniel T. Griswold, *NAFTA at 10: An Economic and Foreign Policy Success*, Free Trade Bulletin No. 1 (Dec. 2002), online at www.cato.org (visited Mar. 1, 2010).

[123] Edward D. Mansfield and Helen v Milner, *The New Wave of Regionalism*, in Paul Diehl, ed., *The Politics of Global Governance* 313 (Rienner 2001).

[124] Morton Boas, *Regulation, Deregulation and the Trade-Environment Debate: The Case of Regional Trade Institutions*, Paper presented at the International Studies Association annual meeting, Mar. 1998. (Accessed via CIAO).

[125] Gus Van Harten, *Private Authority and Transnational Governance: the Contours of the International System of Investor Protection*, 12 Rev. Int'l Pol. Econ. 600 (2005).

[126] Lloyd Gruber, *Rethinking the Rational Foundations of Supranational Governance: Lessons from the North American Trade Agreement*, University of Chicago, Harris School Working Paper Series: 99.19 (Sept. 19, 1999), online at www.cid.harvard.edu/cidetrade/issues/regionalism.html (visited Dec. 2, 2002).

dispute resolution mechanisms. The first is the traditional state-to-state dispute resolution system, and the other is the unique investor-to-state arbitration mechanism. The latter is an example of the type of power that Sassen discusses, for it is a new form of institution that authorizes private actors to exert broad powers in regulating global commercial transactions involving states. Further, this area of power opens the door to the development of a new legal framework for international trade.

2.7 Expansion of Private Administrative Law

According to Sassen, "the strategic spaces where global processes are embedded are often national; the mechanism through which new legal forms, necessary for globalization, are implemented are often part of national state institutions."[127] Thus, states must actively participate in this process, she explains, by "setting up the new legal frameworks and in legitimating the new norms."[128] As Sassen sees it, "economic globalization … has emerged as a key dynamic in the formation of a transnational system of power which lies in good part outside the formal interstate system; one instance of this is the relocation of national public governance functions to transnational private

[127] Sassen, *Embedding the Global* at 167 (cited in note 109).

[128] Id. See also *New Development in International Standard and Global Trade*, International Standards, Conformity Assessment, and U.S. Trade Policy Project Committee and the Academy Industry Program (1994), online at www.books.nap.edu (visited Nov. 30, 2002). (Accessed via National Academy Press). The development of new product standards for international trade has increased with the adoption of more bilateral and multilateral trade agreements. Studies on this subject have focused on the ability of states to reduce or eliminate unnecessary rules and regulations that act as barriers to free trade. States are encouraged to rely on the private sector for the development of product and process standards that meet economic and public interests.

arenas."[129] Moreover, she observes "the emergence of mostly private international institutional order wherein the strategic agents are not the national government of leading countries but a variety of private actors."[130]

Historically, there are several forms of bodies of laws applicable to international trade.[131] Although this is not intended to be an exhaustive list of legal structures, the following are some of the most commonly utilized in commercial transactions: customary law, international conventions, national law, arbitration rules, and legislative and judicial activity.[132] Under NAFTA, the parties resolve their disputes through an arbitration tribunal system that follows the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL), or the International Centre for the Settlement of Investment Disputes (ICSID).[133] The concept of arbitrating various private business transactions has existed throughout centuries.[134] There are some common elements in arbitration: two or more parties disagree on an issue; there is an agreement to obtain a resolution to the dispute; and the parties select an impartial person to make decisions regarding the dispute.[135] It is also expected that that the arbitrator will be impartial and

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[129] Sassen, *The State and Economic Globalization* at 110 (cited in note 112).

[130] Id at 111.

[131] Dieter Martiny, *Traditional Private and Commercial Law Rules Under the Pressure of Global Transactions: The Role for an International Order*, in Richard P. Applebaum, William L.F. Festiner, Volkmar Gessner, eds., *Rules and Networks: the Legal Culture of Global Business Transactions* (Onati International Series in Law & Society 2001).

[132] Id.

[133] NAFTA Art. 1120. See generally, Sean D. Murphy, *Contemporary Practice of the United States*, 95 AJIL 881 (2001).

[134] Douglas M. MacDowell, *The Law in Classical Athens* 203-211 (Cornell University 1978).

[135] Id.

owes a duty of justice to the individual parties and even to society as a whole.

How is NAFTA's arbitration mechanism different from other arbitration mechanisms? As will be discussed in Chapter Six, the major difference is that NAFTA's Chapter 11 allows private investors to directly bring claims against its member states without the requirement of a specific contractual agreement between the parties for arbitration.[136] No longer are investors required to seek redress through their home states, which may or may not opt to pursue a claim against another state.[137] This type of arbitration was intended to promote foreign direct investment by providing investors with protection of their assets and investment without just compensation.[138] The reason that this mechanism was included in the multilateral agreement is because, as Hart and Dymond remind us, "the purpose of laws and treatises is often to effect a predictable and stable balance between competing interest, in that it is known beforehand by all parties and cannot be changed arbitrarily and capriciously to the detriment of one or the other."[139]

Further, NAFTA's investor-state dispute settlement mechanism is the type of private arena Sassen described where private actors administer public governance. Unlike the traditional judicial process involving publicly elected or governmentally appointed judges, NAFTA authorizes the investor and state to each select an arbitrator of

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[136] Emmanual Gaillard, *Loewen v U.S.A.: New Ground in NAFTA/ICSID Arbitration*, N.Y.L.J. (Apr. 5, 2001).

[137] Id.

[138] Id.

[139] Michael M. Hart and William A. Dymond, *NAFTA Chapter 11: Precedents, Principles, and Prospects*, in Laura Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law, 2002).

their choice and for both parties to agree upon the presiding arbitrator. So far, these arbitrators have been private actors with certain expertise in international law and public policy.

2.8 NAFTA as a Subdivision of the Global Governance Framework

The concept of global governance needs to be pared down to fundamental components for deeper analysis. Rosenau distinguishes the numerous processes and structures by first examining the "spheres of authority (SOAs) at all levels of human activity—from the household to the demanding public to the international organization—that amount to systems of rules in which goals are pursued through the exercise of control."[140] He argues that:

> [t]he reason for this broad formulation is simple: in a turbulent and ever more interdependent world, where what happens in one corner or at one level may have consequences for what occurs at every other corner and level, it seems a mistake to adhere to a narrow definition in which only formal institutions at the national and international levels are considered relevant SOAs.[141]

Thus, the term "governance" relates to the "'command mechanism of a social system and its actions that endeavor to provide security, prosperity, coherence, order, and continuity to the system.'"[142] Rosenau expands the applicability of a governance system

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[140] James Rosenau, *Along the Domestic–Foreign Frontier: Exploring Governance in a Turbulent World*, 145 (Cambridge University 2000).

[141] Id.

[142] Id. (Quoting the Council of Rome)

to include "any actor who resorts to command mechanism to make demands, frame goals, issue directives and pursue policies" such as nongovernmental actors.[143]

Traditionally, states managed their domestic problems, such as social and security issues, with limited regard to any impact upon polities or individuals outside of their borders.[144] Since borders are now more porous,[145] there is an expanded list of economic, social and environmental issues that cross boundaries.[146] Some of the key issues that now dominate policy discussion on a global level include "pollution, drugs, human rights and terrorism."[147] As indicated above, SOAs are not limited to formal state and government institutions, but increasingly involve MNCs, NGOs, and regional political associations.[148] One commentator notes that the "growth in the number of new forms of political agency and organization reflects the rapid expansion of transnational links, and the corresponding desire by more states for some form of international governance to deal with collective policy problems."[149]

Based on Rosenau's framework of global governance, NAFTA should be viewed as a "sphere of authority" that has established a set of rules governing trade policies and provides a remedy for private actors for state breaches of the agreement. Moreover, NAFTA is a command mechanism that sets the baseline for conduct of states in relation

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[143] Id.

[144] Held, *Global Transformation* at 50 (cited at note 53).

[145] Rosenau, *Along the Domestic–Foreign Frontier* at 4 (cited in note 140).

[146] Held, *Global Transformation* at 50 (cited at note 53).

[147] Id.

[148] Id.

[149] Id.

to investments and is intended to provide continuity of trade through the protection of private investors' property rights. Some commentators argue that the regulatory system under NAFTA is not global governance, or a subpart thereof, because it is regional and does not govern all transactions throughout the global markets. This argument fails to appreciate the concept that global governance is not comprised of one regulatory framework, one governance system, one set of rules, or one SOA. Rather, the level of governance depends on the nature of the issue or policy decision-making.[150] Regional trade agreements serve a critical role in the resolution of trade barriers between member states that are typically located within reasonably close geographical proximity of each other. States can address their concerns and implement consistent national policies through corroboration with other member states. Therefore, in light of this pragmatic approach to global governance, regional trade agreements such as NAFTA should be treated as a subdivision of the current global governance system.

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[150] David Held, *Democracy and the Global Order: From the Modern State to Cosmopolitan Governance*, 235-36 (Stanford University1995). Professor Held describes the varying levels of governance as follows:

> [t]he issues and policy questions which rightly belong to local, workplace or city levels are those which involve people in the direct determination of the conditions of their own association- the network of public questions and problems, from policing to playgrounds, which primarily affect them. The issues which rightly belong to national levels of governance are those in which people in delimited territories are significantly affect by collective problems and policy questions which stretch to, but no further than their frontiers. By contrast, the issues which rightly belong to regional levels of governance are those which require transnational mediation because of the interconnectedness of national decision and outcomes, and because nations in these circumstances often find themselves unable to achieve their objectives without transborder collaboration. Accordingly, decision-making and implementation belong to the regional level if, any only if, the common interest in self-determination can be achieve affectively through regional governance. By extension, the issues which rightly belong to the global level are those involving levels of interconnectedness and interdependence which are unresolvable by local, national or regional authorities acting alone. Id.

2.9 NAFTA Critics and Supporters: Irreconcilable Differences

The literature on NAFTA is extensive and cuts across multiple academic disciplines, including sociology, natural sciences, political science, law, history and economics.[151] Generally, the research and writing on NAFTA Chapter 11's investor-state dispute settlement mechanism focuses on the controversy it generates regardless of the discipline. Sociologists are concerned about, among other things, the impact that NAFTA has had in allegedly causing additional poverty and suffering among the lower income groups in Mexico. On the environmental front, NAFTA critics argue that Chapter 11 tribunals have stripped away the authority of local government officials to effectively manage environmental and health issues within their communities.[152] Political scientists debate whether states have lost parts of their sovereignty under NAFTA's investor-state arbitrations.[153] In addition, economists are split on whether the benefits of NAFTA outweigh the perceived losses in jobs, negative impact on

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[151] Mario E. Carranza, Neighbors or Partners? NAFTA and the Politics of Regional Economic Integration in North America, *Latin America's Politics and Society*, 44:2 (2002), p. 141-142. In this book review, Carranza examines the following five books related to NAFTA: Victor Bulmer-Thomas, ed., *Regional Integration in Latin America and the Caribbean, The Political Economy of Open Regionalism* (Institute of Latin American Studies, 2001); Maxwell A. Cameron and Brian W. Tomlin, *The Making of NAFTA: How the Deal Was Done* (Cornell University 2000); Ann E. Kingsolver, *NAFTA Stories: Fears and Hopes in Mexico and the United State* (Lynne Rienner 2001); Jacqueline Mazza, *Don't Disturb the Neighbors: The United States and Democracy in Mexico*, 1980-1995 (Routledge 2001); and Guy Poitras, *Inventing North America: Canada, Mexico, and the United States* (Lynne Rienner 2002).

[152] See, for example, Konrad von Moltke, *The Need for an International Investment Regime*, in Shahrukh Rafi Khan, ed., *Trade and Environment: Difficult Policy Choices at the Interface* 182-184 (Zed Books 2002).

[153] See generally David Vogel, *Trading Up: Consumer and Environmental Regulation in Global Economy* 234-247 (Harvard University 1995).

manufacturing industries, and claims of reduction in workers' wages.[154]

In analyzing the Chapter 11 tribunal decision in *Metalclad and United Mexican States*, Harbine argues that the tribunal broadly interpreted NAFTA to enter an award in favor of the investor.[155] The award is, as she contends, a "disregard of environmental factors" that "elevates foreign investors' rights over the right of governments to protect human health and the environment." In her view, the Metalclad claim exemplifies what is wrong with Chapter 11 arbitrations. This mechanism was intended to protect investors from expropriation and nationalization of investments, but she sees it as a mechanism for investors "to recover diminished profits resulting from environmental regulation." In essence, Harbine argues that tribunals fail to address environmental concerns, which "perpetuates the aggressive use of the Chapter 11 by businesses whose investment lose value due to legitimate environmental measures."[156]

Tollefson acknowledges that NAFTA's investor-state claim process vests "new rights in non-state actors."[157] This process, he states, raises "provocative and timely questions about state sovereignty."[158] He tries to downplay the public discourse on whether states are losing parts of their sovereignty by parsing the term into different components. Tollefson has perhaps most directly and pointedly addressed the loss of

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[154] See Herman Daly, *From Adjustment to Sustainable Development: The Obstacle of Free Trade*, in Ralph Nader et. al., *The Case Against Free Trade: GATT, NAFTA and the Globalization of Corporate Power*, (Earth Island 1993) and Thea Lee, *Happily Never NAFTA: There's No Such Thing as a Free Trade* in Nader et. al., *The Case Against Free Trade*, Id at 70.

[155] Jenny Harbine, Note, *NAFTA Chapter 11 Arbitration: Deciding the Price of Free Trade*, 29 Ecology L. Q. 371 (2002).

[156] Id at 373.

[157] Chris Tollefson, *Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime*, 27 Yale J. Int'l L. 141 (2002).

sovereignty concerns by arguing that states must give and take from private actors if they intend to benefit from international trade.

In his opinion, if states are to benefit from trade, they must engage civil society. He sees states' failure to engage different parts of society tends to obscure its ability to look beyond the cursory perspective they are losing sovereignty. Rather than viewing it as an attack on sovereignty, Tollefson argues "if states are to reap the potential social and economic benefits of trade and investment liberalization, they must abandon their tendency to regard engagement with civil society in sovereignty-protectionists terms."[159] He urges states to "collaborate more closely with civil society in order to more effectively incorporate environmental, public health, and other social values into trade law principles and decision-making."[160]

As noted above, the perceived negative impact of NAFTA dominates the literature regarding this trade agreement. In this regard several scholars, among them Robert A. Pastor and William W. Park, emphasize the tendency today to exaggerate the negative impact of NAFTA, or the effects of the Chapter 11 tribunals.[161] In a pointed article, Pastor challenges NAFTA critics to look beyond the superficial analysis touted in

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[158] Id at 143.

[159] Id at 147.

[160] Id.

[161] Robert Pastor is Professor of International Relations at American University. He had previously served as National Security Advisor for Latin America to President Jimmy Carter (1977-1981) and as a Fellow and Founding Director of the Carter Center's Latin American and Caribbean Program. William W. Park is Professor of Law at Boston University and a vice president at the prestigious London Court of International Arbitration.

the media.[162] He even took issue with the calls for increased protectionism by the presidential candidates in 2008. During the presidential campaign, then-Senators Barack Obama and Hilary Clinton criticized NAFTA as being contrary to U.S. interests and advocated amending the treaty to address labor and environmental issues. In Pastor's view, the candidates' "criticism of NAFTA [was] unwarranted" and they "did not seize the opportunity to define a new positive approach to our neighbor and to address the new North American agenda that has emerged since NAFTA."[163]

In Pastor's words, "NAFTA's goals were to reduce and eventually eliminate trade and investment barriers, and it did that."[164] In support of his position, Pastor cites the substantial increase in trade between the three states. Since the inception of NAFTA in 1994, the amount of trade has increased from $289 billion to $846 billion in 2008.[165] Moreover, he notes "[f]oreign direct investment has quintupled, tying the economies closer together and foreign continental firms."[166] Overall, he strongly believes NAFTA is a "success."[167]

NAFTA supporters take aim at labor activists who criticize the treaty for allegedly causing job losses in the U.S. First, they argue that "U.S. employment rose from 110.8 million people in 1993 to 137.6 million in 2007, an increase of 24 percent. The average

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[162] Robert A. Pastor, Stop *Debating NAFTA- Start Shaping a Future for North America*, New Perspective Quarterly (Spring 2008), p. 79. See also Robert A. Pastor, *The Future of North America*, 87 For. Aff. 79, 84 (2008).

[163] Pastor, *Stop Debating NAFTA*, 87 For. Aff. at 79 (cited in note 162).

[164] Id.

[165] Id.

[166] Id.

[167] Pastor, *Stop Debating NAFTA*, 87 For. Aff. 79,79 (cited in note 162). See also Robert A. Pastor, *North America's Second Decade*, 83 For. Aff. 124 (2004).

unemployment rate was 5.1 percent in the period 1994-2007, compared to 7.1 percent during the period 1980-1993."[168] As scholars note, "NAFTA cannot claim all—perhaps even much—of the credit, but it surely cannot be blamed for net job loss."[169] Second, U.S. government studies on wages contradict the assertions of labor activists and union leaders that NAFTA has suppressed wages. According to published official statistics, the "U.S. business sector real hourly compensation rose by 1.5 percent each year between 1993 and 2007, for a total of 23.6 percent over the full period."[170]

In fact, the current United States Trade Representative (USTR) Policy Brief indicates " NAFTA provides an annual tax cut and income gain." According to this brief, "households enjoy higher income from both an increase in the national income as well as a reduction in taxes resulting from the NAFTA."[171] It also states NAFTA raises the gross domestic product (GDP) and income. Specifically, the USTR explains:

> A number of formal mathematical studies of the North American Free Trade Agreement found that the NAFTA, when fully implemented, would raise U.S. GDP by between 0.1% and 0.5%. [Footnote omitted] Relative to the size of the economy in 2000, these estimates suggest and an income gain of between $10 billion and $50 billion. Per an average household of four, this translates into a per year income gain of $140 to $720.[172]

In addition, the trade office contends NAFTA lowers the price of imports. If the

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[168] Office of the United States Trade Representative, *NAFTA: Myths v Fact* (March 2008), online at http://www.ustr.gov/sites/default/files/NAFTA-Myth-versus-Fact.pdf (visited Nov. 2, 2009). Of course, these statistics do not factor the significant economic decline since 2008. During the past two years, the number and percentage of unemployment has drastically increased from 2007.

[169] Pastor, *Stop Debating NAFTA* at 80 (cited in note 162).

[170] Office of the United States Trade Representative, *NAFTA: Myths v Facts* (cited in note 168).

[171] Office of the United States Trade Representative, NAFTA Policy Brief (October 2007), online at www.ustr.gov (visited Nov. 2, 2009). The USTR reports that the annual benefits for NAFTA equals "$350 to $930 in annual benefits per average family of four." Id.

[172] Id.

NAFTA tariff reductions were not implemented, they argue, the "duty collections would have an estimated $14.2 billion higher" within the first fifteen years of the effective date of the agreement.[173]

Unlike NAFTA critics who argue that the members states are losing varying levels of their sovereignty as a result of Chapter 11 arbitration tribunals, many international scholars and legal practitioners view Chapter 11 merely as a dispute settlement mechanism under an investment treaty, and they do not see it as an affront to state sovereignty. Whether states are losing parts of their sovereignty raises two questions: (1) is the Chapter 11 arbitration system unique or unprecedented?, and (2) do states actually lose sovereignty under this system? In response to the former, NAFTA supporters argue there are many different types of dispute mechanisms in international trade agreements and Chapter 11 is just one of those types.[174]

They also note the U.S. is party to hundreds of treaties and each one has a different conflict resolution method. In regard to the latter question, some scholars contend a state's autonomy and security is enhanced with allies rather than maintaining trade and investments strictly within its borders.[175] For example, the U.S. has a long-standing policy of being engaged in multinational agreements such as the United Nations and NATO. Parks acknowledges some elements regarding NAFTA's Chapter 11 framework "may be open to improvement" and clarification such as the confidentiality of

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[173] Id.

[174] Telephone interview with Robert A. Pastor, Ph.D., Professor of International Relations, American University (Mar. 17, 2009).

[175] Id.

its proceedings.[176] Over the past six years, NAFTA member states have addressed this concern by encouraging parties to publish more arbitration information, including transcripts of the arbitration hearings.[177] In the final analysis, these commentators view states as not losing parts of their sovereignty but winning under NAFTA.[178] In other areas of study, scholars reject the argument that states have lost their sovereignty, and point out that states established the dispute settlement mechanism and its participants are only empowered in accordance with the authority delegated to them by the states.

2.10 Do NAFTA Tribunals Promote Transparency of Governance?

The NAFTA member states declared in their Synopsis of the proposed NAFTA that the administration of laws section of the agreement was intended to achieve procedural transparency. The Synopsis states that:

> [t]his section provides rules designed to ensure that laws, regulations and other measures affecting traders and investors will be accessible and will be administered fairly and in accordance with notions of due process by officials in all three countries. Each country will also ensure, under its domestic laws, independent administrative or judicial review of government action relating to matters covered by NAFTA.[179]

This principle of transparency is consistent with other international trade agreements such

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[176] Guillermo Aguilar Alvarez and William W. Park, The *New Face of Investment: NAFTA Chapter 11*, 28 Yale J. Int'l L. 365, 398 (2003).

[177] NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (July 31, 2001), online at http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/NAFTA-interpr.aspx?lang=en (visited Nov. 2, 2009).

[178] Id.

[179] Id.

as Article X of the General Agreement on Tariffs and Trade (GATT). Under GATT, governments are required "to ensure that their laws 'affecting' international trade are 'published promptly' and administered in a 'uniform, impartial and reasonable manner.'"[180]

NAFTA critics argue that the investor-to-state claim arbitration tribunals act as an "anonymous government" influencing state transactions and policy.[181] They contend that "the corporate victories have spawned even bolder and broader challenges, each one further undermining public policy."[182] Although they acknowledge the fact that these arbitration tribunals do not have the same power as the traditional legislative or judicial branches to legislate or overturn laws, the critics contend that arbitration decisions in favor of corporations "would have a devastatingly chilling effect on all such future laws and standards because of the belief that they would not stand up to challenge."[183] Moreover, any discussion of the expansion of NAFTA into the Free Trade Area of the Americas (FTAA) has generated furious opposition by those who perceive the regional trade system as a "sinister process of secrecy."[184]

This skepticism is not only being heard from the environmentalists, anti-globalists and labor unions, but even from the floor of the U.S. Congress. When Congress debated

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[180] Patricia Hansen, *Transparency, Standards of Review, And the Use of Trade Measures to Protect the Global Environment*, 39 Va. J. Int'l L. 1017, 1058 (1999).

[181] Anthony DePalma, *NAFTA's Powerful Little Secret*, N.Y. Times at §3, p. 1 (Mar. 11, 2001).

[182] Id.

[183] Id.

[184] Press Release, International Federation of Journalists, *Journalists Condemn Secrecy in American Trade Talks: 'Threat to the Foundations of Democracy,'* (Apr. 12, 2001), online at http://www.ifj.org/publications/press/pr/203.html.

whether to pass the bill to authorize the president to "fast track" foreign trade agreements, Congresswoman Marcy Kaptur (Democrat-Ohio) vehemently opposed the bill citing NAFTA as the cause of "closed factories, a jobless recovery, and downward pressure on wages."[185] She used the *Methanex* claim as a clear example (to her) of what is wrong with the NAFTA tribunal system.[186] Kaptur argued the Canadian company sued California "[n]ot in the court, but before a secret NAFTA tribunal, claiming the law was trade-restrictive."[187] She viewed NAFTA as giving away local sovereignty rights to MNCs and becoming an obstruction to local authorities needing to protect the health and safety of their own communities.[188]

On the other hand, supporters of the arbitrations point out that the "primary purpose of investor-to-state arbitrations is to provide investors with a secure and predictable atmosphere for their foreign investments."[189] During the early stages of the NAFTA claim litigation, public officials refuted the transparency concerns by noting that lifting of all confidentiality of these proceedings would "undermine the primary purpose of the arbitration mechanism—to help foster commercial development."[190] However, in response to a strong public demand for disclosure and transparency, the three member states issued a joint statement in July 2001, indicating there was no obligation on any

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[185] 107 Cong. Rec. H.3132 (daily ed. Jun. 4, 2002)(statement of Rep. Kaptur).

[186] Id.

[187] Id.

[188] Id.

[189] Todd Weiler, *NAFTA Investment Arbitration and the Growth of International Economic Law*, International Bar Association B.L.I. Issue 2:0 at 158 (2002).

[190] DePalma, *NAFTA's Powerful Little Secret* (cited in note 181).

party to maintain tribunal information confidential and urged the parties to promote disclosure.[191] Nevertheless, under the applicable arbitration rules, certain information cannot be disclosed without the consent of both parties, and it is not unusual for at least one party to be reluctant to fully open their tribunal proceedings to the public.

Between the filing of the first notice of claim by an investor under Chapter 11 in 1997 through July 2001, there was very little information available to the public on the inner workings of the tribunals. NAFTA has minimal mandatory disclosure requirements and it defers to the selected international arbitration rules for determining the extent of confidentiality for the hearings and litigation documents.[192] Under ICSID rules, all documents and the hearings are confidential unless both parties agree to disclosure. NAFTA's Chapter 11 has two disclosure provisions that require the NAFTA Secretariat to maintain a public register of notices of arbitration and to publish final awards against the U.S. and Canada.[193] Mexico had successfully negotiated an exemption from the latter of these requirements, and NAFTA affords them the discretion whether or not to publish awards involving them.

In July 2001, the three member states issued a joint statement interpreting certain provisions of Chapter 11.[194] The relevant section of the joint statement on confidentiality reads:

[n]othing in the NAFTA imposes a general duty of confidentiality on the

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[191] NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (July 31, 2001), online at http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-e.asp (visited Oct. 3, 2002).

[192] NAFTA, art. 1120(1)(a)-(c).

[193] Id at art. 1126(13).

[194] NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (cited in note 191).

> disputing parties to a Chapter Eleven arbitration, and, subject to the application of Article 1137(4), nothing in the NAFTA precludes the parties from providing public access to document submitted to or issued by a Chapter Eleven tribunal.[195]

It further provides that the states would provide timely disclosure of these documents subject to redaction of:

1. confidential business information;
2. information which is privileged or otherwise protected from disclosure under the Party's domestic law; and
3. information which the Party must withhold pursuant to the relevant arbitral rules, as applied.[196]

The states carefully drafted this statement to indicate there was no obligation to keep information confidential, but the above exceptions to disclosure are contingent upon approval of investors. This fact is a clear indicator of the enormous power that private investors have in the disclosure of information to the public during arbitration proceedings.

Some investors have utilized the increased disclosure of government documents and testimony to highlight the alleged unfairness they have suffered in the hands of public officials and to gain support from third parties. For example, ICSID Arbitration Rule 32 provides that only the arbitrators, witnesses, experts, parties and their counsel are permitted to be present during the hearings.[197] However, the tribunal or parties may agree to open portions of the proceedings to the public. For example, in the case of *United Parcel Service v Canada*, the tribunal allowed third parties to file *amicus curiae*

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[195] Id.

[196] Id.

[197] ICSID Arbitration R. 32 (Oral Procedure), online at http://www.worldbank.org/icsid/basicdoc/77.html (visited on Oct. 12, 2002).

briefs in the arbitration proceedings.[198] Moreover, after several weeks of UPS requesting the public be allowed access to the arbitration hearings, Canada consented to observers watching the proceedings via a live video feed in a nearby viewing room.[199]

The member states' July 2001 Note of Interpretation encouraged disclosure and clarified their intent on the appropriate minimum standard of treatment for investors.[200] Ironically, the latter pronouncement generated a flurry of claimant evidentiary requests for the states to produce their NAFTA negotiation notes because states were now asserting a higher minimum standard of treatment. In March 2002, the *Pope* tribunal was deciding whether to grant the claimant's request for Canada's NAFTA drafting documents.[201] Canada's initial response was they were unaware of any documents, but the tribunal noted the government in an unrelated NAFTA Chapter 20 proceeding produced some of these documents.

After further proceedings, in September 2002, the tribunal issued an amended confidentiality order requiring the "public release of virtually all of the written arguments and all of the oral transcripts of the hearings."[202] This order was a sign of greater transparency of tribunal proceedings; of course, assuming the documents are ever

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[198] *United Parcel Service v Canada*, Decision on Petitions for Intervention and Participation as *Amici Curiae* (Oct. 17, 2001), online at http://www.NAFTAclaims.com (visited Feb. 21, 2010).

[199] According to one news report regarding the arbitration hearing, "approximately 20 people attended the public viewing room at the beginning of the two-day hearing, although that number dwindled to one half dozen by the afternoon and never recovered." Todd Weiler, 1 *NAFTA News* (August 2, 2002), online at http://www.NAFTAclaims.com (visited Feb. 21, 2010).

[200] NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (cited in note 191).

[201] Letter of Presiding Arbitrator, Lord Dervaird (March 21, 2002) 1-2. *Pope & Talbot, Inc. v Canada*, UNCITRAL/NAFTA Arbitration (Apr. 10, 2001) (Award on the Merits), 41 I.L.M. 1347.

[202] Todd Weiler, 1 *NAFTA News* (Sept. 12, 2002), online at http://www.NAFTAclaims.com (visited Feb. 21, 2010).

released or released within a reasonable time period. However, the tribunal did grant the Canadian government's request to maintain confidential its NAFTA negotiating text from the early 1990s.[203] One commentator argues, "the reason that this material is being kept secret today is most likely simple: the NAFTA governments do not want the truth to come out."[204] At the end, the NAFTA states have disclosed over forty drafts of the preliminary treaty and posted them on their country web sites.[205]

2.11 Has NAFTA's Private Arbitration Tribunals Caused States to Lose Their Sovereignty?

One of the main issues globalization has raised is whether states have lost, maintained, or strengthened their sovereignty. Rosenau argues that the present condition of state sovereignty to be "in flux and a variety of signals point to a decline in the capacity of states to prevent the expansion of the Frontier."[206] He views the "Frontier" as a "new and wide political space."[207] The Frontier requires us to think beyond the traditional conception of domestic and international politics as "separate playing

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[203] Amended Procedural Order on Confidentiality (Sept. 17, 2002). The Order provides that the Canadian government's documents "may only be disclosed with the express consent of all three NAFTA State Parties." *Pope & Talbot, Inc. v Canada* (cited in note 201).

[204] Weiler, 1 *NAFTA News* (cited in note 197).

[205] Office of the U.S. Trade Representative, NAFTA Chapter 11 Trilateral Negotiating Draft Texts, online at http://ustraderep.gov/Trade_Agreements/Regional/NAFTA/NAFTA_Chapter_11_Trilateral_Negtiating_Draft_Texts/Section_Index.html (visited Jan. 24, 2010).

[206] Rosenau, *Along the Domestic–Foreign Frontier* at 218 (cited in note 140).

[207] Id at 4.

fields."[208] He sees the Frontier "in some respect as an under-organized domain with fragile sources of legitimacy, while in other respects nascent structures of authority can be concerned."[209] Moreover, Rosenau asserts there is a "diverse frontier" where certain events occur such as "societies implode, regions unify, markets overlap, and politics swirl about issues of identity [and] territoriality."[210] These political boundaries, he asserts, have become more porous because people can reach out to others around the world in support of their polities and local causes.[211]

In many respects, NAFTA should be viewed as being part of Rosenau's Frontier of a "wide political space." The agreement's primary goal is to promote free trade between its member states; a goal that requires open societies willing to interact with each other regardless of social, religious, cultural, and political differences. More importantly, states must embrace capitalism to achieve the level of free trade necessary to increase productivity, employment, and flow of direct investments. Mexico is a good example of how a state can stimulate economic development by shifting its dominant public policy of nationalization and protectionism to a more liberal trade policy. However, in doing so these new economic opportunities have also triggered vigorous protests throughout the region regarding environmental degradation, deficient labor standards, and manipulation of economically weaker states (Mexico) by more financially

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[208] Id at 6.

[209] Id.

[210] Rosenau, *Along the Domestic–Foreign Frontier* at 6 (cited in note 140).

[211] Id at 4.

strong states (U.S.).[212] Free trade agreements such as NAFTA also raise public concerns about states losing different levels of their sovereignty to private actors.[213]

There exists some public demand for reform of Chapter 11 because it is perceived as an attack on the sovereignty of the member states.[214] Various organizations have joined forces to lobby for changes that would make the tribunals more transparent and limit the ability of corporations to engage in forum shopping for favorable rulings against states.[215] The confidentiality associated with the tribunals has provoked the perception that states are acquiescing to corporations through secret settlements.[216] This school of thought contends that corporations can now circumvent national court decisions by filing a NAFTA claim to have the same issue reviewed by private actors acting as arbitrators.[217]

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[212] See David Dilts, et. al., *The Impact of the North American Free Trade Agreement on Public Sector Collective Bargaining*, 23 J. Collective Negot. Pub. Sector 91 (1994); Mark Ritchie, *The Green Lobby Raises a Red Flag on Agreement*, Int'l Bus. (Nov. 1, 1991); and Duane Kujawa, *A North American Free-Trade Agreement: The First step toward one America Multinational*, Business Review 1:2 (Fall 1993)

[213] In light of U.S. trade history with Mexico and Canada, the resistance to NAFTA based on sovereignty concerns is not surprising. As Rosenau observed in 1990, the same concerns were raised about the Canadian-U.S. Free Trade Agreement during the 1988 Canadian elections. At that time, "opposition parties and newspapers organizing their campaign around the theme that the agreement threatened Canada's sovereignty through 'economic integration with our Southern neighbor.'" James Rosenau, *Turbulence in World Politics: A Theory of Change and Continuity* 432-433 (Princeton University 1990).

[214] See generally Steve Louthan, *A Brave New Lochner Era? The Constitutionality of NAFTA Chapter 11*, 34 V and. J. Transnat'l L. 1443 (2001); Joyce Hoebing, Sidney Weintraub, and M. Delal Baer, *NAFTA and Sovereignty: Trade-offs for Canada, Mexico, and the United States* (Center for Strategic & International Studies 1996); Ralph Nader, et al, *The Case Against Free Trade: GATT, NAFTA, and the Globalization of Corporate Power* (Earth Island 1993); and Arthur Cockfield, *NAFTA Tax Law and Policy: Resolving the Clash between Economic and Sovereignty Interests* (University of Toronto 2005).

[215] See *NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy: Lessons for Fast Track and the Free Trade Area of the Americas*, Public Citizen (Sept. 2001). (Accessed via BRINT).

[216] Paul Magnusson, *The Highest Court You've Never Heard of*, Business Week (Apr. 1, 2002).

[217] Id.

Sassen believes states "weakened many of its authorities specially those linked to the social fund, but … also gained new powers."[218] She views the use of NGOs and private actors to regulate commerce as a "relocation of some components of national state sovereignty onto supranational authorities or privatized corporate systems.[219] Nonetheless, there is a general apprehension about NAFTA's arbitration mechanism and the perceived ill effects it has on sovereignty. In Haigh's words, "the apprehension is that each NAFTA country has sold its sovereignty down the river by agreeing to subject itself to lawsuits by investors who may seek not only damages, but may also attack these governments at the heart of their policy making capacity."[220]

Congress has also considered amendments to NAFTA when free trade agreements with other countries were pending its approval. In one instance, there was an intense debate in Congress regarding a fast track bill amendment for the U.S.-Chile Free Trade Agreement that would have also required the U.S. Trade Representative to negotiate certain changes to NAFTA.[221] These changes included the requirement for public hearings of tribunal proceedings, and the prompt disclosure of tribunal documents.[222] Despite a large number of supporters for these changes, the amendment did not make it out of committee, and the trade bill was passed by Congress and signed by the President

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[218] Id at 167.

[219] Id.

[220] David Haigh, *Chapter 11- Private Party v Governments, Investor-State Dispute Settlements: Frankenstein or Safety Valve*, 26 Can.-U.S. L.J. 115, 126 (2000).

[221] Cong. Rec. S3795-S3832 (May 2, 2002).

[222] Id.

in December 2002.[223]

Have states lost some degree of their sovereignty? States have indeed entrusted certain components of their sovereignty by delegating regulatory authority to private actors, but also have strengthened their authority in other areas such as national security. If we examine the financial impact the East Asian economic crisis had on states outside of the region, we see there were ripple effects of financial turmoil throughout the world in 1997. [224] For example, the Thailand government closed fifty-six of the country's fifty-eight top finance houses pushing private Thai banks into bankruptcy overnight, and the Thai currency to tumble in value.[225] The economic repercussion of this debacle substantially affected the fragile Russian economy even though that government was working with the IMF to improve its economy.[226] Another financial example is the reliance of the public financial markets on comments of private actors such as stock analysts and credit reporting agencies.[227] Even world organizations like the IMF and World Bank can implement policies that could affect the domestic and global policies of states.[228] These activities only reinforce the concept that private actors, including firms,

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[223] Office of the U.S. Trade Representative, *Free Trade with Chile: Summary of the U.S.-Chile Free Trade Agreement*. http://www.ustr.gov/about-us/press-office/fact-sheets/archives/2001/december/free-trade-chile-summary-us-chile-free-trad (visited Feb. 21, 2010).

[224] Friedman, *Lexus and the Olive Tree Lexus and the Olive Tree* at 8 (cited in note 58).

[225] Id.

[226] Id.

[227] Craig N. Murphy, *Global Governance: Poorly Done and Poorly Understood*, 76 Int'l Aff. 789, 794 (2000).

[228] Paul Diehl, ed., *The Politics of Global Governance*, 259, 277 (Rienner 2d ed 2001).

play a critical role in the global financial markets and exert differing levels of influence on public policymaking and regulatory structures.

CHAPTER 3

THE HISTORY OF U.S.-MEXICAN CLAIMS COMMISSIONS

The development and implementation of NAFTA resulted in a historical achievement for the United States, Mexico and Canada on different levels. It was the first multinational free trade agreement between industrialized nations and a developing nation in modern times. The agreement also set into motion an economic liberalization and modernization movement in Mexico that was unprecedented in its history. Moreover, the institution of a robust investor-state dispute settlement mechanism strengthened the protection of foreign investments of their citizens within the three-state region.

To fully appreciate the enormity of this achievement, it is helpful to examine the long and contentious history between the U.S. and Mexico in settling claims of its citizens against the other state for expropriation and discriminatory national treatment related to investments. This chapter provides an overview of the U.S. and Mexico's relationship between 1821 and 1942 related to the monetary claims of their citizens filed against the other state. The following section will also discuss the major events that led to investor claims and the attempts of both governments to amicably settle these claims through various commissions.

The basic structure of these claims commissions and their arbitration process served as the dispute settlement model when the use of international arbitrations greatly

expanded throughout the world in the late nineteenth century. These claims conventions were perhaps the first treaties with a form of investor-state dispute settlement mechanism that did not require espousal. The legal principle of espousal is that a State has a right to "pursue, in its discretion, by exercising 'diplomatic protection,' thus 'espousing' its citizen's claim" against other states for their alleged wrongful acts committed to the citizen.[1] Equally as important is the fact that NAFTA's investor-state dispute settlement mechanism addressed major flaws of the claims commissions, which prevented it from successfully bringing all of its claims to a final disposition, including payments of any awards.

3.1 The Emergence of Mexico as an Independent State and the Conflict Over Its Northwestern Territory (1821-1845)

In the 1820s, there was a significant shift in U.S. foreign policy. In the prior decade, the U.S. declared war on Great Britain after they continued to stop American merchant ships to search for British deserters, to impress U.S. sailors into the Royal Navy, and to enforce its blockade of neutral commerce that was intended as retaliation against the French. There was no clear victor in the War of 1812, and Americans viewed it as a bitter and costly war in terms of human lives, resources, and finances. It did, however, solidify the American resolve not to allow European influence, especially the British, to gain a foothold within the U.S., or anywhere south of its border.

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[1] James R. Holbein and Donald J. Musch, eds., *North American Free Trade Agreements: Taking Stock of NAFTA Chapter 11 in its Tenth Year: An Interim Sketch of Selected Themes, Issues, and Methods* 29 (Oceana 2004).

During this period, other significant world events influenced American foreign policy such as the revolutions of Latin American countries for independence from Spain, Napoleon's defeat and the Bourbon restoration in France, Russia's expressed ambition to settle the northwestern territory abutting the U.S., and the creation of the Holy Alliance between Austria, Prussia and Russia.[2] In declaring his now-famous "Monroe Doctrine" in 1823, President James Monroe explicitly warned foreign countries that "any attempt on their part to extend their system to any portion of this hemisphere as dangerous to our peace and safety."[3] Moreover, he viewed any "interposition for the purposes of oppressing [any independent nation within the hemisphere] by European power in any other light than as the manifestation of an unfriendly disposition toward the United States."[4]

While Monroe was establishing his foreign policy, Mexico had embarked on a revolution for independence from the Spanish monarchy. Spain had governed Mexico for over 300 years, and it did not easily release its control over this North American nation.[5] Mexican citizens fought hard for many years for their liberty until Spain finally relented and agreed to cede its control to an independent Mexican government in 1821.[6] The Mexican independence prompted Monroe to quickly recognize Mexico, and to

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[2] Elihu Root, *The Real Monroe Doctrine*, 8 AJIL 427, 428 (1914).

[3] Id at 427.

[4] Id.

[5] Joseph Wheelan, *Invading Mexico: America's Continental Dream and the Mexican War, 1846-1848* (Carroll & Graf 2007).

[6] Virginia Gueda, *The Process of Mexican Independence*, 105 Am. Hist. Rev. 116, 129-130 (2000). In August 1821, the representatives of the Spanish crown and Mexican independence movements signed the Treaty of Cordoba which was later rejected by the Spanish royal family. Negotiations between the two sets of representatives continued until 1823 when Spain finally agreed to acknowledge Mexico's independence.

establish diplomatic relations with this new state, which was an indispensable ally to U.S. national security and commerce.[7]

In response to the establishment of the new state, President Monroe searched for the appropriate person who could serve effectively as the American representative. This individual would also be responsible to negotiate a resolution of multifarious claims that were asserted by U.S. citizens against Mexico. These claims involved the loss of, and damage to, American-owned real and personal property caused by the Mexican insurgents during the revolution against Spain. Interestingly, General Andrew Jackson was one of the first persons considered for the minister position.[8] He had become a prominent national figure after he successfully led U.S. troops against the British during the War of 1812, and later against Spain in 1815 to obtain control of Florida. As a result of his battle victories in the latter conflict, the U.S. negotiated a favorable peace treaty with Spain, which included the transfer of all of Florida to the United States. Jackson was also appointed the first American governor of Florida in 1821.[9]

It was the then-Secretary of State John Quincy Adams who recommended Monroe appoint Jackson as the minister to Mexico. Jackson, however, declined the position and wrote a letter to Secretary Adams explaining the reasons for his decision as follows:

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[7] William Spence Robertson, *The Policy of Spain Toward Its Revolted Colonies, 1820-1823*, 6 Hispanic Am. Hist. Rev. 2,136 (1926). In his speech to Congress on March 8, 1822, President Monroe recommended the U.S. acknowledge the new Mexican state as an independent sovereignty. Since the Spanish crown had earlier rejected the Treaty of Cordoba, the news of the U.S. President's message provoked uproar in Spain as it criticized the U.S. policy as "a violation of Spain's rights and defiance of sacred principles of legitimacy." Id.

[8] James M. Callahan, *American Foreign Policy in Mexican Relations* 26 (Macmillan 1932).

[9] Id at 26.

> … The present unhappy revolutionary state of Mexico, with an oppressed people struggling for their liberties against an Emperor; whom they have branded with the epithets of usurper, and tyrant, convinces me no minister from the U. States could at this period effect any beneficial treaty for this country; and of the impolicy of a republican representative at a court which might be construed as countenancing the Empire in opposition to a Republic… With these feelings and wishes, and which I believe to be in unison with my fellow citizens generally; you may readily conceive that my situation at Mexico would be embarrassing to me, independent of the conviction that was rendering no service to my country…"
>
> The President has been kind enough to say, that not having consulted me before he made the nomination it is not obligatory for me to accept, but I will act as meets my convenience and approbation.[10]

In the interim, Monroe appointed James Smith Wicocks of Pennsylvania as the first American consul to Mexico City in 1823, but he continued to search for a permanent minister.

The following year, the President nominated and the Senate confirmed the appointment of Senator Ninian Edwards of Illinois as the minister to Mexico. Edwards resigned from the Senate to assume his new position, but he was unable to leave for Mexico because of an on-going Senate investigation into allegations that Edwards had made against another senator.[11] Monroe forced Edwards to resign, and he was replaced with Congressman Joel Poinsett of South Carolina who went on to serve as the first U.S. Minister to Mexico.[12]

As the two states engaged in extensive negotiations to settle pending claims of U.S. citizens related to the Mexican revolutions, the volume of new claims significantly

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[10] Id at 27. The more likely reason for declining this position was probably Jackson's presidential ambitions which came to fruition in 1829.

[11] Id at 28.

[12] Id.

increased because of the large volume of claims filed by U.S. citizens residing in Texas, which was still a territory of Mexico at that time. Many historians believe Mexico made an extremely bad decision to allow U.S. citizens to settle in Texas in 1823.[13] In an effort to increase production and stimulate the national economy, the Mexican government authorized land grants to American colony companies.[14] The grants allowed settlers to establish farms and other commercial ventures within Mexico's border. The exponential growth of U.S. citizens who had relocated south of the U.S. border created substantial tension with local officials and the new residents.[15] A major point of contention with the settlers was the Mexican law requiring them to become Mexican citizens as a condition of settling in Texas.[16] This requirement was intended to subject the settlers to Mexican jurisdiction and laws, and to strip them of their ability to assert any rights as U.S. citizens in their new home state.

Over time, the American settlers in the northern region of Mexico developed their own forms of government and asserted their own rights to sovereignty and autonomy. For example, in 1824, under the leadership of Stephen F. Austin, a code of laws was established for settlers within his colony.[17] Back in Washington, the White House had viewed this movement favorably and continuously supported the Texans in their assertion of independent rights.[18] Mexico refused to give up Texas as a province, and sent its

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[13] Id at 20.

[14] Wheelan, *Invading Mexico* at 43(cited in note 5).

[15] George P. Garrison, 10 *The First Stage of the Movement for the Annexation of Texas* 72-72 (1904).

[16] Callahan, *American Foreign Policy* at 21 (cited in note 8).

[17] Id.

[18] Id at 63-97.

military troops to the region to contain any type of revolution or new government taken root within its territory. But these military actions did not abate the immigration of new settlers, nor dissuade them from asserting sovereignty for their local governments. These events eventually prompted Mexico to ban all future immigration from the U.S. to its Texan province.[19]

Under the leadership of Stephen Austin and Sam Houston, Texans proclaimed their independence from Mexico and engaged the larger and better equipped and trained Mexican army in several bloody battles.[20] The small bands of Texan volunteers suffered significant losses against the Mexican army in major battles, such as the one fought at the Alamo in 1836.[21] In the battle at San Jacinto, however, Houston led his army to a decisive victory over the opposing forces and captured General Santa Anna, who was the top Mexican general.[22] In May 1836, Santa Anna agreed to all of the Texans' demands, including territorial boundaries, and signed the Treaty of Velasco.[23] The Republic of Texas was formed in 1836 and a new government installed consisting of a president, congress, judiciary, and executive departments similar to the structure of the United States.[24]

The Mexican government's use of military force in Texas led to more claims and

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[19] Wheelan, *Invading Mexico* at 44(cited in note 5).

[20] Id at 45.

[21] Id at 46-47.

[22] Id at 48.

[23] Wheelan, *Invading Mexico* at 48 (cited in note 5). See also Garrison, *The First Stage of the Movement* at 72 (cited in note 15).

[24] Timothy Henderson, *A Glorious Defeat: Mexico and its War with the United States* 84-101 (Hill and Wang 2007).

the total cost of the outstanding U.S. claims increased drastically to over $2 million.[25] U.S. citizens attempted numerous times to settle their claims with Mexico, but political turmoil was a constant hindrance to progress in Mexico. In fact, General Santa Anna was ousted as president on seven non-consecutive occasions between 1833-1855. As time elapsed, Americans in the northern territories of Mexico grew restless for change. Washington officials plotted to annex the new republic as the U.S.-Mexican dispute over the territorial boundaries between the two states intensified. There were also unsuccessful discussions between U.S. and Mexican officials regarding the sale of Mexico's territory west of Colorado.[26] These events would eventually lead to the deterioration of diplomatic relations, and the stage was set for military conflict between these neighboring states.

3.2 War Between Neighboring States Splinters Mexico and Expands U.S. Territory (1846-1848)

The American quest for westward expansion was consistently in the forefront of every presidential policy agenda from Thomas Jefferson to James Polk. After the formation of the Republic of Texas in 1836, the annexation of Texas was added to the list of presidential priorities. Between 1841-1845, as Ulysses Grant later observed, "the annexation of Texas was at this time the subject of violent discussion in Congress, in the

[25] Wheelan, *Invading Mexico* at 68 (cited in note 5).

[26] Eugene Barker, *President Jackson and the Texas Revolution*, 12 Am. Hist. Rev. 788 (1907).

press, and by individuals."[27] According to Grant, "the administration of President Tyler, then in power, was making the most strenuous efforts to effect the annexation, which was, indeed, of the great and absorbing question of the day." [28] "For myself," he explained, "I was bitterly opposed to the measure, and to this day regard the war, which resulted, as one of the most unjust ever waged by a stronger against a weaker nation." As he saw it, "[i]t was an instance of a republic following the bad example of European monarchies, in not considering justice in their desire to acquire additional territory."[29]

At the end of his term in the White House, President John Tyler signed a joint Congressional resolution inviting Texas to join the Union as a state in January 1845.[30] In the matter of days, the new president, James Polk, was sworn into office and announced the annexation of Texas as one of his primary objectives.[31] He also planned to negotiate favorable terms with Mexico for the purchase of California and New Mexico; these two Mexican provinces were also valuable to the U.S. in its quest to extend its territory to the Pacific Ocean.[32] In addition, Congress and Polk were concerned about European interest in the neglected western territory.[33] In particular, Great Britain was developing a closer relationship with Mexico in the hope of purchasing California from the Mexicans.[34]

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[27] *Ulysses S. Grant, Memoirs and Selected Letters* 37 (Literary Classics of the U.S., Inc. 1990) (1885).

[28] Id.

[29] Id at 37.

[30] Wheelan, *Invading Mexico* at 52 (cited in note 5).

[31] Robert S. Henry, *The Story of the Mexican War* 29 (Frederick Ungar 1950).

[32] Id at 29.

[33] Frederick Merk, *The Monroe Doctrine and American Expansionism: 1843-1849*, 41 (Knopf 1971).

[34] Ephraim D. Adams, *English Interest in the Annexation of California*, 14 Am. Hist. Rev. 744 (1909).

Meanwhile, American newspapers started promoting the annexation and territorial expansion proposal as a means to protect U.S. interests.[35]

Despite the media hype regarding annexation, public officials for the Republic of Texas were reluctant to join the Union. They considered Texas to be an independent sovereignty with its own president, legislature and judiciary. Sovereignty supporters included important Texan leaders such as Sam Houston and Anson Jones, who both served as presidents of the young republic. (The latter also served as the last president of the Republic of Texas before it was annexed to the U.S.) These leaders preferred to remain neutral in any dispute between its neighboring states and did not want to draw the wrath of the Mexican army, which could have easily caused havoc and destruction to the republic in its infancy. At the same time, they continued to negotiate with Mexico to be recognized as a sovereign nation.[36]

Polk had great ambitions to expand the presence and land ownership of the U.S. into the western territories in North America.[37] In furtherance of his objective, he sent an envoy to Mexico with full authority to negotiate the purchase of the desired Mexican provinces.[38] Another major element of the negotiations was the proposed settlement of outstanding U.S. citizens' claims against Mexico. Specifically, Mexico had only paid about $500,000 of the total $2 million in claims, a figure that continued to increase as interest owed accumulated and new claims were filed against the state.[39]

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[35] Wheelan, *Invading Mexico* at 30 (cited in note 5).

[36] Id at 58.

[37] Id at 53.

[38] Id.

[39] Wheelan, *Invading Mexico* at 68 (cited in note 5).

The President continued to press Texas to join the Union, and gave them assurances of U.S. military protection against Mexico, so they could maintain the disputed land north of the Rio Grande.[40] After extensive debate and negotiations, the Texas Congress agreed to the annexation proposal and moved toward ratification.[41] Polk immediately ordered General Zachary Taylor and his troops to occupy the disputed territory. This decision, in turn, infuriated Mexico, which viewed these two actions, U.S. annexation and military occupation of Mexican territory, as an act of war.[42]

Polk grew increasingly impatient with the Mexican government's inability or reluctance to proceed with the final negotiations for sale of the region. Mexican officials sent messages to Washington indicating they were willing to sell California and New Mexico to the U.S. for approximately $30 million.[43] Polk authorized the U.S. minister to purchase the territories for a reasonable amount, subject to Congressional approval.[44] Despite American efforts to negotiate a resolution of these issues, the Mexican government proceeded to gather its army and prepare itself for battle against the U.S.

In April 1846, U.S. soldiers walked into a Mexican army ambush in which eleven men were killed and eight wounded.[45] General Taylor immediately notified the President regarding the ambush which prompted him to deliver a message to Congress requesting

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[40] Id at 59.

[41] Justin H. Smith, *The Mexican Recognition of Texas*, 16 Am. Hist. Rev. 36 (1910).

[42] Wheelan, *Invading Mexico* at 60 (cited in note 5).

[43] Id at 77.

[44] Id at 71.

[45] Id at 91-92.

they immediately declare war on Mexico.[46] As chronicled in Wheelan's book *Invading Mexico*, Polk exerted enormous pressure on Congress to expedite the approval of a war bill, which obfuscated the truth concerning actual legal territorial boundaries, and the location of U.S. troops in Mexican territory.[47] In the House of Representatives, the Democrats limited the debate on the war resolution to only two hours.[48] The opposing party members complained this decision required additional information and further deliberation beyond the mere two hours allocated to this issue.[49] In the end, the Democrats prevailed and an appropriations bill containing a declaration of war against Mexico was adopted by a vote of 174-14.[50]

Unlike the House of Representatives, the Senate held heated debates regarding the legality of taking arms against Mexico based on limited circumstances.[51] As Wheelan points out, several senators strenuously demanded to hear the evidence showing Mexico had in fact invaded U.S. territory to justify military action against its neighbor. There were other senators who overreacted to the events and contributed to the confusion by disseminating misinformation regarding the purported hostilities in their debates and speeches on the floor. For example, Senator Sam Houston from Texas had indicated that the Mexicans had crossed the Rio Grande "in military array" and "they had entered upon American soil with a hostile design," when, in fact, no known Mexican troops had

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[46] Wheelan, *Invading Mexico* at 93-99 (cited in note 5).

[47] Id at 96.

[48] Id .

[49] Id.

[50] Wheelan, *Invading Mexico* at 96 (cited in note 5).

[51] Id at 96-99.

crossed the boundary [that was] agreed upon by both countries several years prior to the war."[52]

Another senator who attempted to prod his colleagues to move swiftly on the bill was quoted as saying:

> [A] hostile army is in our country; our frontier has been penetrated; a foreign banner flows over the soil of the republic; our citizens have been killed, while defending their country. A great blow has aimed at us; and while we were talking and asking for evidence, it may have been struck, and our army annihilated.[53]

Later on, to drive home the point to his colleagues, Senator William Allen of Ohio stated "a delay of forty-eight hours might produce events which would become the occasion of a lasting war."[54]

Polk and his cabinet members pushed the bill through Congress, so they could fight the war that was expected to be "speedily terminated."[55] Senator Thomas Hart Benton later wrote "they wanted a small war, just large enough to require a treaty of peace, and not large enough to make military reputations, dangers for the presidency."[56] The bill was eventually approved by a vote of 40-2. Only two senators opposed the bill because they did not believe the U.S. had the requisite legal basis for this action.[57] As Senator Thomas Clayton of Delaware noted, "It was as much an act of aggression on our

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[52] Id at 98.

[53] Id. Senator Lewis Cass of Michigan made this eloquent speech, but it was not factually accurate since U.S. troops that occupied Mexican territory. The Mexican army had never entered U.S. territory during the U.S.-Mexican War.

[54] Wheelan, *Invading Mexico* at 98 (cited in note 5).

[55] Id.

[56] Id. Senator Benton had expressed these sentiments, but he played an essential role in advancing the war bill through his Military Affairs Committee.

[57] Id. Senators Thomas Clayton of Delaware and John Davis of Mississippi voted against the bill.

part as pointing a pistol at another's breast."[58] Furthermore, Senator Calhoun pointed out that "[n]ever was so momentous a measure adopted, with such much precipitancy; so little thought; or forced through such objectionable means."[59]

On May 13, 1846, Polk signed the war bill into law, authorizing him to expand the army. Throughout the country, there was a spark of nationalism in support of the war effort. Sensationalized recruiting campaigns attracted many young men who were in search of adventure to volunteer for the army.[60] Nevertheless, there existed strong pockets of skepticism regarding the primary purpose behind the war. The abolitionists believed it was a pretext for extending slavery into new territories.[61] They felt Polk, who was a slave owner and a strong states rights advocate, was protecting slavery by claiming Mexico invaded the United States. Interestingly, Anson Jones, the last president of the Republic of Texas, criticized the invasion stating "[t]he war was sought to be made everywhere except under the Constitution, and by every means known to human ingenuity."[62]

The same cynical sentiment was present among the rank and file troops. In a letter to his wife dated May 6, 1845, then-Lieutenant Grant wrote that the officers discussed among themselves national issues such as "the annexation of Texas, war with

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[58] Wheelan, *Invading Mexico* at 98 (cited in note 5).

[59] Id.

[60] In a recruiting campaign for Colonel Caleb Cushing's regiment in Massachusetts, the tagline was "MEN OF OLD ESSEX! MEN OF NEWBURYPORT! Rally round the bold, gallant and lion-hearted Cushing! He will lead you to victory and to glory!" Id at 99 (capital in original). Ironically, Caleb would later serve as Mexico's Agent for the U.S. Mexican Claims Convention of 1868. See text accompanying note 174.

[61] Id.

[62] Wheelan, *Invading Mexico* at 98 (cited in note 5).

Mexico, occupation of Oregon, and difficulties with England."[63] He noted "some of them expect and seem to contemplate with a great deal of pleasure some difficulty where they may be able to gain laurels and *advance a little in rank.*"[64] (Emphasis in original) Grant further emphasized that "[t]he Mexican War was a political war, and the administration conducting it desired to make party capital out of it"[65] He believed Polk's desire not to provide an opposing party member undue recognition during the war resulted in his removal of General Winfield Scott from the main war planning meetings during the early stages of the war. "General Scott was the head of the army," Grant added, "a solider of acknowledged professional capacity, his claim to the command of the forces in the field was almost indisputable and does not seem to have been denied by President Polk, or Marcy, his Secretary of War."[66] Despite his military experience and qualifications, Grant believed Scott was "not given command of the 'army of conquest.'"[67] It was widely believed Polk do not want to give General Scott publicity or national recognition for any victories during the war that may have strengthened his presidential aspirations.[68]

During the early stages of the war, Polk planned military actions to "protect" the boundaries of Texas, but also to achieve his ultimate goal of acquiring California and New Mexico. There was even an active U.S. propaganda campaign to convince residents

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[63] *Grant: Memoirs and Selected Letters* at 893 (cited in note 27).

[64] Id.

[65] Id at 83.

[66] Id.

[67] *Grant: Memoirs and Selected Letters* at 83 (cited in note 27).

[68] Id at 84.

in the western Mexican provinces to raise arms against Mexico and seek protection of the U.S. Polk ordered his senior military officers to provoke dissension among residents and merchants to oppose local Mexican authorities.[69] These officers had also engaged in local skirmishes with Mexican troops to destabilize their control within several key towns.[70] These activities also resulted in financial losses to local Mexican businessmen and landowners who would later file claims against the U.S.

The year 1846 marked several major changes in the number of American states, and U.S. policy toward foreign countries. In January, the House of Representatives voted to cease the sharing of the Oregon territory with England. In March, General Taylor's won back-to-back victories against the Mexican forces in the Rio Grande area and captured Monterey.[71] (Over 150 years later, Monterey served as the meeting location for one of the first decisive discussions between U.S. President George H.W. Bush and Mexican President Carlos Salinas regarding a bilateral free trade and investment agreement.)[72] Shortly thereafter, the California Republic declared independence from Mexico as the U.S. Army commenced its occupation of different parts of the Mexico's northwestern territory. In August, the United States annexed New Mexico, adding to its conquest of western territory. Furthermore, Iowa was admitted to the Union as the twenty-ninth state on December 28, 1846.

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[69] Wheelan, *Invading Mexico* at 120 (cited in note 5).

[70] Id.

[71] *Grant: Memoirs and Selected Letters* at 74-82 (cited in note 27).

[72] During this meeting in November 1990, President Salinas reminded President Bush regarding the U.S. troops that marched through Monterey during 1846-1847. Carlos Salinas de Gortari, *Mexico: The Policy and Politics of Modernization* 78 (Plaza & Janes 2002).

After nearly two years of war with Mexico, U.S. troops defeated the Mexican army in Mexico City in September 1847, resulting in a truce while the diplomats undertook to negotiate the peace treaty. Polk had selected Nicholas Trist, the chief clerk of the State Department who was fluent in Spanish and had served as consul in Cuba, to serve as the U.S. diplomat to negotiate a peace treaty.[73] Despite his efforts to negotiate a treaty for several months, the fall of Mexico City and overwhelming U.S. victory over Mexican troops finally drove Mexican officials to seriously negotiate a peace treaty. Over the course of six months, Trist and three Mexican diplomats negotiated the terms of the treaty, which was later known as the Treaty of Guadalupe Hidalgo.[74] As part of the peace treaty, Mexico surrendered California, Nevada and Utah and portions of what is today part of five other states to the United States for approximately $15 million.

The treaty was sent to Polk who, in his final year in office was anxious to end the

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[73] Wheelan, *Invading Mexico* at 338 (cited in note 5). Although Polk had appointed Trist as the chief diplomatic negotiator, he eventually became dissatisfied with Trist for his perceived inability to finalize any deal. In those days, communications between Mexico and Washington traveled slowly. After hearing only about unsuccessful peace talks and unaware of the Mexican surrender at Mexico City, Polk directed Secretary of State James Buchanan to relieve Trist of his duties in October 1847. However, Buchanan's order did not reach Trist until after the fall of Mexico City. Trist knew that the treaty negotiations had to commence immediately without any delay to ensure success and he could not wait for his replacement to arrive from Washington. In addition, the Mexican President Manuel de la Pena y Pena and the British attaché, Edward Thornton, urged Trist not to leave, but to continue the negotiations. Trist replied to Buchanan in a 65-page letter advising him he would go forward with the negotiations despite the recall order; a reply he knew very well would not be received in Washington for several weeks and the president's anticipated response would not be received in Mexico for some time afterwards. Id at 393. Despite Trist's defiance, Polk readily accepted his peace treaty and promptly forwarded it to Congress for ratification. Id at 408.

Interestingly, Trist was never reimbursed for his expenses nor paid any salary beyond the date of his recall. In February 1870, President Ulysses Grant proclaimed the ratification of the Claims Convention of 1868. Trist took this opportunity to petition Congress for the payment of seven months of unpaid salary and the reimbursement of his expenses that he had incurred as a diplomat. *See* Petition of Nicholas P. Trist praying additional compensation for services rendered as commissioner plenipotentiary to the Republic of Mexico. March 7, 1870. Referred to the Committee on Foreign Relations, Serial Set Vol. No. 1408 Session Vol. No. 1, 41st Congress, 2nd Session, S.Misc.Doc. 74.

[74] Wheelan, *Invading Mexico* at 407-408 (cited in note 5).

war and obtain control of the western Mexican territories, forwarded it without change to Congress for ratification.[75] Except for a few revised sections, Congress accepted the terms and ratified the treaty. The Mexican legislature subsequently ratified the treaty in May 1848, and Polk proclaimed the end of the war on July 4th as part of Independence Day celebrations.[76]

During the U.S.-Mexican War, several soldiers were immediately thrust into the national headlines, and they eventually became prominent figures in American history.[77] For example, at the beginning of the war, Colonel Zachary Taylor was promoted to brevet brigadier general and placed in charge of the invasion of Mexico. He later successfully ran for U.S. president as a Whig candidate in 1848, but died from acute gastroenteritis just sixteen months into his term. Other war heroes included Robert E. Lee and Stonewall Jackson who fought side-by-side in the struggle war, and later joined forces to lead the Confederate Army as generals during the Civil War.[78] Other officers such as Lieutenants George P. McClellan and Winfield Scott Hancock served with distinction under General Taylor, and were eventually promoted to the rank of general for the Union Army during the Civil War.

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[75] Id at 409.

[76] Id at 411.

[77] In reference to several of the U.S. officers who fought both in the U.S.-Mexican War and Civil War, Grant observed that "all officers attained rank and fame, on one side or the other, in the great conflict for the preservation of the unity of the nation." *Grant: Memoirs and Selected Letters* at 90 (cited in note 27).

[78] Id.

In addition, the young Lieutenant Ulysses S. Grant saw his first combat action against a formidable enemy on the Mexican battlefields. He, of course, later served as the top general for the Union Army during the Civil War and was elected President of the United States for two terms from 1869-1877. Nearly twenty-five years after the U.S.-Mexican War, President Grant grappled with the thorny issue of the outstanding claims of American and Mexican citizens. As President, he appointed commissioners to the Claims Convention of 1868[79] and gave updates to Congress regarding the Commission's progress.[80] His connection to Mexico continued even after his presidency. In 1881 Grant was appointed the president of the Mexican Southern Railroad, and negotiated with Mexican officials to obtain concessions to start up his company's railroad system.[81] Later, President Chester Arthur appointed Grant to serve as one of the American commissioners "to negotiate a commercial treaty with Mexico" in 1882.[82]

The U.S. won the war and, as previously noted, negotiated a favorable treaty with Mexico that ceded over 1.2 million square miles of territory to the U.S. for the price of $15 million.[83] This vast territory included Texas, Nevada, Oregon, Utah, California and New Mexico.[84] Scholars dispute whether or not Polk should be considered among the

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[79] President Grant appointed Henry Wadsworth of Kentucky as a commissioner to the Claims Commission of 1868. Boston Daily Advertiser (Boston, MA), Issue 90; col. D (Apr. 17, 1869).

[80] See *President Ulysses Grant's Message to Congress*, Boston Daily Advertiser (Boston, MA), Issue 131, col A (Dec. 03, 1872); and *The President's Message: Our Relations with Foreign Powers Generally Satisfactory*, Daily Evening Bulletin (San Francisco, CA), Issue 48, col. D (Dec. 2, 1873).

[81] Simon, John Y., ed., *The Papers of Ulysses S. Grant, Volume 30: October 1, 1880-December 31, 1880*, 1156 (Southern Illinois University 1967).

[82] Id at 1157.

[83] Wheelan, *Invading Mexico* at 428 (cited in note 5).

[84] Id.

most effective U.S. presidents because he accomplished the goals he has set for his administration. Others challenge the notion of his effectiveness by noting Polk provoked a war without a legal basis, and his means did not justify the results.[85] Either way, it is undisputed that the United States vastly expanded its territory to the Pacific Ocean. In the end, the Treaty of Guadalupe Hidalgo also created a mechanism to formally adjudicate the claims of citizens for losses and damages incurred as a result of U.S. or Mexican actions.

3.3 Overview of Mexican History with Foreign Claims

A review of U.S. and Mexican relations from the nineteenth century to the current date usually focus on several historical events involving these two neighboring countries. Of all these events, military actions are perhaps the most significant and well-documented in history. As detailed in the prior section, the U.S.-Mexican War forever changed the political, financial, sociological and geographical framework of each nation. There is also the series of Mexican revolutions that led to the nationalization of several natural resources and major industries in Mexico resulting in a plethora of new American claims against the government. Another momentous event at the turn of the twentieth century was the U.S. military occupation of Vera Cruz by General John "Blackjack" Pershing in 1916 that sparked additional claims for damages by U.S. and Mexican citizens. Perhaps, the most amicable and productive event was the ratification of North

[85] Id at 428-429.

American Free Trade Agreement, effective January 1, 1994, that transformed the three neighboring nations of the United States, Mexico and Canada, into a powerful regional trade association.

An important precedent, little discussed in the conventional histories of both countries, was the establishment of bilateral claims commissions between the U.S. and Mexico from 1848 through 1942. This commission system was an integral part of an amicable, nonmilitary dispute settlement mechanism used to settle claims of its citizens against the other nation. The commissions also set the standard for the development of international arbitration throughout the world in the nineteenth century as a more effective means of resolving financial and commercial matters without having nations resort to military action. Many aspects of these standards still survive today as fundamental principles of modern international arbitration.

The settlement of claims is a major component of Mexican history. During the nineteenth century, several states, including the U.S. and European states, had brought various types of claims on behalf of its citizens against Mexico for losses incurred as a result of actions of the Mexican government. The primary cause for most of these losses are attributable to Mexico's political turmoil and seemingly endless cycles of revolution beginning from its infancy of a state in the 1820s through the 1930s.[86] Revolution was the mechanism that propelled Mexico into an state independent from Spain. But its frequency in Mexico involved of course political instability, transient governments, lack of the rule of law, and a great loss of lives. A consequence of all this turmoil was the

[86] Abraham H. Feller, *The Mexican Claims Commissions 1923-1934: A Study in the Law and Procedure of International Tribunals* 1 (Macmillan 1935).

inevitable injury to persons and property. These claims also became a pretext for those states to expand their territorial ambitions and extract moneys from an unstable Mexico that had a weak military force.[87]

The history of international claims against Mexico after 1823 is generally divided between the U.S. and European states, with the former having asserted the overwhelming majority of the claims. During the 1800s, France, Great Britain and Spain asserted claims against Mexico arising mainly from incidents related to the frequent change of national government that resulted in the seizure and expropriation of foreign goods and investments. Abraham H. Feller, a former Harvard Law School lecturer and senior official at the U.S. Department of Justice, had extensively documented the Mexican claims history in his seminal book titled *The Mexican Claims Commissions 1923-1934: A Study in the Law and Procedure of International Tribunals*.[88] Other legal scholars and historians, such as John Bassett Moore, have also written about the numerous claims arbitrations between citizens of the U.S. and Mexico. The following sections draw upon this existing literature and expands upon it with the author's personal research of original source documents regarding the U.S.-Mexican Claims Commissions from the National Archives.

3.3.1 Mexico and France

The French claims were significant enough for both states to have fought two

[87] Id at 1.

[88] Id.

wars over them in the nineteenth century. The first war was the so-called Pastry War of 1838.[89] According to historians, a mob had ransacked the shops of several French nationals in Mexico City in 1828, one of which was a pastry shop.[90] When negotiations for settlement of the claims were unsuccessful, France sent its fleet to blockade Mexico's ports and seize its ships. This war ended swiftly with a treaty in 1839, which provided for Mexico's payment of pre-war claims, and referred the wartime claims to arbitration with a third state to serve as umpire.[91] The latter claims were referred to the Queen of Great Britain who rendered an award in 1844, which denied any nationals' claims because the injuries were sustained while the two states were at war with each other.[92]

France and Mexico would again lock horns over claims in 1862. During the 1850s, a Mexican revolution resulted in yet another change of power in the government. The new president had negotiated secured loans and assignments in exchange for Mexican bonds with France.[93] Subsequently, a new law was enacted establishing a two-year moratorium on payments on any Mexican obligations.[94] When the president refused to recognize the debt, Napoleon III of France declared war on Mexico and successfully invaded the country. He also established a new government under the Emperor Maximilian from 1864-1867.[95] The Maximilian government subsequently agreed to a

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[89] Id at 7.

[90] Feller, *The Mexican Claims Commissions* at 7 (cited in note 86).

[91] Id.

[92] Id.

[93] Id at 8.

[94] Feller, *The Mexican Claims Commissions* at 8 (cited in note 86).

[95] Id. See also, Enrique Krause and Hank Heifetz, *Mexico: Biography of Power: a History of Modern Mexico, 1810-1996* (Paw Prints 2008).

claims convention that indemnified French nationals in an exorbitant amount of money in excess of 40 million pesos in 1866.[96] Shortly thereafter, Maximilian was captured and executed by another Mexican revolutionary, Benito Juarez.[97] The new government repudiated these conventions and refused to pay the claims. Both states terminated diplomatic relations with each other until 1880 when France waived its rights to the payment of any outstanding claims.[98]

3.3.2 Mexico and Great Britain

In the 1800s, Great Britain had asserted numerous claims against Mexico. A considerable number of these claims involved British bondholders.[99] It was a common practice for the Mexican government to issue bonds to foreign investors to raise funds for financial support of its revolutions or defense against new revolutions. Not surprisingly, the Mexican government constantly experienced economic woes and would suspend payments on its bonds from time to time.[100] British bondholders repeatedly sought diplomatic assistance from the British government to negotiate a settlement with Mexico.[101] Between 1842-1859, both governments had entered into two claims conventions to structure the repayment of the bonds and other debt owed to British

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[96] Feller, *The Mexican Claims Commissions* at 9 (cited in note 86).

[97] Id.

[98] Id.

[99] Id.

[100] Feller, *The Mexican Claims Commissions* at 9 (cited in note 86).

[101] Id at 10.

nationals.[102] However, Mexico was unable to meet its obligations and the debt gradually increased over time. Ultimately, Mexico's inability to meet its obligations to foreign investors led to the Intervention of 1861 with Great Britain, France, and Spain joining forces to compel Mexico to pay its foreign debt.[103]

Great Britain and Mexico continued to seek diplomatic resolution of the claims issue by entering into the Claims Convention of 1862.[104] Although the British government did not ratify this convention, a principal component of the agreement referred the British claims to an international tribunal. Under the convention, the tribunals consisted of two members selected by the two governments, and they would be entrusted with appointing a third member who would serve as the umpire to adjudicate claims.[105]

There were two additional attempts to settle these claims. In 1866 the Maximilian government agreed upon another claims convention.[106] This convention called for the appointment of five commissioners who would decide whether or not to approve a claim if "the Mexican government [was] responsible in accordance with generally admitted principles of international law, and which are in origin, continuity and actuality British."[107] The standard of law applicable to these claims is worth notice because it applied the principles of international law and required proof of citizenship (i.e., the

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[102] Id.

[103] Id.

[104] Feller, *The Mexican Claims Commissions* at 10 (cited in note 86).

[105] Id at 11.

[106] Id.

[107] Id.

claimant is in fact a British citizen) as a jurisdictional element for the validity of a claim.[108] Historical records indicate the commissioners may have heard claims, but there is no indication any awards were issued under this agreement.[109]

Finally, in 1884, the two states agreed to investigate the validity of the claims of each others citizens and to pay any outstanding claims.[110] Mexico, however, inserted a provision that stated 'the examination, liquidation and payment of the credits of British subject will be exclusively subject to the disposition of the laws of Mexico in regard to the settlement of the Public Debt.'[111] This provision was inconsistent with the legal standard previously agreed to in the Convention of 1866, which was based upon international law. It did reflect the changing sentiment in Mexico, and throughout Latin America, that favored the disposition of claims in national courts, applying national laws rather than the application of international law (also known as the "Calvo Doctrine") as the legal standard for deciding claims involving foreign nationals doing business within its borders.

3.3.3 Mexico and the United States

For the past 170 years, arbitration has been an integral part of U.S. and Mexican policy to settle claims between its citizens. Between 1825 and 1839, U.S. diplomats in

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[108] Feller, *The Mexican Claims Commissions* at 11 (cited in note 86).

[109] Id.

[110] Id at 12.

[111] Id.

Mexico protested the enforcement of Mexican customs regulations that were harsher for American merchants than for Mexican nationals. The number of U.S. claims increased with allegations concerning "American vessels [being] fired upon, American citizens illegally arrested and maltreated, and their property arbitrarily confiscated."[112] The Texas revolution against Mexico also sparked a myriad of claims. In 1836 U.S. attempts to negotiate a settlement with Mexican officials stalled as their government was unable agree upon terms acceptable to the Americans. Moreover, internal civil revolts in Mexico combined with frequent changes in presidents destabilized the government and rendered it ineffective for diplomatic negotiations.[113]

The issue of unresolved claims became a higher priority starting in President Andrew Jackson's Administration. U.S. Minister Powhatan Ellis went to Mexico to engage his Mexican counterpart in settlement discussions at the urging of the President. After not receiving a prompt response, Ellis informed Mexican officials he would return to Washington. The official replied that this issue was "not in his power to control" and, due to the "neglect" of Ellis's predecessor, Mexico required more time to obtain documents related to the claim from the governments prior to responding to the claims.[114] Subsequently, the two ministers exchanged terse letters that did not help facilitate the effective resolution of the issues. The Mexican official explained the circumstances

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[112] Feller, *The Mexican Claims* Commissions at 2 (cited in note 86).

[113] Callahan, *American Foreign Policy* at 91 (cited in note 8). Between 1825-1836, thirteen individuals served as Mexican president on nineteen separate occasions, and as many as four individuals served as president for a only few months each in 1833 alone. Government of Mexico, List of Mexican Presidents, online at http://www.presidencia.gob.mx/felipecalderon/?contenido=40336 (viewed Nov. 28, 2009).

[114] *The United States and Mexico*, Daily National Intelligencer (Washington, DC), Issue 7493, col. D (Feb. 16, 1837).

behind some of the claims, and insisted his country had insufficient information to determine the veracity of the other claims. Nevertheless, Mexico acquiesced to Ellis's demand for the return of his passport, so he could leave the country without any further negotiation.[115]

These events prompted President Jackson to take the claims issue directly to Congress. In a message to the Senate in February 1837, Jackson expressed his disappointment that Mexico was unable to settle the claims and he urged Congress to take action to resolve this matter. He told them:

> The length of time since some of the injuries have been committed, the repeated and unavailing applications for redress, the wanton character of some of the outrages upon the property and persons of our citizens, upon the officers and flag of the United States, independent of recent insults to this Government and people by the late Extraordinary Mexican Minister, would justify, in the eyes of all nations, immediate war.[116]

Accordingly, the President requested Congress to pass a law "authorizing reprisals" and the use of the Navy against Mexico, unless they agreed to settle the claims.[117] This request was submitted to the Senate Foreign Relations Committee, which reviewed and rejected the request. The Committee preferred "the more reasonable and politic course of awaiting the results of a due representation of the several alleged grievances, with the proofs thereof, to the Government of Mexico, as provided by the existing Treaty between the two countries."[118]

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[115] Id.

[116] *From Washington: Message in Relation to Mexico*, Virginia Free Press (Charlestown, WV), Issue 3, col. E (Feb. 16, 1837).

[117] Id.

[118] *Proceedings in the Senate: Increase of the Army*, Daily National Intelligencer (Washington, DC), Feb. 20, 1837, Issue 7496, col. D. The Senate committee also stated: "Fortunate will it be for our country, if, in future time, upon the introduction of exciting questions upon our Foreign Relations, there be always found

3.4 Claims Commission of 1839: The First Arbitration System for the Claims of U.S. Citizens Against Mexico

The U.S. Congress continued to receive constituent complaints regarding Mexico's failure to adjust their claims, and they proposed establishing an arbitration process for adjudicating the claims. Not everyone was convinced arbitration would resolve this matter. In fact, in February 1839, Representative Richard Biddle of Pennsylvania introduced a statement signed by U.S. citizens at a meeting in New Orleans to the House of Representatives, Select Committee on Public Lands.[119] The statement "expressed, in strong terms, a belief that the proposal for an arbitration had its origin in a wish to amuse and baffle."[120] The citizens also questioned Mexico's desire to ratify any convention with the U.S. because they had played the "same game" for years.[121] Even the Committee Chairman, Benjamin Howard, had expressed concerns that "this arbitration was a mere device to gain time, and would end in nothing."[122]

Since 1839 there have been several treaties between the U.S. and Mexico establishing arbitration commissions and delegating adjudicative authority to its

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in its Legislative council's wisdom and deliberation to restrain the propensity to rush to arms as a remedy for grievances, which amicable measures are better adapted to redress, with honor to the nation." Less than ten years later, Congress perhaps should have heeded its own advice when it rushed to vote in favor of a declaration of war against Mexico in 1846, without legally sufficient evidence to justify approving such drastic action.

[119] *Twenty-Fifth Congress, Third Session In Senate*, Daily National Intelligencer (Washington, DC), Feb. 18, 1839, Issue 8116, col. A.

[120] Id.

[121] Id.

[122] Id.

appointed representative or an umpire who is not a national of either state.[123] For example, the Claims Convention of 1839 established a commission of four commissioners consisting of two representatives appointed by each president.[124] The commission was responsible for reviewing and determining the validity of the claims and any compensation payable by Mexico.[125] During the negotiation of this treaty, Mexico was unsuccessful in negotiating the inclusion of its citizens' claims; thus, this treaty only applied to claims of U.S. citizens against Mexico.[126] If the arbitrators could not agree upon a decision, the claim would be referred to the King of Prussia as umpire for final adjudication.[127] The commission was authorized to act in accordance with the convention, but only for a period of eighteen months.[128]

The treaty authorized each country to appoint a secretary who was required to be

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[123] Claims Convention of 1839, 8 Stat. 372; Claims Convention of 1843, 8 Stat. 578; Treaty of Guadalupe Hidalgo (Peace Treaty of 1848), 9 Stat. 922; Claims Convention of 1868, 15 Stat. 679; Claims Duration of Joint Commission, 19 Stat. 642; Arbitration Treaty of 1908, 35 Stat. 1997; and Chamizal Arbitration Treaty of 1910.

[124] John Bassett Moore, *History and Digest of the International Arbitrations to Which the United States Has Been a Party* 1218 (G.P.O. 1898). Claims Convention of 1839, Article I. The U.S. Senate ratified the convention on March 17, 1840 and President Martin Van Buren signed it on April 6, 1840.

[125] Id.

[126] Letter of Francisco Pizarro Martinez, Mexican Minister to the U.S. Secretary of State John Forsyth, dated September 3, 1838. Martinez wrote: "The desire of my Government is, and has been since I had the honor to address to your Excellency my note of the 7th of April last, that the United States should join Mexico in submitting all complaints, claims, and differences which are unfortunately pending the two nations, to the opinion of his Majesty the King of Prussia; for it is persuaded that in the way (considering how difficult it has been to restore harmony between the two nations by means of direct negotiation) Mexico and the United States will obtain a definitive and permanent adjustment." Forsyth replied to Martinez informing him that "it is not probable that the President will agree to any mode of adjusting those questions other than that I have suggested to you in our official conversations in the progress of the negotiation just concluded." President Jackson only agreed to submit U.S. claims to arbitration under the Claims Convention of 1839. *Official: From the Globe- Relations with Mexico*, Daily National Intelligencer (Washington, DC) June 3, 1839, Issue 8206, col. A.

[127] Moore, *History and Digest* at 1218 (cited in note 122). Claims Convention of 1839, Article VII.

[128] Id. Article IV.

fluent in English and Spanish to support the commission. The commissioners were required to publish notices in two newspapers announcing the hearings to be held in Washington, D.C.[129] Each country agreed to pay half of the umpire's travel expenses and compensation which was equal to the half the amount paid to the American arbitrator plus half the amount paid to the Mexican arbitrator.[130] The umpire was also allowed to delegate the review of the claims to his representative who was required to attend the proceedings in Washington.[131] Initially, an earlier draft of the treaty did not establish a process for designating a substitute umpire in the event that the King of Prussia declined or was unable to service as umpire. As it would be, the King declined to participate in the arbitration and the ratification of the treaty was delayed pending revisions to the treaty to allow for substitutions.[132] The final treaty provided that if the Prussian King declined, the parties agreed the Queen of England would serve as umpire and if she declined, the King of Netherlands was authorized to appoint an umpire to act on his behalf.[133]

Although the U.S. and Mexico agreed to arbitration, the convention did not establish specific rules on how claims should be submitted, or how the commission was to run the proceedings. The commissioners only "agreed upon five trivial rules,

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[129] *Official: By the President of the United States of America M. Van Buren*, Daily National Intelligencer (Washington, DC), Issue 8478, col. C (Apr. 17, 1840).

[130] Moore, *History and Digest* at 1219 (cited in note 124). Claims Convention of 1839, Article VII.

[131] Id.

[132] *Claims on Mexico*, Daily National Intelligencer (Washington, DC), Issue 8129, col. E (Mar. 5, 1839).

[133] Moore, *History and Digest* at 1219 (cited in note 124). Claims Convention of 1839, Article IX.

providing for the length of sessions, and the times of meeting and adjournments."[134] They also allowed the selection of arbitration locations "with an eye to their case and convenience, without indicating the slightest inequality, between them."[135] In addition, any commissioner was allowed to "call for a vote on any question before the commission."[136] This major gap in rules and procedures would later hinder the commission's ability to effectively and efficiently manage the large claim docket within the relatively short time span of the commission's authorization.

There were other issues related to the arbitration proceeding, including scheduling, claimant requests to appear before the Commission to present their claim, discovery delays, integrity of documentary evidence, and lack of remedy to address deadlocked voting between the commissioners when the issue was not the type referable to the umpire under the convention. First, under the convention, the commissioners were required to start reviewing claims within ninety days of its ratification. The two U.S. arbitrators met on the scheduled date for the first meeting in Washington, but their counterparts did not appear.[137] The American waited for three weeks for the Mexican commissioners but to no avail. Finally, they rescheduled the meeting five weeks after the original date.[138] Since the Commission's tenure was only eighteen months long, they lost precious time due to this delay.

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[134] Robert C. Morris, *International Arbitration and Procedure* 122-123 (Yale University 1911).

[135] Id at 122.

[136] Id at 123.

[137] Richard S. Coxe, *Review of the Relations Between the United States and Mexico, and of the Claims of the Citizens of the United States Against Mexico* 63 (Wilson & Co. 1846).

[138] Id.

The lack of uniform arbitration and procedural rules complicated the resolution of disagreements between the even number of arbitrators who invariably voted with their national colleague. For example, when the Mexican commissioners arrived they insisted claimants or their agents did not have the right to appear before the commission to present their claims.[139] Although the convention did not stipulate to such a right, the U.S. vehemently opposed this position based upon "fundamental principles of justice."[140] In this situation, where the four arbitrators were deadlocked on a claim decision, there was no rule or procedure to address this dilemma. Under the convention, they were authorized to refer claim decisions to the umpire, but not any procedural issues that they could not agree upon. After two additional months of delay, the Americans relented and allowed the claim decisions to be based on the papers, so the commission would not lose any more time.[141]

The next issue that caused further delays was the Mexican government's requests to obtain documents from their country. The requests were forwarded to the Mexican officials, but many of them were never replied to, or if the documents were sent, there was an extensive time lag before their receipt in Washington.[142] This delay usually resulted in the claim being suspended indefinitely, or the commissioners ran out of time to complete their review before the expiration of the commission. According to Richard S. Coxe, an attorney who represented three claimants before the Commission, there was

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[139] Id at 63-64.

[140] Id at 64; See also Testimony of Richard S. Coxe, Report of the Select Committee of the Senate in Relation to the Mexican Claims Proceedings, Washington, D.C., Congress. Senate Select Committee on Mexican Claims, 33rd Congress, 1st Sess., Rep. Comm. No. 182 (July 14, 1852).

[141] Coxe, *Review of the Relations* at 64 (cited in note 137).

also evidence several documents produced by the Mexican government were either "false or imperfect."[143] The American commissioners reportedly identified five false documents in several cases, but the claims were left unresolved.

Despite these procedural and evidentiary challenges, the first claims commission was viewed as a partial success after decades of unadjudicated claims. The Commission entered final decisions for a total of seventy-two cases and awarded $2,025,393 in monetary damages to the claimants.[144] Of these seventy-two cases, the commissioners approved eleven claims in the amount of $439,393 in damages and only denied four cases.[145] Of the fifty-seven cases referred to the umpire, he denied four cases and approved fifty-three cases in the amount of $1.586 million.[146] The commission expired after eighteen months leaving hundreds of claims unresolved.

3.5 The Trend Toward Claims Commissions Continues into the Next Century

After the 1839 Claims Commission, the U.S. and Mexico had subsequently entered into several treaties establishing new commissions to adjudicate claims of citizens from both countries. These treaties included: The Claims Convention of 1843, Treaty of Guadalupe Hidalgo (1848), Claims Convention of 1868, and several other types

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[142] Id.

[143] Id.

[144] Feller, *The Mexican Claims Commissions* at 3 (cited in note 86).

[145] Id.

[146] Id.

of claims commissions between 1910-1942. The following section provides an overview of the major claims conventions and several examples of claims decided by the commissioners.

3.5.1 The Claims Convention of 1843

At the end of the 1839 Claims Commission in 1842, Mexico determined it could not afford to pay the damages awards that amounted to millions of dollars. This predicament prompted the parties to negotiate another claims commission, but this time it included the claims of both governments and their citizens, including those unresolved U.S. citizen claims from the prior commission. The situs of the Commission was set in Mexico. Congress ratified the treaty on March 2, 1843, and President Tyler signed it on March 29, 1843. In his message to Congress in December 1843, President John Tyler reported Mexico was making timely payments for U.S. claims that had been adjudicated so far under the Commission. He also advised that the U.S. Minister to Mexico was engaged in negotiations with Mexican officials to establish a new commission for settlement of any unadjusted claims.[147]

Subsequently, Congress objected to two articles in the treaty: (1) the Commission being located in Mexico, and (2) the provision allowing Mexican government claims against the U.S., especially any claims related to its support of the Republic of Texas's revolt against Mexico. Accordingly, the U.S. amended the Convention to change the

[147] *President John Tyler's Message To the Senate and House of Representatives*, N.Y. Herald, Issue 324, col. B (Dec. 6, 1843).

location to Washington and inserted a reservation provision to exclude any government claims from the treaty.[148] Mexico disagreed with these amendments and refused to ratify the amended convention. Hence, no further action was taken and the Claims Convention of 1843 was unsuccessful.

3.5.2 Treaty of Guadalupe Hidalgo (1848)

As detailed in Section 3.2 above, the U.S. declared war on Mexico, and a two-year conflict ensued resulting in the defeat of Mexican forces in 1848. In the Treaty of Guadalupe Hidalgo, Mexico agreed, among other things, to pay the sum of $3,250,000 as compensation for all decided and liquidated claims that were unpaid from the prior two conventions.[149] The payment would be made in full satisfaction of any claim from U.S. citizens prior to the signing of the treaty. The Treaty also established a board of commissioners to determine the validity and compensation, if any, for all other claims.

Under this Treaty, the board was obligated to follow the rules set forth in two articles from the unratified 1843 Convention. The board consisted of four commissioners, two from each country. They were required to take "an oath to examine and decide impartially the claims submitted to them." Article IV of the 1843 Convention established basic rules for the Commission, including the requirement that arbitrators

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[148] See original text of Claims Convention of 1843. *The Convention with Mexico*, Daily National Intelligencer (Washington, DC), Issue 9387, col. D (Mar. 20, 1843). See also *Message of the President Transmitting Correspondence Relative to the Claims of Citizen of the United States upon the Mexican Government*, House Doc. No. 158, 28th Cong., 2d Sess. (1845).

[149] Treaty Between The United States and Mexico of February 2, 1848, Articles XIII, XVI. This treaty is also commonly referred to as the "Treaty of the Guadalupe Hidalgo."

determine the legality of claim based upon "proofs which shall be presented, the principles of right and justice, the law of nations, and the treaties between the two Republics."

The Treaty also provided that Mexico should produce "any books, records, or documents in the possession or power of the government of the Mexican republic" that was "necessary to the just decision of any claim." Mexico agreed to provide such information "at the earliest possible moment after the receipt of such demand."[150] This Commission eventually awarded $3,208,314 in 198 cases and rejected seventy claims.[151]

3.5.3 Claims Convention of 1868

After the Civil War, there was a short period of political stability in Mexico that made it advisable to conclude another convention. On July 4, 1868, U.S. Secretary of State William H. Seward and Matias Romero, Mexican Minister to the U.S., completed a convention for the adjustment and settlement of all claims. This treaty was "largely copied after that of February 8, 1853, between the United States and Great Britain, which Seward regarded as a model."[152] Under the Claims Convention of 1868, "[a]ll claims of the citizens of either country against the government of the other arising since the signature of the Treaty of Guadalupe Hidalgo were to be submitted to a commission." The U.S. Senate ratified the treaty on July 25, 1868, and the Mexican Congress approved

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[150] Id. Article XV.

[151] Feller, *The Mexican Claims Commissions* at 5 (cited in note 86).

[152] Willis Fletcher Johnson, 2 *America's Foreign Relations* 200 (Century Company 1916).

it in January 1869.[153]

The 1868 Treaty also provided for the submission of all claims arising since the Treaty of Guadalupe Hidalgo to a commission consisting of one commissioner appointed by each country. The two commissioners were authorized to select a third person as an "umpire to decide in case of difference between the commissioners."[154] This system marked a significant change from the 1839 Commission by reducing the number of national commissioners in half and allowing the commissioners, not the states, to appoint the umpire.[155] Both commissioners and umpires were required to take an oath that they would "impartially examine and decide, the best of my judgment according to the public law, justice, and equity, without fear, favor, or affection to their own country, upon all such claims above specified as shall be laid before them on the part of the governments of the United States and of the Mexican republic, respectively."[156] In addition, the commissioners were required to meet in Washington, and they maintained the Commission's office at 1412 H St. (now designated as the Northwest section) in the district. It was an expensive office located three blocks from the White House and cost the State Department $3,000 in rent annually.[157]

In 1869 President Grant appointed former Congressman William Henry

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[153] *Editorial: Mexico*, Bangor Daily Whig & Courier (Bangor, ME), Issue 6, col. B (Jan. 7, 1869).

[154] Feller, *The Mexican Claims Commissions* at 6 (cited in note 86).

[155] Article I, Convention with Mexico. Message from the President of the United States, in relation to the convention between the United States and the Mexican Republic. March 1, 1869, Serial Set Vol. No. 1381, Session Vol. No.13, 40th Congress, 3rd Session, H.Exec.Doc. 98.

[156] Id.

[157] Memo of R.S. Chew, Chief Clerk of State Department, to J.H. Saville, Esq., Chief Clerk of Treasury Department, dated March 4, 1871, Removal of the National Capital Report, House of Representatives,

Wadsworth of Kentucky to serve as a commissioner. Wadsworth was an attorney, colonel in the Civil War, and elected four times as U.S. Representative from 1861-1865 and 1885-1887.[158] The Mexican President, Benito Juarez, appointed Francisco Gomez Palacio as commissioner. He was a Mexican jurist, politician, author, and former Attorney General for Mexico.[159] Palacio resigned in 1871 to become the Mexican Minister to the U.S., and General Leon Guzman succeeded him in April 1872.[160] The General's tenure was merely eight months long because he and Wadsworth could not tolerate each other.[161] Manuel Maria de Zamacona, former Mexican Minister of Foreign Relations, replaced Guzman as commissioner.[162]

Nearly two thousand claims were presented to the Commission in an "aggregate amount of over half a billion dollars."[163] It was essential for both countries to select an umpire who was a prominent figure, independent, and knowledgeable of the law. At first, for some inexplicable reason, the Commissioners offered the umpire position to William Cullen Bryant, who had practiced law in his youth, but had spent most of his

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Committee on Public Expenditures, March 3, 1871, Serial Set Vol. No. 1464, Session Vol. No.1, 41st Congress, 3rd Session, H.Rpt. 52.

[158] Biographical Directory of the United States Congress, online at http://bioguide.congress.gov (visited Nov. 28, 2009).

[159] Palacio compiled various opinions from the Claims Commission and wrote a book titled *Claims of Mexican citizens against the United States for Indian depredations: being the opinion of the Mexican Commissioner in the Joint Claims Commission, under the convention of July 4, 1868, between Mexico and the United States* (Judd & Detweiler 1870).

[160] Hubert Howe Bancroft, *History of Mexico: 1861-1887*, 13 (The History Company 1888).

[161] Id at 443.

[162] Report of U.S.-Mexican Claims Commission. Zamacois, Niceto de, *Historia de Méjico Desde Sus Tiempos Mas Remotos Hasta Nuestros Dias* 775 (J.F. Parres 1880).

[163] Lewis R. Harley, *Francis Lieber: His Life and Political Philosophy* 99 (Columbia University 1899).

adult life as the editor of the *New York Evening Post*.[164] Bryant promptly declined and informed the Commissioners he was engaged in other "pressing" matters and was unable to attend to this responsibility.[165] He also questioned his qualifications for such a position. After careful consideration, President Grant, U.S. Secretary of State Hamilton Fish, Mexican diplomats, and the claims commissioners agreed to appoint Dr. Francis Lieber, the distinguished international scholar who lived in New York City, as the umpire.[166]

Initially, Lieber declined the offer stating he had "written on the importance of umpires not being monarchs or governments."[167] When pressed for a detailed explanation for his rejection of the offer, Lieber intimated to Secretary Fish and Mexican Minister Ignacio Marescal that the convention's umpire compensation provision "placed the umpire in an undignified position, which might actually lead to a discussion about

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[164] Letter of William Cullen Bryant to Francisco Palacio and William Wadsworth, dated Jan. 12, 1870. Moore, *History and Digest* at 1299 (cited in note 124). See also John Bigelow, *William Cullen Bryant* 34-53 (Riverside Press 1890). There is some indication in the personal papers of Matias Romero, the Mexican Minister to the U.S., that he was acquainted with Bryant because the editor was a frequent guest of the Mexican government's dinner banquets held at the famous Delmonico's restaurant in New York City during the Civil War. At these banquets, the Mexican attempted to build up American support for its war effort against France which had invaded Mexico in 1864. Robert Ryal Miller, *Matias Romero: Mexican Minister to the United States during the Juarez-Maximilian Era*, 45 Hispanic Am. Hist. Rev. 228, 233 (1965).

[165] Moore, *History and Digest* at 1300 (cited in note 124). The "pressing" matter referenced in his letter to the Commissioners was most likely his writing project to translate Homer's *Odyssey* and *Iliad*. See Bigelow, *William Cullen Bryant* at 166-168 (cited in note 164).

[166] Thomas Sergeant Perry, ed., *The Life and Letters of Francis Lieber* 394 (James R. Osgood 1882). Letter of Hamilton Fish to Francis Lieber (Feb. 1870). Lieber was a German-American legal scholar and political philosopher who lived from 1800 to 1872. He was the founder and editor of the Encyclopedia Americana. From 1856 until 1865, he taught at Columbia University and was one of the first scholars referred to as a "political scientist." During the Civil War, he wrote his acclaimed military code of wartime conduct ("Lieber Code") for the Union Army. This code was eventually adopted by several countries and became recognized as the international law on war.

[167] Id. Letter of Francis Lieber to Hamilton Fish (Feb. 6, 1870).

fees."[168] Article VI states "The amount of compensation to be paid to the umpire shall be determined by mutual consent at the close of the commission, but necessary and reasonable advances may be made by each government upon the joint recommendation of the commission."[169] Lieber believed that this type of compensation arrangement would raise conflicts of interest, and he would not be paid reasonable fees.[170] Thus, Fish and Marescal agreed to set Lieber's compensation at the beginning of the commission, and he agreed to serve as the umpire, which he did until his death on October 2, 1872.[171] Upon Lieber's death, the Commission appointed Sir Edward Thornton, the then-British minister to U.S. and an observer at the negotiations of the Treaty of Guadalupe Hidalgo in 1848, as the new umpire.

The convention authorized each commissioner to hire its own secretary to "assist them in the transaction of business," including their obligation to "maintain an accurate record and correct minutes of their proceedings."[172] It also allowed each state to appoint an "agent" to attend the Commission proceedings "to present and support claims on its behalf, and to answer claims made upon it, and to represent it generally in all matters connected with investigation and decision" of the claims.[173] President Grant appointed

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[168] Id at 394. Letter of Francis Lieber to Hamilton Fish (Mar. 2, 1870).

[169] Convention with Mexico. Message from the President of the United States, in relation to the convention between the United States and the Mexican Republic. March 1, 1869, Serial Set Vol. No. 1381, Session Vol. No.13, 40th Congress, 3rd Session, H.Exec.Doc. 98.

[170] Harley, *Francis Lieber* at 1300 (cited in note 163).

[171] Id at 99.

[172] Article VI. Convention with Mexico. Message from the President of the United States, in relation to the convention between the United States and the Mexican Republic. March 1, 1869, Serial Set Vol. No. 1381, Session Vol. No.13, 40th Congress, 3rd Session, H.Exec.Doc. 98.

[173] Id. Article II.

Joseph Hubley Ashton, Esq. to be the agent for the United States, and Mexico named Caleb Cushing as its agent. Both of these men had distinguished careers and were highly respected for their legal knowledge and skills.

Prior to this appointment, Ashton was a former Assistant U.S. Attorney General and a law professor at Georgetown University.[174] In 1862 he also served as counsel to Admiral Farragut's fleet that captured thirty-six Confederate ships in New Orleans during the Civil War.[175] His counterpart was Cushing, a seasoned politician who served over ten years as a Massachusetts state legislator and four terms as a U.S. Representative. From 1841-1843, he chaired the U.S. House Committee on Foreign Affairs. During the U.S.-Mexican War, Cushing served as a general of a Massachusetts regiment.[176] In addition, he also served as the U.S. Attorney General under President Franklin Pierce from 1853-1857.

A major challenge for the Commission was to examine and investigate approximately 2,000 claims in two and one half years before its expiration date.[177] The claimants filed their petitions and notices of claim together with any proofs and written statements ("memorials") in support of their position. As you can imagine, the task of sorting through thousands of documents in English and Spanish was daunting for the

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[174] James Easby-Smith, 2 *Georgetown University in the District of Columbia, 1789-1907: Its Founders, Benefactors, Instructors and Alumni* 87 (Lewis 1907).

[175] See generally *United States v Farragut*, 89 U.S. 22 (1874).

[176] Biographical Directory of the United States Congress, Biography of Caleb Cushing (1800-1879), online at http://bioguide.congress.gov (visited Jan. 24, 2010).

[177] The U.S. and Mexico entered into three subsequent conventions to extend the Commission until it expired in 1876. Final Report of J. Hubley Ashton, Agent of the United States before the United States and Mexican Claims Commission, to the Secretary of State (Hamilton Fish), dated January 20, 1877. National Archives, Record Group 76, Commission, United States and Mexico, Created under the Claims Convention of July 4, 1868 (1868 - 1876).

agents, commissioners and Commission staff. The investigation of the claims was a time-consuming and, sometimes futile, part of their jobs.[178] Many claims contained insufficient information regarding the alleged facts, a description of the property lost or damaged, the dates of events, or how the claimants calculated their damages. Since each government was permitted to investigate and obtain additional facts and evidence to dispute the claimants' proofs, a large segment of the claims were set aside pending receipt of the information requested by the agents.

There was a huge claimant response to this convention in comparison with the two prior conventions. Due to the overwhelming number of claims, the two countries extended the Commission's expiration date (originally scheduled for January 31, 1872) three times until January 31, 1876.[179] Overall, the Commission received a total of 2,015 claims, consisting of 1,017 U.S. claims and 998 Mexican claims.[180] Awards were issued in 186 cases in favor of American claimants and 167 for Mexican claimants. The Commissioners decided approximately three-quarters (1,488) of the claims and the balance (495) by the umpire. Not surprisingly, the Commissioners rarely agreed upon an award (205 cases approximately ten percent), but the remaining balance of their dispositions were claims that were dismissed or disallowed for lack of evidence. The Commission's Final Report stated the "aggregate amount of the claims of American citizens against Mexico, including interest, to be $470 million, but the final awards only

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[178] Id at 14.

[179] William Malloy, *Compilation of Treaties in Force: Prepared Under Resolution of the Senate* 531 (G.P.O. 1904).

[180] Frederick S. Dunn, *The Diplomatic Protection of Americans in Mexico* 94 (Columbia University 1933).

totaled $4.1 million."[181] The total claim amount of the Mexican claims was $86 million, but less than $151,000 was awarded to the claimants.[182]

3.5.4 Cases Decided Under the Claims Convention of 1868

The following sections will provide an overview of three sample cases decided by the Claims Commission of 1868. These cases highlight the types of common issues that were raised by the claims and the interactions between the commissioners and umpires.[183]

a) Jonas Marks & Company v Mexico

It is evident from reading the various opinions of the commissioners and umpires that adherence to procedural rules was a critical component of the claims evaluation process for the Commission. Each commissioner focused on the key facts and circumstances to determine whether or not the claim was valid and if so, whether it merited any monetary award. As part of this review, they determined whether the commission had jurisdiction over the claim. For purposes of the Claims Commission, eligible claimants were required to be either a citizen of the United States or Mexico to bring a claim against one of the countries other than the country of their citizenship.[184]

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[181] Id.

[182] Id at 95.

[183] Unless noted otherwise, all of the claims documents referenced in this section are found in the U.S. National Archives, Record Group 76, Commission, United States and Mexico, Created under the Claims Convention of July 4, 1868 (1868 - 1876).

[184] See generally Opinion of Commissioners, filed November 6, 1873, H.G. Norton, as assignee of Gabon Naphegyi v Mexico, Claim nos. 398, 399, 400, 401, 402, 403, 404, 405, 406 and 407. In these claims, the Commission consolidated the claims filed by the same claimant for different incidents involving Mexico.

The Commissioners also scrutinized the claim documents to determine whether the claimants provided sufficient evidence to support the specific amount of damages requested.

In 1870 the three owners (Jonas Marks, John Marks, and Lambert Cain) of the Jonas Marks & Company filed a claim against Mexico alleging its soldiers entered into their Matamoras store in 1864, and unlawfully seized a large quantity of goods without returning them or providing compensation to the claimants.[185] In addition, the Mexican soldiers forced the owners to make loans (the so-called "forced loans") to them that were never repaid. According to the claimants, the Mexican officers were acting under the orders of General Ruiz, who was also appointed governor of the state of Tamaulipas, when they seized the goods to set up barricades around their town to fend off the invasion of French soldiers. As a result of these acts, the Marks Company allegedly incurred $50,000 in damages arising from the military actions.

In a brief written opinion, Commissioner Wadsworth determined the claimants were U.S. citizens and owners of the company. He also ruled they were entitled to an award under the circumstances described in their claim. [186] Wadsworth wrote:

The commissioners alleged that the claimant or his assignee submitted a certificate of citizenship with an altered date of citizenship. On its face, the claimant would have qualified to file a claim as a U.S. citizen. Upon review of the document, however, the commissioners questioned its authenticity and requested the issuing authority to examine and confirm the validity of the document. The authority authenticated the signature on the certificate, but the date had been changed to a date prior to the alleged injuries. Thus, the Commissioners held that the claimant was not a citizen of the U.S. on the date of the alleged injuries and dismissed all ten claims.

[185] Opinion of Umpire Edward Thornton, dated Jan. 29, 1876, *Jonas Marks & Company v Mexico*, Claim no. 639.

[186] Opinion of Commissioner William Wadsworth, *Claim of Jonas Marks & Company v Mexico*, Claim no. 69.

> Claimants were merchants of large capital doing business in a New Orleans and Matamoros. They suffered severely from military exactions, in money and goods, that one time a large quantity of the goods was taken by force…
>
> It is my decision that they are entitled to an award for all the money and goods exacted by force or taken for public use, or appropriated by the military for any purpose, with interest. The case is sent to the Umpire for his final decision.

Although he did not question the veracity of the claimants, his counterpart disagreed with him and wrote a seven-page opinion in Spanish.

Mexican Commissioner Zamacona seriously questioned whether all three claimants were owners of the store, whether they had actually incurred any damages, and if the claimant had authorized a third party, John Key, to act as their attorney-in-fact to the file the claim. He wrote:

> En todo el expedente no hay un solo documento que prueba- que Jonas Marks or que John Marks hayan dado su representacion a [John Key], ni a ningun otro abogado o procura dar, ni tampoco que indique por parte de ellos proposito de riela mar cosa alguna.[187]
>
> Translation: There is not one document in the entire file that proves that Jonas Marks or that John Marks had given their representation to Key, nor to any other attorney or power of attorney given, nor have they indicated who among them intended to file a claim.[188]

Zamacona was not convinced the Marks Brothers were aware of the claim because ("Estos dos individuos no aparecen para nada, si no en el memorial") "these two individuals did not appear anywhere except in the memorial [written statement]."[189] In addition, he contended Cain was a Frenchman and not a U.S. citizen when the claim arose. Therefore, Cain and the Matamoras store were ineligible for any award under the

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[187] Opinion of Commissioner Zamacona, undated, *Jonas Marks & Company v Mexico*, Claim no. 639.

[188] Translated by the dissertation author.

[189] Opinion of Commissioner Zamacona (cited in note 187).

Claims Convention.

Since the commissioners did not agree on the claim decision, the matter was referred to the Umpire, Sir Edward Thornton, British Ambassador to the U.S. The Commissioners had established a formal process for their referrals to the umpire. If they could not agree on a claim, the Commission's Secretary would complete a pre-printed Order template for each referral. This Order stated: "The Commissioners having investigated this case and being unable to agree in opinion thereupon, Mr. Commissioner Wadsworth being in favor of making an award to claimant and Mr. Commissioner Zamacona being in favor of rejecting the claim, it is now referred to the Umpire for his final decision. The Secretary in charge of the paper will see to the due execution of this order."[190]

Thornton acknowledged there were some minor contradictions in the claim documents, such as the exact date of the goods seizure, but he did not see it as the basis for denying the claim.[191] He did not address any of Zamacona's concerns regarding Cain's citizenship when Lieber had previously ruled prior to his death that the owner was a U.S. citizen on the date of the event in question. As for the claim regarding forced loans, Thornton ruled, as he had previously decided in other cases, that forced loans were not "injury to persons or property by Authorities of the Mexican Republic within the meaning [of the] Convention" and therefore, denied any compensation for the loans. The

[190] This text was copied from the Order of the United States and Mexican Claims Commission, Docket 306, John Jones v Mexico. Due to the voluminous claim documents and lack of detailed cataloging of these 1870s records, the author was unable to locate the referral order for the *Marks* case in the National Archives.

[191] Opinion of Umpire Edward Thornton, dated Jan. 29, 1876, *Jonas Marks & Company v Mexico*, Claim no. 639.

most challenging aspect of the claim to Thornton was determining the value of the pillaged goods. The award amount was difficult to calculate because the claimants did not explain how they estimated the value of the goods to be no less than $50,000, nor did they submit any documentary evidence in support of the alleged damages. However, the Umpire felt he was not "justified in awarding the whole amount claimed" and entered an award for $30,000 in Mexican gold dollars together with six percent interest to be calculated from 1864 to the date of the final award.[192]

b) The Arco Mining Company v Mexico

The Claims Convention of 1868 authorized the commission to examine and decide "[a]ll claims on part of corporations, companies, or private individuals, citizens of the United States, upon the government of the Mexican republic arising from injuries to their persons or property by authorities of the Mexican republic" that occurred within a certain time period, and vice versa in regard to claims of Mexican citizens against the United States. The Commissioners generally struggled with cases where the claimants did not present adequate evidence to prove their losses due to an alleged injury, or if the proofs appeared to be exaggerated. The typical claim arose from the confiscation or destruction of personal property and commercial goods, loss of agrarian rights and real property, forced loans, false imprisonment, bodily injuries caused by Mexican soldiers, robberies by army personnel, and, in at least one corporate claim, the claimants allegedly incurred revenue losses when their mineworkers were forced into Mexican military service.

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[192] Id.

In the case of *The Arco Mining Company v Mexico*, the claimant alleged: (1) the Mexican army required it to make forced loans to Mexico; (2) Mexican soldiers stole money and property from the company; and (3) they involuntarily impressed its mineworkers into military service during Mexico's military conflict with France in the mid 1860s.[193] As a result of these alleged acts, Arco claimed to have suffered a loss in the amount of $1,155,620, excluding any loss related to the alleged forced loans.[194] Most of the damages were derived from the alleged loss of their investment in the mines when they had to cease operations due the lack of miners who were impressed into military service.

Commissioner Wadsworth questioned the accuracy of Arco's damages calculations. He noted "[t]he method by which such startling figures are reached, in calculated not only to prejudice the claim, but to run it into ridicule."[195] Wadsworth could not believe the company with a substantial amount of capital stock ($703,400) and natural resources was unable to continue operating the mining company. In his opinion, the company's "attempt to show that such a wealthy company with such rich ores, and prosperous business, was broken up and forced to quit work in or about 1864, by the hiding of their own mules, and the taking of some powder, fails…"[196] Accordingly, the Commissioner held that "the large claim for loss of investment profit should be rejected"

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[193] Opinion of Sir Edward Thornton dated July 26, 1876, *The Arco Mining Company v Mexico*, Claim no. 937.

[194] Opinion of U.S. Commissioner William Wadsworth, *The Arco Mining Company v Mexico*, Claim no. 937.

[195] Id.

[196] Id.

but allowed Arco's claim for compensation related to the alleged stolen property.[197]

Mexican Commissioner Zamacona was also not convinced that Arco was unable to operate the mines after some of its workers were drafted into military service. First, he reaffirmed the Umpire's prior decision in other cases that involved the Mexico's right to impose military conscription upon its citizens. He wrote:

> Nuestro tercero en discordia ha explicado satisfactoriamente el derecho de Mexico para llamar a las armas a todos sus hijos, y ha declarado de una manera terminante, que 'no pude hacerse reclamacion alguna contra el Gobierno Mexicano por las perdidas, que sufreun estrangero en consecuencia de la obligacion legal, que compele a los Mexicanos, a prestar servicios militares.'[198]
>
> Translation: Our third person [the Umpire] in a prior decision has satisfactorily explained Mexico's right to call upon all of her sons [citizens] to take up arms and has declared unequivocally that 'no claim can be made against the Mexican Government for the losses sustained by foreigners in consequence of the legal duty of Mexicans to perform military service.'

He also determined the company failed to provide sufficient evidence to show the Mexican government's actions caused it to abandon the mines. Even assuming the company was inconvenienced by the military, the Commissioner indicated Arco started its operations "at a time when the war was at its height and was a universally known fact."[199] Under these circumstances, the company had assumed the risk of loss for operating in the middle of armed hostilities between two states.

Zamacona also found the claimant failed to adequately prove their damages for the stolen property and forced loans. He cited to witnesses' testimony that the property

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[197] Id.

[198] Opinion of Mexican Commissioner Zamacona, *The Arco Mining Company v Mexico*, Claim no. 937(Quoting Records of Decisions by the Umpire, p. 153).

[199] Id.

was left behind at the mines. In concluding the entire claim should be dismissed, the Mexican commissioner wrote:

> La extraordinaria exageraction de los terminos, agravado con el hecho, de que los socios de la misma empresa han demandado ademas, en reclamaciones particulares, lo que conceptuo les corresponde por su parte de estos mismos prejuicios e indeminizacion, hacen mas procedente todavia la decision indicada.
>
> Mi parecer por tanto es, que se deseche esta reclamacion.
>
> Translation: The extraordinary exaggerations of your terms, aggravated with the fact, that the members of the same enterprise have additionally demanded in particular claims, what I opine belongs to them of on their part of these same prejudices and indemnification, make the decision indicated all the more proper.
>
> My belief then is that this claim should be denied.[200]

The two commissioners disagreed on whether to grant an award for damages to compensate Arco for its purported loss of property. In reviewing the entire claim, Umpire Thornton noted the claim was "marvelously exaggerated."[201] The alleged amount of damages for the mines highlighted the "spirit of exaggeration which pervades the whole of the claim."[202] He reiterated his prior ruling that the "Mexican government has a full and perfect right to exact military service from its citizens and that no charge can be made against it on that account."[203] Also, he determined that the claimant failed to produce any evidence to support its allegations concerning the forced loans and almost the entire claim concerning its stolen property. However, Thornton found the claimant had introduced credible testimony regarding the loss of certain goods on three dates, and

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[200] Id.

[201] Opinion of Sir Edward Thornton dated July 20, 1876, *The Arco Mining Company v Mexico*, Claim no. 937.

[202] Id.

[203] Id.

he entered an award for Arco in the amount of $2,000 in Mexican gold dollars.

3.5.5 Fraudulent Claims Beset the Claims Commissions

The Claims Commissions were highly susceptible to fraudulent schemes for several reasons: (1) it had a very small staff to thoroughly investigate the heavy volume of filed claims; (2) the commission had a relatively short life span to complete the review of thousands of claims; (3) the reviews were conducted almost exclusively based on the written submissions of the claimants; (4) the commissioners were highly regarded, experienced and intelligent individuals, but they were not experts in the wide range of issues raised by the claims; (5) technology and modes of communication were primitive at that time; and (6) the long distance between the two capitols caused significant delays in responding to document requests and hampered the ability of witnesses to readily testify in Washington.

There are several major cases that initially resulted in high awards, but they were subsequently determined to be fraudulent, including those involving claimants George Gardiner, Benjamin Weil and the La Abra Silver Mining Company. These cases will not be discussed in any great detail because there exists a plethora of literature describing the widespread news coverage of these claims while they were pending for almost thirty years, including multiple congressional investigations, criminal prosecution of fraudulent claims, and several U.S. Supreme Court decisions.[204] Also, they have been thoroughly

[204] *La Abra Silver Mining Co. v United States*, 175 U.S. 423 (1899); *People ex rel Boynton v Blaine*, 139 U.S. 306 (1891); and *Frelinghuysen v Key*, 110 U.S. 63 (1884).

discussed in law journals, newspaper articles and books.[205] Thus, these cases are referenced to alert the reader to the existence of these fraudulent claims and to highlight the multi-faceted challenges that beset the claims commissions.

In the *Gardiner* case, the claimant was a dentist who filed a claim against Mexico under the Claims Convention of 1848.[206] He alleged Mexico wrongfully expelled him from the country after he had worked extensively in a mine and lost his investment in the mine.[207] Although the commissioners were suspicious of the claim, they still entered an award in favor of Gardiner in the amount of $428,760.[208] This claim resulted in one of the highest awards granted by the 1848 Commission, and raised public criticism throughout both countries. The U.S. Congress subsequently investigated and determined that award was based on forged documents and false statements of witnesses.[209] Gardiner was indicted for fraud, but committed suicide before his trial.[210]

Under the Claims Convention of 1868, there were two controversial cases involving fraud. In the first case, a U.S. citizen, Benjamin Weil, filed a claim against Mexico alleging they had destroyed 1,914 bales of his cotton in 1864 that was worth

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[205] See generally R. Floyd Clarke, A Permanent Tribunal of International Arbitrations: Its Necessity and Value, 1 AJIL 2, 342, 363 (1907); Earl McClendon, *The Weil and La Abra Claims against Mexico*, 19 Hispanic Am. Hist. Rev. 31 (1939); Both the Executive and Congress Have Certain Plenary Powers Over Such Fund and the Distribution Thereof, 7 AJIL 388 (1913); Comment, Extent of Judicial Power-Interference with Executive Power, 9 Yale L. J. 223 (1900); John Y. Simon, ed., *The Papers of Ulysses S. Grant, Volume 30: October 1, 1880-December 31, 1882*, 322-323 (Southern Illinois University 1967).

[206] *The Gardiner Claim: The Report of the Investigating Committee Ordered by Congress*, N.Y. Times 8 (Oct. 9, 1852).

[207] Dan Plazak, *A Hole in the Ground with a Liar at the Top: Fraud and Deceit in the Golden Age of American Mining* 10-15 (University of Utah 2006).

[208] Clarke, *A Permanent Tribunal* at 363 (cited in note 205).

[209] Id.

[210] Id.

$334,950.[211] After reviewing the claim, the Umpire, Sir Edward Thornton, entered an award against Mexico in the amount $487,810 (consisting of a base award of $285,000 plus 6% interest accrued from 1864 to 1875) in Mexican gold payable to Weil.[212] The second case involved the claim of the La Abra Silver Mining Company that alleged "the company was dispossessed of its property by the forcible interference of the Mexican authorities" resulting in the loss of its investment.[213] The claim commissioners disagreed on the decision in *La Abra* and referred it to Umpire Thornton who entered an award against Mexico in the amount of $683,041.32.

After Mexico paid some of the installments of the awards, they notified the U.S. that "newly discovered evidence" showed that both claims were "fictitious and fraudulent."[214] Nearly seven years after the Umpire's decision, in 1882, the U.S. and Mexico signed a treaty to allow the reopening of this claim, but the Senate refused to ratify the agreement. The State Department continued to press the Senate to reconsider its decision and recommended it sign the treaty.[215] After another decade of wrangling between U.S. presidents and senators, in 1892 the latter agreed to allow the cases to be reopened and tried before the U.S. Court of Claims. In both cases, federal judges held the claims was fraudulent and ordered any award amount against Mexico that had not yet

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[211] Case of Mexico Upon the Newly Discovered Evidence of Fraud and Perjury in the Claim of Benjamin Weil and La Abra Silver Mining Company, U.S.-Mexican Claims Commission iii (Judd & Detweiler 1878).

[212] Moore, *History and Digest* at 1324-1327 (cited in note 124).

[213] *La Abra Silver Mining Co. v United States*, 175 U.S. 423, 438 (1899).

[214] Id at 428.

[215] See also *Boynton v Blaine*, 139 U.S. 306 (1891). The Supreme Court denied the claimant's request for a writ of mandamus against Secretary of State Blaine to compel him to release all payments to the claimants.

been paid was forever barred.[216]

3.5.6 President Díaz's Administration and Modernization of Mexico (1880-1910)

Historians generally agree the thirty-year period between 1880-1910 under President Porfirio Díaz's administration was one of stability and tranquility in Mexico.[217] The favorable investment and economic conditions in Mexico invited American and other foreign investments to the country. The number of new claims significantly decreased over this time period, and Díaz made an effort to make payments to the U.S. to settle the older claims. This period of relative tranquility abruptly ended with the Mexican Revolution of 1910 and the collapse of the Díaz Administration.

3.5.7 Claims Commissions Between 1910-1942

As the history of Mexico shows, revolution spawns political and economic instability and often for long periods of time. It also results in the proliferation of claims of U.S. citizens against Mexico. This was certainly true for the Mexican revolution in 1910 that led the resignation of President Díaz and ushered in an era of widespread violence, nationalization of industries and natural resources, agrarian reform, and anti-foreigner sentiment. To address the concerns of the U.S. and other nations regarding the

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[216] *United States v La Abra Silver Mining Co*., 32 Ct. Cl., 462 (1897), affm'd *La Abra Silver Mining Co. v United States*, 175 U.S. 423 (1899); *United States v Weil*, 35 Ct.Cl. 42 (1900).

[217] Callahan, *American Foreign Policy* at 409 (cited in note 8). See also Feller, *The Mexican Claims* Commissions at 7 (cited in note 86).

investments of their nationals, Mexico created a Consultative Claims Commissions to review claims, but it was obviously ineffective because only one claim was ever paid.[218]

Other conventions between the U.S. and Mexico included: the U.S.-Mexican General Claims Convention of 1923; U.S.-Mexico Special Claims Convention (claims arising only from the revolution); and Special Mexican Claims Commission of the U.S. (ratified in 1935, this Commission had jurisdiction over all the claims for the 1923 Convention and Special Claims Convention).[219] The latter established a dispute settlement mechanism to handle the various types of claims, including claims related to Mexico's extremely controversial expropriation of American-owned oil businesses. A three-person arbitration commission was convened to determine the amount of compensation due to the American investors.[220] This mechanism was never used for the oil claims, which were eventually resolved by the appointment of two experts agreed upon by both countries; and the final compensation awards were issued in 1943.[221]

The final awards in the oil cases settled approximately 4,300 claims in the amount of $40 million payable by the Mexican government.[222] U.S. oil companies protested the settlement arguing the value of their investments far exceeded the amount of their awards.[223] However, national security played a major role in the settlements.[224] When

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[218] Feller, *The Mexican Claims Commissions* at 16 (cited in note 86).

[219] Id at 56-68, 543.

[220] Cordell Hull, 2 *The Memoirs of Cordell Hull* 1141 (MacMillan 1948).

[221] Id at 1141-42

[222] *Pact with Mexico Ratified in Senate*, N.Y. Times 10 (Jan. 30, 1942).

[223] *Oil Firms Wary of Mexican Pact*, N.Y. Times 6 (Oct. 10, 1941). In his memoirs, Cordell Hull wrote about his meetings with American oil company representatives who opposed the settlement and "asserted that [the Administration] was sacrificing the principle of property rights. They said they would rather see

the U.S. entered World War II in December 1941, President Franklin Roosevelt and Secretary of State Cordell Hull were concerned about the relationships between Nazi Germany and certain Latin American countries.[225] To strengthen the United States' relationship with Mexico as part of the Good Neighbor Policy, to curtail Nazi influence within the hemisphere, and to preserve a necessary supply of Mexican oil during the war, Roosevelt agreed to the settlement and ensured that the lingering and contentious claims were promptly disposed of and payments made to the claimants.

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the question remain unsettled, even with the result of losing the property than see this principle sacrificed." Hull, *Memoirs* at 1141 (cited at note 218).

[224] *Oil Firms*, N.Y. Times at 6 (cited in note 223). According to Senator Elbert D. Thomas of Utah, who shepherded the treaty through the Senate Foreign Relations Committee, "'the losses have been extremely great'" and that friendship is probably costly.' But, he added, he believed it to be worthwhile." Id.

[225] Hull, *Memoirs* at 1141 (cited at note 220). Hull impressed upon the oil company representatives the importance of the settlement and he "sought to place it on a broader basis by outlining to them the world situation and the important role Mexico could play in cooperation" with the U.S. "I stressed the Axis activities," he explained, "being conducted in Latin America and the help Mexico had already given us in preventing strategic materials from going to Japan." Id.

CHAPTER 4

OVERVIEW OF THE BUSH WHITE HOUSE STRUCTURE FOR MANAGING GENERAL TRADE ISSUES

4.1 Prior to NAFTA (1989-1993)

4.1.1 United States

During the 1980s and early 1990s, the political and economic climate within North America was ripe for the expansion of free trade among the three states. The United States experienced a significant change in its economic outlook as President Ronald Reagan's fiscal and monetary policies moved the national economy out of stagflation of the 1970s toward increased investor optimism and a growing economy by the end of the 1980s. This is not to say this period was void of any major economic setbacks that hampered a longer term of prosperity.

Some of these setbacks included double-digit unemployment rate, as high as 10.8% in 1982;[1] the national average monthly mortgage rate hit a high of 18.45% in April 1981;[2] and the national debt outstanding tripled from 1980 to 1989.[3] Also, the U.S. trade

[1] U.S. Department of Labor, Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey, online at http://www.bls.gov/cps/ (visited Nov. 26, 2009).

[2] Freddie Mac, Survey of Monthly Average Commitment Rate and Points on 30-Year Fixed-Rate Mortgages Since 1971, online at www.freddiemac.com (visited Nov. 26, 2009).

[3] U.S. Department of the Treasury, Bureau of the Public Debt, Chart of Historical Debt Outstanding - Annual 1950-1999, online at www.treasurydirect.gov (visited Nov. 26, 2009)

deficit had drastically increased in the 1980s leading to protectionist measures such as the "Super Section 301" of the Trade Act of 1988, which was intended to force other trading partners to buy American goods. Moreover, there was the shocking stock market crash on "Black Monday" in October 1987. Meanwhile on Capitol Hill, the Republicans had taken control of the House and Senate, and a new Republican majority under the leadership of Representative Newt Gingrich had gained popularity and power.[4] All these events worked to transform U.S. trade policy when President George H.W. Bush took office in January 1989.

To understand the development of NAFTA, we must examine U.S. and world events that significantly influenced the treaty negotiations during the Bush Administration.

4.2.2 Canada

The Canadian economy was experiencing a deep recession, including high inflation and unemployment. Prime Minister Brian Mulroney focused on "structural reforms (including privatization, tax, labor market reforms)" and "measures to address the growing fiscal imbalance."[5] He also pushed Canada into trade discussions with the

[4] Congressman Gingrich would later be known as the "architect" of the "Contract with America" that led to the Republicans capturing the majority in the House of Representatives in 1994 for the first time in 40 years. He served as the Speaker of the House from 1995-1999, online at http://bioguide.congress.gov (visited Jan. 18, 2010)

[5] Organization for Economic Co-operation and Development, *Canada: Maintaining Leadership Through Innovation* 19 (OECD 2002).

U.S.[6] The Prime Minister believed his country could not neglect nor ignore the obvious fact that the largest consumer population in the world was located on its border. In 1985, Mulroney began discussions with President Reagan to expand trade through the reduction and elimination of trade barriers.

Preparing for a meeting with Mulroney in April 1988, Reagan's advisors provided him with a brief background paper that provided an interesting American perspective on Canada and Mulroney.[7] This declassified document described the political assessment of foreign affairs advisors in the Reagan administration. The following are interesting excerpts from this background paper:

> Who is Brian Mulroney, the man who would govern this complex country[?]. Through American lenses he seems ideal: strong, personally attractive, successful businessman (in a U.S. company), and well–disposed toward us. The average Canadian in the street sees him differently: a man who swings with the political winds, and seems a bit too close to the Americans for comfort. It's not a matter of liking him – most Canadians didn't "like" Trudeau—but rather a perceived lack of strength of character, of dependability.[8]

Mulroney certainly had a close friendship with Presidents Reagan and Bush. As former Secretary of State James Baker describes it, Mulroney was a "steadfast friend of the United States and had grown very close to George Bush.[9] So close was the relationship between these two heads of state that there was a running joke that Mulroney "would say 'yes' to President Bush before the telephone even rang."[10] The White House

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[6] Id.

[7] Background Paper, Mulroney and Canada: A Perspective, n.d., folder "Canada April 1988 - [4 of 5]," box CFOA 92134, Tyrus Cobb Files, Ronald Reagan Library [hereinafter Mulroney Background Paper].

[8] Id.

[9] James A. Baker, *The Politics of Diplomacy: Revolution, War and Peace, 1989-1992*, 42 (Putnam 1995)

[10] Robert Moran and Jeffery Abbott, *NAFTA: Managing the Cultures Differences* 77 (Gulf 1994).

also had a favorable impression of Mulroney. He was viewed as:

> … bright, honest, straightforward, ambitious Prime Minister who cares deeply about the welfare of his country and its future. He is essentially a pragmatist, driven by a great need to succeed, and he will consider many paths to reach his goals.[11]

Unlike Reagan who was deemed to be the "Teflon president," Mulroney was seen as suffering from the opposite effect. As one U.S. government analyst described it:

> He suffers from a "reverse Teflon factor"—good news won't stick to him. During the past year, he has significant successes: an accord to bring Quebec fully into the constitution, the best economic performance of any major western country including our own, and the Free Trade deal with us. The picture is improving for him, but the average Canadian is still slow to credit him for these and other success stories.[12]

Although both countries have coexisted peacefully without any military incidents since 1815, there was still reluctance among many Canadians to bind themselves closer to the U.S. economy. Some scholars believe it is attributable, in part, to Canada's historical mistrust of its southern neighbor's intention that has existed since the 1800s advent of U.S. adherence to the manifest destiny doctrine and territorial expansion.[13]

A White House internal report describes the Canadian perspective of its role in the world and how it interacts with the United States as follows:

> These facts of life—historical, cultural and psychological—color and shape the Canadian body politic, limit the parameters of Canadian cooperation with the U.S. Canadians do not see themselves as a major power in world affairs, and they do not aspire to be one. In those selected areas where they want to have a role outside North America, they will normally choose the multilateral route. Consistent with their national makeup, this course maximizes a proper, helpful "middle power" role, but ensures it will always be a low-risk option and one with

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[11] Mulroney Background Paper (cited in note 7).

[12] Id.

[13] Moran and Abbott, *NAFTA* at 24 (cited in note 10).

> minimum bilateral identification with us. French-English language tension and wide regional economic disparities also contribute to keeping limited resources domestically focused.[14]

Indeed, the Canadians initially entered into a bilateral trade agreement with the U.S., but eventually joined the U.S. and Mexico in the negotiation of NAFTA, which is consistent with the report's assessment.

The Canada-U.S. Trade Agreement (CUSTA) became a political milestone for Reagan's legacy. Canada did not view CUSTA as the panacea for economic recovery in the 1980s, but as a necessity to stimulate its national economy. Mulroney extensively lobbied the Canadian legislature and ran a major public relations campaign to emphasize the positive effect that freer trade with the U.S. would have on their economy. He also needed a significant economic achievement to improve his odds for reelection in 1988. Undoubtedly, Mulroney was a close ally of the U.S. who wished to see his close friends stay in office for another term. Another White House assessment of Mulroney's outlook for reelection concluded:

> The outlook? For Mulroney the best routes back to the top are the Trade Agreement and more progress on Acid Rain. Getting the FTA through Parliament is probably just a matter of time. Mulroney's real task is to create a national consensus that it's good for Canada and that it was done by Brian Mulroney along with many other good things, and he deserves to lead for another five years. Mulroney probably believes he can win reelection, but only if he can show demonstrable progress on acid rain to complement his FTA success.[15]

Thus, free trade became a critical component of Canada's foreign and economic policy and also became an essential part of its domestic policy.

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[14] Mulroney Background Paper (cited in note 7).

[15] Id.

4.1.3 Mexico

In the 1980s Mexico experienced significant political and economic turmoil that many observers regarded as typical for this developing country. Mexico's population of 89 million residents faced challenging times during this decade. A large portion of the Mexican population was and still is poor. Even more troubling is the fact that nearly a quarter of its citizens lived in extreme poverty.[16] In 1994 the labor force was predominately services-oriented (45%) followed by manufacturing (19%).[17] It also had a larger rural population and lower literacy rate than its two northern neighbors. In addition, the rise of violent crimes and drug trafficking over the U.S.-Mexico border had taken its toll on the domestic front. The demographic data reflected those of a developing nation and heightened its severe vulnerability to economic downturns.

During the 1970s Mexico benefited from huge profits derived from the surge of oil prices. There was also a significant increase in U.S. investment in Mexico, but this growth had "increased Mexican fear of U.S. domination."[18] In response to these fears, the government imposed various restrictions on foreign investors, including: allowing only Mexicans citizens to hold majority ownership and management control in new companies; restricting foreign takeover of established firms; requiring government approval of present and future contracts for the acquisition of patent rights, production processes, and technical assistance; and reducing parent companies' royalties from their

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[16] Moran and Abbott, *NAFTA* at xvi (cited in note 10).

[17] Id at 5.

[18] Central Intelligence Agency Intelligence Memorandum titled "Mexico's Toughening Policy Toward Foreign Investments (Nov. 1973).

subsidiaries' use of product designs and product processes.[19] These new requirements made U.S. investors reluctant to cede majority ownership in their companies and to "refrain from investing unless they [could] qualify for waiver of … these requirements."[20] Furthermore, U.S. officials believed Mexico's "technology law … discourage[d] investment, in some instances by making the transfer of technology less profitable."[21]

As oil prices stabilized and profits diminished in the early 1980s, the boom of the prior decade was over and a downturn in the economy was seemingly inevitable.[22] By the mid-1980s the Mexican economy was in shambles as result of a crippling debt crisis and bank failures. In a move resembling the policies of prior Mexican presidents, President Jose Lopez Portillo nationalized the banks in 1982, which created a higher level of uncertainty and anxiety among Mexicans and foreign investors.[23] In light of Mexico's history of nationalizations of oil and telecommunications industries, investors feared the government would engage in yet more nationalizations. This precipitated a decrease in direct foreign investment and a substantial increase of transfers of investments from Mexico to the U.S. and other countries. In addition, the nation faced a continuing debt crisis under the new leadership of President Miguel de la Madrid with an external debt of

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[19] Id.

[20] Id at 4.

[21] Id at 6.

[22] Sidney Weintraub, *A Marriage of Convenience: Relations between Mexico and the United States* vii (Oxford University 1990).

[23] Id at 106.

over $100 billion, making it the second largest debtor among developing nations.[24] As a means of paying its debts, Mexico fell into a vicious cycle by 1987 of borrowing more money to avoid defaulting on its loans.[25] With rising interest rates in the U.S. and other capital markets, this pattern of borrowing was unsustainable and further propelled Mexico into a financial crisis.[26]

These financial events could have sent Mexico into economic collapse and resulted in social and political upheaval. Realizing the potential negative economic impact that a bankrupt Mexico would have on the U.S. economy and far beyond, the U.S. developed and implemented the Baker Plan, which was subsequently enhanced by the Brady Plan, to assist Mexico renegotiate its commercial loans with U.S. banks.[27] Initially, the Baker Plan called for Mexico to exchange new bonds with its creditors which were collateralized by U.S. Treasury bonds. It also allowed Mexico to reschedule its debt payments, which "had a positive, but only offered a transitory respite."[28] Treasury Secretary Nicholas F. Brady later revised this plan to emphasis debt forgiveness and allow a certain portion of the new bonds to be guaranteed by the World Bank and the IMF.[29]

In the 1980s the Reagan Administration was also concerned about the effect that

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[24] Id at 133.

[25] Id.

[26] Weintraub, *A Marriage of Convenience* at 133 (cited in note 22).

[27] Carlos Salinas de Gortari, *Mexico: The Policy and Politics of Modernization* 14, 19 (Plaza & Janes 2002).

[28] Id at 14.

[29] Weintraub, *A Marriage of Convenience* at 149 (cited in note 22). See also Baker, *The Politics of Diplomacy* at 606 (cited in note 9).

Mexico's turmoil was having and would have on non-economic issues important to the U.S. On the political front, Mexico's economic instability had prompted dissension within its various political groups and caused a resurgence of communist activism. According to a former senior U.S. Department of State official who worked on Mexican affairs during the Reagan administration, this was a "very nervous time" for Mexicans but also for Americans.[30] This concern was not unfounded considering the major events that were occurring throughout Latin America at that time.

In Nicaragua the fall of Anastasio Somoza from power and rise of the Sadinista revolution marked a potential shift in power within the region. The new Sadinista leader, Daniel Ortega, was popular and had developed strong ties to the Soviet Union and Cuba. In 1985, Ortega traveled to Moscow to obtain economic aid.[31] Earlier that year, Fidel Castro went to Managua to attend Ortega's inauguration and to discuss Cuba's forgiveness of $45 million debt that Nicaragua had incurred building a sugar mill.[32] The mere sight of Castro and Ortega standing shoulder to shoulder before the world media reinforced the White House's concern that another country within the hemisphere could fall to hard line communists.[33] Moreover, Castro's growing relationship with Mexico and

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[30] Interview with a former senior U.S. Department of State official who provided the author with off-the-record information concerning major political and economic issues between the U.S. and Mexico during the 1980s.

[31] Stephen Kinzer, *Nicaraguan Leader Predicts U.S. Will Broaden Embargo*, N.Y. Times A6 (May 15, 1985); Edward Schumacher, *Nicaraguan President Praises Moscow as a Friend*, N.Y. Times 6 (May 12, 1985); and Stephen Kinzer, *Nicaraguan Aide Says Embargo Will Bring Closer Ties to Moscow*A1 (May 2, 1985).

[32] Stephen Kinzer, *Castro Takes Off From Nicaragua After Keeping His Plans a Secret*, N.Y. Times A2 (Jan. 14, 1985).

[33] Interview with a former senior U.S. Department of State official who provided this information off-the-record.

President Salinas would later be an issue for the U.S. during the NAFTA discussions.[34]

From a U.S. foreign policy perspective, the political and military events that took place in Central America overshadowed Mexico in the 1980s. President Reagan supported the Nicaraguan Contras whom he declared to be "freedom fighters." The State Department, however, was still closely monitoring communist activity at the local level, especially communist party members in Mexico City who were developing ties to the Soviet Union.[35] If the White House was concerned about communists gaining a foothold in Central America, the thought of a communist revolution spilling over to an unstable Mexico was even a more terrifying scenario.[36]

In the event the economic crisis and a potential revolutionary situation was not enough to hamper an effective domestic policy in Mexico, the government also faced challenges with increased cross-border drug trafficking and violent crimes resulting in a significant number of deaths.[37] This issue would stay at the forefront of the U.S. foreign policy with Mexico throughout the Reagan administration and carry over to President Bush's administration as well as those beyond. Due to high demand for narcotics in the U.S. and lack of economic alternatives in Mexico, the drug trafficking issue, of course, continues to be a headline issue for both countries.[38]

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[34] See chapter 5.12.

[35] Interview with a former senior U.S. Department of State official who provided this information off-the-record.

[36] Id.

[37] Id.

[38] In 2009 we see similar patterns on the Mexican domestic front. Between 2006-2009, there were an estimated 10,000 murders in Mexico related to drug trafficking. See Statement of Lanny Breuer, Assistant Attorney General, U.S. Department of Justice, before the U.S. House of Representatives Committee on Oversight and Government Reform, Hearing on "The Rise of Mexican Drug Cartels and U.S. National

4.2 Canada-U.S. Trade Agreement (CUSTA): Free Trade Between Northern Neighbors

As noted in Section I of this chapter, Canada sought to reinvigorate its economy by negotiating the reduction and elimination of trade barriers with the U.S. In 1985, Reagan and Mulroney agreed it was time to promote free trade because their countries were each other's largest trading partner. This joint decision started a three-year negotiation of the Canada-U.S. Trade Agreement (CUSTA), which would be the precursor to NAFTA.

The concept of a free trade agreement within the region was an idea that had existed for some time, but it was Reagan who effectively communicated this goal. He first discussed his vision of a "North American Accord" during his presidential election in 1979. Although when he took office, Reagan faced a myriad of complex issues such as inflation and the Cold War, he never lost sight of a free trade agreement between multiple nations within the North American hemisphere. So when Mulroney expressed an interest in pursuing such a free trade agreement, Reagan assigned this task to his Treasury Secretary James A. Baker to get it done. Baker was from Texas and a strong confidant of George H.W. Bush, having helped him run for congress in the 1970s. Initially, he served as Reagan's White House Chief of Staff before being appointed by the President to serve as the nation's 67th treasury secretary. Once the President made the decision to go forward with a free trade agreement with Canada, Baker thrust himself into

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Security," July 9, 2009. www. justice.gov (visited Jan. 18, 2010). The violence has spilled over to border towns and has even hit major tourist areas and resorts, which is a primary lifeline of the Mexican economy. During a recent trilateral meeting of the heads of state for the United States, Mexico and Canada, the

the task and "spent a large amount of time negotiating" CUSTA with senior Canadian officials.[39]

A free trade agreement between these neighbors signaled to the rest of the world the U.S. and Canada were committed to expanding international trade. In his autobiography, Baker noted:

> The 1990s were shaping up to be an era of economic opportunity and risk. Interdependence was inexorably binding our domestic economy to the outside world. Economic rivalry between the Unites States and its traditional allies in Western Europe and Japan was on the rise, a trend that grew stronger as the common Soviet threat receded.[40]

As Western Europe moved toward a stronger union, the State Department looked toward its own hemisphere to identify opportunities to strengthen its political and economic ties with other nations within the region. Baker knew a shift toward regionalism was imperative to the American economy at this stage of history. "I was convinced," he later wrote, "that we could advance our economic interests through innovative regional strategies."[41] To further emphasize the broader implications of this approach, the Secretary stated:

> Regional agreements could deliver great results, in terms of opening market to American goods and service, than one-on-one negotiations. They could complement other American interests in a region by extending our presence and enhancing our influence. And they could help lay the institutional groundwork for ongoing economic cooperation. Issues come and go. But institutions abide.

Consistent with Reagan's vision, Baker was instrumental in the successful negotiation

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subject of crime was a leading agenda topic along with immigration and trade. Linda Thompson and Marc Lacey, *Obama Sets Immigration Changes for 2010*, N.Y. Times A6 (Aug. 10, 2009).

[39] Baker, *The Politics of Diplomacy* at 42 (cited in note 9).

[40] Id at 604.

[41] Id at 605.

and implementation of CUSTA. Canada supported this trade agreement because it was an "economic necessity" and reflected a "newly emerging feeling that the private sector is probably a better vehicle for future prosperity than heavy reliance on the government."[42]

4.3 The "Framework of Principles and Procedures for Consultation Regarding Trade and Investment Relations": The Precursor to NAFTA

The United States and Mexico have a long history of trade disputes. Prior to NAFTA, the two states struggled to resolve their differences without an effective dispute settlement mechanism, which usually had a negative impact on U.S. and Mexican businesses and consumers. This insufficiency in the markets and regulation prompted private individuals and organizations from both states to collaborate with government officials to develop innovative solutions to promote and increase cross-border trade and investments. The Mexico-U.S. Business Committee ("MEXUS") is one of those key organizations that helped bridge the cross-border gap with the development of an innovative consultation framework that became the foundation for NAFTA.

After World War II Mexico adopted the trade policy of import-substitution industrialization (ISI). This policy imposed significant tariffs and onerous import permits that resulted in giving an advantage to Mexican businesses over U.S. importers as a means to stimulate Mexican economic growth. In the midst of this protectionist period in

[42] Mulroney Background Paper (cited in note 7).

Mexico, U.S. and Mexican businessmen jointly organized MEXUS in 1946.[43] Its primary goal was to "build a consensus between the private sectors of the two countries on public policies of mutual concern."[44] These issues included "excise taxes, impediments to trade, guest works, and sectorial agreement like the 1966 Automobile Pact."[45]

Between 1946-1982, MEXUS was involved in high-level policy discussions and met with Mexican officials to identify potential opportunities for U.S. investments in their country. At that time, the government imposed tight restrictions on foreign firms seeking to conduct business in Mexico, unless they entered into joint ventures with Mexican firms. Eventually, MEXUS became passive and membership sharply declined until the early 1980s. The organization's true mission was lost on its members, and it became a "collegial society" that met for half days and played golf the rest of the time.[46] It was not until former Mexican President Jose Lopez Portillo's expropriation of private banks in 1982 that U.S. and Mexican businessmen clamored for real solutions to address trade issues between the two states.

In 1980, Rodman Rockefeller, the son of former U.S. Vice President Nelson Rockefeller, became the co-chairman of MEXUS, which marked a major turning point for the organization. He was determined to transform MEXUS into a proactive organization that would develop policy proposals and solutions to address trade issues

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[43] After the implementation of NAFTA, this organization changed its name to the North American Business Committee, online at http://www.as-coa.org (visited Dec. 6, 2009)

[44] George W. Grayson, *The Mexico-U.S. Business Committee: Catalyst for the North American Free Trade Agreement* 63 (Montrose 2008).

[45] Id.

and reduce the negative publicity related to the breakdown of communications between the U.S. and Mexico. The latter issue was a likely event, for example, if the U.S. clamped down on a product that would generate extensive negative publicity in Mexico. For example, if the U.S. took action against inflatable party balloons worth, let us assume, only $400,000 in annual trade revenue, the Mexican media highly publicized the action as another example of the Americans causing harm to the ordinary Mexican citizen.

Mexican vegetable farmer Manual Clouthier and American attorney Robert Herzstein joined Rockefeller to identify and develop a protocol that would assist the U.S. and Mexico in managing trade disputes. Herzstein, a partner at one of the largest and prominent U.S. law firms and a former Undersecretary of Commerce for International Trade (1980-1981), had previously conducted an analysis of these issues. After further discussion among the trio, he was tasked, together with Guy F. Erb, a former senior U.S. official with the National Security Council and several federal agencies involved with international economic issues, to develop the concept of a binational framework to settle disputes for broader trade issues, not just product-specific issues.[47]

The MEXUS team drafted the framework then met with several key leaders in the Commerce Department, Congress, the National Security Council, and USTR to seek their support of this initiative.[48] They also met Mexican leaders for important feedback and

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[46] Interview with Robert Herzstein, Partner, Miller & Chevalier, in Washington, D.C. (Mar. 20, 2009).

[47] Id. See also Grayson, *The Mexico-U.S. Business Committee* at 67 (cited in note 44).

[48] Robert O'Brien, *North American Integration and International Relations Theory*, 28 Can. J. Pol. Sci. 693 (1995). As O'Brien notes:

support. After several years and rounds of revisions of the protocol between both governments, USTR Clayton Yeutter and Mexican Commerce Secretary Hector Hernandez signed the Bilateral Framework Agreement on Trade and Investments in November 1987.[49]

The bilateral agreement was the first time in recent history that both countries agreed to a dispute settlement mechanism for trade and investments issues.[50] The U.S. media viewed it as a positive sign coming from Mexico City that the government was ready to liberalize its trade agenda and to discuss expanded trade with the U.S. beyond the traditional trade goods.[51] Likewise, the Mexican government viewed it as a critical step toward removing trade obstacles, and for its country to be part of the globalization era.[52] The agreement was structured, as Herzstein describes it, into two key components.[53] The first component allowed the parties to gather facts regarding a trade dispute, then secondly, established procedures for frequent consultation aimed toward amicable resolution of the issues. The underlying purpose of this protocol was to

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> In the year following the debt crisis, the binational Mexico-US Business Committee submitted a proposal for a bilateral commercial agreement to the Office of the United States Trade Representative. The first major binational measure to improve trading relations was an agreement to ease the problem of subsidy disputes between Mexico and the United States, signed in April 1985. Later that year Mexico began to negotiate to join the GATT, and was admitted in July 1986. In November 1987, the United States-Mexico Framework Agreement was signed. Id at 708.

[49] Herzstein interview (cited in note 46). For a detailed account of the development of the binational framework, please see Grayson's book on this subject cited in note 44. See also U.S. and Mexico Bilateral Framework on Trade, Investment Dispute Settlement, BNA (Nov. 11, 1987).

[50] See generally Clyde Farnsworth, *Preliminary Trade Pact With Mexico Is Shaped*, N.Y. Times D1 (Oct. 7, 1987).

[51] See Clyde Farnsworth, *Reagan ready to sign trade pact with Mexico*, Houston Chronicle sec. 1 (Oct. 7, 1987); William Orme, *Mexico, U.S. to Ink Landmark Trade Pact*, J. Commerce 3A (Oct. 27, 1987); and Larry Rother, *U.S. and Mexico in Trade Pact*, New York Times D2 (Nov. 6, 1987).

[52] Salinas, *Mexico* at 41 (cited in note 27).

[53] Herzstein interview (cited in note 46).

promote "more open and predictable environment for international trade and investments."[54]

The MEXUS team would later play an important role in the NAFTA negotiations. The organization built strong support for NAFTA among business executives in the U.S. and Mexico. It also hired the Peat-Marwick accounting firm "to estimate global gains and losses, and to distribute them across 44 sectors in both countries."[55] The White House Council of Economic Advisors often cited this report to bolster the Administration's rationale for supporting the free trade agreement.[56] In addition, Herzstein served as Mexico's lead American counsel for the NAFTA negotiations. In this capacity, he again played a key role in expanding cross-border trade between the neighboring countries. As Hermann von Bertrab, the former chief Mexican representative for NAFTA in the U.S., explains, "[s]everal publications referred to me as the trainer and manager of the team and to Bob Herzstein as the quarterback."[57] He further stated that Herzstein "guided [the Mexican team] reliably, prudently, and courageously through the intricacies and complications of the game we were playing."[58]

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[54] Bilateral Framework Agreement on Trade and Investments, Personal Papers of Robert Herzstein.

[55] Michael E. Conroy and Amy K. Glasmeier, *Unprecedented Disparities, Unparalled Adjustment Needs: Winners and Losers on the NAFTA 'Fast Track'*, 34 J. Interamerican Studies & World Affairs 1, 16 (Winter 1992-1993).

[56] KPMG Peat Marwick. 1991. Analysis of Economic Effects of a Free Trade Agreement between the United States and Mexico, U.S. Council of the Mexico-U.S. Business Committee, Washington D.C.

See Memorandum of Bob Staiger to David Walters (USTR), dated April 9, 1991, George Bush Presidential Library document no. 8815. See also Mary E. Burfisher, Sherman Robinson, Karen Thierfelder, *The Impact of NAFTA on the United States*, 15 J. Economic Perspectives 125, 137-138 (2001); and Jaime Ros, *Free Trade Area or Common Capital Market? Notes on Mexico-US Economic Integration and Current NAFTA Negotiations*, 34 J. Interamerican Studies & World Affairs 53, 68 (1992).

[57] Hermann von Bertrab, *Negotiating NAFTA: a Mexican Envoy's Account* 109-110 (Praeger 1997).

[58] Id.

More importantly, the Bilateral Framework Agreement on Trade and Investments served as the model for the dispute settlement mechanisms established in NAFTA. Several of its key components are evident in the various NAFTA chapters, including Chapter 11's investor-state dispute settlement mechanism. Under Article 1118, the claimant is encouraged to "first attempt to settle a claim through consultation or negotiation."[59] A claimant is also required to file a notice of intent to submit a claim to arbitration with the disputing state, and wait ninety days prior to initiating any arbitration proceeding.[60] This notice allows the parties to have another opportunity to consult or negotiate the settlement of a claim. Unlike the Bilateral Framework Agreement, NAFTA's Chapter 11 allows aggrieved investors to directly compel a disputing state to arbitration without the consent of either the disputing state or the investor's own national state. As further discussed in Chapter Six, the mandatory arbitration provision is the real "teeth" of NAFTA's dispute settlement mechanisms but also the most controversial.

4.4 Policy Decision-making in President George H.W. Bush's Administration

For cabinet members and White House staff, the ability to have access to the president is critical to assist them with presenting key information to the president for decision-making purposes. Depending upon an individual's title, seniority, and job

[59] NAFTA Article 1118. Consultation is an informal process and not mandatory. Also, a disputing state may refuse to consult or negotiate with a claimant.

[60] NAFTA Article 1119.

responsibilities, they may have more interaction with the president, including face-to-face meetings with the chief executive. For example, the Secretary of Defense and National Security Advisor generally brief the president on military and national security issues on a daily basis. Also, a specific crisis may result in an individual having a significant amount of interaction with the president. For example, if there were a major issue brewing at a national level related to health issues, the Secretary of Health and Human Services would most likely be called upon to attend meetings, press conferences, and to publicly explain the administration's position on specific health issues.

According to a former senior official responsible for White House administration, President Bush established a formal decision-making process, but he kept it flexible enough to keep in touch with his staff regardless of title or rank.[61] He made it clear that if a cabinet member sent him a memo, he wanted to see it. Cabinet members were permitted to send confidential or personal memos to the president without the Chief of Staff or National Security Council (NSC) screening the memo to determine whether or not to forward it to the President for his review. During his term, Bush relied heavily on General Brent Scowcroft who was not only his National Security Advisor, but also one of his most trusted confidantes along with Secretary Baker.[62] Scowcroft is widely recognized as an expert in foreign policy and national security. [63] The General was also a

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[61] Roman Popadiuk, *The Leadership of George Bush* (Texas A&M University 2009). The author had an extensive interview with Ambassador Popadiuk several months prior to the release of his book regarding the decision-making process during the Bush administration. Telephone Interview with Roman Popadiuk, Executive Director, George H.W. Bush Foundation, in College Station, Texas (Mar. 11, 2009).

[62] George Bush and Brent Scowcroft, *A World Transformed* 35 (Knopf 1998).

[63] General Scowcroft's long daily schedule and lack of sleep is well chronicled in President Bush's book *All the Best*. George Bush, *All the Best* (Knopf 1999).

workaholic who worked "the longest hours of anyone in the White House."[64] He closely kept track of those issues that seemed innocuous at face value, but touched upon broader national security policy implications such as trade issues.

Non-cabinet members were still required to submit their memos to the Chief of Staff and NSC. As one former NSC official explained, some White House staffers or agency heads wrote to the president to propose specific initiatives or policy, but they were inconsistent with issues or policy that were already being handled at a higher level such as the National Economic Council (NEC). For example, in 1990 there was a significant trade issue sparked by Canada's dumping of a large quantity of its low priced beer into the U.S. The USTR requested the president impose stricter sanctions against the Canadians to curtail this behavior.[65] Although the USTR memo involved trade, the request was subject to NSC approval due to national security concerns. Specifically, Sadam Hussein had invaded Kuwait in August 1990, and President Bush was focused on building a coalition of allies to fight this aggression. Canada was a key U.S. ally, and the NSC deemed it paramount not to upset the Canadians at a time of war over a trade issue involving beer. Needless to say, the NSC denied the request and the USTR memo never made it to the president's desk. Eventually, the trade issue was resolved without the President's intervention, and Canada served as a close ally of the U.S. and U.N. coalition during the Persian Gulf War.

Moreover, the President's staff reviewed internal memos, but it was not unusual

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[64] Bush and Scowcroft, *A World Transformed* at 33 (cited in note 62).

[65] Interview with a former senior White House official who provided the author with off-the-record information concerning this issue.

for them to be returned to the authors for more details, or the referral to the president to be denied. In some situations, the matter could have been referred to another agency for further review or action. Referrals to other agencies played an essential part in the vetting process and maintaining a systematic approach to managing paper in the White House. As one White House staffer humorously noted, an "action transferred was an action completed" and it allowed the staff to focus on the next crisis, of which there was no scarcity on any given day.[66]

Another aspect of managing issues and crisis is the ability of the president to effectively control his team of cabinet members and staff even if they do not necessarily agree with his position, or keep a close grip on the flow of information. President Bush learned several lessons while serving as Vice President under Reagan for two terms. One of those lessons was to keep abreast of what was going on in the White House and to deploy loyal staffers to key positions to maintain a steady flow of information beyond the hierarchical structure established in his administration. For example, numerous books and articles have been written about Richard Darman, Director of the Office of Management and Budget (OMB), who was well-known to "horde" information during the Reagan administration.[67] Bush respected Darman for his abilities, but he knew that information could get trapped at certain levels even if it had the potential to assist the president to make decisions.

In an interview with James Cicconi, former Deputy Chief of the Bush White

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[66] Id.

[67] See Charles Kolb, *White House Daze: The Unmaking of Domestic Policy in the Bush Years* (Free Press 1994).

House Staff, he shared his personal experience with President Bush in a one-on-one meeting held shortly after the inauguration. The President clearly described his expectations on how he wanted the Deputy Chief to do his job.[68] Bush also took the opportunity to remind Cicconi that he worked for the President of the United States and that he expected the official to raise issues to him if they were not being properly escalated to him. To assist him in keeping track of various issues, Bush ensured he was invited to important meetings, including NSC briefings. This way Cicconi maintained access to the President and had the opportunity to flag particular items directly to his attention.

Another situation that highlights how political, economic and foreign relations issues are intertwined was when President Bush faced hostility and heavy opposition from Congress concerning a policy related to Nicaragua that was a legacy issue left over from the Reagan administration. Secretary of State Baker knew the importance for the new administration to quickly resolve those old issues or "festering sores," as a former White House official described it, and to move forward with Bush's own agenda. Otherwise, the agenda would be marred by his predecessor's policies, and Congress would not be receptive to any new initiatives while there were unresolved issues. In early 1989, Baker met with congressional leaders and proposed to allocate a humanitarian aid package to Nicaragua after Congress eliminated funding after the Iran-Contra debacle.[69] The aid was intended to assist the Nicaraguan government transition to peaceful and

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[68] Telephone interview with James W. Cicconi, Senior Executive Vice President-External and Legislative Affairs, AT&T, in Washington, D.C. (May 19, 2009). This meeting is also detailed in Roman Popadiuk's book titled *The Leadership of George Bush* which was released in September 2009.

[69] Robert Pear, *Bush's Trade: Behind the Transformation Of Central American Policy*, N.Y. Times E2 (April 16, 1989).

productive activities. To reassure Congress the money would be used appropriately, Baker agreed not to obligate funds beyond a specific date without prior consultation and concurrence from congressional leaders."[70] This proposal was a compromise but necessary to obtain congressional approval of the appropriations.

However, White House Counsel Gray Boyden felt the transaction was inconsistent with the U.S. Supreme Court's decision in the case of *Chadha,* which held that the one-house legislative veto violated the constitutional separation of powers.[71] Upon hearing about Boyden's opinion, Baker became "apoplectic" and strenuously disagreed that the proposed legislation constituted a one-house veto. This legislation was critical, in Baker's estimation, to move American beyond the Iran-Contra scandal and to close an old "open sore." The administration took the position that the proposal did not violate *Chadha*.

In fact, Cicconi, who was also an attorney by training, wrote to Boyden arguing the proposal was "akin to a voluntary commitment by the Secretary."[72] As he saw it, "Money legally authorized and appropriated is within the legal power of the Executive Branch to obligate such finds after November 30, 1989 without prior consultation and written concurrence of the Congressional leadership and relevant committees."[73] In light of the manner this arrangement would work between the two branches, Cicconi

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[70] Memorandum of James W. Cicconi to C. Boyden Gray, dated Mar. 24, 1989, regarding "Draft Letter from Secretary of State on Central American Agreement." George Bush Presidential Library document no. 11602.

[71] *Immigration and Naturalization Service v Chadha*, 462 U.S. 919 (1983).

[72] Cicconi to Gray memorandum dated Mar. 24, 1989 (cited in note 70).

[73] Id.

concluded "this is not so much an infringement of executive powers by Congress as it is a voluntary restraint by the executive branch on the exercise of its own legal powers." At the end, President Bush believed it was a low risk matter, and he made the difficult decision to approve Baker's deal. Eventually, the President's decision became the subject of front-page headlines for a brief period in the *Washington Post*. Former senior officials speculate the leak was probably made by a White House official who disagreed with the President on this issue.[74]

At times, the decision-making process within the Bush administration became mired in internal "turf wars," and issues were subjected to extensive debate by various committees.[75] This was true for trade issues and negotiations. The USTR is the smallest agency at the cabinet level, and it prides itself in its efficiency and consistent track record for bringing closure to issues and deals.[76] After a year on the job, the U.S. Trade Representative Carla Hills faced significant challenges with juggling large initiatives such as the Uruguay Round, trade talks with Russia, initiatives with Eastern Europe, and the controversial trade deficit with Japan of the late 1980s. In addition, she also had to manage the competing interests of several fellow cabinet members on trade issues.[77]

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[74] Pear, *Bush's Trade* at E2 (cited in note 69).

[75] Charles Kolb, a former Assistant to President Bush for Domestic Policy, wrote an interesting and entertaining book regarding his experiences working on domestic policy in the Bush administration. Since Kolb's book is one of the few insider books critical of the Bush administration, the thesis author questioned over ten former White House officials who knew Kolb and had read his book containing numerous stories about bureaucratic inefficiency and political morass. These individuals uniformly acknowledged that it is one person's perspective, and it reflected Kolb's obvious dislike of Richard Darden and John Sununu, but they considered the book to be "realistic."

[76] George W. Grayson, *The North American Free Trade Agreement: Regional Community and the New World Order* 74 (University Press of America 1995).

[77] Telephone interview with a former senior White House official who provided this information off the record.

To accomplish the key objectives of Bush's substantial agenda laden with many foreign affairs and trade issues, Ambassador Hills knew that her office required well-thought out and timely decisions from the White House. In early 1989, she sought approval to commence negotiations with the European Community and Korea regarding the removal of telecommunications trade barriers which was agreed upon by all agencies.[78] Moreover, she also requested the President give her a "broader grant of authority which would have allowed her to begin negotiations in the future without the necessity of additional Presidential decisions."[79] Specifically, she requested authority to "enter into negotiations with any other government that was subsequently designated as a 'priority foreign country'" under an executive order implementing the Trade Act of 1988."[80] Since trade matters cross multiple areas, such as national security, and foreign policy and domestic policy, the NSC and Cabinet Affairs reviewed Hills's request.[81] After a careful review, they were reluctant to support the proposal because "such a designation would [have been] an overly broad delegation of the President's power." [82] Bush eventually sided with his staff's recommendation not to delegate broad powers to the USTR, and Hills had no objection to the existing narrow delegation authority.[83]

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[78] Memorandum of Roger B. Porter to James W. Cicconi, dated Feb. 16, 1989, regarding Ambassador Carla Hills's request for broad authority to begin future trade negotiations. George Bush Presidential Library document no. 3932.

[79] Memorandum of James W. Cicconi to President Bush, dated Feb. 17, 1989, regarding Ambassador Carla Hills's request for broad authority to begin future trade negotiations. George Bush Presidential Library document no. 3930.

[80] Id.

[81] Cabinet Affairs is the unit within the White House that coordinates all major policies to ensure consistency and that the appropriate approvals are obtained.

[82] Cicconi to President Bush memorandum, dated Feb. 17, 1989 (cited in note 79).

[83] Id.

4.5 Structure of Trade Negotiations

One of the key strengths of President Bush was his extensive diplomatic experience and broad appeal to world leaders. When the U.S. domestic economy was struggling in early 1989 and "[e]xpectations for the foreign policy review [were] extraordinarily high," the White House communications strategists designated the month of May 1989 as the time for the President to show "high visibility time for foreign policy."[84] The highlights for this campaign ranged from US-Soviet relations to NATO Summit updates to the results of the President's policy review, including the "rise of free enterprise in national economies."[85] Not surprisingly, Bush had decided early on in his presidency that trade was one of the top priorities as part of his foreign and domestic agenda.

Trade issues are intermingled with various areas of domestic and foreign policies such as financial, agricultural, manufacturing, and national security concerns. A government agency can make a decision related to trade that can have a broader implication for the U.S. For example, a decision to appropriate subsidies to corn farmers can trigger an unfair trade claim against the U.S. by one of its trading partners. In light of this potential dilemma, Congress knew it was important to maintain an organized and coordinated process for vetting trade issues within the Executive Branch, and to keep congressional leaders involved in the decision-making process. In 1988, Congress passed

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[84] Memorandum of Marlin Fitzwater to John Sununu and General Brent Scowcroft, dated May 1, 1989, George Bush Presidential Library document no. 618.

[85] Id.

the Omnibus Trade and Competitiveness Act establishing the interagency structure for handling trade policy issues. It also reinforced Congress' long-standing insistence to be part of the decision-making process on trade agreements along with the executive branch. Under this law, the USTR is not only responsible for coordinating trade issues with other agencies, but he or she is designated as "chair of the interagency committee that assists and advises the President in developing and implementing U.S. trade policy."[86]

From the beginning of the Bush administration, including the presidential transition period prior to the inauguration, Hills worked vigorously to ensure she was recognized as the point person for trade policy, and her role was consistent with the legal requirements. Prior to the inauguration, there was an internal debate among transition members whether the USTR should chair the key White House committee that dealt with trade policy. In December 1988, Hills and Clayton Yeutter, who was the USTR under President Reagan at that time, wrote to Governor John Sununu, the then-Chief of Staff-designate, to clarify the role that USTR would play within the new administration and to provide recommendations on how to address congressional concerns regarding the independence of the USTR.[87] Yeutter indicated Congress had "very strong feelings" when it approved the Omnibus Trade bill, which required the USTR to serve as the chairperson of the interagency committee.[88] As is customary for cabinet nominees, Hills met with key congressional leaders during the transition period. The joint memo also

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[86] Office of the United States trade Representative, History of USTR, online at http://www.ustr.gov/about-us/history (visited on Jan. 3, 2010).

[87] Memorandum of Clayton Yeutter and Carla A. Hills to John Sununu, dated Dec. 19, 1988, regarding the chairmanship of interagency sub-cabinet group and trade policy. George Bush Presidential Library document no. 11589.

[88] Id.

noted these leaders expressed the view that Congress had the constitutional authority to regulate commerce with foreign nations and to "create an independent regulatory body to deal with trade."[89]

Yeutter and Hills noted that "[f]or many years the interagency sub-cabinet group dealing with trade policy (the Trade Policy Review Group , or TPRG) has been chaired by a Deputy USTR," such as Yeutter had done when he served in that position during the Ford Administration.[90] In the second-term of the Reagan administration, there was a change in that structure and the Economic Policy Council, which was chaired by the President himself, managed trade issues. In the event of his absence, the treasury secretary served as Chairman Pro Tem. Congress took issue with the treasury secretary chairing discussions on trade policy, which was designated for the USTR.[91] In fact, during Hills's confirmation hearing, Senator Lloyd Benston "expressed criticism of past administrations for a lack of consultation and cooperation with Congress" on trade policy.[92] Hills reassured the senators she would maintain close consultations with members of Congress and keep them abreast of trade issues.

Although Yeutter and Hills acknowledged the President could argue that he has the "constitutional right to organize the Executive Branch as he sees fit," they recommended a rotation of the chairperson depending on the issue before the council.[93]

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[89] Id.

[90] Id.

[91] Yeutter and Hills to John Sununu memorandum, dated Dec. 19, 1988 (cited in note 87).

[92] Norio Naka, *Predicting Outcomes in United States-Japan Trade Negotiations: The Political Process of the Structural Impediments Initiative* 152 (Quorum Books 1996).

[93] Yeutter and Hills to Sununu memorandum, dated Dec. 19, 1988 (cited in note 87).

Under this structure, "the USTR chair[ed] the trade issues, and the Secretary of Treasury chair[ed] all others."[94] As they described it, "For USTR to serve as chair on trade issues is also consistent with the 'honest broker' function of USTR."[95] This way, they could avoid "a confrontation with the Congress" on this issue.[96]

After extensive internal discussions, the Economic Policy Council (EPC) consisted of Treasury Secretary Nicholas Brady (who also served as Chairman Pro Tempore for the Council), Governor Sununu, Commerce Secretary Mosbacher, USTR Carla Hills, Dick Darman, Michael Boskin, Roger Porter, and David Bates.[97] The EPC developed an overall framework for trade strategy review in meetings limited to principals (department Secretary or Deputy Secretary).[98] It also identified essential factors to improve the country's trade position, and made recommendations for trade policy priorities to the President. Bush approved of the EPC's strategy and allowed them to work together to iron out any territorial fights among the cabinet members regarding a wide array of trade-related issues.[99]

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[94] Id.

[95] Id.

[96] Id.

[97] John Sununu served as President Bush's first Chief of Staff, Darman served as Director of the Office of Management & Budget (OMB); Boskin was Chairman of the President's Council of Economic Advisors; Porter was Assistant to the President for Economic and Domestic Policy; and Bates was Assistant to the President and Secretary to the Cabinet.

[98] Memorandum from Nicholas F. Brady to President Bush, dated Mar. 8, 1989, regarding "Trade Strategy." George Bush Presidential Library document no. 4999.

[99] President Bush made notations on Brady's memorandum which was customary for him to do. He wrote "Thanks Sec. Brady," "Yes" next to text concerning the proposal to develop an overall framework for trade strategy, and "Fine" next to the paragraph focusing on specific trade issues. Interestingly, he put a check mark only next to Mosbacher's name. This mark may have reflected the President's contentment with keeping Mosbacher engaged on trade issues.

4.6 Tide of U.S. Protectionism in the 1980s

By the late 1980s, American sentiment toward protectionism was growing strong. Congress became increasingly dissatisfied with the huge trade deficits with America's trading partners. For example, as the U.S. auto industry was rebounding from an abysmal decade of car sales and significant market share loss to foreign car companies, there was extensive media attention on the growing trade deficit between the U.S. and Japan. As one commentator noted, there were "numerous U.S.-Japanese trade frictions over steel, cars, textile, color TVs, and semiconductors" at this time.[100] The trade deficit with Japan had peaked at "$55 billion out of the total U.S. trade deficit of $138 billion in 1986."[101]

In response to public outcry for protectionism, Congress enacted several bills to establish a more coordinated effort to review and develop trade policy. They also passed the Trade Act of 1988, which established the "Super 301" standard. This requirement is named after Section 301 of the Trade Act and was intended to open up the markets of U.S. trading partners who have large trading deficits with the U.S. due to their protectionist measures against American imports. By 1989, the sentiment had escalated to the point even former President Reagan raised concerns about protectionist legislation to President Bush.[102] Bush was not too concerned about these bills, but he knew that some industries, such as textiles, were planning to organize support for a few of them.[103]

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[100] Naka, *Predicting Outcomes* at 1 (cited in note 92).

[101] Id.

[102] Memorandum of President George H.W. Bush to Carla A. Hills, dated Apr. 26, 1989. George Bush Presidential Library document no. 1203.

[103] Id.

In June 1989, the U.S. faced severe criticism from foreign ministers at the Organization for Economic Cooperation and Development (OECD) meeting because of the adoption of Section 301.[104] The Section 301 sanctions struck a chord of discontent among the ministers who were reluctant to negotiate with the U.S. under the threat of these sanctions. One commentator described Section 301 as "a crowbar to pry open" foreign markets.[105] They "criticized Washington's use of Section 301, saying members of the international trade system 'should not be judge and jury of their own case.'"[106] The prevalent concern of these leaders was that "Washington's action could provoke more unilateral actions and retaliation, thus undermining world trade."[107] Carla Hills tried to ease some of their concerns by stating "the United States would use it 'in a manner that strengthens the global trading system and increases trading opportunities, not just for the United States but for the benefit of all nations.'"[108]

Eventually, the issues were resolved to a manageable point and the parties made concessions that were accepted to their constituents. The U.S. business community saw Bush's diplomatic experience as a vital factor by successfully persuading the Japanese to agree to certain concessions that facilitated trade talk between the two countries. As Malcolm Forbes, a prominent American businessman, explained in an editorial published in his widely-read Forbes magazine:

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[104] Steven Greenhouse, *U.S. Trade Move Is Assailed at O.E.C.D.*, N.Y. Times D13 (June 1, 1989).

[105] David Gergen, *Japan and United State Suffer from Mutual Disrespect*, U.S. News & World Report, (July 19, 1989). See also Phillip Eubanks, *A War of Words in the Discourse of Trade: The Rhetorical Constitution of Metaphor* 55 (Southern Illinois University 2000).

[106] Eubanks, *A War of Words* at 105 (cited in note 105).

[107] Id.

[108] Id.

> [President Bush's] forceful personal diplomacy persuaded Japan's prime minister to make meaningful concessions. At the same time, he and his trade representative, Carla Hills, skillfully punctured protectionist pressures in Congress. A few weeks ago the idea that Japan would be taken off a congressionally mandated trade offender list--a continued listing would trigger sanctions--would have seemed remote. But when the Administration did just that at the end of April, the announcement was greeted with a yawn.[109]

The administration would focus on other major trade issues as the U.S. moved closer to negotiating a free trade agreement with Mexico.

4.7 Trade Meetings with the USSR and Former Eastern Bloc States

In early 1989, there were ongoing discussions within the Bush Administration on how to organize the negotiations for the trade and investment agreements with the Soviet Union. There were two proposals for the negotiation process and an assessment of the advantages was prepared for the Chief of Staff John Sununu. Under the first option, the USTR could lead the interagency trade process. The following were the advantages for this process as described in a White House staff report:

- Consistency with the USTR's statutory responsibility for developing and coordinating U.S. policy and negotiations on trade and trade-related investments;
- USTR's Congressional oversight committees preferred USTR leadership in these matters;
- Prior presidents had reorganized the process and designated the USTR to coordinate East-West trade;

[109] Malcolm S. Forbes, Jr., *Trade War Averted- For Now*, Forbes 19 (May 28, 1990).

- USTR was already the chief negotiator for the US-USSR Long-Term Agreement on Grains;
- Avoided "fragmenting the interagency process on trade and investment issues;" and
- USTR planned to designate a Commerce Under Secretary as the *de facto* negotiator, subject to the direction through the USTR-led process.[110]

The second option was to use a Commerce-led process under the auspices of the US-USSR Joint Commercial Commission (JCC). The JCC was created in 1972 to negotiate a trade agreement with the USSR. According to the assessment findings, use of the JCC would allow it to continue its mission and maintain continuity of discussions that had occurred within the prior year. It would also allow "better integration of export control issues, on which Commerce is a lead agency."

Ultimately, the President designated the USTR to lead the trade negotiations with the USSR and Eastern Bloc nations. According to Ambassador Hills, her team was well-equipped to negotiate and complete the free trade agreements with the Soviets.[111] They were experienced veterans in drafting and negotiating the nuances required for such agreements. In addition, the Office of the USTR was statutorily authorized to engage in this activity and was consistent with their mission. Interestingly, the U.S. had preferred to negotiate a regional agreement that included the USSR and other eastern European states to save time negotiating several separate agreements with individual states, especially states that would have generated a minimal amount of trade with the U.S.

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[110] Paper titled "How Should the Administration Organize for Negotiating Trade and Investment Agreement with the Soviet Union," dated Jan. 5, 1990, George Bush Presidential Library document no. 11944. This document is stamped "CHIEF OF STAFF has seen."

[111] Telephone interview with Carla A. Hills, CEO of Hills & Company and Co-Chair of the Council on Foreign Relations, in Washington, D.C. (Dec. 4, 2009).

However, the former communist states did not want to be associated with the USSR and requested they have their own agreements to signify their sovereignty and autonomy. Hills fully appreciated their concerns and her team negotiated separate agreements with those states.[112] President Bush signed agreements with the Czech Republic, Slovakia, Romania, Poland, Bulgaria, and Armenia.[113] Several other agreements were started during the Bush administration but signed by President Clinton such as the agreements with Albania, Estonia, Georgia and Ukraine in 1994.[114]

4.7.1 Uruguay Round

In early 1989, the USTR focused on finalizing the Uruguay Round, which was top priority on the Administration's trade policy agenda. The multi-state discussions had been going since 1986, and over 100 states were willing to negotiate and commit "to principles of free and fair trade based on enforceable international rules."[115] It was the first time main issues related to "agriculture, intellectual property, trade in services and trade-related investment measures" were being negotiated under a single multilateral system.[116]

In December 1988, the participating states had made some headway in approved

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[112] Id.

[113] U.S. Department of Commerce, International Trade Administration, Trade Compliance Center, online at http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp (visited Jan. 18, 2010).

[114] Id.

[115] USTR document, Background Paper on Uruguay Round of Multilateral Trade Negotiations, Mar. 27, 1989, George Bush Presidential Library document no. 5041.

[116] Id.

"negotiating frameworks" for the majority of the negotiating groups. They were, however, unable to agree upon four issues: agriculture, intellectual property, safeguards, and textiles. In the area of agriculture, the U.S. and then-European Community (EC) were unable to find a middle ground on the negotiating framework. For the trade-related intellectual property (TRIPS) issues, India took a hard line against adopting comprehensive reforms in the protection of intellectual property. The key obstacle was developing standards that were enforceable in the "internal markets (where piracy and counterfeiting occur), and at the border—to preclude pirates from reaping further economic benefits from their unfair acts."[117] Finally, the USTR believed negotiations for textiles and safeguards were going to be "the most challenging and arduous."[118]

The primary objective for the USTR was to maintain an active dialogue and input from significant American stakeholders, including the private sector, Congress, and other government agencies. As a USTR background paper noted, "[i]f the negotiations are to be successful, the United States will have to continue its traditional role as the leader on issues of international economic cooperation."[119] The Uruguay Round was supposed to have been completed by the end of 1990, but the U.S. and EC could not agree on the agriculture issues and the discussions were extended.

In May 1990, the Quad Meeting of Trade Ministers (US, EU, Japan and Canada) was held in Napa, California. The ministers covered a wide range of issues related to the

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[117] Id.

[118] Id.

[119] USTR document, Background Paper on Uruguay Round (cited in note 115).

Uruguay Round, including "agriculture to services to reforming GATT rules."[120] Afterwards, Ambassador Hills reported to the President that she "succeeded in confirming the many areas where our positions converge in the Round" and "[t]here was strong agreement to continue to cooperate closely" to conclude the Round by December 1990.[121] The ministers were also "unified" to "develop a common approach to reforming the GATT dispute settlement system."[122] Hills believed the Administration was "beginning to build up a good head of steam for the OECD Ministerial [in May], and look[ed] to the Houston Economic Summit to add further impetus to the Round."[123]

By September 1990, the Uruguay Round negotiations were at an impasse. Ambassador Hills notified the President that it was imperative to complete the Round's final stage, or otherwise it would be a "disaster."[124] The Round was being held up due to several trade issues involving extensive negotiations including agriculture, market access, rules to protect market access, and services trade.[125] The major area that stalled the negotiations was agricultural reform. The EC was reluctant to agree to various aspects of the U.S. proposals and had proposed its own reform standards, which were considered "unacceptably weak" from Hill's perspective.[126] Not surprisingly, the EC "vowed never

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[120] Memorandum of Carla A. Hills to President Bush, dated May 8, 1990, regarding "Quad Meeting of Trade Ministers." George Bush Presidential Library document no. 1486.

[121] Id.

[122] Id.

[123] Id.

[124] Hills to Bush memorandum, dated May 8, 1990 (cited in note 120).

[125] Id.

[126] Id. The EC was reluctant to implement significant reforms to export subsidies and barriers to market access.

to 'Americanize' the EC proposal."[127] Hills recommended the President use his political influence with the leaders of the other trading nations to put pressure on the EC and "to 'de-Americanize' this issue."[128] The bloc of nations that was crucial to assist the U.S. included the United Kingdom, Japan and Latin American nations such as Argentina, Brazil, Columbia, Mexico, Uruguay, and Venezuela. In particular, she proposed that President Bush inform President Salinas he was "excited by the prospect of an FTA" but Mexico should not forget about the Round.[129]

4.8 Expansion of Free-trade zone Concept

During the Bush Administration, the White House staff partnered closely with several agencies to develop and implement multiple initiatives related to free-trade zones. As noted above, the President had decided that the expansion of free trade was a top priority on his agenda, and his staff worked feverishly to develop different types of incentives and structures to accommodate the various trade blocs in Latin America and Pacific Rim. The following sections describe two examples of these trade initiatives with major U.S. trading partners.

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[127] Id.

[128] Hills to Bush memorandum, dated May 8, 1990 (cited in note 120).

[129] Id.

4.8.1 Andean Trade Initiative

In November 1989, the Bush Administration announced a broad-based counternarcotics strategy. One component of that strategy, the so-called Andean Trade Initiative, was intended to curtail drug production and trafficking in Colombia, Peru, and Bolivia through sponsorship of economic alternatives to such illicit business.[130] In conjunction with law enforcement support, the Administration decided to cut tariff rates on additional imports as part of this initiative.[131] Several countries including Colombia, Peru, Bolivia and Ecuador had requested Generalized System of Preferences (GSP) treatment for 152 products.[132]

The White House had geared up for a significant backlash from the business community because some of these products were deemed to be "politically sensitive."[133] In a memo to Marlin Fitzwater, the White House Press Secretary, and Fred McClure, Director of Legislative Affairs, Roger Porter noted:

> The problem is that the Andean countries are minuscule suppliers of some politically sensitive products, e.g., stainless steel flatware, glassware, ceramic tiles, plywood, certain vegetables. Other third world suppliers, e.g., Mexico, Venezuela, the Philippines, would stand to gain much more from GSP treatment. Under the GSP law, we cannot discriminate among countries.[134]

After an interagency review of the products, a decision was made to study 129 of those

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[130] Memorandum of Roger B. Porter to Marlin Fitzwater and Frederick McClure, dated Mar. 2, 1990, regarding "Heads Up on USTR Announcement on Andean Trade." George Bush Presidential Library document no. 9660.

[131] Id.

[132] Id.

[133] Id.

[134] Porter to Fitzwater memorandum, dated Mar. 2, 1990 (cited in note 130).

products that were not prohibited by law to receive special tariff treatment. To avoid unwanted political flak and negative reaction from U.S. businesses, Porter recommended that the White House reaffirm the President's commitment to the Andean Trade Initiative and indicate that a study was being conducted to "enhance that [which] Andean counties derive from the GSP program."[135]

Despite some opposition from Congress, the Andean Trade Preference Act (ATPA) was enacted in December 1991. The ATPA still assists eligible countries in their fight against drug production and trafficking by expanding their economic alternatives. The current beneficiaries of the ATPA are Colombia, Ecuador and Peru. Countries that are unable to meet their obligations under the agreement can have their designation as a beneficiary country suspended until they comply with such requirements. For example, Bolivia failed to meet its obligations related to counternarcotics cooperation, and President George W. Bush suspended their eligibility for preferential trade treatment in 2008.[136] Thus, the Andean Trade Initiative is one of those initiatives of President Bush's (41) foreign policy that is still in effect today.

4.8.1 Japan-U.S. Free-trade Zone

In 1989, Europe was gradually moving toward unification and Western Europe became the largest economic region. The changing European scene generated great

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[135] Id.

[136] Office of the U.S. Trade Representative, Fourth Report to the Congress on the Operation of the Andean Trade Preference Act as Amended , Apr. 30, 2009, online at http://www.ustr.gov/sites/default/files/USTR%202009%20ATPA%20Report%20Final.pdf (visited Jan. 24, 2010).

interest to the White House staff tasked with exploring options for the U.S. to expand free-trade zones with its major trading partners. Since Japan is one of the leading industrialized nations, there was interest in creating a Japan-U.S. Free-trade zone. This idea had enormous potential, but there were several key obstacles. First, there was little support for a free trade agreement with Japan. As noted in Section 4.4 above, the massive billion-dollar trade deficit between the two nations was causing Congress to take a hard line of protectionism against Japan. Second, the general U.S. public sentiment toward Japan was negative because the automobile, steel and telecommunications industries faced significant economic challenges with higher imports of cheaper Japanese goods. Moreover, corporations were increasingly concerned about Japan's restrictive market access for U.S. imports. Lastly, the USTR's preference was to focus on opening markets through the Uruguay Round rather than negotiating bilateral agreements.

In the opinion of Roger Porter, Assistant to the President for Domestic and Economic Policy, "[r]esorting to further bilateral agreement is considered by USTR and others as something of a fallback position if the multilateral approach fails to produce adequately." He did note there were "Foreign Trade Zones" in the U.S. that were only available to Japanese-owned firms. In these zones, Porter stated, a foreign car manufacturer like Toyota could import parts duty-free to its assembly plant in Kentucky and not have to pay any duty until it shipped vehicles to U.S. car dealers. Toyota would save money because the duties were cheaper for finished cars than for parts only.

Unlike the Andean Trade Initiative, the Japan-U.S. Free-trade zone never materialized. As noted in other sections of this dissertation, the negative American sentiment toward Japan during the Bush (41) Administration hindered any meaningful

discussion with Congress regarding negotiating a free trade agreement with Japan. The huge U.S. trade deficit due to Japan's protectionist trade policies was a major hurdle that made it virtually impossible to convince congressional leaders to pursue such an agreement without risking a significant constituent backlash in their home states.

CHAPTER 5

THE DEVELOPMENT AND NEGOTIATION OF THE NORTH AMERICAN FREE TRADE AGREEMENT

5.1 Preliminary Discussions on a Bilateral Free Trade Agreement Between the U.S. and Mexico (1990)

As early as 1979, President Ronald Reagan had envisioned a North American Accord in which all three nations would agree on free trade issues, but the idea did not materialize beyond the existing CUSTA until Mexico's newly elected President Carlos Salinas decided to pursue a bilateral trade agreement with the U.S. In 1988, Salinas was the PRI nominee who ran against Cuauhtémoc Cárdenas and Manuel Clouthier in the general elections. Despite a public outcry of election fraud and protests concerning the accuracy of the vote count, Salinas was elected president, and he immediately faced the daunting task of implementing solutions to his country's political and economic turmoil. The weak economy was taking its toll on Mexico and, after one and a half years in office, Salinas knew he had to take a significant step to bring Mexico out its perpetual economic woes and to generate trade and investments with its largest trading partners.[1]

While attending the World Economic Forum in Davos, Switzerland in February 1990, Salinas broached the subject of negotiating a bilateral free trade agreement with the U.S. with his Secretary of Commerce and Industrial Development, Jaime Serra Puche, a

[1] Carlos Salinas de Gortari, *Mexico: The Policy and Politics of Modernization* 37 (Plaza & Janes 2002).

young intellectual with a Ph.D. in economics from Yale University.[2] As the story is told, Salinas went to Serra's room one evening to inform him he had finally decided to propose a free trade agreement with the U.S. and directed Serra to commence discussions with Carla Hills, the U.S. Trade Representative (1989-1993) under President Bush.[3] Bilateral free trade agreements were common to the U.S., but considering that Mexico was not even a member of the General Agreement on Tariffs and Trade (GATT), a free trade agreement with the U.S. was a significant progressive step for Mexico into the global markets.

At Davos, Serra and Hills discussed Salinas's proposal.[4] Salinas was only in the second year of his *sexenio*, or six-year term, and Serra urged the American diplomats to start the negotiations while he still had time left in his presidency to see the completion of the agreement.[5] The USTR was receptive to the idea, but hesitant to start another free trade negotiation while she was still working on other trade priorities.[6] These preliminary discussions set into motion a series of subsequent discussions between the two states. Due to the close geographical proximity of the two countries, and the substantial volume of cross-border transactions that flowed between these nations, many U.S. government

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[2] Maxwell A. Cameron and Brian W. Tomlin, *The Making of NAFTA: How the Deal Was Done* 2 (Cornell University 2000).

[3] Salinas, *Mexico* at 47-48 (cited in note 1).

[4] Telephone interview with Carla Hills, CEO of Hills & Company and Co-Chair of the Council on Foreign Relations, in Washington, D.C. (Dec. 4, 2009).

[5] In his autobiography, President Salinas states that "[t]here is an ideal moment for establishing agreements of this nature: the period when the Mexican and U.S. presidential administrations begin simultaneously. Otherwise electoral calendars make an in-depth discussion almost impossible. Such a period occurs every twelve years." Salinas and Bush began their terms a few months apart and the continuity of administrations contributed to the success of the NAFTA negotiations. Salinas, *Mexico* at 219 (cited in note 1).

[6] Hills interview (cited in note 4).

officials and business leaders saw a trade agreement with Mexico as an opportunity to further expand trade and investments between both nations. In the White House there were extensive discussions about whether to proceed with trade negotiations at that time with Mexico, or wait until the Uruguay Round negotiations were completed.

5.2 Evolution of Mexico FTA Proposal (March 1990)

As discussed in Section 4.1.3 above, Mexico was undergoing significant economic reform in 1990 that was gradually becoming more evident in the daily lives of the average Mexican, and was drawing favorable reviews from the foreign investment community. President Salinas still required increased investment capital inflows and exports to catapult the economy into the next stage toward economic recovery and away from the ill-advised policies of his predecessors. The following sections discuss key events that led to the negotiations initially for a bilateral trade agreement and eventually expanded to a trilateral agreement that included Canada.

5.2.1 U.S. Embassy Telex Cable that Set the Stage for Face-to-Face Discussions with the U.S.

During the early days of March 1990, a confidential cable message was transmitted from the U.S. Embassy in Mexico City to Secretary Baker.[7] In this nine-page

[7] Cable Message of U.S. Ambassador John Negroponte to Secretary of State James Baker, March 1990, George Bush Presidential Library, 2005-03610MR. The Author of this dissertation was the original FOIA

cable, U.S. Ambassador John Negroponte sent a message, indicating "Thoughts on a Possible U.S.-Mexico Free Trade" in the subject line.[8] He notified the Secretary of State regarding growing interest of Mexican officials to negotiate a free trade agreement with the U.S. and, possibly, Canada. "Over the past several months," Negroponte wrote, "the Mexican Authorities have quietly expressed a growing interest in negotiating a free trade area with the United States (and perhaps Canada)." In his opinion, "President Salinas seem[ed] to be firmly behind this idea as do [*sic*] his most influential economic advisors."

Mexican officials informed the Ambassador they were "convinced that Mexico, as the lesser developed country, has at least as much, and probably more to gain economic benefits from increased integration as does its northern neighbor." Moreover, those officials realized a free trade area served key political and economic purposes for the Salinas administration. They viewed it as a great opportunity to "increase public confidence in Mexico and help induce large amounts of capital to flow into the country" that was "critical to the future growth of the economy." This marked a sharp contrast to past Mexican administrations that were opposed to "a free trade area because of the large disparity in economic development between it and the U.S., and probably more

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requestor for this White House document which was previously classified as confidential and unavailable to the public until October 2009.

[8] President George H.W. Bush's nomination of Negroponte to the Mexico post was one of his first ambassadorial appointments. White House Press Release, February 21, 1989, online at http://bushlibrary.tamu.edu (visited on Oct. 8, 2009). During his thirty-seven years of government service, Negroponte served as Deputy Assistant to President Reagan for National Security Affairs (1987–1989), U.S. Ambassador to Honduras (1981 - 1985); and various State Department positions prior to his appointment to the Mexico post. He also served as Ambassador to the Philippines (1993-1997) during the Clinton Administration. In addition, President George W. Bush appointed Negroponte as the U.S. Ambassador to the United Nations (2001-2004), Ambassador to Iraq (2004-2005), the first Director of National Intelligence (2005-2007), and Deputy Secretary of State (2007-2009).

importantly for political reasons."[9]

This cable message is unlike most of the American embassy cables transmitted to cabinet members. Typically, the cables consist of a few pages containing a summary of conversations between U.S. personnel and foreign officials, a high level overview of issues, or set forth embassy officials' brief recommendations for action steps. In his cable, Negroponte wrote an extensive message that was more akin to an advocacy paper than an embassy communiqué updating Washington officials. The cable contained detailed facts and analysis under eight sections discussing compatibility with GATT obligations, U.S. Views on FTAs, the expansion of the Europe Community, and a possible U.S.-Mexico FTA.

> The Ambassador's cable provided an overview of key issues, history of trade agreements, world events, obstacles and Mexico's recent actions to liberalize its economy. For example, Negroponte wrote:
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> Mexico has argued publicly that freer trade between the two countries must be negotiated in gradual increments, i.e., sector by sector. (Behind the scene this position seems to be changing quickly.) It had also undertaken substantial trade and investment reforms and privatization of state enterprises.

The Mexican government understood that the Bush Administration's primary trade objective at the time was to complete the Uruguay Round. They hoped the GATT negotiations would finish quickly, so the U.S. could focus on "greater economic integration with Mexico."

The establishment of a dispute settlement mechanism acceptable to Mexico was an obstacle to any trade negotiations with its neighbors. Negroponte noted: "The dispute

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[9] Ambassador Negroponte noted the Mexican government's reluctance "to be perceived as having an excessively close alliance with the U.S." Cable Message of Ambassador John Negroponte to Secretary of State James Baker, March 1990, George Bush Presidential Library, 2005-03610MR.

settlement procedures of the Canada-U.S. FTA were relatively easy to negotiate because of the similar legal procedures in unfair trade regulations of the partner. This may not be true in the case of Mexico." His underlying concern was Mexico's historical reluctance to deviate from the Calvo Doctrine and the fear of losing its sovereignty to larger trading neighbors. This aspect of the cable also confirms a common concern among senior U.S. policymakers regarding the protection of U.S. investments in Mexico and the need for an effective investor-state arbitration system.

Finally, he emphasized the high likelihood that a FTA was inevitable but it depended on both countries' desire and will power to achieve this goal. He wrote:

> An FTA between the U.S. and Mexico would have to be the result primarily of a political decision by both governments. The Salinas Administration may have already quietly made the decision. The Mexican Authorities are aware that eventually a free trade area or at least more economic intregation [*sic*] with the U.S. (an perhaps Canada) is inevitable. Given all the rapid changes that are going on in other areas of the economy (agriculture, industry, financial services) the Mexican now seem to believe that this is a propitious moment to push for a free trade area." —U.S. Congressional attitudes toward Mexico seem to be improving and this would facilitate that negotiation of an FTA should the U.S. Executive Branch decide it is desirable.

In his closing comments, Negroponte foreshadowed one potential obstacle if the U.S. decided to move forward with an FTA. He ended the communiqué with a final comment that "labor movements would be a more thorny issue … and one which the Mexicans certainly would try to address."[10]

[10] As Negroponte predicted, as well as others who are familiar with Mexican affairs and trade agreements, labor issues became a central part of the NAFTA negotiations and the presidential election race in 1992. See accompanying text in sections 5.13-5.16.

5.2.2 Salinas's Telephone Call to Bush Triggers a Meeting with the State Department

After the Mexican debt reduction negotiations were completed, President Salinas was concerned about the imminent unification of Europe that was scheduled for 1992, which would have most likely left Mexico in the sidelines of international trade. He desired to restart discussions with President Bush regarding the possibility of a FTA between the two countries.[11] During a meeting with Henry Kissinger in Mexico, Salinas shared with him the idea of a FTA.[12] The former Secretary of State urged Salinas to speak directly with Bush regarding this idea and to do so earlier than later. The following day, March 8, 1990, Salinas called Bush to discuss the possibility of a free trade agreement and the president "responded to the proposal with great enthusiasm" and gave instructions to his staff to start the negotiations.[13]

In addition to this telephone conversation with President Bush, Salinas' sent a delegation to meet with Secretary Baker and his staff in Washington, D.C. On March 9, 1990, Mexican Commerce Minister, Jaime Serra, and one of President Salinas's most trusted advisors, Jose "Pepe" Cordoba, met with Secretary Baker and Commerce Secretary Mosbacher at the State Department.[14] The Mexican officials urged Baker to

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[11] According to Salinas, Bush had first raised the subject of a free-trade zone with him during their initial meeting merely two weeks after Bush's election victory in November 1988. But Salinas had deferred any discussion regarding a free trade agreement until the debt crisis was resolved. Salinas, *Mexico* at 12 (cited in note 1).

[12] Id at 56.

[13] Id.

[14] Cordoba was considered one of the Salinas most trusted advisor. Like many other members of Salinas' inner circle, Cordoba was trained in economics at a top U.S. university, Stanford University. He earned his Ph.D. in economics from Stanford University. Colin Harding, *Special Report on Mexico: Discreet administrator in the President's office: Colin Harding describes how an outsider entered the inner circle to*

move fast on bilateral negotiations for the FTA.[15] They impressed upon the Secretary of State that the economic conditions in Mexico had compelled their government to initiate significant economic reforms and programs to stimulate their national economy.[16] It is clear from declassified "Secret" State Department meeting notes taken by then-Deputy Secretary of State Lawrence Eagleburger that the State Department staff considered Mexico's decision to enter into a FTA to be a "surprising" decision.[17]

Serra explained that Mexico was initially reluctant to discuss a FTA until it was able to address their debt crisis. He also noted "the world had further evolved." The European Union was expected to be finalized in a few years, and Mexico saw that "a North American Free-trade zone offered attractive possibilities in terms of markets, labor and growth potential." Interestingly, Serra informed Baker that "he envisaged this zone as resulting from separate bilateral agreements. Not a three-way U.S., Mexico, Canada arrangement." Hence, as the State Department records indicate, "Given the evolution in the Mexican thinking, President Salinas called President Bush on March 8 to signal his interest in an FTA and had asked his advisor to come to Washington in order to pursue the topic with the relevant USG officials."[18]

The Mexican commerce secretary pressed hard to immediately start the negotiations and advised that President Salinas wanted to announce this major event prior to his

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become an influential adviser, online at www.independent.co.uk/news/world/ (visited on Sept. 12, 2009).

[15] U.S. Department of State Meeting Notes Regarding Mexican Commerce Minister Serra and Presidency Coordinator Cordoba Call on Secretary Baker on Mar. 9, 1990, Files of Pryce, Folder CF00729.

[16] Id.

[17] Id.

[18] Id.

address to the Business Roundtable on June 11, 1990. The rationale for this prompt announcement was, he stated, to avoid "conflict with the Uruguay Round in the GATT and the desire not let the Round proceed almost to its conclusion and then appear to destabilize it with a surprise announcement of a [U.S. and Mexico] separate agreement."[19] Serra also acknowledged that the announcement would have a strong impact on the domestic economic and political situation for the Mexican President. He told Baker "the pressure was building to roll-back some of the changes which had been implemented unless the economy showed dramatic progress."[20] The Mexican officials viewed the FTA as a confidence builder, giving Mexico and the world a "sense of permanence in the direction of the Mexican economy."[21]

In addition, there were several key Mexican congressional and gubernatorial elections in September 1991 that were important to the Salinas administration and they preferred that the FTA debate not "peak during this period."[22] Baker "heartily endorsed the FTA concept" and he fully appreciated the "political ramifications of an FTA were historic."[23] He reminded Serra that since 1981, when President Reagan took office, the U.S. had expressed a desire for a North American free trade agreement. The 1988 agreement with Canada was seen as the preliminary step toward such a goal. Serra and Baker agreed that they had to coordinate their "approaches [with Canada] to avoid their

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[19] State Department meeting notes regarding Serra and Cordoba meeting with Baker (cited in note 15).

[20] Id.

[21] Id.

[22] Id.

[23] State Department meeting notes regarding Serra and Cordoba meeting with Baker (cited in note 15).

taking a negative position out of fear or ignorance."[24]

Despite the fact he was sympathetic to the Mexican officials' desire to promptly move forward with negotiations, Baker also knew that the U.S. process was complex and it would take time to make any public announcements. He noted "it was essential to move quickly and quietly."[25] He also advised Serra that a premature announcement would "scare entrenched interests and provoke protectionist sentiments in Congress and elsewhere." In addition, the Secretary of State emphasized the need for Serra to work closely with Ambassador Hills since the USTR was the lead agency for GATT and free trade agreements.

At the end of the meeting, Secretary Baker expressed his "pleasure" that Mexico wanted to proceed with a free trade agreement in "an expeditious way on this visionary project."[26] He also reiterated President Bush's support for this agreement as a way to "ensure a better future for both Mexicans and Americans." Finally, Baker stated that this agreement was "an important symbol politically as well as economically, and was of historic significance."[27] Both Serra and Cordoba agreed with Baker's assessment on the magnitude of the agreement.

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[24] Id.

[25] Id.

[26] Id.

[27] State Department meeting notes regarding Serra and Cordoba meeting with Baker (cited in note 15).

5.3 Public Reaction to FTA Talks (March-April 1990)

It is difficult to keep major presidential decisions a "secret" in Washington, and the FTA talks with Mexico were no different. Within a few weeks, there were leaks to the media regarding the trade discussions between the two states. The *Wall Street Journal* was one of the first major newspapers to report on the negotiations.[28] Other newspapers picked up on the story for their front headlines. The *New York Times* reported the preliminary trade discussions in a favorable light. It described Mexico's long history of nationalism and saw these discussions as a "break" from the government's past.[29] This disclosure prompted the Mexican government to formally announce its intent to negotiate a free trade agreement with the U.S. President Salinas believed 'it was necessary to act immediately in order to avoid 'antibodies' developing against the negotiation" in Mexico.[30]

Robert E. Herzstein, a former Under Secretary of Commerce for international trade, was quoted as saying, "There is more confidence, more a common interest with the United States, and more a feeling that Mexico can be a beneficiary of trade with the United States."[31] The *New York Times* noted the "democratization of Eastern Europe" would cause increased competition for foreign investments, and it motivated Mexico to

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[28] Peter Truell, *U.S. and Mexico Agree to Seek Free-Trade Pact*, Wall St J A3 (Mar. 27, 1990).

[29] Larry Rother, *Free-Trade Talks with U.S. Set Off Debate in Mexico*, N.Y. Times A1 (Mar. 29, 1990).

[30] Salinas, *Mexico* at 56-58 (cited in note 1).

[31] Clyde H. Farnsworth, *U.S. Sees Rapid Movement on Mexican Trade Talks*, N.Y. Times D4 (Mar. 28, 1990). Herzstein played a key role as the lead American legal counsel for the Mexican government during the NAFTA negotiations.

move toward "closer economic ties" with the U.S. A trade expert also stated that "[a] free trade agreement would buy security of access to the American market that would galvanize investment in Mexico."[32]

The Canadians were on the sidelines, but they were carefully observing what was going on between Washington and Mexico City. At that time, a Canadian official stated "his government would follow the Mexican-American negotiations 'with interest' and seek 'assurances Canadian interests were safeguarded.'"[33] To ensure the focus on completing the GATT negotiations, Ambassador Hills issued a statement reassuring the public and fellow GATT countries, that there was "no agreement" to negotiate a trade pact at that time, and she refused to speculate as to future events related to the preliminary discussions.

The U.S. business community viewed the trade agreement as a very favorable sign for improving the economies of both countries. As one prominent business publication noted, "The decision by Mexico and the U.S. to negotiate a free trade agreement is the best economic news in a long time, a heartening contrast to the dangerous deterioration in our relations with Japan and to protectionist pressures that are cropping up in Europe."[34] Over the years, U.S. corporations were reluctant to invest in Mexico, and the country had "severely limited its economic potential with its 80 year-old policy of protectionism, nationalization, and excessive regulation and taxation."[35]

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[32] Id.

[33] Id.

[34] *Enormously Consequential*, Forbes 20 (Apr. 30, 1990).

[35] Id.

5.4 White House Advisors Debate Over the Prioritization of Trade Agreements

Within the Bush administration there was a split among cabinet members whether to proceed or delay trade negotiations with Mexico.[36] In early 1990, the top priorities on the trade agenda included completing the negotiations for the GATT's Uruguay Round. How critical was the Uruguay Round? In a 1990 memo to President Bush, Carla Hills summarized the urgency for the U.S. to finalize the Uruguay Round negotiations in the following manner:

> A tremendous amount is at stake in these talks. A failure of the Uruguay Round would be a disaster: trade would contract, nations would fission into inward-looking trading blocs, and trade disputes would become more commonplace and rancorous. Moreover, economic and political stability in developing countries would be undermined, as the promise of growth through participation in the world markets disappears.
>
> On the other hand, success in the Round would spur world economic growth by an estimated $500 billion. In addition, we will have created a rules-based system designed to enhance global stability and growth, and the orderly resolution of dispute.[37]

It is evident that Hills was focused on the bigger global picture of completing the GATT Round, which would have a far greater economic benefit for the U.S. than a bilateral trade treaty with Mexico.

Other cabinet members, such as Secretary of State James Baker and Secretary of

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[36] George W. Grayson, *The North American Free Trade Agreement: Regional Community and the New World Order* 55 (University Press of America 1995). The dissertation author also confirmed this information in interviews with over ten former senior White House, State, and USTR officials.

[37] Memorandum of USTR Carla Hills to President Bush, dated Sept. 28, 1990, regarding "Update on the Uruguay Round." Bush Presidential Library document no. 1490.

Commerce Robert Mosbacher, were in favor of getting a deal done with Mexico. They were personal friends of President Bush from Texas, and the president valued the advice of the former perhaps more than any other cabinet member.[38] This is not surprising considering that Baker was at Bush's side for all of his elections and served as a trusted confidante of the President for over thirty years.[39] As Baker describes it, he had "one luxury none of my modern-day predecessors had ever enjoyed—an unprecedented personal relationship with the President of the United States."[40] The Secretary of State's job impacts more than just foreign policy and, as Baker points out, "everybody is out after your turf." He felt "[b]eing close to the President made doing the job a thousand times easier. I never worried about being undercut. I could operate without ever having to look over my shoulder, or worry about my backside."[41]

Baker saw the chance for a free trade agreement with Mexico as a continuation of the economic liberalization that was occurring within Latin America. In June 1990, President Bush announced the development of the Enterprise for the Americas Initiative (EAI) or, as it later known as in Latin America, the "Bush Initiative."[42] The EAI included "additional debt relief, the creation of a multilateral investment fund for Latin America, and a formal administration offer to negotiate free-trade and investment

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[38] Interview with Eric D. K. Melby, Ph.D., Principal of Scowcroft Group and former Director of International Economic Affairs, National Security Council (1989-1993), in Washington, D.C. (Mar. 19, 2009).

[39] James A. Baker, The Politics of Diplomacy: Revolution, War and Peace, 1989-1992, 17-18 (Putnam 1995).

[40] Id at 18.

[41] Id at 21.

[42] Memorandum from Carla Hills to President Bush, dated Nov. 23, 1990, regarding "Trade Themes for Your Trip to South America." Bush Presidential Library document no. 10.

agreements with Latin American nations."[43] It was Bush's attempt for hemispheric prosperity within the region that focused on "trade, not aid."[44]

> In light of this situation, President Bush engaged his cabinet in discussions regarding this initiative. Early on in the discussions, several cabinet members were jockeying for the position as the lead in the trade negotiations, perhaps motivated to raise the prominence of their own department. For example, Treasury Secretary Brady initially promoted the key role that his department would play in any bilateral agreement involving investments since his department was responsible for financial services and monetary policies. Any of his aspirations for leading the trade talks quickly dissipated because the deal involved more than just financial services such as agricultural, technology, and manufacturing industries which were beyond the expertise of the Treasury Department.

Another cabinet member who extensively lobbied the President for the primary role was Commerce Secretary Mosbacher. White House memos reveal he worked aggressively behind the scenes to take the lead in drafting the trade agreement, or at least coordinating the U.S. efforts to negotiate the deal with Mexico. In March 1990, the Secretary scheduled lunch with the President, but he had more in mind than food and social talk. Prior to the meeting, Mosbacher wrote a memo to Bush explaining the true purpose of his lunch meeting was to recommend the Commerce Department coordinate all trade activities of the various departments and agencies through what he called "Commercial Diplomacy."[45]

The memo dated March 6, 1990, the day before their lunch date, states:

Dear Mr. President:

I'm very much looking forward to our lunch tomorrow, but I thought in fairness I

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[43] Baker, *The Politics of Diplomacy* at 606 (cited in note 39).

[44] Id at 607.

[45] Memorandum of Robert Mosbacher to President Bush, dated Mar. 6, 1990, Bush Presidential Library, no. 2183, SO 003 129418.

> should warn you, I do have plan I'd like to run by you.
>
> The good news is that this time it is an initiative which this Department is uniquely charged with, both by Congress and by OMB—therefore you. Specifically, I'm talking about International Trade and Export Promotion.
>
> Since this is already in Commerce's purview, why the "Special Plan"? Because in order to pursue your competitive initiative, stay in front of Congress, and especially to make the most effective use of our resources, we need to concentrate our efforts in trade promotion through a Presidential initiative called perhaps – Commercial Diplomacy. You might form a Trade Promotion Council and charge the Department of Commerce to coordinate all trade and export promotion activities with State, Treasury, USTR and others such as OPIC, ExIM Bank as well as the relevant other agencies to give U.S. business, either exporters or investors, a central "one-stop shopping opportunity….
>
> Identifying key markets for U.S. exporters, particularly smaller businesses, can put us or keep us on top of global trade and competitiveness as well as building our economic security.
>
> Best,
> Bob[46]

This memo also reflects Mosbacher's attempt to lead free trade agreement negotiations, which was rebuffed because the primary responsibility was vested with the USTR. This time he tried to position this new initiative as a matter that the Commerce Department was "uniquely charged" with by the President or Congress.

On May 10, 1990, Mosbacher wrote to Bush regarding the President's, or as he

[46] Id.

phrased it, "*their"* accomplishments with the Trade Promotion Plan, and how it would help the business community with exports and investments in Eastern Europe. This was a segue to his indirect appeal for involvement when he wrote:

> I'm excited about all we can accomplish through your (our) Trade Promotion Plan by giving the business community a more coordinated focal point for information and support. We should be more helpful to U.S. business in Poland and Hungary and Czechoslovakia as well as helping these countries plus others in Eastern Europe with the Administration clearing the way for private sector exports, investments, and joint ventures. And what we can accomplish—Mexico and Latin American might be even more significant as well as being more singly our responsibility….
>
> It all may add up to good diplomacy, happy politics, and may even accomplish something positive for all. [47]

It is not unusual for the commerce secretary to attempt to position his department to take a more active role in trade negotiations. As Carla Hills points out, she got along with Mosbacher, but there is always a natural tension between the USTR and the Commerce Department.[48] Under federal law, the latter is responsible for specific aspects of international trade in the U.S. Specifically, the Commerce Department assesses "the impact of proposed domestic and international regulatory policies that affect U.S. industry's competitiveness and the expansion of U.S. exports."[49] It also is the lead agency to enforce countervailing and anti-dumping requirements under trade laws and agreements. In light of its mission toward helping American corporations, especially in the heavy industries, the Department is challenged in maintaining an impartial perspective for international trade.

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[47] Id.

[48] Hills interview (cited in note 4).

[49] U.S. Department of Commerce, International Trade Administration, General Overview, online at http://trade.gov/index.asp (visited on Jan. 3, 2010).

On the other hand, Congress created the Office of the U.S. Trade Representative to serve as an impartial agency and consensus builder between the president, Congress and various agencies.[50] Prior to 1962, the Department of State served as the primary negotiator of trade agreements and administrator of the presidential trade agenda. In the Trade Expansion Act of 1962, the president is required to appoint a trade representative to negotiate trade agreements, and to chair an interagency council to develop trade recommendations to the president.[51] This legislation is seen as reflecting "Congressional interest in achieving a better balance between competing domestic and international interests in formulating and implementing U.S. trade policy."[52] Several subsequent federal laws and executive orders elevated the USTR to the cabinet level as part of the Executive Office of the President and expanded its responsibilities to develop and implement various aspects of U.S. trade laws.[53]

As Mosbacher argued his case for a role in trade negotiations, Hills took a firm position regarding her role in the administration as it pertained to trade negotiations. She knew she had to establish her "territory" early on in the administration because, as Baker describes it, "everybody is out after your turf." Hills was already a veteran of Washington politics and internal White House territorial spats having served as the Secretary of Housing and Urban Development during the Ford Administration. She had

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[50] Hills interview (cited in note 4).

[51] 19 U.S.C. § 1801, *et. seq*.

[52] Office of the United States trade Representative, History of USTR, online at http://www.ustr.gov/about-us/history (visited on Jan. 3, 2010).

[53] Some of these laws and orders include: Section 141 of the Trade Act of 1974; Reorganization Plan No. 3 of 1979 pursuant to Executive Order 12175 (1979); Executive Order 12188 (1980); Omnibus Trade and Competitiveness Act of 1988; Uruguay Round Agreements Act of 1994 (URAA); and Trade and Development Act of 2000.

also served as Assistant U.S. Attorney General in the Nixon administration.[54] As several former White House officials intimated to this author during interviews, Hills was "not going to take a backseat to anyone," and her experience in two prior administrations taught her to stake out her ground early before someone else did it for her.[55]

One of her first goals was to ensure she participated in key meetings involving trade. In early January 1989, prior to Bush being sworn in as president, or she being confirmed by the Senate as the USTR, Hills sought to establish her role as the USTR. For example, she wrote to John Sununu, who had been designated as Bush's White House Chief of Staff, before the inauguration requesting the USTR be included with the team attending the annual Economic Summit.[56] She was facing an uphill battle because the Economic Summit was generally reserved for the president, secretary of state, national security advisor, and treasury secretary. The USTR was typically not on the invitation list, and she had, according a former senior White House official, "no right" to attend this event.[57]

This memo clearly reflects Hills's deft skills as a lawyer as she penned this persuasive memo. It was a "no-risk, high reward way," she wrote, "of demonstrating the President-elect's considerable interest in trade and delivering on his pledge to make the

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[54] Hills was also on President Ford's short list of potential nominees to the U.S. Supreme Court to fill a vacancy when Justice William O. Douglas resigned in 1975. Ford eventually nominated then-federal circuit judge John Paul Stevens who was subsequently confirmed by the Senate and is still serving on the Court after 34 years.

[55] Interviews with several senior White House officials who provided this information to the author off the record.

[56] Memorandum of Carla A. Hills to John Sununu, dated Jan. 16, 1989, Bush Presidential Library, no. 11597.

[57] Interview with a senior White House official who had attended the Economic Summits during the Bush administration and provided information to the author off the record.

USTR 'our trade minister at home and abroad.'"[58] In the event the president-elect's own pledge would not suffice, Hills stated "Congress has repeatedly urged USTR attendance at the Summit, which has not occurred since Bob Strauss' tenure."[59] Strauss served as the USTR under President Carter and is considered by historians and congressional leaders to have been one of the most effective USTR in the country's history. So it would not hurt her case to cite precedent of a prior USTR attending the Summit.

Moreover, she reiterated the comments she recently received from key congressional leaders during her pre-confirmation courtesy calls. For example, Congressman Rostenkowsi, the then-powerful Chairman of the Ways and Means Committee, was quoted as telling her that the President-elect informed him he was "high on raising the level of the trade representative."[60] She also cited the 1988 Omnibus Trade Bill, which established expectations that the "new Administration [would] give trade issues top priority."[61] Finally, she noted that other countries, such as Japan, have their trade ministers at the table when discussing key trade issues, and her attending the Summit would put her on "equal footing" with those trade ministers.[62]

Governor Sununu assessed the implications of another cabinet member at the negotiating table. It was obvious to him that "one of two 'secretaries' must, at the right time, give her the room at the table."[63] He scribbled on the memo to "get precedents on

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[58] Hills to Sununu memorandum, dated Jan. 16, 1989 (cited in note 56).

[59] Id.

[60] Id.

[61] Id.

[62] Hills to Sununu memorandum, dated Jan. 16, 1989 (cited in note 56).

[63] Id.

… intl. mtgs."[64] Also, he wanted to refer this matter to the White House counsel and wrote: "get lawyer…why special role on trade" in reference to the 1988 Omnibus Trade Bill that was referenced in her memo. Despite her efforts to persuade others in the administration to allow her to participate at the Economic Summit, a search of publicly available White House documents do not reveal whether or not the President or Sununu approved her request, or whether it was approved and other events prevented her from attending before the Summit.

Either way, this issue became moot because Hills was called to testify before a congressional committee that was investigating the lobbying efforts by other former HUD officials with their former agency.[65] As the Economic Summit was wrapping up in Paris in July 1989, Hills, as former HUD Secretary, was testifying before a House subcommittee to defend her role in negotiating a deal for a former legal client several years after she had left HUD.[66] However, Hills did eventually participate at the Summit

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[64] Id.

[65] *Former Official Refuses to Testify in HUD Scandal*, Seattle Times A2 (July 18, 1989), 1989 WLNR 664179. During congressional hearings, Hunter Cushing, a former deputy assistant HUD secretary, took the Fifth Amendment and did not testify before the subcommittee investigating HUD transactions. Congressmen questioned Hills regarding her representation of certain corporate clients who were seeking to obtain funding from HUD. No allegations were asserted against Hills and she left the hearings unscathed. Nevertheless, the unwanted media attention concerning these hearings prompted Hills to seek public relations advice from Marlin Fitzwater, former White House Press Secretary for President Bush. Fitzwater encouraged her to keep the "Fitzwater Rule" in mind- "The only answer to a bad story is a good story." He suggested that she not take the defensive but to "[s]tay in the news on other issues. Those are the good stories that answer the bad." As further wrote to Hills, "[t]he best defense in the world won't change public perception once it's established. Rather, you have to create a new perception. Fortunately, you have many, many opportunities to do that." Memorandum of Marlin Fitzwater to Carla A. Hills, dated Aug. 15, 1989, Bush Presidential Library, document no. 6203.

[66] Id. Hills did not attend this Economic Summit and Congressional leaders lamented her absence from the negotiations. One news report indicated that:

> In the omnibus trade bill of 1988, Congress indicated it was worried that the summits were being wasted as well. Congress urged the President take along the US Trade Representative (USTR) to the high-level powwows. Senator Bentsen wishes President Bush had Carla Hills, the current USTR, with him, since trade actions will be discussed.

the following year which was held in Houston, Texas.[67]

Hills was recognized and highly respected for her intelligence and results-oriented approach to her job. Baker described her as a "capable and tenacious" USTR.[68] She also "suffered no fools," as several senior White House and USTR officials informed the author, off the record, even before being asked the question regarding her management style.[69] Hills laid the foundation for her role by reiterating her statutory authority and mission to President Bush, knowing very well he was being lobbied by other cabinet members, in particular, Secretary Mosbacher, to take the lead on trade issues.

In a handwritten note on her personal stationery, she wrote to President Bush requesting him to reaffirm his policy for the USTR to serve as the primary person in trade policy and negotiations with the Soviets and former Soviet bloc nations.[70] She wrote:

> Dear Mr. President:
>
> Welcome home! You did a great job, and you have generated enormous excitement about trade opportunities with Poland, Hungary and the U.S.S.R. As a result, you may be asked to designate a cabinet office other than U.S.T.R. to lead these trade negotiations.
>
> U.S.T.R. has only two functions:
> 1) to coordinate the Administration's trade policy, and
> 2) to serve as the Administration's lead negotiator of trade agreements.

Ron Scherer, *Summit Leaders to Stress Debt Environment, Trade, and Drugs Will Also Be On the Agenda At Paris Economic Summit World Economy*, Christian Science Monitor (July 13, 1989).

[67] The President's News Conference Following the Houston Economic Summit, July 11, 1990, George Bush Presidential Library, online at http://bushlibrary.tamu.edu/research/public_papers.php?id=2067 &year=1990&month=7 (visited Aug. 29, 2009).

[68] Baker, *The Politics of Diplomacy* at 611 (cited in note 39).

[69] Professor Grayson has also written that Hills "neither suffered fools gladly" nor enjoyed "schmoozing." Grayson, *North American Free Trade Agreement* 75 (cited in note 36).

[70] Personal note from Carla A. Hills to President Bush, dated Dec. 5, 1989, regarding USTR role and responsibilities. George Bush Presidential Library, document no. 13621.

> In both coordination and negotiation USTR takes an inclusive approach, sharing responsibility with all interested cabinet agencies. However, in my experience, successful negotiations require consistency and continuity, which are best assured by having a clearly designated lead negotiator.
>
> If you contemplate changing this policy, I would appreciate the opportunity to discuss it with you.
>
> Warm personal regards,
>
> Sincerely,
> Carla

Her reference to trade talks in Eastern Europe was clearly aimed at the Commerce Department's attempt to take the lead in trade negotiations.

The President requested his staff to review Hills's memo and to provide feedback. His Cabinet Secretary, David Q. Bates, discussed the letter with Sununu and they recommended the President inform Hills "how much you value her work and that you will want her instrumentally involved in the follow-up trade and investment talks with the Soviet Union, Poland, and Hungary." [71] Sununu agreed to sort out the details and to get back to her since she would play a key role. Bush, who was always concerned about his cabinet members and staff, immediately directed Scowcroft, Sununu and Bates to consult with him before any decisions were made concerning Hills's request.[72] At the end of the

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[71] Memorandum of David Q. Bates to President George H.W. Bush, dated December 6, 1989. George Bush Presidential Library document no. 13620.

[72] Memorandum of President George H.W. Bush to John Sununu, David Bates and General Brent Scowcroft, dated Dec. 7, 1989. George Bush Presidential Library document no. 19860. Not only was Hills facing a challenge from Secretary Mosbacher regarding taking the lead on trade talks, but she also began to deal with media speculation that Housing and Urban Development Secretary Jack Kemp was interested in moving over to the White House as the USTR. One major publication reported that "the representative's job attracts Kemp, who is still hoping for the Presidency, because it promises high visibility and a potentially large payoff as trade issues move even closer to the center of the political stage in the '90s. As for Carla Hills, who now occupies the post and is a Bush favorite, she is a strong candidate for the next Supreme Court vacancy." Charles Fenyvesi, *Trading Places*, U.S. News & World Report (May 14, 1990), at 27.

day, the President sided with Hills and the USTR successfully negotiated the Russian free trade agreement.[73]

5.5 Congressional Leadership Challenges the President's Executive Power to Negotiate Trade Agreements

During the Reagan administration, Congress pressed hard to increase its participation in drafting and negotiating trade agreements. This movement raised interesting constitutional questions related to the role and powers of the Executive Branch and Congress related to foreign trade. Under Article II of the U.S. Constitution, the president "shall have power, by and with the advice and consent of the Senate, to make treaties, provided two thirds of the Senators present concur." However, Article I states that Congress is authorized to "To regulate commerce with foreign nations." Congress argued that the latter provision authorized them to participate in trade agreement negotiations.

The legislature also took steps to enact laws to expand its control over the process. For example, the Trade Act of 1988 required the USTR to chair any policy review committees related to trade. They also went as far as to draft a bill that would have prohibited the president from keeping records of congressional micromanagement. The White House Counsel described this bill as an "especially delicious example of Congressional micromanagement of the Executive Branch." This prompted President Bush to scribble a reply to his counsel stating: "This is horrible. I hope we can challenge

[73] Louis Uchitelle, *A Crowbar for Carla Hills*, N.Y. Times SMA 20 (June 10, 1990).

it. Maybe use our line item veto authority."[74]

This was not the only incident where Congress challenged Bush's authority to negotiate trade agreements. In the spring and summer of 1991, there was tremendous pressure on the NAFTA negotiation teams for all three states to prepare and issue a draft of the agreement. It was critical for each state to review the treaty draft for its validity with their own constitutions and to use it to garner sufficient support of their legislatures in adopting such a landmark agreement. During this time period, Daniele Glickman (D-Kansas) informed the President it was Congress and not he that had final authority over trade agreements.[75] Apparently, the Congressman had conducted his own research and concluded Congress was the only federal branch with such authority.[76] Glickman's statement prompted President Bush to request a legal opinion from White House Counsel C. Boyden Gray.[77] In his memo to Gray, President Bush wrote:

> Rep. Glickman gave us a little lecture today on the Congress' [*sic*] role in negotiation [*sic*] all trade agreements. I realize they have a special role here. He went back to the Federalist papers and concluded that Congress has the <u>full</u> say. AT least that's how he explained it to us. Please give me

[74] Memorandum of C. Boyden Gray to President Bush, dated Aug. 15, 1989, regarding "Legislative Encroachment on Executive Power." George Bush Presidential Library document no. 5413.

[75] Rep. Glickman was a member of Congress from 1977-1995 and a graduate of George Washington University Law School. He practiced law as an attorney for several years in private practice and at the United States Securities and Exchange Commission prior to being elected to Congress. In Congress, he served as the Chairman of the Permanent Select Committee on Intelligence. He also served as the Secretary of Agriculture during the Clinton Administration (1995-2001).

[76] Memorandum of President George H.W. Bush to C. Gray Boyden, May 16, 1991, ID#13076, WHORM: Alpha File Subject File, Bush Presidential Records, George Bush Presidential Library.

[77] Gray served as White House Counsel to Bush (41) while he was President and Vice President. Prior to this position, he was a partner in the law firm of Wilmer, Cutler, Pickering in Washington, D.C. Gray had also clerked for U.S. Supreme Court Chief Justice Earl Warren (1968-1969). After his White House experience, he returned to private law practice and subsequently served as the U.S. Representative to the European Union, and later as Special Envoy for European Union Affairs during President George W. Bush's Administration. Online at http://useu.usmission.gov/About_The_Ambassador/Gray/Gray.asp (visited Aug. 29, 2009)

> a short paper on this question. Who does what to whom?? Signed: GB 5-16-91 (Capitalization and underlining in original).

In response to the President's request, Gray advised the President he had the "sole authority to determine the form and manner in which negotiations with foreign nations are conducted." This position, Gray wrote, was consistent with prior U.S. Supreme Court cases upholding the president's authority in this area. However, he did note it was advisable for the President to consult with Congress on these matters because it had the "congressional authority to 'regulate commence with Foreign Nations'" and it "would facilitate the approval of agreements.[78] Bush cheerfully wrote back to Gray, "Good report."

5.6 U.S.-Mexican Free Trade Agreement Negotiations Announcement (June 1990)

According to a senior White House official, President Bush had previously agreed with the USTR, National Security Advisor, and key cabinet members that the Uruguay

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[78] Memorandum of C. Boyden Gray to President George H.W. Bush, dated May 21, 1991, ID#13075, WHORM: Alpha File Subject File, Bush Presidential Records, George Bush Presidential Library. Gray's legal opinion stated:

> This responds to your note about Cong. Glickman's theory that Congress has the full say in negotiating trade agreements.
>
> I should first emphasize that the President has the sole authority to determine the form and manner in which negotiations with foreign nations are conducted. As the Supreme Court said in 1936: "[T]he President alone has the power to speak or listen as a representative of the nation." This applies in the context of trade agreements as much as in any other. Congress absolutely cannot negotiate trade agreements or dictate to the President the terms on which he must negotiate.
>
> In a practical sense, however, the power of the President in the trade areas is severely restricted by the fact that the Congress has the constitutional authority to "regulate Commerce with Foreign Nations." Under this power, Congress is free to establish tariff rates and trade regulations by statue, whether or not they are consistent with agreement that the President has negotiated.
>
> In effect, therefore, the President's power is only to negotiate proposals that will then be presented to Congress. Consequently, Presidents have found that they must consult with Congress while negotiating trade agreements in order to assure that the agreements can actually be put into effect. There is, however, no constitutional obligation to do so, and Congress could not displace the President by negotiating agreements on its own behalf.

Round would take priority over a free trade agreement with Mexico.[79] The President, however, truly believed a free trade agreement with Mexico would be historic and beneficial to both countries. Prior to the telephone call with Salinas, the NSC and the various agencies, including USTR, had approved talking points for Bush, which were typed on index cards. Most of the key points emphasized the United States' commitment to complete the GATT negotiations, and there was a minor reference in one of the last talking points to the possibility of a free trade agreement with Mexico only after the Uruguay Round was completed. The senior official noted that former President Reagan, was excellent, not surprisingly for a former actor, with keeping to his prepared talking points.[80] This was not the case with Bush on this occasion, or other ones when he had conversations with national leaders.

All telephone calls between the U.S. president and foreign leaders are monitored by, at least, two senior White House, NSC or State Department officials on a listen-only mode telephone line. One of those officials is assigned to take notes of the conversation and prepare a memorandum of conversation ("memcon") for distribution to key officials

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[79] Interview with former senior White House officials who have personal knowledge of this telephone conversation between Presidents Bush and Salinas. This information was provided to the author off the record.

[80] Id.

and agencies for their information. During his telephone call with Salinas, Bush became excited when Salinas expressed his government's interest in a free trade agreement. President Bush had considered the potential benefits that a FTA with Mexico would have on both countries. He also envisioned such an agreement generating a significant flow of cross-border trade and investments which would strengthen the relationship between the U.S. and Mexico as well as spark economic growth in the region. To the call monitors' surprise, the President decided to ignore his more cautious advisors. He skipped the talking points regarding the priority of the GATT negotiations and went straight to the points on a trade agreement with Mexico.[81]

Needless to say, President Bush's emphasis on the Mexican FTA over GATT had shifted the prioritization of U.S. trade negotiations during his telephone call with Salinas. The NSC staff immediately contacted USTR to inform them about what had just transpired. USTR officials were skeptical the President had shifted the focus of a major trade issue without the prompting from the NSC. As one White House official described it, the USTR initially believed the NSC had "sandbagged" them by pushing the President to reprioritize the FTA with Mexico. It took the NSC staff some time afterward to convince the USTR the President had made this policy change on his own, and it was not the result of a NSC "conspiracy" to circumvent the them.[82]

After Bush and Salinas had decided to pursue negotiating a free trade agreement, there were extensive discussions between the two governments on the timing and content of the announcement. Since Congress had to first grant fast track authority to the

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[81] Id.

[82] Id.

President, U.S. officials were cautious not to portray the White House's decision to go forward with a FTA as a done deal without Congressional input and approval. There were several other domestic and foreign stakeholders who would also have to be consulted with prior to negotiations.

Ambassador Hills reiterated these concerns to John Sununu, including the substance and process for the announcement. "As you know, she wrote to the Chief of Staff, "it is indispensable that we consult with Congress, the private sector, and other governments (e.g., Canada and others in Latin America) prior to initiating formal negotiations if we are to be successful."[83] She objected to any statement in the president's speech indicating that "both Presidents agreed that the FTA 'would be concluded expeditiously.'"[84] (Underlined in original)

> Not the type of person to miss an opportunity to clearly articulate her position, the Ambassador further advised Sununu that she and her deputy, Jules Katz, had negotiated the text of the announcement only to later find out that White House staffers altered the text and sent it directly to Salinas without first clearing it with the USTR. This action reportedly prompted Serra to ask Katz "'who are we supposed to negotiate with?'" In her view, "[t]his process of multiple negotiators has undermined the clarity of [USTR's] negotiating authority in the eyes of the Mexican and with the Congressional committees of jurisdiction."

In June 1990, Hills testified before the House Ways and Means Subcommittee on Trade regarding the U.S.-Mexico trade relations. She pointed to the decision of Presidents Bush and Salinas to "endorse the goal of a comprehensive bilateral free trade agreement between the Unites States and Mexico" and they would "begin the preliminary

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[83] Memorandum of Carla A. Hills to John H. Sununu, dated June 8, 199, regarding "Mexico FTA Announcement." George Bush Presidential Library document no. 11628.

[84] Id.

work necessary to begin those negotiations."[85] She acknowledged the long history of Mexico "whose policies were highly interventionist, characterized by trade protection, a restrictive investment enforcement, a large degree of state ownership, and control of business, and an overly regulated business climate."[86] However, to show the committee members Mexico had changed its political and economic positions related to free trade, Hills outlined the new Mexican policies and how the U.S. relations had improved. For example, she referenced the Salinas administration's actions to reduce tariffs below GATT requirements, to reduce the number of import licenses, to issue new investment regulations, and to extend patent protections.[87]

On the same token, Hills highlighted several of the key U.S. policies toward Mexico. Beginning with the development of the "Framework of Principles and Procedures for Consultation Regarding Trade and Investment Relations" in 1987. As discussed in Chapter Four, the Framework "established a consultative mechanism to discuss trade issues and resolve trade differences."[88] Both governments had also furthered its trade discussions through the signing of the "Understanding regarding Trade and Investment Facilitation Talks" (TIFTS), which established a mechanism to negotiate sector or specific issues. In addition, Hills noted the drastic reduction of Mexico's policy of its government owning business. A compelling fact evidencing this change was Mexico's decision to divest itself of over 800 enterprises of the total 1,155 enterprises

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[85] Legislative Referral Memorandum dated June 11, 1990, CF 00729.

[86] Id.

[87] *Trade Pact with Mexico Endorsed*, Seattle Times E3 (June 15, 1990).

[88] Legislative Referral Memorandum dated June 11, 1990, George Bush Presidential Library, CF 00729.

owned by the state in 1982.[89]

During the subcommittee hearings, members expressed their concerns to Hills regarding the potential negative impact of the FTA that could depress U.S. wages.[90] To address their concerns, the USTR advised "past studies indicate that U.S. wages would not necessarily be depressed by a free trade accord with a low-wage country such as Mexico."[91] Some Congressmen even suggested linking the approval of the FTA to increased law enforcement cooperation in order to force Mexico's commitment to work with the U.S. in controlling illegal drug traffic.[92] Hills sidestepped this issue to avoid linking these two separate issues, but she did acknowledge that the FTA might strengthen cooperation between the two countries in their law enforcement efforts.[93]

As Hills was testifying before Congress, Agriculture Secretary Clayton Yeutter was meeting with his counterpart in Canada. Yeutter reported back to President Bush that the U.S.-Mexico FTA was on the forefront of Canada's mind. A Canadian official expressed the desire to be "involved in the process in an appropriate way."[94] They "suggested" that "it would be helpful if they were encouraged to do so by the United States and Mexico," a message Yeutter promised to pass to Hills. The official also "felt reasonably confident that they'll hold the Canadian federation together for the moment,

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[89] Id.

[90] Richard Lawrence, *Congress Wary of Trade Pact with Mexicans*, J. Commerce (June 15, 1990), 1990 WLNR 587083.

[91] Id.

[92] Id.

[93] Id.

[94] Memorandum of Clayton Yeutter to President Bush, dated June 15, 1990, George Bush Presidential Library document no. 2915.

but he also expects additional demands from Quebec in the future, so the situation will likely remain fragile."

On the home front, President Bush's carefully worded FTA announcement was generally considered successful for not generating intense criticism from the various anti-trade factions. By deferring the negotiations until the end of 1990, many U.S. officials felt they could focus on Uruguay Round and would "hopefully avoid this becoming an issue in some of [that] year's political campaigns (particularly the governorships of California, Florida and Texas).[95] However, they were gearing up for confrontation in Congress with its members who sat on committees that had jurisdiction over the various sectors that were part of the FTA. For example, several drafts of the 1990 farm bill were circulating around the House Agriculture Committee. The Committee was described as being in "disarray and [mired by] considerable partisan bitterness."[96] Notably, Senator Bob Kerrey was seen as "causing more divisiveness than anyone." Yeutter attributed Kerry's behavior to his "Presidential/Vice Presidential aspirations."[97]

5.7 Appointment of a Special U.S. Negotiator for Free Trade Agreement (July 1990)

By July 1990, the U.S. had committed to begin FTA discussions with Mexico at

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[95] Id.

[96] Id.

[97] Id. Interestingly, President Bush wrote back to Yeutter noting on the memo that he had 'read with interest.'" In regards to Senator Kerrey's presidential aspirations, Bush had underlined the sentence and placed a large asterisk with the notation "J.S. note." "J.S." referred to Chief of State John Sununu.

the end of the year, but the Uruguay Round was still pending. The Bush Administration's primary objective was to complete the Uruguay Round before starting trade talks with Mexico. Several White House and cabinet staff became concerned about the USTR's ability to effectively manage these major trade negotiations at the same time because they were extensive, complex and time consuming.[98] Thus, the Cabinet Secretary, Ede Holiday, proposed to John Sununu that a special negotiator be assigned to solely focus on the U.S.-Mexico FTA similar to the arrangement that was made for CUSTA. It was imperative this proposal be handled in a manner "that does not appear to undercut USTR." Roger Porter, Assistant to the President for Economic and Domestic Policy from 1989 to 1993, assumed the responsibility to discuss this proposal with Hills. In Porter's and Holiday's views, it was "obviously useful for USTR itself to embrace this notion, rather than appear to be the unwilling recipient of pressure."

After consulting with the White House staff and National Security Council, Hills appointed Julius ("Jules") Katz, a Deputy U.S. Trade Representative, to serve as the lead U.S. negotiator for NAFTA.[99] Prior to his appointment as Deputy USTR in March 1989, Katz was the chairman of the Government Research Corporation, vice president for the Consultants International Group, Inc., and chairman of Donaldson, Lufkin and Jenrette Futures, Inc. Further, he had a vast experience in international trade having served in several top positions at the State Department between 1950-1979.[100]

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[98] Memorandum of Ede Holiday to Governor Sununu, dated July 26, 1990, regarding "Special Negotiator on the U.S.-Mexico Free Trade Agreement." George Bush Presidential Library document no. 12099.

[99] President George H.W. Bush Press Release regarding "Nomination of Julius L. Katz To Be a Deputy United States Trade Representative" (Mar. 20, 1989) , online at http://www.presidency.ucsb.edu (visited Dec. 7, 2009).

[100] Id.

Katz was the perfect choice for this role. As a former National Security Council official described him, Katz was considered "a giant in his field" and was "enormously respected."[101] His extensive experience in trade, international business, and government relations provided him with the essential tools to complete the complex and daunting task of negotiating a free trade agreement between two major states with large national economies. Ironically, Katz was selected to negotiate this trilateral agreement, but he personally preferred to complete the GATT negotiations instead of negotiating bilateral or regional agreements. He saw these types of agreements as a "spaghetti bowl of discriminatory practices."[102] Nevertheless, Katz put aside his personal preferences and focused on completing the NAFTA negotiations, which was a top priority for President Bush's foreign and economic policy agenda.

5.8 President Bush Seeks Fast Track Authority (August 1990)

The literature on NAFTA is replete with details on the Bush Administration's strategy and efforts to obtain "fast track" authority from Congress. This thesis is not intended to cover this part of NAFTA's history in great detail, but the following section will provide a general overview of the proceedings and policy issues. It will also provide insight on the process from behind the scenes mainly derived from unpublished White House documents and candid interviews with key U.S. and Mexican officials involved in

[101] Melby interview (cited in note 38).

the NAFTA negotiations.

Under the Trade Act of 1988, Congress was authorized to approve "fast track authority" for the president to negotiate trade agreements on a specific schedule without amendments.[103] Upon receipt of a formal request for a trade agreement from a foreign country, the president was required to "notify the House Ways and Means and Senate Finance Committees of his intent to negotiate and give them sixty legislative days in which to deny 'fast track' authority."[104]

In 1990 the timing of President Bush's formal notice to Congress of his intent to negotiate the FTA with Mexico was vital and heavily based on several political factors. There were pros and cons to notifying Congress early on in the fall of 1990 before the Uruguay Round was completed. The USTR believed early notification to Congress in September 1990, after they had reconvened from their session recess, would support Salinas and Mexico.[105] Since he had assumed "political risk" in advocating for a FTA, Hills thought the U.S. could "give him a political boost" by making the Congressional notification in September.[106] Moreover, the earlier time period would enable the Administration to "mobilize support in both the Congress and from press, academic and

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[102] Interview with Robert Herzstein, Partner, Miller & Chevalier, and former Undersecretary of Commerce for International Trade (1980-1981), in Washington, D.C. (Mar. 20, 2009).

[103] See generally Hermann von Bertrab, *Negotiating NAFTA: A Mexican Envoy's Account* (Praeger 1997); Cameron and Tomlin, *The Making of NAFTA* (cited in note 2); and Grayson, *The North American Free Trade Agreement* (cited in note 36).

[104] Memorandum of Carla Hills to President Bush, dated Aug. 2, 1990, regarding U.S.-Mexico Free Trade Agreement. George Bush Presidential Library document no. 17410.

[105] Id.

[106] Id.

other opinion leaders to counter special interest group opposition to the FTA."[107]

On the other hand, early notification could have caused Congress to question "whether the Round [was] truly the Administration's highest trade priority." [108] Back in August 1990, Hills thought this risk would be "allayed" because FTA negotiations would not commence until after completion of the Round. [109] (At that time, little did she imagine the Round negotiations would be sidetracked by the EU in the Fall of 1990 and would continue for several more years.) Also, early notification may, in the USTR's view, give FTA opponents more time to take action to undermine the public support for the Round. In light of these risks, Hills still recommended, and President Bush concurred with the proposal, for him to publicly announce his intention to notify Congress during the U.S.-Mexico Binational Commission meeting held in August 1990.

In September 1990, Bush formally notified Congress of his intent to negotiate a FTA with Mexico. After Congress approved fast track authority, representatives from each of the parties to the agreement met periodically to identify issues and determine the scope of the agreement. Meanwhile, the White House continued to refine its strategy to obtain and maintain support of various stakeholders such as Congress, business and industry associations, environmental groups, and labor unions. The latter group was one of the first to enter the fray by lobbying Congress to oppose the FTA. As Hills wrote to Bush, "organized labor's early and vigorous lobbying efforts are succeeding in obtaining

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[107] Id.

[108] Id.

[109] Id.

commitments that will be difficult to unlock later as a vote approaches."[110] The President and his team were determined to run in front of the issue and started to intensify their lobbying strategy with face-to-face meetings with congressmen and their staff.[111]

During the period of August 1990 through February 1991, there were other pressing world events that required President Bush's increased attention and placed the FTA negotiations in a holding pattern. On August 2, 1990, Iraqi leader Saddam Hussein and his army invaded Kuwait claiming this sovereign nation as part of its territory. This military action was met with broad international condemnation, including Arab and Muslim nations throughout the world. The UN Security Council immediately passed Resolution 660 condemning the invasion, and demanded a complete and unconditional withdrawal of Iraqi troops.[112] Over the next several months, Bush built up a coalition of over twenty-seven nations and successfully used military force to defeat and expel Iraqi troops from Kuwait in February 1991.[113]

In early 1991, the Administration experienced intense opposition from Congress and different special interest groups. As the initial fast track authority was set to expire on March 1, 1991, the President requested an extension from Congress. According to the 1988 Trade Act, the President could make such a request if he provided Congress with a report describing the progress in trade negotiations, and a statement describing the reason

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[110] Memorandum of Carla Hills to President Bush, dated Feb. 27, 1991, regarding "Fast Track." George Bush Presidential Library document no. 8813.

[111] Interview with Nicholas E. Calio, in Washington, D.C. (Mar. 18, 2009). Calio served as Assistant to the President for Legislative Affairs for both President George H.W. Bush and President George W. Bush.

[112] Baker, *The Politics of Diplomacy* at 278 (cited in note 39).

[113] Speech of President George H.W. Bush, Message to Allied Nations on the Persian Gulf Crisis (Jan. 8, 1991), online at www.bushlibrary.tamu.edu (visited on Dec. 18, 2009).

for supporting the extension request. Bush's report highlighted the key reasons, including the necessity for the President to be able to effectively negotiate trade agreements with congressional approval, if a vote was required within a certain date and there were no amendments to the legislation. Fast track authority was also critical to complete the Uruguay Round, NAFTA and other trade initiatives such as the EAI. Overall, the President believed these agreements would "enhance the global competitiveness of the United States, and create new opportunities for American workers, American exports, and American economic growth."[114]

After President Bush requested an extension of fast track authority, there was an enormous public reaction from both sides of the FTA issues. The USTR's short assessment of the situation was that it was going to be "a difficult fight." The President spoke to different trade and business groups to promote the FTA, which was well received by the audiences. He was an integral part of the public relations strategy to gain support for the agreement. As Hills described it, his "presence added indispensable credibility to [their] efforts to convince industry of the importance of fast track."

In addition, a major challenge was convincing a large plurality of congressmen who were still undecided on fast track. In response, the USTR and White House staff met frequently with the legislators and their staff.[115] Specialized teams of Administration

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[114] Memorandum of David A. Weiss to Members of the Trade Policy Review Group, dated May 1, 1991. Files of Eric Melby, Mexico/FTA CF 01759, Folder 5. Attached to this memo is a copy of President Bush's template letter sent to House Ways and Means Committee Chairman Dan Rostenkowski and Majority Leader Dick Gephardt.

[115] 1991 Congressional Record, page H5747 (July 24, 1991). Rep. Jim Kolbe (R-Arizona) acknowledged Carla Hills's efforts to keep Congress informed throughout the fast track process. Kolb complimented her for these efforts on the House floor:

> I believe Carla Hills should be congratulated for her Herculean efforts to conduct two major trade negotiations and at the same time bend over backward to meet with Members of Congress. In the

experts and officials scheduled numerous meetings with Congressional committees and individual members and their staff to address their questions and concerns.[116] In some situations, members of Congress committed their support after receiving assurances from the White House that certain bills and federal grants important to their districts would not be sidetracked or delayed due to the Administration's concentrated focus on NAFTA.[117] For example, a Congressman requested confirmation of the approval of a $5 million bloc grant for his district. In another case, a Congressman wanted to have "quality time" with the President on Air Force One to discuss his district's concerns. Both of these requests were easily accommodated and their support for fast track authority secured.[118]

In the interim, Congress debated whether to extend fast track authority. The longer it took Congress to decide on the extension, the more intensely President Bush monitored the situation and frequently requested updates. He was in constant contact with Hills who provided him with timely updates throughout the process. For example, in a White House telephone call memo, Bush noted several key issues related to the

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> month that NAFTA negotiations have been underway, Ambassador Hills has met with the Speaker, the majority leader, has held two executive sessions each with the Ways and Means and Finance Committees, and plans an additional session with each in the near future. And the USTR's Office has already been to the Hill to exchange information and input with the House Agriculture Committee, House Foreign Affairs Committee, and the House Energy and Commerce Committee.
>
> Before the August recess, every single relevant committee in Congress--and that means nearly every congressional Committee--will have been paid a visit by the USTR's Office. Again, I commend Carla Hills and her office for the extraordinary efforts they have taken to interact with Congress on the progress of trade negotiations.

[116] Memorandum of Carla Hills to President Bush, dated Mar. 8, 1991, regarding "Trade Update." George Bush Presidential Library document no. 5604.

[117] Interview with a former senior White House official who provided information off the record.

[118] Id.

timing of NAFTA during his conversation with Hills on May 29, 1991.[119] He wanted the agreement completed by January 1 and wrote "finish negot. [*sic*]" to emphasize his desire to complete all trade negotiations by the end of 1991.[120] They also discussed the timeline for fast track approval, such as Congress had forty-five legislative days to decide, which the President considered to be a "long time."[121]

Another of his concerns was noted on the memo—"this goes past our election date."[122] The President was well aware Congress was less likely to approve any controversial legislation during an election year, and that signaled the need to step up the Administration's lobbying efforts. In addition, Bush wrote the following note: "Don't have Hispanics in our pocket." The memo concludes with another notation for a "political decision" and indicates that a meeting was to be scheduled with Hills, Scowcroft, Sununu, and Secretaries Baker and Yeutter.

Bush knew he had to obtain solid support from Hispanic groups who were in favor of NAFTA. The White House designated specific resources to promote NAFTA to various Hispanic associations and organizations, including La Raza and the United States Catholic Conference.[123] In fact, Roger Porter had scheduled meetings with the leadership of La Raza. John Sununu personally talked to Cardinal Bernard F. Law of Boston, who

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[119] Presidential Telephone Call Memo with Carla Hills written by President Bush, dated May 29, 1991. George Bush Presidential Library document no. 5382.

[120] Id.

[121] Id.

[122] Id.

[123] Memorandum of Roger B. Porter to Governor John Sununu, dated Apr. 17, 1991, regarding "Mexican-American and Catholic Support for the Fast-Track." George Bush Presidential Library document no. 13096.

was considered to be one of America's most prominent churchmen at that time.[124] Other White House staff met with key Hispanic leaders in Denver in July 1991.[125] Furthermore, the USTR's Office developed its own strategy to seek greater input from Hispanics in its process.[126] Carla Hills agreed to appoint Hispanic candidates for private sector advisory committees and arrange occasional meetings with La Raza. In addition, former San Antonio Mayor Henry Cisneros set up an informal meeting with Washington representatives of Hispanic organizations to provide updates on negotiations, and arrange briefings for her with the Hispanic media.

5.9 Canada Joins the Trade Talks and NAFTA is Created (September 1990)

As momentum built up for the U.S.-Mexico FTA, Canadian officials knew that a significant event was on the horizon, and they were sitting on the sidelines. A successful FTA between the U.S. and Mexico, the third largest trading partner of the U.S. in 1992, would most likely negatively impact the Canadian economy. If Mexico reduced and eventually eliminated tariffs with the U.S., American businesses and consumers would be seriously tempted toward shifting some trade to Mexico rather than to Canada, which was United States' largest trading partner in 1990.

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[124] Id. This memorandum is stamped "THE CHIEF OF STAFF has seen" followed by a handwritten notation indicating "and talked with Cardinal Law."

[125] Memorandum of David Demarest and Shiree Sanchez to President Bush, dated July 12, 1991, regarding "North American Free Trade Agreement/Hispanic Outreach." George Bush Presidential Library document no. 15228.

In light of the potential loss of U.S. trade with Canada, Prime Minister Mulroney and his cabinet diligently evaluated two primary options: sit tight and observe this major event, or join the discussions for a trilateral agreement. They chose the latter strategy in September 1990.[127] In a letter to Ambassador Hills, Canadian trade minister, John Crosbie, formally notified the U.S. his government had "decided in principle to pursue the prospect of a free trade agreement linking Canada, the United States and Mexico."[128]To remove any doubt of its intentions, he further stated that "[i]t is Canada's view that this negotiation should be conducted from the outset exclusively on a trilateral basis."[129]

5.10 The Influence of Private Actors on Free Trade Agreement Negotiations

Throughout the NAFTA negotiations, there were various types of private actors who were asserting different degrees of influence on the White House and Congress. The following section provides an overview of the activities of two of these actors- labor organizations and multinational corporations.

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[126] Memorandum of Gary Edson to Carla Hills, dated July 3, 1991, regarding "Hispanic Input on NAFTA Negotiations. George Bush Presidential Library document no. 4066.

[127] Cameron and Tomlin, *The Making of NAFTA* at 65 (cited in note 2).

[128] Letter of John C. Crosbie to Carla Hills, dated Sept. 10, 1990. George Bush Presidential Library, CF 00729.

[129] Id.

5.10.1 Labor Organizations

During the early stages of the free trade agreement with Mexico, the White House was in constant contact with various groups of private actors to discuss their concerns and feedback on how any trade agreement should be structured to protect their interests. For example, President Bush not only met with U.S. labor leaders, but also those from the G-7 countries in 1990.[130] Since the U.S. was host to the 1990 Economic Summit in Houston, Texas, tradition called for the host country's leader to meet with the labor leaders from the G-7 countries. These leaders were part of the OECD's Trade Union Advisory Committee, and they focused on the "social aspects of the current economic situation, calling for full recognition of trade union and human rights, and economic and social justice."[131] Interestingly, the National Security Council anticipated there would be "no surprises" from the group, except from the Canadian labor leaders.[132] The NSC believed this delegation would express their concerns about the U.S.-Canada Free Trade Agreement.

National Security Advisor Brent Scowcroft advised the President to "briefly enumerate the principal issues likely to come up at Houston." The NSC had prepared talking points for the President on index cards.[133] Some of the key points included:

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[130] Memorandum of Brent Scowcroft to President Bush, dated June 5, 1990, regarding "Meeting with Trade Union Leaders From G-7 Countries." George Bush Presidential Library document no. 9671.

[131] Id.

[132] Id.

[133] Id.

- We will be meeting in Houston at a time of unprecedented political and economic change in the world. The free trade union movement has been a moving force behind the drive for freedom and democracy;

- The Economic Summit countries have an important role to play by helping to ensure sustained world growth, low inflation and continued improvement in external imbalances;

- We must work to open trading opportunities worldwide. The key to this is concluding the Uruguay Round this year, with substantial agreements in all areas. Not to do so, risks igniting protectionist pressures, which will harm us all; and

- We will also be discussing the environment at Houston, as well as that terrible scourge, narcotics.[134]

In addition, Scowcroft recommended that the President turn to Labor Secretary Elizabeth Dole to respond to any specific labor issues.[135]

The Bush Administration did not want to muddy the waters by adding specific labor issues to the free trade agreement even though it was willing to negotiate refinements to existing dispute settlement mechanisms with Mexico.[136] President Salinas and his cabinet were also concerned labor as well as environmental provisions were unnecessary in the free trade agreement and, if added to the negotiation agenda, it would prolong the drafting and ratification of any agreement.[137] Thus, the White House and

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[134] Scowcroft to President Bush memorandum, dated June 5, 1990 (cited in note 130).

[135] Id.

[136] Memorandum of Roger Porter to John Sununu, dated Apr. 16, 1991, regarding Fast-Track Package. George Bush Presidential Library document no. 13095.

[137] Memorandum of Conversation with President Salinas of Mexico, Meeting held on Nov. 27, 1990 in Monterey, Mexico. George Bush Presidential Library document. Secretary Jaime Serra stated to President Bush and several members of his cabinet: "President Salinas mentioned to President Bush our worry about the tendency of interest groups to bring non-trade issues into play regarding the Free Trade Agreement. These issues concerning non-trade matter create unhelpful background noise… You may hear some Senators who will talk about non-trade issues. They do get involved in issues like environment and human rights. This could be a problem." Id.

Congress consulted labor organizations, but they did not play a significant role until President Bill Clinton took office in January 1993, and he pursued a side agreement to NAFTA on labor issues.[138]

5.10.2 U.S. Business Roundtable

The Bush White House files on NAFTA contain extensive documents to and from the Business Roundtable (BR), which was a coalition of forty-four major American corporations. During the development and negotiation of NAFTA, James Robinson III, CEO of American Express, and Kay Whitmore, CEO of Kodak, were the co-chairs of the organization. They also were co-chairs of the Advisory Committee on Trade Policy and Negotiations (ACTPN), established by the Trade Act of 1974, consisting of thirty committees representing various sectors ranging from agriculture to financial services to investments. The ACTPN serves as advisors to the USTR and Commerce Department regarding trade issues, and U.S. officials debriefed its members on confidential negotiation information. As one commentator notes, "Advisory committee members not only had privileged access, they could not transmit what they knew to others outside the process or to the media. Interest groups left outside were not happy."[139]

From the beginning of the trade agreement negotiations, the BR was seen as a

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[138] See accompanying text in section 5.16 that discusses President Clinton and the NAFTA side agreements negotiations.

[139] Frederick W. Mayer, *Interpreting NAFTA: The Science and Art of Political Analysis* 114 (Columbia University 1998) .

major player in the development and ratification of the FTA.[140] When Secretary Jaime Serra met with Secretary Baker in March 1990, he requested the U.S. to announce its support of the FTA prior to President Salinas's speaking engagement at a Business Roundtable meeting in June 1990.[141] Mexican officials strongly believed they had to demonstrate their commitment economic and financial reforms to build up investor confidence. As President Salinas explains, "[w]e worked closely especially closely with member of the Business Round Table [*sic*], thanks to the effective coordination of" Robinson and Whitmore.[142] This relationship was a key component of Mexico's strategy to widen its contacts and circle of pro-NAFTA influence.

The BR contributed to the Bush administration's analysis of the FTA by developing negotiating objectives and providing in-depth recommendations regarding the different components of the agreement. The key objectives included: broad liberalization of trade in goods, services and investments; policies that enhance the global competitiveness of both countries; increased cooperation between the two countries; accrual of benefits, to the extent consistent with the GATT, to the U.S. and Mexico; a mechanism of ongoing dialogue between the two countries to facilitate continued economic deliberation; and effective dispute resolution procedures.[143] Some people have questioned whether the BR wielded significant influence in the NAFTA policy decision-

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[140] See generally Letter of Kay R. Whitmore and James D. Robinson, III, to Roger Porter, dated November 14, 1991. George Bush Presidential Library no. TA005 293048-294556.

[141] See section 5.3.2.

[142] Salinas, *Mexico* at 87 (cited in note 1).

[143] The Business Roundtable, Building a Comprehensive U.S.-Mexico Economic Relationship: Preliminary Negotiating Objectives of The Business Roundtable (June 1991). George Bush Presidential Library, File TA 005, 293048-294556.

making process.[144] The fact that the final version of NAFTA's Preamble refers to all or variations of the above objectives speaks volumes of the BR's influence during the treaty negotiations.[145]

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[144] Interview with a former senior White House official who worked on economic policy issues during the NAFTA negotiations. This information was provided to the author off the record.

[145] NAFTA Preamble states:

> The Government of Canada, the Government of the United Mexican States and the Government of the United States of America, resolved to:
>
> STRENGTHEN the special bonds of friendship and cooperation among their nations;
> CONTRIBUTE to the harmonious development and expansion of world trade and provide a catalyst to broader international cooperation;
>
> CREATE an expanded and secure market for the goods and services produced in their
>
> territories;
>
> REDUCE distortions to trade;
>
> ESTABLISH clear and mutually advantageous rules governing their trade;
>
> ENSURE a predictable commercial framework for business planning and investment;
>
> BUILD on their respective rights and obligations under the General Agreement on Tariffs
>
> and Trade and other multilateral and bilateral instruments of cooperation;
>
> ENHANCE the competitiveness of their firms in global markets;
>
> FOSTER creativity and innovation, and promote trade in goods and services that are the
>
> subject of intellectual property rights;
>
> CREATE new employment opportunities and improve working conditions and living
>
> standards in their respective territories;
>
> UNDERTAKE each of the preceding in a manner consistent with environmental protection and conservation;
>
> PRESERVE their flexibility to safeguard the public welfare;
>
> PROMOTE sustainable development;
>
> STRENGTHEN the development and enforcement of environmental laws and regulations; and
>
> PROTECT, enhance and enforce basic workers' rights.
>
> Office of the U.S. Trade Representative. www.ustr.gov (visited on Dec. 7, 2009).

The BR's recommendations were also included in the ACTPN's Committee Report on NAFTA. Interestingly, the Committee highlighted the fact that NAFTA "provides an avenue for investors to challenge taxes that approach the level of *de facto* expropriation."[146] As will be discussed in Chapter Eight, the NAFTA provisions on expropriation is an indispensable investor protection tool which is exemplified in three recent "sugar cases" involving a Mexican excise tax on American products that resulted in large NAFTA arbitration awards in favor of investors in the amount of $130 million against Mexico in 2009.

5.11 Bush Trade Policy Expansion: Easing Latin America's Concerns About the Free Trade Initiative (November 1990)

By November 1990, Latin American heads of state watched as the three major economic powers within their hemisphere announced the negotiations toward a trilateral trade agreement which would make it one of the most formidable trading blocs in the world. At the same time, the U.S. pressed hard for the completion of the Uruguay Round. These concurrent events put the U.S. in a difficult position of promoting a multilateral trade policy with GATT nations while commencing a regional trade initiative. Some GATT nations saw the Enterprise for the Americas Initiative (EIA) as a "protectionist trade bloc for the Americas."[147] Moreover, Latin American leaders were

[146] A Report to the President, The Congress, and the United States Trade Representative Concerning the North American Free Trade Agreement, prepared by the Advisory Committee For Trade Policy and Negotiations (ACTPN), Sept. 1992, p. 50. Bush Presidential Library, TA/005, folder 348873-350872.

[147] Memorandum from Carla Hills to President Bush, dated Nov. 23, 1990, regarding "Trade Themes for Your Trip to South America." Bush Presidential Library document no. 10.

"not sure whether [U.S.] vision [was] one where political or economic relationship will take precedence in determining which countries will follow Mexico in the FTA queue" to join NAFTA.[148]

Around this time, President Bush scheduled a trip to South America and Carla Hills suggested he take certain steps to allay the concerns of his counterparts in that region. She recommended he reiterate his "commitment to free trade in the hemisphere and to emphasize that the initiative is not incompatible with multilateral trade liberalization."[149] Also, it was important, she thought, that Bush emphasize this is a hemispheric initiative and not all about the U.S. As Hills wrote, Bush should "clarify that [his] vision of free trade in the Americas is not one of a 'hub-and-spoke' system of FTAs with the U.S. at the center."[150] In her opinion, "[t]o maximize growth in the region, we must have 'lateral' trade liberalization among Lain American countries on compatible terms and timetables."[151]

During the first week of December 1990, Bush traveled throughout South America hoping to effectively convey his theme of "A new dawn for a New World."[152] His itinerary included stops in Venezuela, Uruguay, Chile and Argentina. Unfortunately, his visit and message were overshadowed by several events, including Operation Desert Shield in the Persian Gulf, an attempted military coup in Argentina just two days before his arrival in Buenos Aires, a rebellion of police officers in Panama during the prior

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[148] Id.

[149] Id.

[150] Id.

[151] Hills to President Bush memorandum, dated Nov. 23, 1990 (cited in note 147).

[152] Maureen Dowd, *Bush, in Uruguay, Vows Oil Price Aid*, N.Y. Times A16 (Dec. 5, 1990).

week, and the detonation of six bombs in Santiago, Chile.[153] As the U.S. along with its allied coalition were preparing for military action against Saddam Hussein and his Iraqi army, Uruguay like other Latin American countries were growing concerned about the production, supply and rising price of oil due to the invasion.[154] The President spent a considerable amount of time reassuring Latin American leaders and the public that this situation was "not going to go on forever."[155]

In Uruguay, Bush was met with anti-war protestors in the streets who "chanted in Spanish that [he] was a murderer."[156] He gave a speech to the Uruguayan legislature that was boycotted by several members while others walked out during the customary standing ovation for the President. News reports noted that the President's stated theme for the trip was "diminished by the Uruguayans' expressed concerns about the situation in the gulf." [157] Moreover, the attempted coup in Argentina distracted the media from Bush's message encouraging support for his Enterprise for the Americas Initiative, and reporters focused their questions to the President on the stability of the democracies in South America. Treasury Secretary Brady, who was accompanying the President, told reporters that Bush "felt 'very badly' that other events had distracted attention from his message on free markets and blossoming democracy."[158]

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[153] See Clifford Krauss, *In South America, Bush Finds Warmth And Restiveness*, N.Y. Times E2 (Dec. 9, 1990); and Maureen Dowd, *Fidgety Bush Gets No Eggs on Latin Trip*, N.Y. Times 3 (Dec. 9, 1990).

[154] Dowd, *Bush in Uruguay* (cited in note 152).

[155] Id.

[156] Id.

[157] Id.

[158] Id.

5.12 What's Castro Got to Do with NAFTA? (November 1991)

The preliminary negotiations for the U.S.-Mexico free trade agreement encountered many potential minefields that could have derailed the entire initiative, including a series of events involving Fidel Castro. In 1991 the Central Intelligence Agency (CIA) provided the National Security Council with periodic updates regarding its surveillance and assessment of Mexico's connections with Cuba. As a result of the author's Freedom of Information Act (FOIA) requests for the release of these CIA reports, the National Archives released one of these reports in September 2009.[159] This document contained secret intelligence information that the author's research determined has not been previously published, nor discussed in the NAFTA literature.[160] The report provides fascinating details of the CIA's surveillance of President Salinas's interaction with Castro and Mexico's economic activities related to Cuba.[161]

During the NAFTA negotiations, the CIA was concerned about Salinas's close relationship with Castro, and his willingness to assist Cuba in trade matters. The CIA report noted the historical Mexican position toward Cuba. "Mexico traditionally," the report stated, "has extended a helping hand to the Castro regime." As documented in the extensive literature on the Cuban Revolution in the 1950s, Castro was allowed to build up

[159] The U.S. Government has denied the release of several CIA reports related to NAFTA and, as of February 2010, the appeal of these FOIA denials is still pending.

[160] The author is the FOIA requestor for this document which was first released in late 2009.

[161] Central Intelligence Agency Report on Mexican Matters, dated Nov. 1, 1991. George Bush Presidential Library, File Location OA/ID-CF01379 [5].

anti-Batista operations while exiled in Mexico. Despite the Eisenhower Administration's attempts to persuade Mexico to "isolate Havana after Castro's takeover," Mexico rebuffed the U.S. and "defiantly defended the Cuban revolution viewing it as a surrogate in the fight against the same U.S. interventionist policies that had threatened Mexican sovereignty."

The White House was also closely monitoring the political environment in Mexico. In May 1991, Vice President Dan Quayle and his National Security Advisor, Karl D. Jackson, met with key officials of PAN ("Partido Acción Nacional" or National Action Party), which was the major opposition political party to Salinas's Institutional Revolutionary Party ("Partido Revolucionario Institucional" or PRI).[162] These officials included Luis Hector Alvarez, Chairman of PAN, Carlos Castillo Peraza, Norberto Corella Gil, and Alberto Ortega Venzor. Quayle was interested in obtaining details regarding the political situation in Mexico and how strong the opposition parties like PAN were. Alvarez advised the Vice President that "while there had been some progress on the economy, political change had been slower."[163] He also noted that the "opposition controlled twenty percent of the seats in the lower house - - [*sic*] the largest representation ever conceded by the ruling PRI party" and PAN had won several other local key positions.[164]

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[162] Memorandum of Conversation by Karl D. Jackson, May 10, 1991, regarding "Vice President's May 8 Meeting with Members of the Mexican Pan Party." George Bush Presidential Library. 2005-0376-MR. This information is contained in a White House document that was first publicly released in September 2009 as a result of the author's FOIA request that was pending for nearly five years.

[163] Id.

[164] Id. The PAN Party would eventually pick up a significant number of votes in the Mexican presidential elections in 2000 when one of its party officials, Vicente Fox, won the election. PAN's victory broke PRI's 71-year control of the Mexican government. See generally Vicente Fox, *Revolution of Hope: The Life, Faith , and Dreams of a Mexican President* (Plume 2007).

They also discussed Salinas's decision to allow majority foreign equity participation in Mexican enterprises, which was a change Corella suggested be institutionalized into law to avoid arbitrary interpretation. Overall, the PAN officials criticized PRI, the ruling political party for over sixty years in Mexico, for the massive fraud in the election process. Quayle concluded the meeting by "indicating that the United States strongly supported the principles of private property and democracy- two of the elements of the PAN's political credo."[165]

In July 1991, Mexico served as the host for the Ibero-American Summit, a conference between leaders from all of the world's Spanish and Portuguese-speaking nations.[166] Castro was invited and predictably was a very vocal opponent of the United States' policies in Latin America. This trip was crucial for Cuba because it had lost "nearly all trade and economic support it once received from countries of the former Soviet bloc" and it was Castro's attempt to foster and develop relationships with other Latin American leaders.[167]

The CIA believed "President Salinas's hosting of a summit [in October 1991] with the Presidents of Venezuela, Colombia, and Cuba raised the profile of Mexico City's relations with Havana and could complicate bilateral dealing with Washington." In support of their opinion regarding the political environment, the Agency noted Mexico had offered Cuba "$300 million in credit or investment guarantees." Nevertheless, the CIA determined "Salinas's commitment to achieving a free trade agreement with the

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[165] Id.

[166] Mark Uhlig, *Castro Gets Attention But Not Money from Latin Leaders*, N.Y. Times 112 (July 21, 1991).

[167] Tim Golden, *Mexico's Chief, in a Shift, Meets Two of Castro's Main Foes in Exile*, N.Y. Times A8 (Oct. 5, 1992).

United States and Canada will constrain him from defying the U.S. embargo of Cuba, and we believe he will make a concerted effort to keep Washington informed of his government's actions and intentions."

Interestingly, twelve months later Salinas made headlines when he met with two Cuban exiles who were considered to be Castro's most despised adversaries. [168] This event was significant because it marked a change in Mexico's long-standing relationship with Castro. The media reported this was Salinas' attempt to distance himself from Cuba and to gain Cuban-American support for NAFTA. Mexican officials were quick to deflect any connection between Salinas's meeting with the exiles to NAFTA, and advised reporters the meetings were "intended as a signal of Mexican support for broad political changes on the island."[169] According to these officials, "Mr. Salinas had told Mr. Castro that Cuban membership in the Latin American community would depend on his willingness to adopt the values of democratization and economic liberalization that most of the region's countries hold."[170]

Salinas's relationship with Castro would develop over time. In fact, Salinas revealed publicly for the first time in his 1,371-page autobiography published in 2002, that he served as the intermediary between Castro and President Bill Clinton during the Cuban refugee crisis in 1994-1995.[171] At that time, Clinton had recruited Salinas to relay messages to and from Castro concerning "the exodus of *balseros*, the people who were

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[168] Id.

[169] Id.

[170] Id.

[171] Salinas, *Mexico* at 241-256 (cited in note 1).

trying to flee from Cuba to Florida on makeshift rafts."[172] Americans believed the increasing number of people risking their lives to escape Cuba for the U.S. would result in a significant number of deaths.

Also, U.S. officials wanted to avoid the same negative domestic issues that occurred with the *marielitos* from the mid-1980s. In the prior situation, thousands of refugees, including numerous former convicts and mental institution patients, arrived to U.S. shores, but were shipped off to various detention centers for immigration processing at military bases throughout the country. As Salinas noted, the detained refugees' "behavior and eventual escape from the centers," such as the major facility in Arkansas, "generated such conflict in that state the then-Governor Bill Clinton was not re-elected."[173] President Clinton was determined not to have a repeat situation of the *marielitos* event, and he told Salinas, 'We don't want a crisis."

5.13 The Last Push to Finalize NAFTA in a Presidential Election Year (January – October 1992)

The White House strategy memos regarding NAFTA negotiations are replete with recommendations and numerous revised timelines to complete the trade agreement negotiations by the end of 1991. As that year slipped away, the USTR and White House staff geared up for a hectic and politically adverse environment to conduct any trade agreement, especially one involving its southern neighbor. President Bush was seeking

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[172] Id at 241.

[173] Id.

re-election, and the Democratic presidential frontrunners sought to exploit any opportunity to capitalize on the perceived weaknesses of the Bush administration.

President Bush is still widely viewed as an effective leader on foreign policy issues, having successfully managed the role of the United States in major events and conflicts throughout the world during his presidency. Several of these key events included: the fall of the Berlin Wall and reunification of Germany; the end of the Cold War; a closer American relationship with Russia and its leadership; the independence of former Soviet bloc nations; and the U.S. and its allied coalition's victory against Iraq in the Gulf War. Further, NAFTA would eventually be recognized as a major achievement of the Bush administration in several areas: economic, political and social.

Despite significant domestic public policy reforms, Bush's domestic policy record is criticized as being far less stellar than his foreign policy record. The President had successfully negotiated with Congress historic laws such as the American with Disabilities Act and the revision of the Clean Air Act. But the national economy was mired in a recession, and his broken campaign pledge (also known as the "read my lips, no new taxes" pledge) not to raise taxes was repeatedly used by the media and his opponents throughout the campaign.[174] His administration proposed several high potential initiatives such as "America 2000," an effort to implement educational reforms for the new millennium.[175] In addition, urban enterprise zones were proposed to provide economic incentives for businesses to stay in urban areas, to hire and retain local residents, and to continue contributing to the local tax base. The momentum of these

[174] Roman Popadiuk, *The Leadership of George Bush* 203 (Texas A&M University 2009).

initiatives never got off the ground due to the public focus on the Gulf War, recession, ever-increasing deficit, and tax increases.[176]

The Bush campaign realized NAFTA was controversial to certain groups such as environmentalists and labor unions. Congressional supporters of the deal urged the President to "[k]eep the agreement as far as possible from partisan politics; and, to that end, push as much of the process as possible out of the political season."[177] They juggled the massive task of completing the trade agreement without provoking any more controversy than what existed as a result of Congressional scrutiny of the deal and NAFTA opposition expressed by popular presidential candidates. For example, in 1992 Ross Perot made, in a folksy fashion, what is perhaps the most quoted anti-NAFTA statement of all time.[178] During the second presidential debate in October, in a response to a question regarding his proposals to open foreign markets so more jobs can come back to the U.S., Perot criticized NAFTA, and described the potential job loss to Mexico as "a giant sucking sound going south."[179]

During the summer of 1992, Carla Hills, Jaime Serra and Michael Wilson agreed to push their teams to a final "all hands on deck" effort to complete the negotiations by September. They wanted to avoid prolonging the negotiations during a heated

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[175] Charles Kolb, *White House Daze: The Unmaking of Domestic Policy in the Bush Years* 16 (Free Press 1994).

[176] Id at 229.

[177] Memorandum of Nicholas Calio to Sam Skinner, Clayton Yeutter, and Bob Teeter, dated July 15, 1992. Bush Presidential Library, document no. 15235.

[178] Charlyne Berens, *Amplifying the Giant Sucking Sound: Ross Perot and the Media in the NAFTA Negotiations*, 20 Newspaper Research Journal (1999).

[179] Id.

presidential election year. President Bush also wanted to complete the deal before the Republican National Convention on August 17, 1992, so he could announce it at the event.[180] Moreover, Mexico was more determined to finalize the agreement than were the other two countries. They also knew if Bush was to be re-elected, Congress would have most likely ratified the agreement as early as February 1993.[181] If he lost, they dreaded the thought that only uncertainty loomed for NAFTA after Election Day.[182]

In response to this urgent call, the three national negotiation teams broke out into their respective industry working groups to hammer out the details and agree upon the final text. At the end of July and early August, the negotiations intensified and the teams held around-the-clock meetings for two weeks negotiating numerous terms at the Watergate Hotel in Washington, D.C. The negotiators labored over complex details in the agreement, and the various parties continued to request concessions from the other party, which made very long days for the teams. Cameron and Tomlin humorously note in their book *The Making of NAFTA* regarding this negotiation session: "A senior U.S. negotiator described the Watergate process as 'part negotiation, part bazaar, and part show business.' His Canadian counterpart described it more simply as a 'zoo.'"[183]

At the end of this negotiation blitz, the teams completed the draft of the free trade

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[180] Cameron and Tomlin, *The Making of NAFTA* at 179 (cited in note 2).

[181] Hills interview (cited in note 4).

[182] In his autobiography, President Salinas expressed this concern as follows:

> In the middle of June 1992, Ross Perot vehemently attacked NAFTA. He declared that if elected president, he would not sign. The polls showed him ahead. Many analysts thought that his anti-NAFTA attitude helped him among voters. The prospect of Perot derailing our negotiations caused the Mexican stock market to suffer its greatest decline since the November 1987 crash. On the day of Perot's declaration, one of the heaviest flights of capital in my six-year term in office occurred. Salinas, *Mexico* at 135 (cited in note 1).

agreement and a summary of its provisions on August 12, 1992. On that date, President Bush appeared before the White House press corps to announce the completion of the trade negotiations. He highlighted the significance of this event by stating:

> Today marks the beginning of a new era on our continent, on the North American Continent… This historic trade agreement will further open markets in Mexico, Canada, and the United States. It will create jobs and generate economic growth in all three countries. Increased trade with North America will help our Nation prepare for the challenges and opportunities of the next century." [184]

The teams continued to refine the draft all the way up to the last day before the three trade chiefs were scheduled to initial the draft legal text in a ceremony held in San Antonio, Texas on October 7, 1992. On October 6, Mexico's Deputy Secretary of Foreign Affairs Andres Rozental sent a facsimile transmission of a letter from him to Acting Secretary of State Lawrence Eagleburger that was captioned "URGENT FAX MESSAGE."[185] According to his letter, he and Mexican Foreign Minister Fernando Solana called Eagleburger a few minutes prior to the facsimile to request specific text be added to Scope Section of the treaty. Specifically, they requested to add "a now-standard clause in all [of their] bilateral treaties to the NAFTA text, as a second paragraph to Article 1 (Scope of Treaty), as follows:

> <u>This Treaty does not empower one Party's authorities to undertake, in the territorial jurisdiction of the other, the exercise and performance of functions or authority exclusively reserved to the authorities of that other Party by its national laws or regulations.</u> (Underlined in original)

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[183] Cameron and Tomlin, *The Making of NAFTA* at 164 (cited in note 2).

[184] John T. Woolley and Gerhard Peters, The American Presidency Project [online]. Santa Barbara, CA, online at http://www.presidency.ucsb.edu/ws/?pid=21317 (visited on Jan. 9, 2010).

[185] Facsimile letter from Andres Rozental to Lawrence Eagleburger dated Oct. 6, 1992, attached to Facsimile transmission sheet from Robert Morley, National Security Council, to Ambassador John Negroponte. George Bush Presidential Library, Charles Gillespie, Folder CF 01377, Box 4.

Further, Rozental advised Eagleburger "[i]t's our understanding that the Department of State representatives to the NAFTA final scrub talks in Washington have objected to this text, whereas all other parties to the negotiations agree."

Interestingly, senior members of the U.S. and Mexican negotiations teams do not recall this issue being raised at the eleventh hour.[186] Nor were they aware the Mexican foreign affairs minister and his deputy had contacted Eagleburger regarding specific NAFTA provisions.[187] This type of contact was certainly unusual and outside of the long-established NAFTA negotiation process between the two countries. The Bush White House records on NAFTA do not indicate the outcome of this last minute appeal to the State Department. However, a review of the final version of NAFTA's Scope Provision does not contain the text requested by Rozental.

To further investigate the outcome of this event, the author interviewed the former Deputy Foreign Minister to find out the background to his memo. Rozental was a career diplomat for over thirty-five years having served Mexico as Deputy Foreign Minister during the Salinas administration, Ambassador to Sweden (1983-88), and Permanent Representative of Mexico to the United Nations in Geneva (1982-83). In addition, Rozental was appointed to the lifetime rank of Eminent Ambassador of Mexico in 1994.

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[186] Telephone interviews with Charles (Chip) Roh, partner, Weil Gotshal, and former Deputy Chief U.S. Negotiator for NAFTA, in Washington, D.C. (Dec. 9, 2009); and Guillermo Alvarez Aguilar, partner, Weil Gotshal, and former Chief Counsel for Mexico, NAFTA drafting and negotiation team, in New York, New York (May 15, 2009).

[187] Telephone interview with Andres Rozental, in Mexico (Dec. 28, 2009). Ambassador Rozental noted that the Mexican Foreign Ministry had the primary responsibility for the preamble and closing section of NAFTA, and he acknowledged that there was process gap in reviewing the text between his department and the Mexican commerce department that was handling the final text of the treaty. In fact, the Foreign Ministry had not seen the final draft until a few days before the initialing ceremony in San Antonio. This is the reason for the last minute appeal to the U.S. State Department, without knowledge of drafting teams, even though the negotiations had concluded.

As Ambassador Rozental explained, his memo to Eagleburger was prompted by the actions of the U.S. Supreme Court and federal officials in the case of *Alvarez-Machain*.[188] This famous case involved the death of an undercover agent of the U.S. Drug Enforcement Agency (DEA), Enrique Camarena, who was kidnapped, tortured and killed by Mexican drug lords in 1985. After several unsuccessful requests to the Mexican government to extradite the alleged criminals who participated in Camarena's murder, several DEA officials conspired with Mexican nationals to bring in a physician, Dr. Humberto Alvarez-Machaín, who was accused of aiding the murderers in the torture of Camarena, to the U.S. for trial.[189] In 1990 he was kidnapped in Guadalajara and flown in a private plane across the border to Texas to face criminal prosecution.[190]

This incident set off a major diplomatic crisis between the two countries during the Bush Administration. Mexico firmly denounced the DEA's actions as a violation of its sovereignty and international law. In fact, President Salinas describes it as an event that "caused tremendous tension in the Mexican-U.S. diplomatic relationship" and "[t]he crisis was so severe it nearly derailed the free trade negotiations."[191] The U.S. refused to return Alvarez-Machaín to Mexican authorities and the tension climaxed when, in 1992, the U.S. Supreme Court ruled the DEA did not violate extradition laws and allowed the federal government to continue its prosecution of the defendant.[192] Back in Mexico, the

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[188] Rozental interview (cited in note 187).

[189] *United States v Alvarez Machaín*, 504 U.S. 655 (1992).

[190] Id.

[191] Salinas, *Mexico* at 59 (cited in note 1).

[192] *U.S. v Alvarez-Machaín*, 504 U.S. 655 (1992). The case was remanded for trial which resulted in the trial court dismissing the charges after a full trial in 1993. This dismissal did not end the litigation related to the abduction of Alvarez-Machain. He later filed a civil action against the U.S. and the individuals who

court decision infuriated Salinas, and he countered with imposing unprecedented restrictions on the DEA's activities in Mexico that virtually required his government's approval on any of their movements within his borders.[193] In his view, "[i]t was incomprehensible that members of a U.S. agency should create tension in the bilateral relationship, precisely when Mexico was about to begin a strategic revision in [its] policy regarding the United States."[194]

In addition to the DEA restrictions, Mexico insisted all bilateral agreements with the U.S. include the provision indicated in Rozental's letter. It was their attempt to restrict the U.S. from engaging in unauthorized operations within their borders in total disregard of Mexico's sovereignty and laws. Although the proposed provision was not included in the final text of NAFTA, Ambassador Rozental recalls that subsequently there was an exchange of diplomatic communications between the two countries to resolve this issue.[195] Also, President Bush and his successor "sent personal letters promising not to permit, encourage, or tolerate their agents to repeat such acts."[196] The prohibition on cross-border kidnapping was formalized in a 1994 extradition treaty between the two countries.[197]

This is an important event relevant to NAFTA and its Chapter 11 dispute

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abducted him seeking damages for personal injuries sustained during his abduction. Years later, the civil case was appealed to the U.S. Supreme Court.

[193] Salinas, *Mexico* at 60 (cited in note 1).

[194] Id.

[195] Rozental interview (cited in note 188.

[196] Salinas, *Mexico* at 136 (cited in note 1).

[197] Id.

settlement system. Not only did the *Alvarez-Machain* case nearly sidetrack the NAFTA negotiations, but also it clearly shows how other political issues can impact economic transactions such as trade negotiations. Prior to NAFTA, investors who had a claim against a member state other than their own state of residence had basically two options. First, they could engage in an expensive and time-consuming effort to convince their state to take up their cause and file a claim against the other member state. Or, investors were left with recourse of litigating the matter in the national courts of the offending state. In the former scenario, national bias and inflammatory public sentiments could prompt the investor's state to decline filing a claim because it could disrupt the sensitive diplomatic relationship or negotiations between the two states in a crisis, such as in the *Alvarez-Machain* case. Moreover, the investor may not be afforded unbiased or impartial justice before a foreign jury or judge who may be susceptible to negative publicity regarding the investor's home state. NAFTA's Chapter 11 is intended to pull investor-state claims out of the mercurial world of international politics and tensions so investors could seek a fair adjudication of their claims. As will be discussed further in Chapter Seven, recent sugar cases decided by Chapter 11 tribunals highlight how NAFTA sidesteps politics to bring final resolution for investors.

Despite the last minute drama related to the *Alvarez-Machain* case, on October 7, 1992, President Bush, Prime Minister Mulroney, and President Salinas stood proudly behind each of their respective trade ministers as they initialed the 2,000-page draft legal text.[198] The timing of this signing was not lost on anyone, including the other heads of

[198] Martin Crutsinger, *Bush Marks Free Trade Pact in Texas Ceremony*, New Orleans Times Picayune A21 (Oct. 8, 1992).

state.[199] It was less than a month away from Election Day and the Bush campaign was basking in the limelight of this significant achievement. Several major events occurred during this key week of the 1992 presidential election campaign: the three neighboring states celebrated the conclusion of the NAFTA negotiations, the three major presidential candidates (Bush, Clinton and Perot) debated each other on national television, and Governor Clinton announced his final position on NAFTA.

5.14 A Peanut Farmer Prompts Governor Clinton to Announce His Qualified Support of NAFTA

For most of the campaign, then-Governor Bill Clinton refused to commit to a definitive position whether to support or oppose NAFTA. He was reluctant to support the agreement from fear of causing a backlash within the Democratic Party's rank and file.[200] Since his personal issues had become the subject of daily media attention, Clinton tried to avoid any additional controversies prior to Election Day.[201] Each day his foreign affairs and economic advisors implored him to publicly state his support of NAFTA. The agreement was seen as opening the trade and financial markets in Mexico and to a lesser

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[199] Salinas, *Mexico* at 145 (cited in note 1). "I knew [the trade minister signing]," Salinas explains, "was an event that played into the electoral strategy for Bush's re-election. I also knew that in view of the signs of his eventual defeat at Clinton's hands, the new tactics of the NAFTA opponents, in Mexico as well as in the United States, were based on denigrating the negotiations and marketing them as a supposed campaign tactic to favor Bush. They wanted to provide an adverse reaction to the agreement in Clinton" Id.

[200] Editorial, *Clinton and Trade*, Christian Science Monitor 20 (Oct. 8, 1992).

[201] Clinton faced multiple issues concerning his character, including allegations of an affair with Gennifer Flowers, inhaling from a marijuana joint but not exhaling, and dodging the draft during the Vietnam War. See generally Andrew Rosenthal, *Bush Assails Clinton's Patriotism During the Vietnam War Protest Era*, N.Y. Times, Oct. 8, 1992, at A1; and *The Sleaze Factor*, N.Y. Times A22 (Aug. 5, 1992).

extent in Canada, which was already operating under CUSTA. It was also expected to spur a significant economic growth in the U.S. Despite the trade studies and economic forecasts, Clinton required more information and time to deliberate on the impact of the trade agreement.

In response to strong anti-NAFTA criticisms from labor unions and environmental groups, Robert Pastor, Ph.D., a Clinton advisor on international affairs and former director of Latin American and Caribbean Affairs on the National Security Council in the Carter Administration, had been working on the idea of side agreements for labor and environmental issues as early as March 1992.[202] Pastor had been advising the campaign through Clinton's two principal foreign policy advisors—Tony Lake and Sandy Berger, and he also was visiting Mexico regularly. On most visits, he met with the Mexican president, who was a friend from the time that both had attended the Kennedy School of Government in the early 1970s.[203]

At a meeting in the spring of 1992, at Salinas's request, Pastor provided an assessment as to the likelihood of the Democratic Presidential candidate supporting NAFTA. He told Salinas the candidate was most likely to be Bill Clinton, and that Clinton would face cross pressures from unions and environmentalists who would lobby against NAFTA, and from key opinion-makers who would argue in favor. Pastor thought that Clinton would eventually lean in favor because it would be hard to look presidential and protectionist at the same time.

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[202] Faculty profile of Professor Robert Pastor, Ph.D., online at http://www.american.edu/sis/faculty/rpastor.cfm (visited on Dec. 4, 2009) Pastor is currently a professor of international relations and co-director of the Center for North American Studies and the Center for Democracy and Election Management at American University in Washington, D.C.

[203] Telephone interview with Professor Robert Pastor, in Washington, D.C. (Mar. 17, 2009).

Pastor said he was not authorized to speak for the candidate, but in his judgment, a Democratic President would need to adjust the agreement—perhaps with additional or side agreements—to assuage the concerns of labor and the environment. He asked Salinas if these would be acceptable. Salinas said he did not think any such agreements were needed, but if these were required to get approval, and if they were fair, reciprocal, and not onerous, he would probably accept them. When Pastor returned to Washington, he reported to Sandy Berger, and worked with him to develop two options for Clinton, both based on support for NAFTA. The first option would be that he would support NAFTA and ask for two side agreements. The second option would be support on the condition that two side agreements were included. Both Pastor and Berger supported the first option, which would not require re-negotiation of NAFTA, and would be easier for both Mexico and Canada to accept. They worked on the speech together that was eventually given at North Carolina State University.

But Clinton resisted taking a position for as long as he possibly could. According to President Salinas's autobiography, he met with Henry Cisernos, his former Harvard classmate and a close advisor to Clinton, regarding the Governor's decision to support NAFTA on October 3, 1992 (two days before Clinton's speech at North Carolina State).[204] Although the press was notified Clinton was going to publicly announce his support of NAFTA in his upcoming speech, he was still not completely convinced this was the way to go. Pastor recalls a telephone call Clinton made to former President

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[204] See also John Maggs, *Mexico Opens Door To Clinton Proposal*, J. Commerce 3A (Oct. 13, 1992). According to news reports, "Mr. Salinas has said repeatedly that the proposed North American free-trade pact will not be renegotiated, but at a business conference in Hot Springs, Va., he said any final decision would have to wait until after Election Day. 'Wait for the Americans to decide . . . until after Nov. 3,' he told reporters." Id.

Carter that symbolized his deep inner conflict regarding the agreement.[205] As Clinton was studying the various reports and data regarding the potential impact of NAFTA the night before his North Carolina speech, he briefly read about the potential adverse impact the trade agreement may have on U.S. peanut farmers. In his mind, this issue could have served as one of the reasons for not endorsing NAFTA at that time. He immediately called former President Carter to discuss his concerns about peanut farmers.

Carter was a strong supporter of free trade agreements, and as early as 1991, he co-authored with Pastor, who was his former NSC advisor and Senior Fellow at the Carter Center, an op-ed in favor of NAFTA. [206] He was also familiar with the peanut issue because Pastor, had previously briefed him on it and, as a result, Carter wrote a short article in a south Georgia newspaper to explain why peanut farmers should not oppose NAFTA. Carter had taken some heat from his fellow south Georgian farmers, but he felt the agreement was worth the political cost. If Clinton thought he was going to be able to finagle his way out of supporting NAFTA, Carter, who was more knowledgeable about this issue than Clinton, did not give him any room to back away from it. After he

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[205] Pastor interview (cited in note 203).

[206] Jimmy Carter and Robert Pastor, *Fear and Confidence*, Baltimore Sun A8 (May 14, 1991). In arguing that the benefits of NAFTA outweighs the cons, the authors concluded that.

> Our concerns about human rights and democracy in Mexico are legitimate, but our views are likely to become more influential as our economies and societies begin to integrate under a NAFTA.
>
> If we worry about instability in the Persian Gulf or poverty in Africa, think for a moment of the impact on the U.S. of instability and continued economic deterioration in Mexico. The consequences for America would be grave.
>
> Our country has always stood for inclusion and justice. We are at our best when we welcome outsiders and when we strive to ensure that the benefits of unity are shared. The North American Free Trade Area offers us an unprecedented opportunity to welcome a neighbor into a wider community, and to work with Mexico and Canada to build a continental arrangement that will be the model for relations between rich and poor in the 21st century.

finished his conversation with Clinton, Carter called Pastor to tell him what had just occurred. The former president went straight to the heart of the matter and said "if Clinton wants to be in the White House, he has to look at these issues from a national level and not focus only on peanut farmers in Georgia."[207]

The following day, Clinton appeared before a large audience on the North Carolina State University campus and announced his support for NAFTA. He immediately told the crowd, "I came here today to tell you why I support the North American Free Trade Agreement." These words encouraged President Salinas and his negotiation team. They now knew what was Clinton's official position toward NAFTA and regardless of the presidential election outcome, Mexico was optimistic that all member states would eventually ratify the agreement.

The second item in the speech that elated the Mexican government was Clinton's statement regarding not renegotiating the agreement, although he believed the agreement was deficient and required supplemental agreements, [208] Clinton did acknowledge "we can address these issues without renegotiating the basic agreement."[209] He also reflected on the positive policy implications of NAFTA. To drive home the point regarding the importance of NAFTA, Clinton reminded the attendees, "whether the North American Free Trade Agreement is a good thing for America is not a question of foreign policy, it is a question of domestic policy. If we are not strong at home, we will inevitably be

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[207] Pastor interview (cited in note 203).

[208] Gwen Ifill, *The 1992 Campaign: The Democrats; With Reservations, Clinton Endorses Free-Trade Pact*, N. Y. Times A1 (Oct. 5, 1992).

[209] Id.

weaker abroad,"[210]

Clinton's speech had its critics, including President Bush and USTR Carla Hills. "Once upon a time he said he was for NAFTA," Bush told a rally on his campaign road trip. "Then the labor bosses told [Clinton] they were against it, so he said he wasn't sure he was for it or against it. Now he's looked at the polls and he sees the American people want NAFTA, so just yesterday he said he's for it. He saddled his support with all kinds of reservations and qualifications," Bush said.[211] Similar to Salinas's position regarding existing arrangements between the two countries, Hills said the "'omissions' Clinton identified already had been alleviated by the agreement, which is the product of more than a year of negotiation by Bush administration officials."[212] In the end, Clinton achieved his goal of publicly supporting NAFTA and assuaging concerns related to labor and environmental issues.

5.15 The Signing of NAFTA (December 1992)

On November 4, 1992, the Bush administration's hope for a second term quickly faded away. Clinton successfully pulled together the Democratic voter base and, with a little help from Perot who lured some voters away from Bush, he garnered 370 electoral

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[210] J. Jennings Moss, *Clinton Endorses Treaty on Trade with Conditions*, Washington Times A5 (Oct. 5, 1992).

[211] *Bush Says Clinton Waffles*, Albany Times Union (NY) A6 (Oct. 6, 1992).

[212] Ifill, *The 1992 Campaign* (cited in note 208).

votes to 168 for Bush.[213] The popular voting results show Clinton received 44,908,254 votes (43.2% of the total popular votes) compared to 39,102,343 (37.6%) for Bush and 19,741,065 (19%) for Perot who received no electoral votes.[214] America elected a new president on January 20, 1993, which marked a significant change in the remaining phase to ratify NAFTA .

Clinton was now the president-elect, but he would have to wait until January 20, 1993 to assume the office of the presidency. Under the U.S. Constitution, Bush was still the president of the United States and was fully authorized to continue his policies until Clinton was sworn into office. Bush knew he only had a short period of time remaining to finalize the agreement. The NAFTA negotiators understood the significance of completing the final agreement before the end of Bush's term. It would be the ultimate recognition of his enormous effort, inspiration and contribution in turning a dream into reality. The negotiators aggressively refined the agreement until it was ready for final signature. On December 17, 1992, the three heads of state signed the final agreement in their respective national capitols. In a ceremony held at the Organization of American States headquarters in Washington, D.C., as a symbol of extraordinary opportunity for the hemisphere, President Bush put his pen to paper and signed the North American Free Trade Agreement marking a new era of cooperation within the region.

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[213] U.S. National Archives and Records Administration, U.S. Electoral College, 1992 President Election Results, online at http://www.archives.gov/federal-register/electoral-college/scores.html#1992 (visited on Dec. 5, 2009).

[214] Id.

5.16 NAFTA Opposition Galvanizes and Clinton Faces a Contentious Fight with Congress for Ratification

The negotiation and signing of the final version of NAFTA in December 1992 was a major hurdle before it could be sent to Congress for ratification. Because of the change of the American president, the ratification process became complicated with the drafting of the labor and environmental side agreements. The focus of this study is the development and negotiation phase of NAFTA and its Chapter 11 investor-state dispute settlement mechanism and is not intended to delve into NAFTA's final phase of ratification and the development of side agreements. The latter topic is covered extensively in existing NAFTA literature. This section will only provide a brief overview of the significant issues leading to the ratification.

There were several key pros and cons for Mexico and Canada in the election of Bill Clinton as U.S. President. First, they were pleased that Ross Perot was not elected. This event alone may have lowered the anxiety levels of their national investors and tempered the exodus of foreign direct investments from their countries as a result of Perot's anti-NAFTA tirades and growing popularity in the U.S. As President Salinas indicated several times in his autobiography, the Mexican financial markets took a beating every time Perot, an "unusual character" as Salinas described him, made headlines by attacking NAFTA. For example, in June 1992 Perot went on the offensive against NAFTA. When voter polls indicated Perot was in the lead in the presidential race, "the prospect of [him] derailing our negotiations," as Salinas recalls, "caused the Mexican stock market to suffer its greatest decline since the November 1987 crash."[215]

[215] Salinas, *Mexico* at 135 (cited in note 1).

In addition, Perot's declaration not to sign NAFTA sparked a significant wave of investments to leave Mexico.[216]

The change in the U.S. president proved to be a major disadvantage to the NAFTA negotiation teams. If Bush had been reelected, cabinet officials strongly believed, Congress would have ratified NAFTA by February 2003.[217] Bush and his team expended an enormous amount of time, energy, and chits negotiating the final agreement with Congress and various interest groups by December 1992. They had paved the road toward ratification through their relationships and negotiations over the course of two years. Perhaps most importantly, Bush would not have agreed to, nor would he have probably needed, the side agreements to get NAFTA ratified. A new administration with new ideas for NAFTA meant the opposition had additional time to galvanize their positions and the fight to ratify would continue for almost another eleven months while the teams were bogged down with the side agreements.[218]

Since the side agreements were part of his political compromise for NAFTA during the election campaign, President Clinton faced the challenge of negotiating them with a hostile Congress and a different negotiating team. The political science literature on the early Clinton White House years indicates the President experienced bitter political battles with Congress as interest groups reorganized into more powerful and effective advocates. These groups gained momentum with key congressional leaders in a way they were unable to do under the prior administration.

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[216] Id.

[217] Hills interview (cited in note 4).

[218] Id. See also William P. Avery, *Domestic Interests in NAFTA Bargaining*, 113 Political Science Quarterly, 281, 300 (1998).

Clinton spent significant political capital in his first year in office. He also had to agree to costly political deals as the price for the side agreements.[219] It is estimated that all of the special appropriations and grants allocated to the districts of congressmen who voted for NAFTA "cost taxpayers as much as $50 billion."[220] Regardless of the total value of political deals cut by Clinton, the side agreements did not establish any legal norms and lacked the "teeth" to effectively enforce violations against offending states.[221] The final text contains general provisions obligating the member states to maintain high standards, but they leave it to the states to adopt and enforce its own labor and environmental laws.[222] The primary remedy for violations of important labor rights is a "consultation" between the member states.[223] Ambassador Hills still points out these agreements do not, in essence, provide more protection than the agreements that existed between the parties prior to NAFTA.[224]

During the last days before the congressional vote on ratification in November 1993, key NAFTA opponents claimed they had the votes to defeat it. But the White House went on the offensive to confirm congressional votes and also to change public opinion regarding NAFTA, including holding a debate on CNN between Vice President

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[219] Avery, Id at 301, 303

[220] Sarah Anderson and Ken Silverstein, *Oink, Oink*, Nation 752 (Dec. 20, 1993).

[221] The side agreements are perceived to be weak compared to the proposed enforcement provisions initially drafted for the agreements. At one point of congressional debates, Senator Max Baucus (D-Montana) stated: "Without trade sanctions as a last resort … NAFTA is not in this country's best interest. Simply put: No teeth, no NAFTA. The threat of sanctions is a necessary deterrent." Mayer, supra note 139.

[222] Anderson and Silverstein, *Oink, Oink* (cited in note 220).

[223] Jack Garvey, *Trade Law and Quality of Life--Dispute Resolution under the NAFTA Side Accords on Labor and the Environment*, 89 AJIL 439, 443 (1995).

[224] Hills interview (cited in note 4).

Al Gore and Ross Perot.[225] Clinton even thrust three former presidents before the public to show their support for NAFTA.[226] After a brutal battle to garner the requisite number of congressional votes in favor of the agreement, on November 18, 1993 the House of Representatives ratified NAFTA, including the side agreements. It was a close call, but NAFTA was ratified with a final count of 234 votes in support and 200 against the agreement. Finally, on December 8, 1993, President Clinton signed the North American Free Trade Act into law and the member states geared up to implement the treaty, effective January 1, 1994, to create the world's largest trade zone.[227]

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[225] Mary McGrory, *Gore Lifts NAFTA Off The Mat*, Washington Post A2 (Nov 11, 1993). Gore's performance received excellent reviews and he is credited with taking the air out of Perot's final push to convince voters against NAFTA.

[226] Keith Bradsher, *Mickey Kantor Breaks the Mold of Trade Chief Representative Splits with Some Old Allies and Forges New International Deals for the U.S*., N.Y. Times Magazine (Dec. 30, 1993); and Ann Devory, *Clinton Enlists Carter, Bush and Ford in Fight for Trade Pact*, Washington Post A1 (Sept. 19, 1993).

[227] Miller Center of Public Affairs, Remarks of President Bill Clinton on the Signing of NAFTA (Dec. 8, 1993), online at http://millercenter.org/scripps/archive/speeches/detail/3927 (visited on Jan. 9, 2010).

CHAPTER 6

NAFTA CHAPTER 11 DISPUTE SETTLEMENT SYSTEM

6.1 Overview of Political and Historical Influences on the Development of the Investor-to-State Arbitration Process Under NAFTA

Generally, free trade agreements provide great potential economic opportunities for participating states, but these agreements obviously are subject to a significant amount of politics and negotiations.[1] NAFTA went through a similar approval process as other free trade agreements in the U.S., except that it captivated the general public's interest, which resulted in even more intense negotiations and a public relations blitz. A primary purpose for NAFTA was to increase trade between Canada, Mexico, and the United States. In August 1992, the three states issued a Synopsis of the then-proposed agreement in which they expressed their "commitment to promoting employment and economic growth in each country through the expansion of trade and investment opportunities in the free trade area and by enhancing the competitiveness of Canadian, Mexican and U.S. firms in global markets …."[2] NAFTA eventually became the largest

[1] Daniel Drache, *The Limits of Trade Blocs in International Regulatory Competition and Coordination: Perspectives on Economic Regulation in Europe and the United States*, in *International Regulatory Competition*, eds., William Bratton, Joseph McGeary, Sol Picciotto, et al., 420-21 (Oxford University 1996).

[2] Canadian Department of Foreign Affairs and Investment Trade. Synopsis of the Proposed North American Free Trade Agreement, online at www.international.gc.ca (visited Feb. 16, 2010) .

free trade area in the world, but is still highly controversial.[3]

NAFTA Chapter 11 is the treaty's most controversial section. Chapter 11 provides for a dispute resolution process for investor-to-state claims that was designed to accomplish two key goals.[4] Foremost, the member states sought to force regional integration by the establishment of a compulsory system to encourage member states to comply with the most favorable nation status requirements under NAFTA. The other key goal was to protect the investment of private investors from expropriation, nationalization or unfair national treatment by the member states. An unintended consequence of this goal has been to highlight the substantial and substantive powers exercised by private actors in global governance.

The NAFTA investor-state dispute settlement mechanism marks a significant departure in several aspects from the traditional multinational or bilateral trade agreements that only allow state-to-state claims.[5] First, Chapter 11 provides private investors with a legal cause of action directly against states for economic harm to their investments due to a state's economic policies, legislation, or regulatory action.[6] Second, it also compels states to enter into this dispute resolution process without affording states

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[3] Speech by Robert B. Zoellick, former U.S. Trade Representative at the National Foreign Trade Council, Washington, D.C. (Jul. 26, 2001). http://www.ustr.gov (visited June 3, 2002). See also *The North American Free Trade Agreement: Five Years, Three Countries, One Partnership* (U.S. Government 1998) , online at http://www.ustr.gov (visited Jun. 15, 2002). The U.S. government estimates that during NAFTA's first five years, there was a $93 billion export growth which constituted two-fifths of the growth in U.S. exports to the world. Id.

[4] North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 605, 639-49 (1993) [hereinafter NAFTA]. Art. 1115.

[5] United Nations, *Investor-State Dispute Settlement and Impact on Investment Rulemaking* (2007). See also Drache, *The Limits of Trade Blocs* at 418 (cited in note 1).

[6] Ari Afilalo, *Constitutionalization Through the Back Door: A European Perspective on NAFTA's Investment Chapter*, 34 N.Y.U. J. Int'l & Pol.1,3 (2001).

the option to deny the claim. Furthermore, Chapter 11 allows the parties to appoint a three-member panel of arbitrators. The private investor has the sole discretion for selection of one arbitrator and input in the selection of the presiding arbitrator. Ultimately, the panel is empowered to review the claim and to rule whether to deny the claim or grant a monetary award in favor of the claimant.

Historically, regional trade agreements stipulated member states must treat trade from each other with most favorable nation status, and an aggrieved state could bring a claim against another state.[7] However, the traditional agreement contained no provision for aggrieved private investors to bring claims directly against states for their actions against investors, including national policies and regulatory enforcement.[8] Nor did the agreements require a state to submit itself to arbitration with private investors without its consent.[9]

Typically, only states have legal "standing" to bring a claim against another member state on behalf of itself or its citizens.[10] For example, Mercosur, the trade agreement between Argentina, Brazil, Paraguay and Uruguay, has a traditional dispute

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[7] Michael Hart and William Dymond, *NAFTA Chapter 11: Precedents, Principles, and Prospects* (paper presented at the NAFTA Chapter 11 Conference held at Carleton University, Canada, Jan. 16, 2002), online at http://www.carleton/ca/ctpl/chapter11/ (visited Oct. 3, 2002).

[8] Id. See also Lorraine Eden, *The Emerging North American Investment Regime*, 5 Transnational Corporations 61-98 (1996).

[9] See Antonio R. Parra, Deputy Secretary-General of the International Centre for Settlement of Investment Disputes, *Applicable Substantive Law in ICSID Initiated Under Investment Treaties*, Paper delivered at the 17th Joint ICSID/American Arbitration Association/ICC Court Colloquium on International Arbitration held in Washington D.C. (Nov. 10, 2000), online at www.worldbank.org/icsid/news/n-17-2-5.htm (visited Nov. 6, 2002).

[10] Christopher Wilkie, *The Origins of NAFTA Investment Provision: Economic and Policy Considerations*, 20 (January 16, 2002)(Paper presented at the NAFTA Chapter 11 Conference held at Carleton University (Canada). http://www.carleton/ca/ctpl/chapter11/ (visited Oct. 3, 2002). The legal term "standing" is defined as "the legal right of a person or group to challenge in a judicial forum the conduct of another especially with respect to governmental conduct." Barron's Law Dictionary (1984).

settlement system.[11] In 1991 these countries agreed to establish a "common market of the southern cone of the Western Hemisphere."[12] This agreement was intended to facilitate the total integration of Latin America consistent with the objectives of the Montevideo Treaty in 1980.[13] Under Annex III of the Mercosur, any disputes between the member states are settled under a dispute settlement system for the common market.[14] This treaty does not provide private investors with a legal right directly against the member states.[15]

Another example of a traditional dispute settlement system is Chapter 19 of the Canada-U.S. Free Trade Agreement (CUSTA) that was ratified by the two states in

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[11] According to Article 1 of this treaty, the parties decided to establish a common market called Mercosur which is a contraction of the Spanish words "mercado" (market) and "sur" (south). Treaty Establishing a Common Market between the Argentine Republic, the Federal Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay (Mercosur), online at http://www.sice.oas.org/trade/MRCSR/treatyasun_e.asp#CHAPTER_I (visited Feb. 24, 2010).

[12] Id.

[13] The Preamble to MERCOSUR states:

> CONSIDERING that the expansion of their domestic markets through integration is a vital prerequisite for accelerating their processes of economic development the social justice,
>
> BELIEVING that this objective must be achieved by making optimum use of available resources, preserving the environment, improving physical links, coordinating macroeconomic policies and ensuring complementarily between the different sectors of the economy, based on the principles of gradualism, flexibility and balance,
>
> BEARING IN MIND international trends, particularly the integration of large economic areas, and the importance of securing their countries a proper place in the international economy'
>
> BELIEVING that this integration process is an appropriate response to such trends,
>
> AWARE that this Treaty must be viewed as further step in efforts gradually to bring about Latin American integration, in keeping with the objectives of the Montevideo Treaty in 1980,
>
> CONVINCED of the need to promote the scientific and technological development of the States Parties and to modernize their economies in order to expand the supply and improve the quality of available goods and services, with a view to enhancing the living conditions of their populations,
>
> REAFFIRMING their political will to lay the bases for increasingly close ties between their peoples, with a view to achieving the above-mentioned objectives.(Capitalized in original). Id.

[14] Id.

[15] Id.

1988.[16] Under this system, a member state was the only party authorized to bring a claim against the other state. During the negotiations of the initial draft of NAFTA in 1991, Mexico proposed the treaty contain an investment dispute settlement mechanism similar to CUSTA's Chapter 19 state-state dispute settlement system. USTR officials were challenged to reconcile the United States' opposition to adopt a dispute settlement system like that of Chapter 19, which provides for a binding binational panel review with its "insistence upon an investor-state dispute settlement mechanism in the investment provisions of NAFTA."[17] They believed that Chapter 19 proceedings focused on "whether a State has acted consistently with its own domestic law[, which was] arguably a much greater intrusion on national sovereignty."[18] Under NAFTA's investor-state mechanism, the central question is "whether the State has acted consistently with a treaty or an investment contract with an investor."[19]

The U.S. strongly pushed for the investor-state arbitration model for several reasons. First, an investor's claim against a state raises the issue "whether a sovereign has observed its treaty or contractual obligations with a foreign investor, which can involve national courts in politically sensitive matters."[20] Thus, this situation resulted in a "more compelling need for a forum that is separate from the State whose actions are

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[16] Id.

[17] Email of Daniel Price, USTR Deputy General Counsel, to Charles (Chip) Roh, Deputy Chief U.S. Negotiator for NAFTA, Subject line: "19/disp. Settlement" (Dec. 13, 1991, 12:48 (EST)). National Archives, USTR Computer Group, DGMAIL, Price.Dan.911213.01.

[18] Id.

[19] Id.

[20] Id.

called into question."[21] Second, CUSTA's Chapter 19 was intended to provide "the two parties comfort that national administrative proceedings are conducted in accordance with national law."[22] On the other hand, the investor-state dispute system was intended to:

- provide a neutral forum for deciding disputes about the interpretation of the treaty provisions (not national law); and
- allow investors the option, as an alternative to court, of referring to neutral arbitration disputes arising from investor- state investment contracts (such as joint ventures).[23]

USTR officials felt the nature of matters to be reviewed by the arbitration panels would focus on a state's conformity with treaty rules and they would "never determin[e] whether the state has followed its own law."[24]

6.2 The American Public's Negative Reaction to NAFTA

There are several significant political reasons for the creation of the investor-to-state dispute settlement mechanism. As the agreement was being negotiated in 1991 and 1992, several interest groups opposed NAFTA, including environmentalists who viewed

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[21] Email of Price to Roh, Dec. 13, 1991(cited in note 17).

[22] Id.

[23] Id.

[24] Id. Price advised Roh that:

> [w]e cannot accept the precedent of dropping the investor-state arbitration provision from the NAFTA; it is critical to our investment community, and Mexico should realize it would harm investment to refuse such provisions. If Mexico really wants a chapter 19, then Mexico will have to revise its law and provisions for judicial review of its law to be comparable to what we provide in our law, as was done in the CFTA process. Id.

the strong push for a free-trade zone as the beginning of "a race toward the bottom" for environmental standards related to factories along the U.S.-Mexican border.[25] Other opponents included labor unions that feared loss of American jobs to Mexico where investors would find attractive the lower wages and benefits earned by Mexican workers.[26]

As a former senior U.S. Labor Department official explained, the NAFTA negotiations prompted many special interest groups to decry the agreement as detrimental to U.S. workers, and they blamed every negative labor issue on NAFTA.[27] These groups were concerned about Americans losing their jobs to low-wage earners in the *maquiladora* of Mexico.[28] What these groups did not realize, or want to accept, was that many jobs would eventually move outside of the U.S. not only to Mexico, but to other countries such as India and China. Or, they refused to acknowledge that companies operating in the U.S., including foreign-owned subsidiaries, could close their factories or eliminate jobs for reasons unrelated to NAFTA. In one case, NAFTA was blamed for the closure of a Japanese-owned manufacturing plant in the U.S. even though NAFTA had

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[25] Amy Skonieczny, *Constructing NAFTA: Myth, Representation and the Discursive Construction of U.S. Foreign Policy*, CIAO (paper presented at the International Studies Association Annual Convention, Mar. 14-18, 2000), online at www.ciaonet.org (visited Nov. 26, 2002).

[26] Thomas R. Donohue, an executive of the AFL-CIO, argued that "[a]mong those who would suffer the most from NAFTA are industrial workers in the United States. It would pave the way for tens of thousands of their jobs to be exported to Mexico…" Thomas R. Donohue, *The Case Against a North American Free Trade Agreement*, Columbia J. World Bus. 93 (1993).

[27] Interview with Oliver Quinn, in Newark, N.J. (Nov. 16, 2009). Mr. Quinn is a former Deputy Solicitor of Labor for the U.S. Department of Labor during the Clinton Administration when the labor side agreement to NAFTA was negotiated in 1993.

[28] See generally Statements of Rep. Luis V. Gutierrez (D-IL), Hearing Before the Committee on Banking, Finance and Urban Affairs, House of Representatives, *Financial Services Chapter of NAFTA*, Sept. 28, 1993 (Serial no. 103-71) (GPO 1994).

nothing to do with the foreign parent company's decision to shut down the facility.[29]

As previously mentioned, NAFTA also became a lightning rod for controversy during the U.S. presidential election of 1992. [30] Ross Perot, the independent candidate and staunch opponent of the free trade agreement, initiated a media campaign against it and complained of a potential "giant sucking sound going south" which symbolized the exodus of U.S.-based jobs to Mexico.[31] NAFTA opponents used this phrase throughout the campaign to sway public opinion against the agreement.

6.3 Mexico's History of Expropriation Solidifies the Need for a Strong Investor-State Dispute Settlement Mechanism

The less publicized, but equally important, underlying political reason for Chapter 11 was the common belief among U.S. and Canadian negotiators that Mexico would not abide by the terms of the treaty during a recession or national economic crisis.[32] They were concerned Mexico would nationalize or expropriate the investments of American

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[29] Sam Howe Verhovek, *Tire Factory Shuts Doors in Dispute Over Safety*, New York Times, A16 (Apr. 20, 1994). In response to a fatality and several injuries to employees at a tire-manufacturing factory, then-Labor Secretary Robert Reich personally traveled to Dayton Tire's Oklahoma facility to issue a citation to Dayton Tires for its alleged willful violation of safety rules. The Secretary also held a press conference on that same date to highlight the aggressiveness of the Clinton Administration in cracking down on poor work conditions. Dayton Tire was a subsidiary of the Japanese-owned Bridgestone-Firestone company. The Japanese owners were offended by the manner that the Labor Department had handled this matter in the media, and they made a decision less than two days later to shut down the plant in response to Reich's visit and press conference.

[30] Donohue, *The Case Against a North American Free Trade Agreement* at 93 (cited in note 26).

[31] *Transcript of Second Television Debate Between Bush, Clinton and Perot*, N.Y. Times A11 (Oct. 16, 1992).

[32] Another major political reason for this type of system has been attributed to the American intent to increase the bargaining power of the U.S. with Japan and Europe. Susan Strange, *Mad Money: When Markets Outgrow Government* 103 (University of Michigan 1998).

and Canadian investors as it had done to foreign investors on several occasions during the twentieth century.[33] One commentator notes "Chapter 11 was born of out efforts by the United States to protect its investors' interest in less-developed countries such as Mexico."[34] For example, Mexico nationalized the oil industry in 1938, banking in 1982, and telecommunications in 1991.[35] The nationalization of the oil industry is perhaps the most contentious expropriation by Mexico of U.S. investment in the twentieth century. In 1938, President Lazaro Cardenas led the government takeover of the oil industry as a visible symbol of Mexican ownership of its natural resources, and it served to invigorate a high level of nationalism among Mexicans.[36] Shortly thereafter, the U.S. asserted claims on behalf of American oil companies against Mexico for the loss of their property and investment.[37]

6.4 The White House Rejects OPIC's Proposal for a Modified Calvo Approach

Although official NAFTA treaty documents do not expressly discuss the expropriation concern discussed above, Chapter 11 clearly provides a remedy for

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[33] Afilalo, *Constitutionalization Through the Back Door* at 12 (cited in note 6).

[34] Id at 4.

[35] Luis Ceuto Preciado, *Negotiations and Legislative Strategies for Allowing Private Investment in Mexico's Electric Sector* (paper prepared for the Monterey Institute of International Studies, May 1, 2002), online at www.commercialdiplomacy.org/ma_projects/preciado.htm. (visited Nov. 14, 2002).

[36] Id. In 1938 Mexico nationalized the portion of the oil industry owned by American and British investors. During the following year, the ruling political party, the Mexican Revolutionary party, approved a proposal for complete nationalization of Mexico's oil industry. *Oil Plan wins in Mexico: Nationalization Proposal Backed by Official Party's Assembly*, N.Y. Times 7 (Nov. 3, 1939).

investors for damages incurred as a result of expropriations by a member state. It is also evident in recently declassified White House documents that senior officials were concerned about Mexico's history of favoring expropriation, and they insisted on having an effective investor-state dispute settlement mechanism in NAFTA. Another underlying political concern for requiring investor-to-state arbitrations focused on Mexico's consistent adherence to the "Calvo Doctrine," holding that international trade disputes should be resolved in national courts.[38] Mexico has long objected to foreign investors litigating their investment-related claims against states in international tribunals instead of local courts.[39] On one occasion, the USTR's chief NAFTA negotiator, Julius Katz, and a senior Treasury official took a strong stance against another agency's proposal that deviated from the Bush Administration's objective for a strong dispute settlement provision in NAFTA.[40]

During the NAFTA negotiations in 1991, the Overseas Private Investment Corporation (OPIC) was negotiating a separate investment incentive agreement with Mexico, but they were at an impasse as to the type of dispute settlement mechanism that

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[37] Cordell Hull, *Memoirs of Cordell Hull: Volume I*, 610 (Macmillan 1948).

[38] The Calvo Doctrine is named after Carlos Calvo who was an Argentinean judge in the 1800s who advocated that:

> national courts should have exclusive jurisdiction over investor disputes. The Calvo clause stated that no international tribunal or other foreign intervention would interfere with the national judge's application of law in disputes involving foreign investors. Of course, the national judge would apply the domestic law of the regulating state and not the international investment law that the United States advocated. Id at 16.

[39] Wilkie, *The Origins of NAFTA Investment Provision* at 21 (cited in note 10).

[40] Memorandum of Fred M. Zeder to William T. Pryce, dated Nov. 27, 1991, regarding "OPIC Agreement with Mexico." George Bush Presidential Library document no. CF01379.

would be required under the agreement.[41] Not surprisingly, Mexico was reluctant to commit to an arbitration system that was final and binding on them without recourse to their national courts. Several months later, the then-Chief Executive Officer of OPIC, Fred Zeder, had recommended to the NSC that President Bush raise with Salinas the prospect of completing the investment incentive agreement even if NAFTA were to be delayed. Katz and William Barreda, the senior Treasury official sitting on the NAFTA negotiation team, vehemently opposed Zeder's recommendation.[42]

Barreda objected to Zeder's request that Bush encourage President Salinas to resume the negotiations of the OPIC agreement because he thought any concessions to the Mexicans regarding the investor arbitration mechanism "would compromise the U.S. negotiating position on the right of investor access to international arbitration" in NAFTA.[43] Around the same time of this discussion within the White House, the U.S. negotiation team provided the first draft of Chapter 11 provision to Mexico. "The negotiation of this issue," Barreda indicated, "will be among the most delicate of the NAFTA as a result of the Mexican constitutional provision containing the 'Calvo Doctrine.'"[44] "On the other hand," he reiterated, "U.S. investors view the right to

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[41] OPIC was established as an independent agency of the U.S. government in 1971. They provide financing and sell political risk insurance to U.S. investors, contractors, exporters and financial institutions doing business today in over 130 countries. Political risk insurance can cover an investor's losses derived from currency inconvertibility, expropriation and political violence. OPIC also "promotes U.S. best practices by requiring projects to adhere to international standards on the environment and worker and human rights." OPIC, online at http://www.opic.gov/about-us (visited Nov. 10, 2009)

[42] Barreda was Deputy Assistant Secretary for Trade and Investment Policy at the U.S. Department of Treasury.

[43] Memorandum of William E. Barreda to Dr. William T. Pryce dated Dec. 5, 1991 regarding OPIC Agreement with Mexico. George Bush Presidential Library document.

[44] Id.

international arbitration as a critical component of the NAFTA."[45] In his opinion, "[a]cceptance of anything less than full rights to international arbitration by a U.S. Government agency [would] be viewed by Mexico as an indication of what [would] be acceptable in the NAFTA."[46] Therefore, he recommended to the NSC that the OPIC negotiations be delayed pending the outcome of NAFTA.

Likewise, Julius Katz expressed his concerns that reviving the OPIC investment incentive agreement would "prejudice the outcome of NAFTA, especially with regard to investor-state dispute settlement."[47] In a terse reply letter to Zeder, he unequivocally stated the U.S. was "seeking an absolute right for nationals and companies of the United States to take the government of Mexico to international arbitration should a dispute concerning their Treaty rights of investment agreement arise."[48] Although Katz acknowledged that the USTR had previously supported a "soft" dispute mechanism for Latin America, he noted the U.S. has "since determined that a 'modified Calvo' approach to dispute settlement is inconsistent with U.S. international investment policy."[49] This change was reflected when the U.S. withdrew its offer for a modified Calvo approach in the Bilateral Investment Treaty (BIT) with Uruguay. Subsequently, Argentina agreed to the investor-state model in its BIT with the U.S. that was signed in November 1991. The latter agreement would serve as the template for NAFTA's Chapter 11 dispute settlement

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[45] Id.

[46] Id.

[47] Letter of Julius L. Katz to Fred M. Zeder, dated Dec. 10, 1991, regarding "OPIC Agreement with Mexico." George Bush Presidential Library document no. 16992.

[48] Id.

[49] Id.

mechanism.[50]

A top priority of the NAFTA negotiations was to obtain strong protections for U.S. investors in Mexico. U.S. officials recognized that "[t]his [would] be extremely difficult, however, as Mexico is a strong adherent to the Calvo clause."[51] To avoid sending mixed messages to Mexico, Katz stressed the OPIC agreement must contain a strong dispute provision equal to the one in NAFTA.[52] Accordingly, he recommended the President not raise the OPIC agreement with Salinas. In the end, the OPIC proposal was denied and their agreement was tabled for the remainder of the NAFTA negotiations.

6.5 Congressional Pressure for a Strong and Effective Investor-State Arbitration System in NAFTA

There was also significant pressure from Congress for the U.S. to negotiate a strong dispute provision in NAFTA. Legislators expected the Bush Administration to take a tough stance in negotiating substantive provisions related to various industry and business sectors, but Mexico was pushing for "a small, quick package dealing primarily with tariff elimination on goods."[53] According to Rep. Newt Gingrich, the then-Republican Whip, "there was strong sentiment in House of Representatives that

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[50] Telephone interview with Guillermo Aguilar Alvarez, former Chief Counsel for Mexico's negotiation team, in New York, New York (May 15, 2009).

[51] Letter of Julius L. Katz to Fred M. Zeder, dated Dec. 10, 1991 (cited in note 39).

[52] Telephone interview with Daniel Price, former Principal Deputy General Counsel for the USTR and principal U.S. drafter of Chapter 11 (May 4, 2009).

[53] Letter of Nicholas Brady to President Bush, dated Dec. 12, 1991. George Bush Presidential Library document no. 8603.

Americans are increasingly tired of one-sided trade agreements."[54] He further noted in relation to GATT negotiations while NAFTA was pending, "[t]here is growing belief that the American negotiating position lacks firmness, toughness, and adequate technical details. … The old game of trading real concessions for theoretical future gains simply will not be acceptable to the American people or the Congress."[55] Therefore, the U.S. was determined to negotiate "a big package of substantive results (including investment, financial services, energy), which without it would not be supported by Congress."[56]

As Congress debated GATT and NAFTA, Cabinet members faced harsh and extensive questioning from legislators during numerous Congressional hearings. For example, Treasury Secretary Brady complained to Bush that his recent appearance before the Senate Finance Committee had "convinced [him] "beyond any doubt that the Democrats have a well organized plan to take down the Bush Administration by repeating words such as HOOVER, DEPRESSION, UNFAIR, HEALTH CARE etc. [*sic*]. They were repeated over and over at Senate Finance."[57] (Emphasis in Original) Undoubtedly, the fact President Bush was entering an election year had complicated any Congressional support for new trade agreements, and the partisan posturing was reflected in the comments of Democratic legislators made at public hearings.

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[54] Letter of Newt Gingrich to President Bush, dated Jan. 28, 1992. George Bush Presidential Library document no. TA005/326803.

[55] Id.

[56] Letter of Nicholas Brady to President Bush, dated Dec. 12, 1991. George Bush Presidential Library document no. 8603.

[57] Note of Nicholas Brady to President Bush, dated Dec. 14, 1991, regarding Senate Finance Hearing and NAFTA. George Bush Presidential Library document.

6.6 Private Investors' Claim for Damages Against Mexico Draws Attention of the White House and Prompts Discussion Regarding Investor Protection in NAFTA

Although there are numerous writings that discuss Congressional wrangling with the White House and legislative debate related to NAFTA, there is an interesting investor case that highlights the political pressure put on the Bush Administration to negotiate strong investor protection that is not reported in the NAFTA literature.[58] As NAFTA negotiations were pending, Senator Orrin Hatch referred a corporate constituent, the Export Group, with a pending multimillion-dollar damages claim against Mexico, to senior White House, USTR and State Department officials for prompt action. The following section discusses behind the scenes activities related to the Export Group claim, including a review of extensive unpublished documentation contained in White House files and information obtained from interviews with key participants on the U.S. and Mexican negotiations teams.

The Export Group was an international trade company based in Utah and California. They specialized in representing North American companies on an exclusive basis in the sale of commercial and industrial products to the Mexican government. In 1981, the Export Group almost won the bid for a Mexican government contract on behalf of a U.S. manufacturer of tarpaulins. Under this contract, the Mexican agency, Almacenes Nacionales De Desposito, S.A. ("ANDSA"), agreed to pay a certain sum of money to purchase a bulk supply of tarpaulins. During the bidding process, however, a

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[58] See generally Hermann von Bertrab, *Negotiating NAFTA: A Mexican Envoy's Account* (Praeger 1997); Frederick W. Mayer, *Interpreting NAFTA: The Science and Art of Political Analysis* (Columbia 1998); and George W. Grayson, *The North American Free Trade Agreement: Regional Community and New World Order* (University Press of America 1995).

corrupt ANDSA official divulged Export Group's bid to a Mexican Coffee Institute (MCI) agent and a Mexican agency official, and they both conspired to submit a lower competing bid. These individuals used this inside information to submit the lowest bid to sell the same tarps, through a shell company, that enabled it to be awarded the contract. The Export Group sued all the participants, including ANDSA and MCI, in this scheme in 1983 and several years later settled with all of them, except the MCI. The Institute refused to enter an appearance in the U.S. federal court case asserting sovereign immunity as a foreign agency. The Export Group proceeded to obtain a default judgment against MCI for approximately $2.1 million in 1991.

With a default judgment in hand, the Export Group attempted to collect their multimillion-dollar award from Mexico, which rebuffed their efforts for payment. The company owners turned to Senator Hatch for assistance in getting the Bush Administration's attention on their claim. In his letter to USTR Carla Hills, Senator Hatch described Export Group's difficulty in collecting on the default judgment and also took the opportunity to advocate for an effective dispute settlement process in NAFTA.[59] "My purpose," he wrote, "in bringing this case to your attention is to point out the severe need, as you are well aware, for a credible disputes settlement agreement as our government negotiates the North American Free Trade Agreement with Mexican and Canadian officials."[60] Moreover, he stated "[t]here is no question that as more and more bilateral business transactions take place between U.S. and Mexican entities, the lack of a

[59] Letter of Senator Orrin G. Hatch to Carla A. Hills, dated Dec. 12, 1991, regarding Export Group's default judgment against the Mexican Coffee Institute. George Bush Presidential Library document no. OA/ID CFO 1376, Charles Gillespie-Mexico-General-June 1992 folder.

[60] Id.

dependable disputes settlement forum in which businesses can be assured of contract enforcement will hinder economic growth for both nations."[61] Accordingly, Hatch requested Hills bring Export Group's claim to "the table as [she worked] with Mexican negotiator to come to a sound disputes settlement agreement."[62]

The senatorial referral sparked extensive internal discussions among USTR and NSC staff regarding the legal status of the MCI and whether Export Group could collect against it if the MCI was a parastatal entity.[63] After numerous telephone calls with State Department officials and U.S. Embassy personnel in Mexico, USTR and White House staff determined the MCI was in fact a governmental agency of Mexico that could avail itself of sovereign immunity under applicable federal law. Thus, Export Group's legal recourse to recover an award against a Mexican agency was limited, but it still had the political option available. This option entailed the owners lobbying the U.S. government to assert pressure on Mexico to settle this matter.

In addition, Senator Hatch wrote several letters to other key officials such as John Negroponte, U.S. Ambassador to Mexico, and Michael Glover, Economic Officer at the U.S. Embassy in Mexico City. In a letter to Glover, Hatch reiterated, "this case will help to more fully expose the need for a solid disputes settlement clause in the NAFTA."[64] In March 1992, Hatch updated Ambassador Negroponte regarding his personal efforts to

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[61] Id.

[62] Id.

[63] Letter of Senator Orrin G. Hatch to Carla A. Hills, dated Dec. 12, 1991(cited in note 59).

[64] Letter of Senator Orrin G. Hatch to Michael Glover, dated Feb. 11, 1992, regarding Export Group case against the Mexican Coffee Institute. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder.

request assistance from various agencies to obtain a favorable resolution for his constituent.[65] These efforts included contacting Hills and State Department officials, and Michael Glover of Negroponte's embassy. He had even contacted Mexican Embassy officials in Washington, D.C. who were working with the Mexican Foreign Ministry to resolve this matter.[66] Hatch requested Ambassador Negroponte to "intervene in a consulatory role" to assist in the settlement of this claim.[67] Moreover, he thought that "as [the] two nations entered the crucial phases of the NAFTA negotiations, a positive outcome to this case could have a substantially positive effect on the final draft of NAFTA."[68]

Back in the USTR office, Hills had referred the Export Group matter to Julius Katz who was the chief U.S. negotiator for NAFTA. Katz informed the owners the MCI was a parastatal entity, and they would have to pursue their claims through officials at the U.S. Embassy in Mexico City who would "pursue the matter aggressively with relevant Mexican agencies."[69] He also advised them "our negotiators are taking your overall concerns into account as they work to craft a dispute settlement mechanism for

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[65] Letter of Senator Orrin G. Hatch to John D. Negroponte, dated Mar. 25, 1992, regarding Export Group case against the Mexican Coffee Institute. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder.

[66] Letter of Mexican Ambassador Gustavo Petricioli to Orrin Hatch, dated Feb. 18, 1992, acknowledging receipt of the Senator's letter regarding the Export Group claim. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder. Ambassador Petricioli advised Hatch that he had forwarded the information to the "Foreign Affairs Ministry in Mexico City with a special request for them to offer their good offices in order to settle the case."

[67] Id.

[68] Id.

[69] Letter of Julius Katz to Jack Andrews, Export Group, dated Mar. 17, 1992. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder.

[NAFTA]."[70] They were also exploring "whether recourse to arbitration and other alternatives dispute settlement mechanism currently available can be encouraged or even enhanced for private disputes between U.S., Mexican, and Canadian individuals and businesses."[71]

The Export Group continued to lobby U.S. officials for assistance. There were several additional rounds of correspondence between the company owners and U.S. embassy officials, State Department employees, White House staff, senior Mexican officials, and American legal counsel for the Mexican NAFTA negotiation team. They even wrote directly to President Bush requesting he intervene with Mexican officials on their behalf.[72] During this time, embassy officials had engaged Mexican agricultural officials to discuss a proposal for them to offer the Export Group an opportunity to broker another deal for the sale of grain dryers to the Mexican government in lieu of a cash settlement of the default judgment.[73] There were extensive diplomatic discussions regarding this option, but the Mexican officials did not follow through to provide any equipment specifications and the proposal was short lived.[74]

Despite Export Group's extensive pressure upon U.S. government officials to

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[70] Id.

[71] Id.

[72] Letter of Jack Andrews and Emilio Figueroa to President Bush, dated May 13, 1992. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder.

[73] Letter of John D. Negroponte to Orrin Hatch, dated Apr. 13, 1992; Letter of Jack Andrews to Michael Glover, U.S. Embassy in Mexico City, dated Apr. 10, 1992. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder.

[74] Letter of Andrews and Figueroa to President Bush, dated May 13, 1992 (cited in note 64); Letter of Jack Andrews and Emilio Figueroa to Russell Frisbie, Assistant Deputy Trade Representative, dated June 2, 1992. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder.

resolve this matter, Mexico took no meaningful action to settle the claim with the company. Katz had taken the claim all the way to the top of the Mexican negotiation team for NAFTA. He discussed this case with Herminio Blanco, who was his Mexican counterpart, and urged him to offer some form of settlement to Export Group. According to National Security Council memos, Katz had called Blanco "who said he did not want to be involved further in this issue."[75] After six months of negotiations, Export Group's attempt to leverage U.S. political influence to prompt Mexico to settle their claim appeared to have failed.

The Export Group was nonetheless relentless in their pursuit of collecting on their default judgment. They even caused some additional strife for Mexico by lobbying the House Energy and Commerce Committee Chair, Rep. John Dingell, to investigate Mexico's securities offering filed with the U.S. Securities Exchange Commission (SEC). In August 1992, Export Group and another U.S. trading company, Arriba, Ltd., complained to Congressman Dingell that Mexico failed to "disclose outstanding financial judgments against government-related entities" in its preliminary prospectus filed with the SEC for a $250 million note issue offering.[76] In response to these concerns, Dingell requested the SEC to investigate these allegations that "Mexico is not providing potential U.S. investors all the information it should on its financial position."[77]

Eventually, the Mexican government filed a motion with the U.S. federal court to set aside the Export Group's default judgment entered against it. They argued that the

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[75] Memorandum of Robert Morley to William Pryce, dated May 27, 1992. George Bush Presidential Library, Charles Gillespie-Mexico-General-June 1992 folder.

[76] *Mexican Relations Hit Bump*, J. Commerce 8A (Aug. 24, 1992).

[77] Id.

MCI was a foreign government entity and was not subject to the jurisdiction of U.S. courts under the Foreign Sovereign Immunities Act (FSIA). A federal district court agreed with Mexico and granted their motion to vacate the default judgment. However, the case was appealed to the Ninth Circuit Court of Appeals, which reviewed the applicability of a commercial activity exception under FSIA.[78] In 1995 a panel of three circuit judges held that Mexico was not immune from the jurisdiction of the U.S. courts in this case because the FSIA exception did not apply to the type of "non-commercial activity" alleged in the plaintiff's complaint (i.e., fraud).[79] Accordingly, they reversed the district court and remanded it for further proceedings.

This case continued for several more years. The federal district court again vacated the default judgment and granted Mexico's request to dismiss the case on the grounds the case was time-barred by a two-year statute of limitations. Export Group appealed to the Ninth Circuit, which agreed with the district court's decision and affirmed its order to vacate the default judgment.[80] The Export Group owners even filed a petition for writ of certiorari with the U.S. Supreme Court. In a simple one-sentence order issued in 1999, the Supreme Court ruled the "Petition for writ of certiorari to the United States Court for the Ninth Circuit [was] denied."[81] This order ended a sixteen-year legal battle in favor of Mexico, and the Export Group lost its bid to recover approximately $2 million in alleged damages.

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[78] *Export Group v Reef Industries, Inc.*, 54 F.3d 1466 (9th Cir. 1995).

[79] Id at 1477.

[80] *Export Group v Reef Industries, Inc*., 152 F.3d 925 (9th Cir. 1998).

[81] *Figueroa v Mexican Coffee Institute*, 535 U.S. 1141 (1999).

The Export Group case is important for several reasons. First, Export Group's underlying claim related to Mexican officials conspiring to unfairly deprive U.S. investors of their investment in Mexico is the type of claim that NAFTA's Chapter 11 was intended to compensate for in the event of Mexico's failure to accord investors fair and equitable treatment, and full protection and security under international law. Second, the prolonged length of time this case took to meander through the judicial system and political process highlighted the need for the more efficient dispute settlement mechanism found in Chapter 11. As will be discussed in greater detail in the next chapter of this study, there have been several Chapter 11 cases involving large multinational corporations with alleged damages in excess of $100 million dollars that have resulted in a final disposition within three to five years from the original filing of the investor's arbitration notice. The resolution time period for these Chapter 11 cases pales in comparison to the sixteen-year trek experienced by the Export Group.

Third, the common political challenges that investors face in recovering damages from a state is evident in this case. States tend not to readily acknowledge liability for any damages unless forced to do so. NAFTA allows investors to proceed with arbitration without first obtaining the consent of the offending member state on a case-by-case basis. In fact, the member states have specifically agreed in advance to waive their sovereign immunity defense against such claims and to subject themselves to arbitration.[82] Moreover, a Chapter 11 tribunal award is final and binding on the member state, and there is no recourse to appeal to a higher authority or opportunity to prolong the litigation

[82] NAFTA, Article 1122(1) states: "Each Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement."

of the claim.

In addition, the Export Group experienced difficulty in collecting any payment from Mexico for its default judgment. They were mired in the political maze that besets many investors and corporations that conduct business in foreign countries. Without any alternative remedy or avenue of recourse, investors may never collect any money for damages awarded to them against a state. Chapter 11 addressed this issue by requiring compensation "be paid without delay and be fully realizable."[83] The latter requirement avoids the issue the Export Group faced when Mexico made an illusory offer to purchase certain farm equipment from the Export Group in lieu of cash compensation for the default judgment.

However, it is worth noting that the impact this case had on the drafting of Chapter 11 is disputed. According to a key member of the Mexican negotiation team for NAFTA, Mexican officials viewed this case to be a "nuisance" and "side show."[84] As this individual recalled, Mexican officials fielded questions from U.S. politicians and officials regarding numerous complaints from American investors during the negotiations phase. They strongly felt the Export Group was attempting to manipulate the political environment of the NAFTA negotiations for their own personal gain.

Mexican officials may have been correct in its assessment of the Export Group's motives and tactics. White House records, however, clearly show senior U.S. officials

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[83] NAFTA, Article 1110(3) states: "Compensation shall be paid without delay and be fully realizable."

[84] Interview with a former senior member of the Mexican negotiation team for NAFTA who provided this information off the record.

spent an inordinate amount of time and effort to resolve the Export Group's claim. This documentation is full of specific references as to how the Export Group's dilemma was being considered in the drafting of NAFTA's dispute settlement mechanism, including correspondence from the chief U.S. negotiator for NAFTA.

Furthermore, the interaction of public and private actors in this case is not unusual. There is ample historical evidence of this type of intense and intimate levels of the private business sector's influence on public policy decision-making.[85] As Ferguson and Mansbach explain: "Even in the United States, where the free market is a fundamental tenet, 'private' business interests have influenced public policy since the republic was founded, and government, in turn, routinely looks to the knowledge and resources of the private sphere for public purposes."[86] Whether the Export Group influenced any specific text in Chapter 11 we may never be able to confirm, but what we know for certain is that NAFTA's investor-state dispute settlement mechanism would have avoided many of the general issues and challenges the Export Group experienced in its claim against Mexico.

6.7 Procedural Framework of Chapter 11 Arbitration Tribunals

Since the effective date of NAFTA on January 1, 1994, there have been

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[85] See Frederick W. Mayer, *Interpreting NAFTA: The Science and Art of Political Analysis*, CIAO, online at www.ciaonet.org (visited Oct. 15, 2002); and Charles Lewis, et. al., *Can Mexico and Big Business USA Buy NAFTA?* Nation (Jun. 14, 1993).

[86] Yale Ferguson and Richard Mansbach, *Global Politics at the Turn of the Millennium: Changing Bases of "Us" and "Them*," 1 Int'l Studies Rev. 92-93 (1999).

approximately sixty-two claims filed against the member states.[87] The exact number of claims or awards is unknown because NAFTA allows the states and investors to maintain certain documents confidential. For example, unlike the U.S. and Canada, NAFTA does not require Mexico to make public any awards entered against it.[88] Of the published claims, as of this writing, twenty-six were filed against Canada, twenty against the U.S., and sixteen against Mexico.

Despite the intense initial criticism of Chapter 11, there have been no amendments to its procedural structure. In fact, all three members view NAFTA as a key contributing factor to balancing economic development, environmental regulation, and reducing trade barriers within the region.[89] For a long time after the effective date of the agreement in 1994, the political climate in both the U.S. and Mexico had changed significantly in favor of the free-trade zone. During President George W. Bush's Administration, the U.S. kept Mexico engaged in expanding free trade. From 2000 through 2006, Vicente Fox, a former Coca-Cola executive, served as President of Mexico, and was a strong supporter of free trade agreements with the European Union and NAFTA members.[90] Fox had initially developed a very amicable relationship with President Bush that strengthened the commitment of both states to remove any remaining

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[87] As of February 28, 2010, sixty-two claims have been publicly identified as having been filed against the member states.

[88] NAFTA, Annex 1137.4.

[89] See *NAFTA at Eight: A Foundation for Economic Growth* (2002). online at http://www.international.gc.ca/assets/trade-agreements-accords-commerciaux/pdfs/NAFTA_8-en.pdf (visited Feb. 24, 2010).

[90] Address by President Vicente Fox to the Mexican Congress, Sept. 1, 2002. online at www.presidencia.gob.mx (visited Nov. 20, 2002).

trade barriers and to foster economic growth.[91] However, the Iraq War had strained their relationship, as Mexico opposed the use of military action. The tension between these two leaders further increased due to the White House's policies on immigration and heightened security along the U.S. southern border.[92]

NAFTA was consistently attacked as unfair to American companies and workers during the recent election.[93] Despite the fact both Democratic candidates Barack Obama and Hilary Clinton voted for the Central American Free Trade Agreement (CAFTA) while serving in the Senate, they criticized NAFTA in their campaign speeches in important electoral states such as Ohio.[94] The focus of their criticism was the environmental and labor provisions in NAFTA, which they were inclined to renegotiate in order to increase those standards.[95] As one reporter noted, they were "groping for a proper balance between being friendly to free trade agreements, believing they are beneficial to the economy, but also seeking to level the playing field for the United States

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[91] See Joint Statement between the United States of America and the United Mexican States, Sept. 6, 2001. John T. Woolley and Gerhard Peters, *The American Presidency Project* [online]. Santa Barbara, CA. online at http://www.presidency.ucsb.edu/ws/?pid=73410 (visited Feb. 24, 2010). This statement indicated that:

> [w]ith trade and investment between the United States and Mexico at record levels, the Presidents took stock of the success of NAFTA in bringing economic growth and development, and with it higher wages, more jobs, and lower prices for our citizens. They stressed the need to abide by the provisions of our free trade agreement and agreed to the importance of vigorous measures to ensure that the full benefits of economic development and trade are extended to all regions of Mexico.

[92] Elisabeth Bumiller, *Bush Is Facing a Difficult Path on Immigration*, N.Y. Times (Mar. 24, 2006). See also Richard Benedetto, *Bush, Fox Push to Mend Strained Relationship at Americas Summit,* USA Today (Jan. 12, 2004).

[93] Michael Luo, *Despite NAFTA Attacks, Clinton and Obama Haven't Been Free Trade Foes*, A23 N.Y. Times (Feb. 28, 2008).

[94] Michael Luo, *Memo Gives Canada's Account of Obama Campaign's Meeting on NAFTA*, N.Y. Times (Mar. 4, 2008) .

[95] Michael Cooper and John M. Broder, *McCain Pushes NAFTA in Visit to Canada as Obama, Again, Defends His View*, N.Y. Times (June 21, 2008).

when it comes to labor and environmental standards and addressing job losses that come with globalization."[96]

After President Obama was sworn into office on January 20, 2009, the controversy did not dissipate. The President seems poised to renegotiate NAFTA as part of his global trade policy, but faces strong opposition from corporate executives and global trade partners. Moreover, his proposed economic stimulus bill has various provisions that would limit federal funding to only U.S. contractors, which has prompted strong outcries—including those of Mexican and Canadian government officials—that the U.S. is shifting toward a conservative protectionist policy.[97] If the U.S. adopts conservative protectionist policies it may result in a substantial increase in the number of investor claims filed against the U.S. Hence, NAFTA's Chapter 11 will be more important than ever as a supranational institution in the global trade governance system.

6.8 The Drafting of Chapter 11 Investor-State Dispute Settlement Mechanism

At the time of the NAFTA negotiations, Mexico participated in the Generalized System of Preferences (GSP) of the United States and Canada, but there was no existing

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[96] Luo, *Despite NAFTA Attacks* (cited in note 93).

[97] White House Press Briefing by Press Secretary Robert Gibbs (Jan. 30, 2009), online at http://www.whitehouse.gov/the_press_office/Press_Briefing_1-30-09/ (visited Jan. 31, 2009); Darlene Superville, *Obama and Mexican President meet in Washington*, Associated Press (Jan 12, 2009), online at http://news.yahoo.com/s/ap/20090113/ap_on_go_pr_wh/obama_calderon_6 (visited Jan. 30, 2009); Veronica Smith, *Buy American' Stimulus Plan Riles Trade Partners*, AFP (Jan. 29, 2009), online at http://news.yahoo.com/s/afp/20090129/pl_afp/uspoliticstradedispute_20090129173404 (visited Jan. 31, 2009).

formal trade agreement between Mexico and the other two states.[98] On the other hand, the two northern neighbors had the Canada-U.S. Free Trade Agreement (CUSTA) that was recently ratified by the parties in 1988.[99] Under the CUSTA, the dispute settlement provision only applied with respect to issues related to antidumping or countervailing duty laws of the U.S. or Canada.[100] In addition, the member states were the only parties permitted to file a claim against the other party and to convene an arbitration panel.[101] CUSTA did not provide any dispute settlement mechanism for private investments, nor did it provide any private right of action for investors to file a claim directly against a member state.[102]

The U.S. government took the position as a matter of policy that a strong investor-state dispute settlement provision was mandatory for NAFTA. In light of this trade policy, the negotiation team was tasked with drafting a provision that would be acceptable to Mexico. Although Canada was also participating in the negotiations, they

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[98] Inés Bustillo and José Antonio Ocampo, *Asymmetries and Cooperation in the Free Trade Area of the Americas* (United Nations 2003), online at www.sela.org (visited on Dec. 21, 2008).

[99] Can.-U.S. Free Trade Agreement, Jan. 2, 1988, U.S.-Can., 27 I.L.M. 281. Article 1901 (General Provisions).

[100] Id. Chapter 19, Article 1901 states:

> 1. The provisions of Article 1904 shall apply only with respect to goods that the competent investigating authority of the importing Party, applying the importing Party's antidumping or countervailing duty law to the facts of a specific case, determines are goods of the other Party.
>
> 2. For the purposes of Articles 1903 and 1904, panels shall be established in accordance with the provisions of Annex 1901.2.

[101] Id. Under Annex 1901.2, parties were required to appoint two panelists, in consultation with the other Party, within 30 days of a request for a panel. A fifth arbitrator was appointed by agreement of both parties. The parties were required to select arbitrators who are "of good character, high standing and repute, and shall be chosen strictly on the basis of objectivity, reliability, sound judgment, and general familiarity with international trade law." A majority of the panelists were required to be lawyers.

[102] Id.

aligned their interests closely to the U.S. on this issue. They, too, were concerned about Mexico's tendency to nationalize industries and expropriate foreign investments.

Several authors highlight one of the dilemmas for scholars who have studied the history of NAFTA. As one author describes it: "Unfortunately, tracing the development of the negotiations in this area is particularly difficult. Few specific comments were offered by negotiators, and the drafts are ambiguous."[103] This study attempts to shed some light on those ambiguities by analyzing unpublished governmental policy memos, negotiations documents, and information derived from numerous interviews with senior negotiators and policymakers behind Chapter 11.

6.8.1 U.S. Bilateral Investment Treaty Model: Precedent for NAFTA Chapter 11

There exists a group of NAFTA commentators who exult the Chapter 11 investor-state arbitration mechanism as "unique"[104] or giving "unprecedented rights to investors."[105] Contrary to these exultations, other commentators challenge the notion the Chapter 11 dispute settlement mechanism is "unprecedented,"[106] and they argue that this mechanism "is heavily precedented."[107] A U.S. negotiator for NAFTA notes "Chapter 11

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[103] Jennifer Heindl, *Toward a History of NAFTA's Chapter 11*, 24 Berkeley J. of Int'l Law, 672, 684 (2006).

[104] Alan C. Swan, *Ethyl Corporation v Canada*, Award on Jurisdiction, 94 Am. J. Int'l L. 159, 166 (2000).

[105] Ann Capling and Kim Richard Nossal, *Blowback: Investor–State Dispute Mechanisms in International Trade Agreements*, 19 Governance 151 (2006); and Lydia Lazar, *NAFTA Dispute Resolution: Secret Corporate Weapon?*, 1(2) J. Global Fin. Markets 49 (2000).

[106] Daniel Price, *Chapter 11: Private Party v Government, Investor-State Dispute Settlement: Frankenstein or Safety Valve*, 26 Can-U.S. L.J. 107 (2000).

[107] Id.

grew out of a long tradition of negotiating first treaties of friendship, commerce, and navigation, or treaties of amity, and later, bilateral investment treaties."[108]

NAFTA is viewed here as an outgrowth of U.S. bilateral investment treaty (BIT) policy.[109] In fact, Chapter 11 was based on the Argentina-U.S. BIT signed in 1991, which has its roots in the 1982 Model BIT.[110] During the past two decades, the number of BITS throughout the world have increased to over 1,500 of such treaties, many of them containing similar dispute settlement provisions to those found in NAFTA.[111] BITs have also become an integral part of Mexico's economic strategy to attract foreign investments. Since 1994, Mexico has entered into BITs with nineteen countries, many of which have investor-state dispute settlement mechanisms similar to NAFTA.[112] The earliest of these treaties is with Argentina, which became effective in July 1998. Not surprisingly, this treaty substantially mirrors the investment dispute settlement mechanism from the U.S.-Argentina BIT.

The model BIT provides investors with the right to elect private arbitration tribunals as the jurisdiction for resolving their investment disputes with any of the

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[108] Id.

[109] Telephone interview with Daniel Price, Partner, Sidley Austin, in Washington, D.C. (May 4, 2009). Mr. Price served as USTR's lead negotiator on investment issues in the NAFTA negotiations during 1991-1993.

[110] Telephone interview with Guillermo Aguilar Alvarez, former Chief Counsel for Mexico's negotiation team, in New York, New York (May 15, 2009).

[111] Price, *Chapter* 11 at 108 (cited in note 98); See also Meg Kinnear and Robin Hansen, *The Influence of NAFTA Chapter 11 in the BIT Landscape*, 12 U. C. Davis J. Int'l L. & Pol'y 101 (2005-2006). In February 2009, Meg Kinnear was elected as the new Secretary-General of ICSID. Previously, Ms. Kinnear was the General Counsel and Director General of the Trade Law Bureau of Canada, a joint legal unit of the Departments of Justice and of Foreign Affairs and International Trade of Canada. In that capacity, she was responsible for managing all international investment and trade litigation involving Canada.

[112] Organization of American States, Listing of Bilateral Free Trade Agreements with Mexico, online at http://www.sice.oas.org/ctyindex/MEX/MEXBits_e.asp (visited Jan. 30, 2010).

member states. However, one key difference between the BITs and NAFTA is the latter was a multilateral agreement. In addition, NAFTA was the first multilateral free trade agreement with this type of dispute settlement mechanism involving three states with major national economies.

Since the U.S.-Argentina BIT served as the actual template for NAFTA Chapter 11, it is important to examine the investor-state dispute settlement provision in that treaty.[113] Under this BIT, a national or company of the other Party state may choose to submit the investment dispute for resolution either to: (1) the courts or administrative tribunals of the state that is a party to the dispute; or (2) to binding arbitration to one of the arbitration facilities set forth in the treaty.[114] If the investor elects to submit a claim to arbitration, the treaty contained a provision in which both states consented to such submission. Each party is required to appoint an arbitrator within a specified time period.[115] The treaty also provided that two arbitrators must select a third arbitrator as Chairman, who is a national of a third State.[116]

6.8.2 Overview of NAFTA's Investor-State Dispute Settlement Mechanism

Under NAFTA, the member states have agreed to treat investors of another

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[113] Treaty Between United States of American and The Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, Signed November 14, 1991; Entered into Force October 20, 1994. United Nations Conference on Trade and Development, online at online at http://www.unctad.org/sections/dite/iia/docs/bits/argentina_us.pdf. (visited on Nov. 15, 2009).

[114] Id. NAFTA, Art. VII(2).

[115] Id. NAFTA, Art. VIII(2).

[116] Id.

member with most favorable nation status.[117] Article 1102 provides that "[e]ach Party shall accord to investors of another Party treatment no less favorable than it accords, in like circumstance, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."[118] The minimum standard of treatment by states of investors is required to be "in accordance with international law, including fair and equitable treatment and full protection and security."[119] This provision has a broader applicability beyond the actions of federal or national authorities. The agreement specifically states the treatment required under subsection (1) is also applicable to states or provinces of the Parties.[120]

Section B of Chapter 11 provides the legal authority for investors to file claims against member states for loss or damages incurred as a result of a member state's breach of its obligations under NAFTA.[121] This Section also established the dispute resolution framework to resolve these claims through arbitration.[122] According to Article 1120, parties to these tribunals have the option of electing the arbitration rules under the United Nations Commission on International Trade Law (UNCITRAL) or the International Centre for the Settlement of Investment Disputes (ICSID).[123] The parties agree upon a panel of three arbitrators and the proceedings are similar to judicial hearings and include

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[117] NAFTA, Art. 1102.

[118] NAFTA, Art. 1102(1).

[119] NAFTA, Art. 1105(1).

[120] NAFTA, Art. 1102(3).

[121] NAFTA, Art. 1116.

[122] NAFTA, Art. 1120.

[123] Id.

presentation of motions, testimony of witnesses and experts, and evidentiary rulings.[124] The arbitrators are required to decide issues in accordance with the agreement and international law.[125] However, tribunal decisions in favor of the investor are limited to an award for monetary damages.[126] The tribunals do not have the power to overturn national laws, or mandate changes to public policy. Furthermore, these decisions are generally final and are not subject to appeal even in the highest courts of the member states.

6.8.3 Chapter 11 Structure and Investor Definitions

During the NAFTA negotiations, both sides knew President Bush was entering the last year of his presidential term, and he faced a major uphill battle during the upcoming election year.[127] There existed the possibility at that time that Bush could lose his bid for a second term. His cabinet and White House staff knew that time was running out, and they had to quickly draft and negotiate the treaty if Bush was going to sign this landmark treaty by the end of 1992. Thus, the NAFTA negotiators worked long days to release its preliminary draft to meet their tight deadline of December 1991.

The first draft of Chapter 11 (the "First Draft"), issued in December 1991, contained a general provision for the establishment of an investor-state dispute settlement mechanism. This provision is uncommon for multinational trade agreements because it allows private investors, such as individual investors and entities, to file a claim directly

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[124] NAFTA, Art. 1133, 1135.

[125] NAFTA, Art. 1131.

[126] NAFTA, Art. 1135.

[127] Charles Kolb, *White House Daze: The Unmaking of Domestic Policy in the Bush Years* (The Free Press 1994).

against another member state. Historically, an investor's only recourse against another state has been to persuade its own state to file a claim on its behalf against the other state.[128] Under that model of a dispute settlement system, the investor's state has no obligation to file the claim even though the investor may have incurred economic damages by the other state. The decision whether to file the claim is strongly based upon the state's own policies, issue prioritizations, and assessment of the current political landscape with the other state. If the two states are currently disputing trade issues related to one industry, the investor's state may opt not to commence another dispute related to a different industry or trade issue.

The First Draft contained an investor-state dispute settlement mechanism in Article "XX07."[129] In Section 1 of this Article, the parties defined the types of investment disputes that would be subject to this settlement mechanism as follows:

> For purposes of this Article, an investment dispute is a dispute between a Party and a national or company of another Party arising out of or relating to (a) an investment agreement between that Party and such national or company; (b) an investment authorization granted by that Party's foreign investment authority (if any such authorization exists) to such national or company; or (c) an alleged breach of any right conferred or created by this Chapter with respect to an investment.

Thus, a national or company could bring a claim against a member state provided it was not their own state. This draft did not use the term "investor," but merely referred to the aggrieved party as "a national or company." Moreover, the First Draft did not define

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[128] Frans Engering, *The Multilateral Investment Agreement, Transactional Corporations* P.158 (UN), online at http://www.unctad.org/en/docs/iteiitv5n3a7_en.pdf (viewed Feb. 27, 2010).

[129] NAFTA Chapter 11 Trilateral Negotiating Draft Texts, online at http://ustraderep.gov/Trade_Agreements/Regional/NAFTA/NAFTA_Chapter_11_Trilateral_Negtiating_Draft_Texts/Section_Index.html (visited on Nov. 15, 2009). The letters "XX" were placeholders in the original drafts for the chapter numbers that had not yet been determined by the negotiators at that stage of the negotiations.

who is a "national," which consequently meant any person or company could avail themselves of this mechanism no matter the amount of their ownership or interest in the investment in question.[130] This significant gap in the definition was addressed in subsequent drafts of the agreement.

6.8.4 Investor's Choice of Forum

The choice of forum for the settlement of investment claims is a central provision of the free trade agreement. The First Draft was unremarkable in its arbitration claim process and designation of the approved foras. The three states desired investors to first attempt to negotiate an amicable resolution of any legitimate claims before commencing litigation against the states. This preference is evident in the notice of claim process set forth in Section 2 of Article XX07.

This section required investors to consult and negotiate with states as a prerequisite to initiating arbitration proceedings. Specifically, Section 2 provides:

> In the event of an investment dispute, the parties to the dispute should initially seek a resolution through consultation and negotiation. If the dispute cannot be settled amicably, the national or company concerned may choose to submit the dispute for resolution:
>
> a) to the courts or administrative tribunals of the Party that is a party to the dispute;
>
> b) in accordance with any applicable previously-agreed dispute settlement procedures; or

[130] See E-mail of Douglas Selin, USTR, to Peter Chase, USTR Director of Investments, Subject line: Mexico Investment Chapter (Oct. 28, 1991, 21:12 (EST)), National Archives, USTR Computer Group DGMAIL, SELIN.DOU.911028.09. Mexico's preliminary draft of the investment chapter raised several other concerns to the USTR legal staff, including overly broad definitions of key terms such as "state enterprises" and "investment of a company."

> c) in accordance with the terms of paragraph 3 [binding arbitration].

These provisions allow investors to bring a claim against a Party in the courts or administrative tribunals of the Party that is a party to the dispute, in accordance with agreed upon dispute settlement procedures. They may also bring a claim to the International Centre for the Settlement of Investment Disputes, or any other arbitration forum mutually agreed upon by the treaty signatories.

6.8.5 Member States Consent to Mandatory and Binding Private Arbitration

Another important provision in the First Draft was the arbitration consent provision. The Parties consented to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice selected by the investor. Section 4 provides, in part, that:

> Each Party hereby consents to the submission of any investment dispute for settlement by binding arbitration in accordance with the choice specified in the written consent of the national or company under paragraph 3.

This provision was intended to bind the member states to an arbitration award and reduce potential loopholes for states to disregard the tribunal decision and to resort to their national court system.

In light of its long-standing adherence to the Calvo doctrine, Mexico had an extremely difficult time accepting the binding arbitration provision in Chapter 11. Although Mexico proposed various versions of a modified Calvo approach, the U.S. and Canadian negotiators rejected any provision short of a mandatory and binding arbitration process. Senior White House policy officials considered Mexico's propensity toward

expropriation and its past history of prolonged and ineffective U.S.-Mexican Claims Commissions as major reasons to insist on a strong dispute settlement mechanism.[131] (Interestingly, White House policymakers considered the history of the former claims commissions relevant in their analysis, but the NAFTA drafters from the U.S. and Mexican teams readily admit these commissions were not on their minds during the drafting of NAFTA. [132] From their perspective, they had started drafting NAFTA using the U.S.-Argentina BIT as their template, which already had an investor-state dispute settlement mechanism, so it was unnecessary for them to evaluate the framework of the prior claims commissions.) After Argentina, the largest economy in Latin America after Mexico and Brazil, had signed their BIT with the U.S. in November 1991, Mexico saw it as a sign the Calvo Doctrine was starting to lose its dominance as a policy in the region.

6.8.6 The Crafting of the Compensation Provision to Avoid Mexican Backlash

During the period of December 1991 through December 1992, there were forty drafts exchanged before the three heads of states signed the final agreement on December 17, 1992.[133] These negotiating drafts show how the states attempted to impose each of their national laws and jurisprudence into the drafts. For example, the U.S. prepared a draft provision on compensation for expropriation. The earlier drafts of this provision

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[131] Interview with former senior White House officials who provided this information off the record.

[132] Interviews with members of the U.S. and Mexican negotiations teams for NAFTA who provided this information off the record.

[133] The three heads of state had signed the agreement, but it was still subject to ratification or approval by the national legislatures of the member states. In addition, NAFTA did not become effective until January 1, 1994, after the Clinton Administration finalized the labor and environmental side agreements in late 1993.

prohibited expropriation of investments unless, among other things, a party provided the investor with "payment of prompt, adequate and effective compensation."

According to commentary notes for the January 16, 1992 draft, "Mexico has not proposed text on this provision although it has agreed this subject should be covered in a manner consistent with its Constitution, which does not preclude fair market value." Mexico agreed conceptually to compensation, but they objected to the phrase "prompt, adequate and effective compensation" in the text. This phrase dates back to Secretary of State Cordell Hull's foreign policy with Mexico from the 1930s, a policy that has remained a sore point of contention between the two countries.[134] In fact, this policy resulted in Mexico enacting a constitutional article limiting payment for expropriation to the fair market value of the property taken by the government.[135]

In light of the wording of the Mexican Constitution, the U.S. agreed to modify the text to use words that conveyed the same concept, but would be acceptable to their Mexican counterparts.[136] The final version of NAFTA's Article 1110(3) states "Compensation shall be paid without delay and be fully realizable." This section does not contain the terms "adequate" or "effective" that were viewed as objectionable to Mexican officials. Article 1110(2) defines "Compensation" as follows:

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the

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[134] See Tali Levy, Note, *NAFTA's Provision for Compensation in the Event of Expropriation: A Reassessment of the "Prompt, Adequate and Effective" Standard*, 31 Stan. J. Int'l L. 423, 430 (1995).

[135] Patrick Del Duca, *The Rule of Law: Mexico's Approach to Expropriation Disputes in the Face of Investment Globalization*, 51 UCLA L. Rev. 35, 120 (2003).

[136] Maxwell A. Cameron and Brian W. Tomlin, *The Making of NAFTA: How the Deal Was Done* 112 (Cornell University 2000).

> intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

In essence, the above definition focuses on the phrase "fair market value" which would be the equivalent to the term of "adequate" under existing international law. Also, the term "effective" is addressed by the requirement that a party pay any compensation "in a G7 currency" plus "interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment." If the payment is not made in G7 currency, Article 1110 sets forth a conversion formula to ensure that payment is effective.[137]

6.8.7 Negotiators Agree Upon a Statute of Limitations

Another example of a key revision was the establishment of a statute of limitations. A statute of limitations is a law "establishing a time limit for suing in a civil case, based on the date when the claim accrued."[138] The early drafts did not contain a statute of limitation for the filing of an investor's claim under Chapter 11. Without any time restriction, investors would be able to sit on claims and file claims against the member states many years later from the alleged NAFTA violation when records or witnesses may no longer be available or the memories of witnesses have faded. After extensive negotiations, the parties agreed to a three-year statute of limitation, which starts from the date investors have knowledge or should have known of the party's alleged

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[137] Thomas W. Merrill, *Incomplete Compensation for Takings*, 11 NYU Envir. L.J. 112, (2002).

[138] Black's Law Dictionary (West 8th ed. 2004).

breach that resulted in damages to the investors.[139] This time period is consistent with those in existing statute of limitation for tortious conduct and discovery rules under state laws in the U.S.[140]

6.8.8 Notice of Claim Procedure

There are also key procedural differences between the initial rounds of drafts and the final agreement. The initial drafts merely required the investor to wait six months from the alleged breach of the NAFTA and encouraged them to "seek resolution through consultation and negotiation" with the Party prior to initiating arbitration. The final agreement established conditions precedent to the submission of a claim to arbitration. First, the disputing investor is required to deliver to the disputing member state "written notice of its intention to submit a claim to arbitration at least ninety days before the claim is submitted."[141] The notice is required to contain the following information:

> (a) the name and address of the disputing investor and, where a claim is made under Article 1117, the name and address of the enterprise;
>
> (b) the provisions of this Agreement alleged to have been breached and any other relevant provisions;
>
> (c) the issues and the factual basis for the claim; and

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[139] NAFTA, Art. 1116(2) states: "An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage."

[140] See generally, District of Columbia, Title 12, Ch. 3, Sec. 12-301; Maryland, Courts and Judicial Proceedings, Sec. 5-101; Massachusetts, Title 5, Ch. 260, Secs. 2A and 4; Mississippi, Title 15, Ch. 1, Secs. 15-1-36, 15-1-35, 15-1-49; Montana, Title 27, Ch. 2, 27-2-204 and 27-2-207; New Hampshire, Title LII, Chapter 508, Sec. 508.4; New York, Civil Practice Laws and Rules, Art. 2, Secs. 214, 214.s, 215; and North Carolina, Title 1, Section 1-52, 1-54.

[141] NAFTA, Art. 1119.

> (d) the relief sought and the approximate amount of damages claimed.[142]

If investors are unable to settle their claim through negotiation or consultation, they may submit the claim under the ICSID Convention, the Additional Facility Rules of ICSID, or UNCITRAL Arbitration Rules.[143]

Of the three bodies of arbitration rules, legal counsel usually advise their clients who are investors to elect ICSID, if it is available. As one leading international law attorney explains it:

> First, ICSID is a member of the World Bank Group and sovereigns are likely to be respondents in such cases, and they tend to be sensitive about how they may be viewed by the international financial institutions, the World Bank in particular. The second and third reasons are ICSID has its own internal system for any review of awards and review is very limited; it's difficult to get a case annulled within that system and there's no other recourse because of the exclusivity of the ICSID convention. The third reason is that every state party is required to enforce in its courts any ICSID award with the same force and effect as if it were a final judgment in that country, not subject to further appeal to the highest court of that state. The defense of sovereign immunity is preserved, but still it's very helpful to claimants.[144]

A review of the published twenty Chapter 11 claims files against the U.S. reveals all of the investors have elected UNCITRAL rules, except two cases that involved either ICSID or ICSID Additional Facility rules. Specifically, NAFTA requires investors to file a written notice of its intention to submit a claim to arbitration at least 90 days before the

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[142] NAFTA, Art. 1119(a)-(d).

[143] NAFTA, Art. 1120. The ICSID rules would apply if the disputing member state and the member state of the investor are parties to the ICSID Convention. As of this date, the United States is the only member state that is a party to the Convention.

[144] *A World-Class International Arbitrator Speaks!,* Metropolitan Corporate Counsel 24 (Aug. 5, 2009). This article contains a transcript of the magazine editor's interview with Charles Brower.

claim is submitted. The waiting period is intended to provide the member state with time to investigate, negotiate, or develop its defense.

6.8.9 Development of Referral Process for NAFTA Interpretations

Another major procedural variation is the referral process to the NAFTA Free Trade Commission. In the first several drafts, any dispute between the parties concerning the interpretation or application of Chapter 11 could have been submitted, upon request of a party, to another arbitration tribunal for final resolution. Specifically, the drafts stated:

> Any dispute between Parties concerning the interpretation or application of this Chapter which is not resolved through consultations or other diplomatic channels, shall be submitted, upon the request of a party, for binding decision in accordance with the applicable rules of international law to an arbitral tribunal composed of three arbitrators.

This type of process was burdensome because another tribunal would have to be convened and three more arbitrators selected. In addition, the states would have delegated the power of sovereign states to officially interpret their own treaties to private arbitrators.

After nearly thirty drafts, the negotiators finally agreed to allow the parties to submit questions regarding the interpretation of the agreement to the tribunal. During September and October 1992, they drafted several variations of articles allowing the tribunal to make interpretations of the agreement similar to a judge in a national court system. However, they continued to debate whether to balance this private authority with a state-centric authority. The final result of this debate was the adoption of the following three Articles:

Article 1128: Participation by a Party

> On written notice to the disputing parties, a Party may make submissions to a Tribunal on a question of interpretation of this Agreement.

Article 1131: Governing Law

1. A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.

2. An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.

Article 1132: Interpretation of Annexes

1. Where a disputing Party asserts as a defense that the measure alleged to be a breach is within the scope of a reservation or exception set out in Annex I, Annex II, Annex III or Annex IV, on request of the disputing Party, the Tribunal shall request the interpretation of the Commission on the issue. The Commission, within 60 days of delivery of the request, shall submit in writing its interpretation to the Tribunal.

2. Further to Article 1131(2), a Commission interpretation submitted under paragraph 1 shall be binding on the Tribunal. If the Commission fails to submit an interpretation within 60 days, the Tribunal shall decide the issue.

Under these Articles, a party may request the Tribunal to interpret a provision of the agreement and the private arbitrators are authorized to interpret such provision but only in accordance with international law. Furthermore, a NAFTA Free Trade Commission was created and authorized to issue its own interpretation of the agreement that is binding on any Chapter 11 tribunal. In the event any party asserts a defense based upon the reservations or exceptions contained in the four annexes to NAFTA, the Commission was also authorized to interpret these sections of the agreement.

6.8.10 Who Are the NAFTA Arbitrators?

The concept of arbitration has existed for centuries before NAFTA. Its utilization dates back as early as Ancient Greece and the early development of the rule of law. One of the most thought provoking Greek play scenes concerning arbitrators is found in Menander's *Arbitration* which dates back to 320 B.C.[145] In one of the scenes from the play, the character Daos claims a right to a set of ornaments that another character, Syriskos, has in his possession. To settle their dispute, they randomly select a stranger who happens to pass by them to serve as their arbitrator. At the end, the arbitrator decides in favor of Syriskos and Daos surrenders the ornaments. This humorous scene is extremely informative of the public perception of arbitration that existed centuries ago.

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[145] The following is an excerpt from Menander's *Arbitration*:

> Syriskos: You're not doing what's right!
>
> Daos: Mind your own business, you wretch! You've no right to keep what's not yours!
>
> Syriskos: We must get someone to arbitrate about it.Daos: Certainly; let's get a decision.Syriskos: Well, who?
>
> Daos: Anyone suits me. But it serves me right; why did I offer you a share?
>
> Syriskos: Will you agree to have that man as judge?
>
> Daos: Just as you like.
>
> **Syriskos: Excuse me, sir. Could you spare us a few moments?**
>
> Smikrines: You? What for?
>
> Syriskos: We're having an argument about something.Smikrines: What's that got to do with me?
>
> Syriskos: We're looking for someone to decide it, a fair judge. If you're not busy, will you settle it for us?
>
> Smikrines: You'll come to a bad end! Walking around in leather jackets, making law speeches!
>
> Syriskos: Well, still, it's quite a small matter, easy to understand. Do us a favour, sir. Please don't think it doesn't matter. On every occasion justice ought to prevail everywhere. That's something which every passer-by should see to. It's a duty of life common to everyone.Daos: (aside): A fair orator I've got mixed up with! Why did I offer him a share?
>
> Smikrines: Well, tell me, will you abide by the judgment I give?
>
> Syriskos: Certainly.Smikrines: I'll hear you; why shouldn't I. (To Daos) You speak first you who've said nothing.

The concept that an arbitrator must be impartial and owes a duty of justice to the individual parties, and even to society as a whole, is still expected in modern arbitration proceedings.

The success of an international arbitration system depends heavily on the quality of the arbitrators selected to serve on the arbitration panels or tribunals. According to R. Floyd Clarke, a prominent international law attorney at the turn of the twentieth century, the selection of arbitrators was one of the key reasons for the failure of international arbitrations involving private and public claims in his time.[146] The underlying principles of his position are as relevant today in 2010 as they were when Clarke wrote about them over a century ago in 1907. First, he believed the "careless selection of unfit judges" would undermine the integrity of the process and produce poor quality decisions.[147] The selection of a judge as a "reward for political services or by reason of family connections," he wrote, would generally result in "men unskilled in the doctrines of international law—a branch of law distinct in itself, and needing careful preparation and study to master its intricacies."[148] He advocated for the selection of individuals based upon their honesty, intelligence, and impartiality.[149] In addition, the arbitrators should be a person of "proven probity, of evident skills in the art involved and having the least

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Maurice Balme, ed., *Menander: The Plays and Fragments* 86-87 (Oxford University 2001).

[146] Clarke, R. Floyd, A Permanent Tribunal of International Arbitration: Its Necessity and Value, 1 AJIL (April 1907). Clarke is well-know for his seminal book titled *The Science of Law and Law Making* published in 1898.

[147] Id at 400.

[148] Id.

[149] Id at 402.

possible bias of personal character or judgment."[150]

Clarke also felt strongly that "the personal and national bias" was a detrimental factor even though he still believed there was value in having a national from a disputing party participate on the panels. In his opinion, an effective method to obtain impartiality was to "remove [arbitrators], as far as possible, from worldly cares and temptations." Moreover, international disputes tended to conjure "the prejudice and bias from [the arbitrators'] surroundings, associates, history and environment are apt to sway the minds and pervert the judgments of good men trying to be just judges." His primary concern was the ability of arbitrators to freely render a decision against their national state and then to return home to make a living without any repercussions.

To address those concerns, Clarke supported setting fixed salaries for arbitrators and creating tenured arbitrator positions. In this regard, NAFTA's arbitrators are private individuals who do not hold tenured positions, but they are well compensated for their services. Generally, arbitrators' fees can be based on the amount of time spent or on the size of the dispute.[151] For example, ICSID has established a fee schedule for its arbitrations. Under this schedule, arbitrators are each paid $3,000 per day of meetings and other work related to the tribunal, unless otherwise agreed upon by the parties. They are also entitled to subsistence allowances, reimbursement for any direct expenses reasonably incurred, and reimbursement of travel expenses in accordance with ICSID

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[150] Id.

[151] See generally November 1996 Report of the NAFTA Advisory Committee on Private Commercial Disputes to the NAFTA Free Trade Commission, online at http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/NAFTA-alena/report12.aspx?lang=en (visited Nov. 26, 2009).

guidelines.[152] As for the issue related to national bias, the following section will discuss several cases involving arbitrator conflicts of interest and how those situations were handled under the Chapter 11 dispute settlement mechanism and applicable arbitration rules.

Under NAFTA, each party appoints its own arbitrator, and the presiding arbitrator is appointed by agreement of the parties.[153] If a party fails to appoint an arbitrator, or the two parties fail to agree upon a presiding arbitrator, the ICSID Secretary-General is authorized to name the arbitrator.[154] Although the Secretary-General has broad discretionary authority to make appointments, she must choose first from a list of qualified individuals agreed upon by the three NAFTA members.[155] The pool of arbitrators consists primarily of international law experts such as professors and attorneys as well as former judges and diplomats.

In Chapter 11 investor-state arbitrations, the parties are free to select their own arbitrator to serve on the tribunal panel. Typically, the attorneys for the parties will interview several prospective arbitrators to determine whether there are any potential conflicts of interest, to better understand the individual's international trade experience, and to discuss their arbitration experience.[156] Since the U.S., Mexico and Canada are

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[152] ICSID Schedule of Fees, online at http://icsid.worldbank.org (visited Dec. 1, 2009). See also Alvarez, Guillermo Aguilar and Reisman, W. Michael, eds., *The Reasons Requirement in International Investment Arbitration: Critical Case Studies* (Martinus Nijhoff 2008).

[153] NAFTA, Art. 1123.

[154] NAFTA, Art. 1124.

[155] Id.

[156] For example, in *Centurion Health Corporation v Canada*, the investor expected to interview over twenty arbitrators prior to selecting one for position of the tribunal president. Blog posting dated May 4, 2009. http://centurionhealthcorp.blogspot.com (visited Nov. 22, 2009).

subject to numerous investor claims, their legal teams (the "Legal Teams") have compiled an informal list of preferred arbitrators over the years.[157] When a claim is filed, the team assigned to the case will hold brainstorming meetings to identify the person who would be the most appropriate for a particular case. Many international arbitrators handle several major cases at the same time. The Legal Teams tend to avoid arbitrators who are too busy, or who were previously designated by the disputing state for other claims.

The claimants are generally inclined to appoint a professor as their arbitrator. Conventional wisdom infers professors are more likely to take a liberal and expansive view of the law rather than international law practitioners who generally prefer the narrow interpretation of the treaty provisions. States prefer experienced trade attorneys, judges and former diplomats who presumably focus on the facts and tribunal process, and are willing to take public policy into consideration as part of their evaluation of claims. For example, in the *Mondev v U.S.* case, the U.S. appointed Judge Stephen Schwebel, a U.S. national, as arbitrator.[158] Judge Schwebel served as a judge on the International Court of Justice in The Hague for 19 years, including serving as its president from 1997 to 2000.[159] In addition, he had served in various legal positions in the U.S. Department of State between 1961-1981 and is a highly respected figure in international arbitration today.

In another case, *Ethyl v Canada*, the tribunal included Karl-Heinz Bockstiegel,

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[157] Interview with a U.S. official who is familiar with Chapter 11 litigation cases. This information was provided to the author off the record.

[158] *Mondev International Ltd. v United States,* ICSID Case No. ARB (AF)/99/2, Award (Oct. 11, 2002), 42 I.L.M. 85 (2003).

[159] See Biography of Judge Stephen Schwebel, online at http://www.cceia.org/people/data/stephen_m__schwebel.html (visited Nov. 22, 2009).

Charles N. Brower, and Marc Lalonde. Bockstiegel is a professor at the University of Cologne Law School in Germany and is considered to be one of the world's foremost experts in international law.[160] Brower is a public international law arbitrator and former partner at a prestigious international law firm in Washington D.C.[161] He served as Acting Legal Advisor to the U.S. Secretary of State in the early 1970s and as a judge on the Iran-United States Claims Tribunal held in The Hague during the 1980s.[162] Likewise, Lalonde is an attorney and a former judge. He was a senior counsel with a prestigious law firm in Montreal, Canada and had served as Ad Hoc Judge of The International Court of Justice.[163] Lalonde is also a former member of the Canadian Parliament and has held several high level cabinet positions in the Canadian government, including Minister of Justice and Minister of Finance.[164]

In major cases, the Legal Teams seek to appoint arbitrators who have extensive international trade experience, strong knowledge of international affairs, and a superior understanding of the disputing state's policies. As a U.S. government official describes it, "gravitas of a claim is a factor" when evaluating potential arbitrators. In those situations, the teams will look for arbitrators who have all the skills listed above, but who are also prominent figures in the international community. For example, the U.S. legal team considered the *Methanex* case to be a significant claim for its potential implications

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[160] International Centre for Settlement of Investment Disputes, List of Arbitrators, online at http://www.worldbank.org/icsid (Feb. 24, 2010).

[161] Biography of Charles N. Brower, online at http://www.whitecase.com/brower_charles.html (visited Oct. 30, 2002).

[162] Id.

[163] Biography of Marc Lalonde, online at http://www2.parl.gc.ca (visited Nov. 22, 2009).

[164] Id.

on public policy at the local government level and on the subject matter, i.e., environmental regulation.[165] They felt enormous pressure not to lose this case, which involved several important U.S. domestic laws and foreign policies.[166] As a result, the U.S. appointed former Secretary of State Warren Christopher as its arbitrator in this case.[167] Undoubtedly, his vast experience as Secretary of State, Deputy Secretary of State, and Deputy Attorney General under three presidents over the span of thirty years added prestige to the panel. It also comforted the U.S. team in knowing a former senior policy official would participate in the tribunal's deliberations and decisions.

Since NAFTA litigation has significantly increased over the past several years and the number of international law specialists is limited, there is a growing concern these arbitrators may not be totally independent due to potential conflicts of interests. In the *Methanex* case, the claimant challenged the appointment of Christopher as an arbitrator after the tribunal entered a preliminary award finding that Methanex failed to meet the legal threshold of Article 1101 to maintain a claim against the U.S.[168] Three weeks later, Methanex filed a notice of challenge for Christopher to resign, or be disqualified as arbitrator because his law firm had engaged in discussions with California state officials regarding representing the state in a public education lawsuit unrelated to

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[165] Interview with a U.S. official who is familiar with Chapter 11 litigation cases. This information was provided to the author off the record.

[166] Notice of Intent to Submit a Claim to Arbitration (July 2, 1999) and Notice of Arbitration (Dec. 2, 1999), online at http://www.NAFTAclaims.com (visited Oct. 30, 2002).

[167] See Methanex v U.S., Claimant's Notice of Challenge, dated Aug. 28, 2002, online at http://www.NAFTAclaims.com/Disputes/USA/Methanex/MethanexCorrespondenceArbitrator.pdf (visited Nov. 22, 2009).

[168] Claimant's Notice of Challenge dated Aug. 28, 2002 at 1-4, *Methanex Corporation v United States of America*, online at www.NAFTAclaims.com (visited on Nov. 22, 2009).

NAFTA.[169] He filed a response to the challenge stating he had no direct involvement in this litigation and had only referred the matter to one of his partners to handle this education law matter.[170] Although the claimant's allegations were tenuous, and he vehemently denied any potential conflict of interest, Christopher voluntarily withdrew from the tribunal to avoid "continuing distractions of this issue for the tribunal and the parties."[171]

The *Methanex* case is not the only time a Chapter 11 arbitrator has been challenged by a party based on an alleged conflict of interest. In the *S.D. Myers and Canada* case, the claimant alleged Canada's choice of arbitrator, Robert Keith Rae,[172] faced a potential conflict of interest because he had entered into discussions with the Canadian government to provide lobbying services unrelated to NAFTA issues.[173] Although the claimant did not allege any actual bias, they still sought to remove Rae from the panel. Subsequently, the Secretary-General of ICSID informed the tribunal and parties "he would uphold the challenge of Mr. Rae unless he discontinued his activities as

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[169] Id.

[170] Response of Arbitrator Warren Christopher to Notice of Challenge (Sept. 20, 2002) at 2-4, online at http://www.NAFTAclaims.com (visited on Nov. 22, 2009).

[171] Id. at 4.

[172] *S.D. Myers, Inc. and Canada*, 40 I.L.M. 1408, 1422 (2001). Mr. Rae served as Premier of Ontario (Canada) and was elected several times to federal and provincial parliaments prior to his retirement in 1996. He was a partner at an international law firm in Canada and has served as a panel member of the Canadian Internal Trade Disputes Tribunal. Online at http://adrchambers.com (visited Nov. 22, 2009).

[173] Todd Weiler, *2000 in Review: NAFTA Investor-State Dispute Settlement Gains Steam* (2001), online at http://www.NAFTAclaims.com (visited Oct. 15, 2002).

a registered lobbyist in connection with the Softwood Lumber Agreement between the USA and Canada."[174] Rae promptly resigned from the tribunal on the next day.[175]

Moreover, in *Glamis Gold v U.S.*, the respondent challenged the appointment of the claimant's arbitrator, Donald L. Morgan, because of "his allegedly undisclosed involvement as an attorney in a concurrent litigation adverse to the United States Department of the Interior."[176] In accordance with Article 1124, the U.S. requested the Secretary-General of ICSID to decide its challenge to Mr. Morgan's appointment to the tribunal. Before the Secretary-General issued a decision, the arbitrator resigned from the tribunal.[177]

In 2009, another Chapter 11 claim was filed against Canada sparking discussions related to conflicts of interest, but this time for the newly appointed ICSID Secretary-General. In *Centurion Health Corporation v Canada*, the claimant expressed concerns about Meg Kinnear, who was elected Secretary-General for ICSID in February 2009, deciding on who would serve as the tribunal president, which is a responsibility bestowed upon the ICSID secretary-general under NAFTA's Article 1124. According to Centurion's owner, Melvin Howard, Ms. Kinnear "was counsel for the Government of Canada in these proceedings before she took her post to become Secretary General."[178]

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[174] *S.D. Myers v U.S.*, Partial Award, dated Nov. 13, 2000, online at http://ita.law.uvic.ca (visited Nov. 22, 2009).

[175] Id.

[176] *Glamis Gold Ltd. v United States of America*, Final Award, dated June 8, 2009, p. 92, online at http://www.state.gov/documents/organization/125798.pdf (visited Nov. 22, 2009).

[177] Id.

[178] Centurion Health Corporation blog posting dated Mar. 29, 2009. online at http://centurionhealthcorp.blogspot.com/2009/03/centurion-to-select-arbitrator-for.html (visited Nov. 22, 2009).

Besides the "obvious conflict," as Howard describes it, he was also concerned about the "amount of authority" the ICSID secretary-general has over the NAFTA dispute resolution process.[179] In his April 15, 2009 blog posting, Howard states "I have heard back from the acting Secretary-General from the World Bank Group that they will take all necessary measures to avoid any potential conflicts of interest." This case is still pending, and no tribunal president has yet been publicly announced.

Overall, the appointment of private arbitrators plays a key role in maintaining the effectiveness and efficiency of the Chapter 11 tribunals. The main purpose behind the investor-state arbitration process was to provide "a forum that is more neutral than host country courts, both politically and procedurally."[180] Supporters of this system argue that "[t]he relative impartiality of international tribunals bolsters investor confidence and inspires greater certainty that the contract will be interpreted in line with the parties' shared ex ante expectations."[181] The NAFTA policymakers and Chapter 11 drafters strongly believe the arbitrators, who are typically experts in international law and trade, are able to sort through the issues and make the appropriate decisions.[182] From a U.S. perspective, they are also confident the tribunals will consist of "sensible arbitrators" and "[i]f the United States is right and the investor is wrong, it is likely that the tribunal will

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[179] Centurion Health Corporation blog posting dated Apr. 15, 2009. online at http://centurionhealthcorp.blogspot.com/2009/03/centurion-to-select-arbitrator-for.html (visited Nov. 22, 2009).

[180] Guillermo Aguilar Alvarez and William W. Park, *The New Face of Investment Arbitration*, 28 Yale J. Int'l L. 365, 369 (2003). Mr. Aguilar Alvarez had previously served as the Chief Counsel for Mexico during the negotiation of NAFTA.

[181] Id at 370.

[182] Interview with Eric Melby, Ph.D., in Washington, D.C. (Mar. 19, 2009). Dr. Melby was the Senior Director of International Economic Affairs at the National Security Council during the Bush (41) Administration. See also Price, *Chapter* 11 at 113-114 (cited in note 106).

so find."[183] Presumably, they also believe that the vice versa is also true where an investor win would be an expected outcome under NAFTA's dispute settlement mechanism. While there exists the potential for conflicts of interest for arbitrators, the Chapter 11 process allows those issues to be vetted and resolved to maintain the integrity of the tribunals, and to achieve NAFTA's intended goal. In the end, Chapter 11's arbitrator selection process may have also addressed R. Floyd Clarke's concerns regarding international arbitrators he warned about over a century ago.

[183] Price, *Chapter* 11 at 113 (cited in note 106).

CHAPTER 7

SIGNIFICANT NAFTA CLAIMS THAT HAVE EMPOWERED PRIVATE ACTORS OVER STATES

Since the effective date of NAFTA in 1994, approximately sixty-two claims have been filed against the three member states.[1] The following is a summary of two NAFTA claims that impacted the governance systems of member states, and a third claim that highlights the potential issues for member states involving financial institutions. The *Ethyl Corporation v Canada* and *Loewen v United States* cases were selected for this study because the claimants challenged a legislative or judicial decision that were scrutinized by panels of private actors serving as arbitrators. They also generated a significant amount of media attention and scholarly articles regarding their implications. The third case is the *Fireman's Fund Insurance Company v the United Mexican States* which was the first and only Chapter 11 case involving a financial institution. The claimant lost the case, but it revealed troubling facts about the Mexican government's decision-making related to the treatment of American investors during its national financial crisis in the 1990s. More importantly, this case may serve as a roadmap for

[1] These figures are current as of February 28, 2010. The Chapter 11 claim information is derived from information posted on the web sites of the U.S. Department of State, Canadian Department of Foreign Affairs and International Trade, Mexican Ministry of the Economy, International Centre of Settlement of Investment Disputes, and NAFTAclaims.com. As noted in section 6.7 of this thesis, NAFTA requires the U.S. and Canada to disclose Chapter 11 claims filed against them. However, NAFTA Annex 1137.4 allows Mexico to disclose such information at its discretion depending upon the applicable arbitration rules for each case. Hence, the exact number of all filed NAFTA claims are not currently available from public sources.

future Chapter 11 litigation against the member states arising from its economic policies and regulations implemented during the current financial crisis.

7.1 Ethyl Corporation v Canada

The Ethyl Corporation (Ethyl) is a chemical manufacturer headquartered in the State of Virginia with a subsidiary operating in Ontario, Canada.[2] It manufactures and distributes methylcyclopentadienyl manganese tricarbonyl (MMT), which is a fuel additive to enhance the performance of unleaded gasoline.[3] Ethyl alleged that Canada's Manganese-based Fuel Additive Act of 1997 ("MMT Act") violated NAFTA Chapter 11 provisions on expropriation and national treatment.[4] The MMT Act prohibited the trade or import of controlled substances for commercial purposes.[5] The only substance prohibited in the Act was MMT under certain circumstances.[6] Specifically, the import of this chemical was banned, but not its production in Canada. Since ninety-five percent of all unleaded fuel sold in Canada contained MMT, and Ethyl was the sole importer of MMT into Canada, the claimant contended the Act caused the company to lose business in excess of US$251 million.[7] Moreover, the claimant alleged the discriminatory nature

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[2] *Ethyl Corp. v Canada*, 38 I.L.M. 708, 709 (Jurisdiction Phase, 1999).

[3] Id at 709.

[4] Id at 710.

[5] Id.

[6] *Ethyl Corp.*, 38 I.L.M. at 711 (cited in note 2).

[7] Id at 713.

of this Act was evident in the provision that would have allowed the manufacture of MMT, or its use in gasoline, if the company had a manufacturing and distribution facility in each province.[8]

In 1996, Ethyl filed a claim against Canada for the alleged breach of NAFTA.[9] During the tribunal proceedings, the arbitrators issued three rulings, or "awards" as they are referred to, regarding sufficiency of the allegations to support the tribunal's jurisdiction over the claim, the confidentiality of specific government documents, and the place where the arbitration would be held.[10] As part of the litigation on the jurisdiction issue, Canada and Mexico argued Ethyl's claim related to a "measure in the trade of goods" under NAFTA Chapter 3 and only a member state could bring such a claim against another member.[11] Ethyl's only recourse, they argued, was to petition the U.S. to intervene and bring a claim on its behalf.[12] The tribunal rejected the governments' argument finding the investor's claim pertained to expropriation and Canada's alleged failure to afford Ethyl with most favored nation status.[13] Therefore, the tribunal held that Ethyl could bring a claim directly against a member state under Chapter 11.[14] After two years of litigation, the Canadian government settled with Ethyl for approximately US$13

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[8] Id at 727.

[9] Id at 710.

[10] *Ethyl Corp.*, 38 I.L.M. at 712, 715.

[11] Id at 720.

[12] Id.

[13] Id at 726.

[14] *Ethyl Corp.*, 38 I.L.M. at 727 (cited in note 2).

million.[15]

Some scholars argue the monetary settlement of this claim is not the most significant aspect of the resolution of this claim. Rather, they point to the actions taken by the Canada in response to the claim that could be viewed as sending a regulatory chill to other NAFTA member states. As Hart and Dymond explain, "Chapter 11 can bring both comfort and discomfort to the contracting parties, at least at the political or immediate level."[16] They view Chapter 11 as a means to ensure accountability for a state's choices and to "ensure that longer term interest trump short-term political calculations."[17] The Ethyl claim exemplifies the need for accountability of state action, especially as it concerns international trade.[18]

Shortly after the settlement of this claim, the Canadian legislature repealed the MMT Act and acknowledged there was no scientific evidence to support the ban.[19] Hart and Dymond suggest Canada "as a whole benefited from a strong affirmation of the rule of law and the reversal of policies were found to be both capricious and discriminatory" and "[t]he fact the litigants were foreign corporations in no way diminishes the value of the judgments."[20]

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[15] David R. Haigh, *Chapter 11--Private Party vs. Governments, Investor-State Dispute Settlement: Frankenstein or Safety Valve*, 26 Can.-U.S. L.J. 115, 133 (2000).

[16] Michael M. Hart and William A. Dymond, *NAFTA Chapter 11: Precedents, Principles, and Prospects*, in Laura Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law 2002).

[17] Id.

[18] Id.

[19] Id.

[20] Hart and Dymond, *NAFTA Chapter 11* (cited in note 16).

7.2 The Loewen Group v United States

The Loewen Group is a Canadian-based funeral services provider with a subsidiary in the State of Mississippi.[21] The NAFTA claim arises from a commercial dispute between the O'Keefe Corporation and Loewen which were competitors in the funeral home and funeral insurance business in Mississippi.[22] The dispute involved three contracts between these two corporations valued between three to five million U.S. dollars.[23] After a jury trial in a Mississippi state court, a jury awarded O'Keefe $500 million in damages plus $400 million in punitive damages.[24]

Loewen alleged the trial judge allowed the O'Keefe's attorney to make irrelevant and highly prejudicial references to their foreign nationality, raced-based distinctions between the parties, and class-based distinctions (large foreign company versus a family-owned business).[25] They attempted to appeal the decision, but were unable to post a bond of 125% of the verdict as required by state law.[26] The state Supreme Court could have reduced or waived the requirement based on "good cause" but denied Loewen's request.[27] The investor argued that this court decision, in essence, foreclosed their right

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[21] *Loewen Group, Inc. v United States*, Award, 42 I.L.M. 811 (NAFTA Arb. Trib. 2003).

[22] Id at 812.

[23] Id.

[24] Id.

[25] Id at 816.

[26] Id at 812.

[27] Id.

to appeal the decision, and they were compelled to settle the lawsuit for $175 million.[28] Subsequently, Loewen filed for bankruptcy protection from its creditors.[29]

In 1998 the company filed a claim against the U.S. alleging discrimination under NAFTA by the actions taken by the State of Mississippi through its judiciary.[30] This is the first NAFTA claim that challenged the decision of a member state's judiciary. Since the case primarily dealt with state laws and court rules, the State Department decided to recruit the U.S. Department of Justice (DOJ) to take the lead in defending the U.S. in this case. As several former State Department officials noted, the State Department regretted ever bringing the DOJ into the case.[31] The State Department is accustomed to dealing with international arbitration and legal issues, trade policies, and diplomatic issues. In international arbitrations involving states, the practice is less litigious and maintaining amicable foreign relations is part of case management. On the other hand, the DOJ attorneys zealously represent the U.S., but they take the general approach to litigate every single issue and delve into extensive discovery and motion practice in hope of wearing down their adversaries. At one stage in the litigation, the State Department and DOJ disagreed on a significant legal position in the case, and the issue was escalated to the White House for a final decision. At the end of the day, the State Department prevailed and its position helped the U.S. win a jurisdiction issue before the tribunal.

Loewen's claim was the subject of numerous legal proceedings in the Louisiana

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[28] Id.

[29] Id.

[30] Id at 846.

[31] Interviews with former State Department officials who provided this information off the record.

state court system and had an extensive litigation history before a NAFTA tribunal. This case is important for several reasons. First, an overwhelming number of international trade lawyers, scholars and former government officials who were interviewed for this study acknowledged the U.S. should have lost this case but for a legal technicality that resulted in its dismissal. If the claimant had prevailed, this case would have been the first loss for the U.S. in a NAFTA Chapter 11 case and may have resulted in a substantial monetary award.

Second, this case highlighted the need for litigation reform in the State of Mississippi. This state has for a long time been known for its "runaway" juries rendering exorbitant awards in favor of plaintiffs.[32] For example, some of the nation's highest jury verdicts have been issued in Mississippi, including cases involving tobacco, pharmaceutical products, and asbestos.[33] Many companies and professionals were concerned about the potential liability exposure for doing business in the state. There was a perceived fear among corporations that huge liability verdicts could bankrupt a corporation.[34] Runaway jury verdicts, such as in the *Loewen* case, were the type of verdicts that prompted the U.S. Chamber of Commerce to publicly denounce Mississippi for its anti-business practices in May 2002.[35] In this unprecedented move, the Chamber "started an advertising campaign urging Mississippi residents to reform the states' legal

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[32] Tim Lemke, *U.S. Chamber Battles Mississippi*, *Washington Times* (May 10, 2002). See also Douglas McCollam, Mississippi turning? Daily Deal (July 5, 2004), 2004 WLNR 17772971.

[33] Id.

[34] Press Release of U.S. Senator Trent Lott, *Right and Wrong: Mississippi's Tort Decision* (May 16, 2002), online at www.lott.senate.gov (visited Dec. 4, 2002).

[35] Press Release of the U.S. Chamber of Commerce, *U.S. Chamber urges Mississippians to Reform Flowed Legal System* (May 8, 2002), online at www.uschamber.com (visited Dec. 4, 2002).

system, a day after it warned its 3 million members against doing business there."[36]

As the media and public scrutiny increased after the Chamber's announcement, the Mississippi governor and legislature felt enormous pressure to quickly enact reforms to alleviate the concerns of its constituents that corporations might flee the state and thus cause a significant loss of jobs.[37] There were numerous bills drafted to impose various caps to punitive damages, liability damages for medical malpractice.[38] Finally, a series of reforms were enacted to limit liability and damages in November 2002.[39] In response, the Chamber of Commerce publicly recognized the state for its prompt actions to plug the gaping holes in its tort system that was subject to extensive abuse by plaintiffs and their attorneys.[40]

7.3 NAFTA Chapter 11 Claim: Fireman's Fund Insurance Company v the United Mexican States

One of the most significant NAFTA claims is the Fireman's Fund Insurance Company (FFIC) and the United Mexican States. It was the first case brought under the Financial Services Chapter of the NAFTA, and the "first occasion for an international

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[36] Lemke, *U.S. Chamber Battles Mississippi* (cited in note 32).

[37] Patricia Sawyer, *Legislative Passes Civil Justice Reform*, The Clarion –Ledger (Oct. 8, 2002).

[38] Id.

[39] See Press Release, U.S. Chamber of Commerce, *U.S. Chamber of Commerce Commends Mississippi Lawmakers- Tort Reform Bill Provides Balanced Liability Protections*. (Nov. 26, 2002), online at www.uschamber.com (visited Dec. 4, 2002); Tim Lemke, *Mississippi Restricts Lawsuit Damages*, Wash. Times (D.C.) (Nov. 27, 2002); and Reed Branson, *Miss. Lawmakers Finally OK Accord on Liability Limits*, Memphis Commercial Appeal (Nov. 26, 2002), 2002 WLNR 7314078.

tribunal to set forth its interpretation of a key provision under this Chapter."[41] In 1999, FFIC, a California-based insurance company that markets and sells various kinds of insurance, filed a notice of its intent to bring a claim against Mexico alleging it had violated NAFTA provisions against expropriation and unfair national treatment by facilitating the repurchase of debentures denominated in Mexican pesos to Mexican investors, but not of debentures denominated in U.S. dollars that were owned by FFIC.[42] Two years later, after unsuccessful negotiations with the Mexican government, the company filed a formal claim for arbitration with the NAFTA Secretariat under the Agreement's Chapter 11 investor-state dispute settlement provisions.

This claim raised significant issues related to the applicability of Chapter 11 to protect investments of financial institutions in cross border transactions between NAFTA member states. Not only does this claim highlight the concern about private actors using the Chapter 11 arbitrations to impact public laws and policy, but it also raised serious concerns whether investors may prevail against the member states in the future for their regulatory or political actions taken during a national financial crisis.

7.3.1 Summary of the Facts

At the end of 1994, there was a major financial crisis in Mexico. A sharp decline in the Mexican peso compared to the U.S. dollar resulted in high interest rates. This

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[40] Id.

[41] *Fireman's Fund Ins. Co. v United Mexican States*, ICSID Case No. ARB(AF)/02/1ARB(AF)/02/1, Award, P 157 (NAFTA Arb. Trib. July 17, 2006)[hereinafter Tribunal Final Award].

[42] FFIC is a wholly-owned subsidiary of Allianz of America, Inc., a Delaware corporation that is in turn wholly-owned by Allianz AG of Munich, Germany. It is a sister corporation to Allianz México, S.A.

financial situation had a significant impact on Mexican banks. By early 1995, the Mexican government took steps to stabilize its national financial system, including providing financial support to Mexican banks.

In 1995, Group Financiero, a holding company incorporated in Mexico, issued two series of subordinated debentures that were convertible to Group Financiero stock. This offering was intended to capitalize BanCrecer, which was a bank subsidiary of Group Financiero. One series was issued to Mexican nationals in Mexican pesos which were valued, at the prevailing exchange rates, in the amount of US$50 million (the "Peso Debentures"). The other series of debentures were issued to U.S. investors based upon the U.S. dollar (the "Dollar Debentures"). FFIC purchased the latter debentures from Group Financiero in the amount of $50,000,000.

As the financial conditions of various banks deteriorated in 1997, Mexico decided to take various measures to stabilize several national banks, including BanCrecer. As a result, a Working Group consisting of various Mexican regulators was formed to "carry out an indemnification and capitalization program with respect to BanCrecer." This Group consisted of representatives from several Mexican governmental agencies, including the Department of Treasury, Bank of Mexico, the Bank Fund for the Protection of Savings, and the National Banking and Securities Commission. The bank had requested and received approval from the regulators to create a "trust to 'repurchase' the Peso Debentures at part value."[43] This proposal was unknown to FFIC even though they owned the same type of debentures, except that the valuation was based on U.S. currency. In essence, the Mexican regulators' approval resulted in the repurchase of debt that was

[43] Tribunal Final Award, ¶ 64.

only owned by Mexican nationals.

As BanCrecer's financial condition deteriorated, and its efforts to secure additional foreign investment were unsuccessful, FFIC requested in July 1999 that the bank obtain regulatory approval to "acquire the Dollar Debentures on the same terms as the Peso Debentures had been 'repurchased.'" [44] The bank immediately applied for such approval, but the Bank of Mexico denied the request "asserting that 'anticipated payment' of convertible debentures is not allowed under Mexican law."[45]

In September 1999, BanCrecer attempted to convert the Dollar Debentures into shares of Group Financiero. FFIC alleged the bank took this action "at the instigation of IBAP" ("Instituto para la Proteccion al Ahorro Bancario" or "Institute for the Protection of the Bank Savings"), which was the agency responsible for taking preventive measures to avoid financial problems for banks and to manage the country's deposit insurance program.[46] Since the conversion would have resulted in a loss of investment value to FFIC, the investor sued the bank and successfully obtained a court injunction to stop the conversion of its investment.[47] In October the bank stopped paying interest to FFIC for the Dollar Debentures. By early November, the bank shareholders voted to allow the IPAB to take control of the BanCrecer, and the bank ceased to be a subsidiary of Group Financiaro. Shortly thereafter, FFIC filed an amended Notice of Intent to Submit a Claim to Arbitration to the NAFTA Secretariat.

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[44] Id at ¶ 86.

[45] Id.

[46] Id at ¶ ¶ 47 and 89.

[47] Id at ¶ 89.

7.3.2 Fireman's Fund Insurance Company's Position

In their notice of claim, FFIC alleged the Government of Mexico had expropriated its investment in Group Financiero in violation of the anti-expropriation provisions under Article 1110 of NAFTA.[48] Specifically, FFIC asserted the "Government of Mexico deprived Fireman's Fund of the use and value of its investment, and did so in a discriminatory and arbitrary manner." They also alleged "Mexico failed to compensate Fireman's Fund for the fair market value of that investment as required by Article 1110" and thus, the State violated its obligations under that provision.[49] To support its claim, the insurer asserted the following:

1. In early 1998, the Government of Mexico compelled FFIC to use its investment to further the Government's Recapitalization Plan for BanCrecer;

2. After compelling FFIC to participate in the Government's Recapitalization Plan, the Government proceeded to thwart the Program to which it had committed itself, thereby depriving FFIC of the value of its investment as envisioned under the Program;

3. At or around the same time the Government approved and then subsequently failed to carry out the Recapitalization Plan for BanCrecer, the Government discriminated against FFIC by refusing to authorize the repurchase of FFIC's Dollar Debentures at face value, as the Government had done for the Mexican investors of the Peso Debentures;

4. The Government of Mexico also deprived FFIC of the value of its investment by return, in November 1998, the non-performing loan portfolios assumed by FOBAPROA from 1995-1997; and

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[48] Claimant's Notice of Arbitration, dated Oct. 30, 2001, Fireman's Fund Insurance Company and United Mexican States, online at http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Fireman/documentos_basicos/Notice_of_arbitration.pdf (visited Feb. 24, 2010).

[49] Tribunal Final Award, ¶ 5.

5. The Government of Mexico, through IBAP, took the ultimate step to deprive FFIC of the value of its investment by taking control of BanCrecer in November 1999.[50]

In addition, FFIC argued that "even if the Tribunal were to find that no single one of the Government's actions individually is sufficient to support a finding of expropriation, it is clear that the totality of the acts and omissions of the Government, considered cumulatively, had the effect of depriving FFIC of the use and value of its investment, thereby expropriating it."[51]

7.3.3 The Government of Mexico's Position

During the litigation of this claim, Mexico took the position that FFIC was a sophisticated investor who made a "risky investment in a bank at a time that there was a very serious financial crisis in Mexico."[52] It also took a two-prong approach to defend itself against FFIC's claim. First, they challenged the jurisdiction of the tribunal related to several issues including:

1. jurisdictional limits;
2. the claim was based on facts and arguments that were outside the competence of the Tribunal;
3. the United States [had] considered to bring a State-to-State claim under Chapter Twenty of the NAFTA; and
4. the Tribunal had to ignore large portions of the [Claimant's claim].[53]

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[50] Id at ¶ 103.

[51] Id at ¶ 105.

[52] Id at ¶ 116.

[53] Id at ¶ 119.

Secondly, Mexico disputed numerous facts asserted by the FFIC and the merits of the case by arguing the claimant misinterpreted Chapter 11 related to the discriminatory treatment claim. They pointed out Chapter 11 does not allow claims for alleged unfair or discriminatory national treatment of financial services companies. Thus, the FFIC's only recourse for such alleged treatment was to convince the U.S. to file a State-to-State claim under Chapter 20. They also disputed the expropriation allegation. Mexico argued that any actions it took were prudential measures authorized by Chapter 14 of the NAFTA and reasonably necessary to stabilize its national financial system, including BanCrecer, which was a Mexican bank. In addition, these measures, they asserted, did not constitute expropriation under international law.

7.3.4 The Players

As might be imagined, this type of case involving a major country and a large multinational financial institution tends to create extensive employment opportunities for many lawyers. All the parties and the other two States that were not parties to this claim had several attorneys representing their diverse interests throughout the arbitration. The lead counsel for the Mexican government was Hugo Perezcano who was the Legal Counsel for Negotiations of the Ministry of Economy. His legal team consisted of partners at two large U.S. firms, Thomas & Partners and Shaw Pittman.[54]

The Fireman's Fund retained the services of Lawrence W. Newman and Raymundo E. Enriquez of the law firm of Baker & McKenzie. Newman was eventually

[54] Transcript of Jurisdictional Hearing, Fireman's Fund Insurance Company and United Mexican States (Feb. 6, 2003), online at http://NAFTAclaims.com/Disputes/Mexico/Fireman/FiremanTranscript1.pdf (visited Feb. 27, 2010).

substituted with Daniel M. Price of the law firm of Sidley, Austin, Brown & Wood, LLP. (Mr. Enriquez stayed on as counsel since he was an experienced attorney located in Mexico City and would assist with local law and witnesses.) Price was one of the lead USTR negotiators who drafted Chapter 11 during the NAFTA negotiations and had extensive knowledge about the nuances of its provisions.[55]

The Arbitral Tribunal was composed of Professor Albert Jan Van den Berg (appointed as President of the Tribunal by the Secretary-General of ICSID), of Dutch nationality, residing in Belgium, Professor Andreas F. Lowenfeld (appointed by FFIC), of U.S. nationality, residing in New York, and Mr. Francisco Carrillo Gamboa (appointed by Mexico), of Mexican nationality, residing in Mexico City.

Professor Van den Berg, is a highly regarded attorney who has practiced international law for over thirty-five years in various legal positions. He is the President of the Netherlands Arbitration Institute and former Vice-President of the London Court of International Arbitration. He also teaches at Erasmus University in Rotterdam, and has served in various positions at several prestigious international arbitration organizations. In addition, a study of ICSID arbitrators identified him as the arbitrator with the second most appointments to ICSID cases between 1972-2006.[56]

FFIC appointed Professor Andreas F. Lowenfeld who is a law professor at New York University School of Law and a preeminent authority on international law. A 1955

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[55] A year after the arbitration had concluded, President George W. Bush appointed Mr. Price as a Special Assistant and Director of International Economic Affairs of the National Security Council until 2008 when he returned to private practice at his prior law firm. In addition, President Bush appointed him as an arbitrator to the International Centre of Settlement Investment Disputes.

[56] Professor Van Den Berg was selected as arbitrator for seven concluded ICSID cases between 1972-2006. The arbitrator with the most appointments is Bernando M. Cremades of Spain with nine completed

graduate of Harvard Law School, he served as legal advisor in the U.S. Department of State during the 1960s. He also served as an arbitrator for numerous cases under the rules of International Court of Claim, UNCITRAL, ICSID and GATT. Furthermore, Professor Lowenfeld has published over twenty textbooks and 110 articles in academic journals related to international law, arbitration, trade and aviation law.

Mexico had first appointed Francisco Carrillo Gamboa as arbitrator. He is a founder and managing partner at Bufete Carrillo Gamboa and had practiced law for over twenty-five years at the time of the arbitration. Also, he earned his Master of Laws at Harvard Law School in 1979. During the arbitration, the parties had learned that Gamboa's law firm had rendered a legal opinion to BanCrecer several years prior to the arbitration and the Government of Mexico had relied on it to make certain decisions related to the bank. As a result, Gamboa resigned from the Tribunal to avoid any conflict of interest, and Mexico appointed Alberto Guillermo Saavedra Olavarrieta as the new arbitrator. Saavedra is a partner at the law firm of Santamarina y Steta in Mexico City. He served as a representative on Pacific Rim Advisory Council, and as a corporate director of Corporacion Geo, S.A.B. de C.V., a publicly traded home-building company on the Mexico Stock Exchange.

Although not parties to this case, legal counsel for the United States and Canada attended the hearings and participated in the proceedings whenever the tribunal requested a country's legal position on the interpretation of NAFTA or national law. Mark A. Clodfelter, Assistant Legal Advisor, and several other attorneys represented the U.S.

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cases. Jeffrey P. Commission, *Precedent in Investment Treaty Arbitration: The Empirical Backing* (2007), online at www.transnational-dispture-management.com (visited Sept. 21, 2009).

from the Office of Legal Advisor at the State Department.

7.3.5 Tribunal's Decision

Even though the use of the arbitration under NAFTA Chapter 11 was intended to expedite the resolution of legal disputes, the procedural process mirrors in many respects the same rules and procedures as in court litigation. The litigation of this case took nearly five years from the filing of the Notice of Arbitration to the date the Tribunal issued its Final Award.[57] During this time period, the Tribunal faced various complex legal issues requiring extensive discovery,[58] interpretation of NAFTA, and the review of national laws and regulatory framework. The parties submitted extensive briefs detailing their legal arguments, documentary and testimonial evidence, and citing the relevant sections of NAFTA, national law, and prior international arbitration claim decisions. In addition, the Tribunal was required to decide on issues related to discovery, motions, and substantive issues such as the Tribunal's jurisdiction to decide this claim.

7.3.6 Preliminary Question on Jurisdiction

One of the preliminary issues before the Tribunal was the issue of jurisdiction. Mexico had challenged the Tribunal's authority to arbitrate FFIC's claim based on alleged violations of Articles 1102, 1105 and 1405 of NAFTA. First, the Claimant argued all of its claims should be considered under Chapter 11 because not all of the

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[57] For a detailed discussion regarding the procedural history of this case, please see the Tribunal Final Award dated July 17, 2006 and Decision on the Preliminary Question, dated July 17, 2003 [hereinafter Decision on Preliminary Question).

[58] Discovery is the legal term meaning the production of evidence which typically includes documents, records, and depositions.

elements of Chapter 14 were present in this case. In particular, FFIC took the position BanCrecer was not a "financial institution" within the meaning of Chapter 14 because it is not "authorized to do business," nor regulated as a financial institution under Mexican law.[59] Mexico countered BanCrecer was owned by Grupo Financiero, a financial holding company, which was subject to regulation and licensing by financial services regulators. Since FFIC did not dispute Grupo Financiero was regulated and licensed by regulatory agencies, the Tribunal held BanCrecer was a "financial institution" under Chapter 14.

Mexico also argued that it took governmental measures related to BanCrecer that were exclusively governed by Chapter 14 of NAFTA relating to Financial Services. Under Article 1101(3), Chapter 11 "does not apply to measures adopted or maintained by a Party to the extent they are covered by Chapter 14 (Financial Services)." This issue highlighted what some legal experts and business executives have called a "flaw" under NAFTA. The "flaw," as they see it, pertains to the inability of aggrieved investors in a financial institution to bring a claim directly against a state under Chapter 11 for violating the principles of national treatment and most favored nation treatment. Without this tool under Chapter 11, investors are left with the least desirable option to lobby their resident state to file a claim against the host state. This process is arduous, costly, political and hampered by extensive bureaucratic "red tape." Historically, states file few claims against each other and the litigation of these claims drag out for many years, sometimes, for decades.

As detailed in the previous section on the drafting of NAFTA, each member state was anxious to increase transborder investments, but they were reluctant to allow investor

[59] Decision on the Preliminary Question, ¶ 77.

claims under Chapter 11 because each state had different regulations and financial policies that were subject to the states' own interpretations.[60] Moreover, potential Chapter 11 claims could disrupt the national regulatory framework of its financial markets or allow arbitrations tribunals to render decisions impacting national laws and regulations. The Tribunal noted:

> the architects of the NAFTA were aware that the Governments of each of the State Parties regulated in considerable detail the activities of financial institutions engaged in securities transactions, insurance, banking and related activities. These regulations were often of a macro-economic character and involved prudential considerations of various kinds.[61]

Thus, Chapter 11 excludes claims for national treatment under Article 1102 and Most-Favored-Nation Treatment under Article 1105. To address the two claims related to cross-border investments by financial institutions, NAFTA drafters created a separate Chapter 14 on Financial Services which allows states to bring these claims against other member states on behalf of its financial institutions.[62] The only cause of action available to financial institutions under Chapter 11 is the claim for expropriation under Article 1110.

Many business executives and legal scholars believe financial institutions operating in a foreign state are more often susceptible to discriminatory treatment rather than expropriation, which requires a higher standard of proof in a legal proceeding.

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[60] Tribunal Final Award, ¶ 2.

[61] Id at ¶ 1.

[62] Id at ¶ 3. See also E-mail from Daniel M. Price, USTR Principal Deputy General Counsel, to Kenneth P. Freiberg, USTR Deputy General Counsel, Subject line: List of Issues (Mar. 30, 1992, 08:53 (EST)), National Archives, USTR Computer Group DGMAIL, PRICE.DAN.920330.01. The NAFTA Lawyers Group had raised several issues to the USTR legal staff related to the interrelationship between the Investment Chapter and Financial Services Chapter, including the exclusion of national treatment and most-favored-nation treatment provisions in the services chapter.

Absent the blatant act of a state's nationalization of a financial institution, such as a bank, the types of facts necessary to prove an expropriation claim is difficult in today's current financial markets. A financial institution can suffer, as Chapter 11 critics argue, significant losses and be placed at a major disadvantage to its national competitors unless there is a level playing field in the financial markets. For example, if a government provides special treatment to national banks not afforded to foreign-owned banks, there is no state-sponsored expropriation, but the foreign banks can still suffer significant losses without the same assistance available to national banks. During a national financial crisis, the availability of government-sponsored assistance can make the difference in banks surviving a dire financial situation instead of facing the prospects of bankruptcy with no hope of rehabilitating itself to financial stability.

After reviewing the text and drafting history of NAFTA,[63] the Tribunal held that FFIC's claims involved an investment in a financial institution as defined in Article 1416 of the NAFTA, and the claims under Articles 1102, 1105 and 1405 were not subject to its jurisdiction. In summarizing the drafter's concerns, the arbitration panel stated:

> it is evident that the drafters carved out the financial sector from significant portions of the general provision, because none of the state Parties were prepared to engage in the kind of harmonization and regulation that would have been necessary to treat banks, insurance companies, and securities firms (as well a other participants in the financial sector) in the same way as, say, the soft drink, retail trade, or shoe manufacturing industries.[64]

This rationale was consistent with the establishment of Annexes to NAFTA that are

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[63] Under NAFTA Article 1131, a tribunal is required to "decide issues in dispute in accordance with s Agreement and the applicable rules of international law." For treaty interpretation, the Tribunal elected to follow the rules of interpretation set forth in the Vienna Convention on the Law of Treaties of 1969. Decision on the Preliminary Question, ¶ 63.

[64] Decision on the Preliminary Question, ¶ 83.

applicable to Chapter 14 in which the parties listed the types of industries and activities reserved and exempt from NAFTA.[65]

The arbitrators stated that the NAFTA negotiators created Chapter 14 in a manner resulting in its applicability to:

> measures adopted or maintained by a Party relating to (a) financial institutions of another Party; (b) investors of another Party, and investments of such investors, in financial institutions in the Party's territory; and (c) cross-border trade in financial services.[66]

It also indicated that Chapter 14 maintained the "overall principles of the NAFTA" to allow "an investor of one state Party to … establish a financial institution in the territory of another state party, and the principle that each Party is to accord national treatment to investors of another Party (Article 1405)." Aggrieved investors may bring a claim under Chapter 14, but they are subject to the state-to-state dispute settlement mechanism established under NAFTA.

7.3.7 Analysis of the Tribunal's Final Award

After nearly five years from the filing of the arbitration notice, the Tribunal issued its Final Award on July 17, 2006. The arbitration panel listened to extensive testimony from numerous witnesses for both parties and carefully considered a plethora of documents entered into evidence throughout this proceeding. In addition, they had availed themselves of detailed legal briefs in which the parties' counsel argued the

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[65] Decision on the Preliminary Question, ¶ ¶ 71 and 83.

[66] Id at ¶ 71.

validity and strengths of their position intended to persuade the arbitrators to rule in favor of their clients. As noted in the prior section, the Tribunal had previously ruled to dismiss most of FFIC's claims and the scope of the Final Award was limited to the issue of whether an expropriation of FFIC's investment had occurred under Article 1110, and if so, what compensation would be owing to the claimant.[67] In the end, the Tribunal held that Mexico's actions related to BanCrecer did not result in the expropriation of FFIC's investment in dollar-denominated debentures issued by Group Financiero.

In its 107-page Final Award, the arbitrators set forth a detailed analysis of the relevant facts and sections of NAFTA. The Tribunal focused on the status of: (a) the Working Group, which was a major influence in BanCrecer's decision-making for major financial transactions; (b) the applicability of the "prudential measures" exemption under Article 1110; and (c) whether Mexico's actions constituted an expropriation of FFIC's investment in the bank.

The following is a summary of the major points of the Tribunal's decision:

7.3.8 Was the Working Group Acting as an Instrumentality of the Mexican Government?

A key issue before the Tribunal was whether the Working Group was an instrumentality or alter ego of the Mexican government.[68] FFIC argued that the Working Group consisted of representatives from all of the major Mexican governmental agencies that regulated the financial industry, and the bank did not make any major financial

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[67] Tribunal Final Award, ¶ 4.

[68] Id at ¶ ¶ 69-73.

decisions without first clearing it by this group.[69] In essence, the Working Group, the Claimant argued, was acting on behalf of Mexico. The Government of Mexico challenged this assertion noting the Working Group was not a governmental organization, nor did it have "the decision-making authority or power to bind the State."[70]

The arbitrators acknowledged the Working Group consisted of representatives from various financial institution regulators.[71] The bank's creditor and shareholders had "to communicate and reckon with" the Group.[72] The Group met frequently with BanCrecer employees regarding the bank's financial conditions.[73] As part of its major transactions, the bank advised their main investors they would have to submit any proposals to the Group for consideration.[74] If the Group did not agree with the recommendation, the bank would reject the proposal. On the other hand, if the Group did not object to the proposal, the relevant agencies would issue the required permits or licenses.[75]

Although the Tribunal considered these facts, the panel focused on FFIC's decision to maintain its investment in BanCrecer even though the bank was on the verge of dissolution. During the arbitrations hearings, there were sufficient facts introduced into evidence to establish that FFIC knew, or should have known, the Working Group

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[69] Id at ¶ 149.

[70] Id.

[71] Id at ¶ 151.

[72] Id.

[73] Id.

[74] Id.

[75] Id at ¶ 152.

only made recommendations to government agencies, not final decisions binding on Mexico.[76] For example, the arbitrators indicated that "no document was produced in the arbitration purporting to be an approval of the Recapitalization Plan, whether by the Working Group or by its member agencies on commendations of the Working Group."[77] Accordingly, "the relations of the Working Group with Claimant," the Tribunal concluded, "do not give rise to liability on the part of the Government of Mexico under the NAFTA."[78]

7.3.9 Did Mexico's Actions Constitute "Prudential Measures"?

The Tribunal had to decide a threshold question as to whether Mexico's actions in this case constituted a "prudential measure" under Chapter 14. They found that the Mexican government had adopted certain measures and established financial assistance programs for financial institutions to help stabilize them during a major financial crisis in Mexico that started a few years before the FFIC transaction.[79] One of those measures was a program "under which the Government, through Fondo Bancario de Protección al Ahorro (FOBAPROA), assumed non-performing loan portfolios from the participating banks in exchange for interest bearing notes issued by FOBAPROA payable in ten years, and guaranteed by the Government."[80] This program was intended to allow banks to rid

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[76] Id at ¶ 154.

[77] Id at ¶ 153.

[78] Id at ¶ 155.

[79] Id at ¶ 48.

[80] Id. "FOBAPROA" was described in the Tribunal's decision as follows:

themselves of bad debt and add interest-generating government notes to improve their balance sheets. In this case, the Claimants showed that "[a]s a rule, for each peso contributed by the shareholders or others to capital, the Government assumed two pesos' worth of loan portfolio."[81]

FFIC argued Mexico could not avail itself of the protections of the "prudential measures" safe harbor under Article 1410 because its measures were not reasonable and/or taken for prudential reasons.[82] If the measures were determined not to be reasonable or taken for prudential reason, FFIC contended these measures "would give rise to liability, or at least to a presumption of liability, under Article 1110."[83] Mexico argued the above measures were "'reasonable measures for prudential reasons' within the meaning of Article 1410 (Exceptions) of the NAFTA."[84]

The Panel closely scrutinized the treaty to determine whether Mexico's measures fell into any exception to the Article 1405 requirement that member states "accord to investors of another Party treatment no less favorable than that it accords to its own investors, in like circumstances, with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of financial institutions

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The Fondo Bancario de Protección al Ahorro ("FOBAPROA"), Fund for the Protection of Bank Savings) is a Trust Fund (fideicomiso) established pursuant to Article 122 of the Ley de Instituciones de Crédito (Act of Credit Institutions, also called Banking Act) whose objective was to take preventive measures in order to avoid financial problems of "instituciones de banca múltiple" [multiple service banking institutions] as well as compliances of those institutions with their obligations. The Fund functioned as a form of deposit insurance. Id at ¶ 47.

[81] Id at ¶ 49.

[82] Id. at ¶ 160.

[83] Id.

[84] Id. at ¶ 156.

and investments in financial institutions in its territory."[85] Article 1410(1) (Exceptions) of the NAFTA provides:

> 1. Nothing in this Part [Five, i.e., "Investment, Services and Related Matters"] shall be construed to prevent a Party from adopting or maintaining **reasonable measures for prudential reasons**, such as:
>
> > (a) the protection of investors, depositors, financial market participants, policyholders, policy claimants, or persons to whom a fiduciary duty is owed by a financial institution or cross-border financial service provider;
> >
> > (b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions or cross-border financial service providers; and
> >
> > (c) ensuring the integrity and stability of a Party's financial system. (Emphasis added)

Under this provision, a member state may take measures that can be discriminatory in nature without investor recourse under NAFTA, if such actions fall within the limited categories described above.

To better understand this provision, the arbitrators also looked to the drafters' intent for the safe harbor. A primary source they relied upon was the book authored by former U.S. Treasury official Olin L. Wethington who was the principal treasury negotiator for Chapter 14.[86] The Panel noted the following:

> [As Wethington wrote:]Article 1410(1)(a) . . . carves out of the national treatment and other obligations of the financial services chapter a right to take reasonable measures even though discriminatory in application, to protect the safety and soundness of the financial system. This regulatory prerogative to protect the integrity of the financial system is accepted internationally.[87] [footnote omitted]

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[85] NAFTA, Article 1405(1).

[86] Wethington served as Assistant Secretary for International Affairs at the Treasury Department from 1991-1992 and Special Assistant to President Bush and Executive Secretary of the Economic Policy Council from 1990-1991. He most recently served as Chairman of AIG Companies in China starting in 2006.

[87] Tribunal Final Award, ¶ 163.

> The author goes on to point out that the prudential exception covers only "reasonable" measures, such as measures relating to capital adequacy, loan loss reserve requirements, cash reserve, and liquidity requirements and various regulations pertaining to diversification of risk. However, evidently focusing on Mexico, he writes:
>
> > However, the exception cannot be used as a guise or an indirect means for discriminating against United States or Canadian entities or for taking arbitrary action in connection with individual firm applications or approval or licensing requests. It does not constitute an exception which permits backhanded avoidance of the national treatment and other significant obligations in the financial services chapter.[88]

Based upon the treaty text and historical background for Article 1410(1), the Tribunal rejected the Claimant's argument noting prudential measures are exempt even if they are discriminatory.[89] Thus the arbitrators did not rule on whether Mexico's measures were reasonable or taken for prudential reasons, rather they held that the Claimant had to first prove that the measures resulted in the expropriation of their investment.[90] In their opinion, they viewed the "prudential measures" safe harbor as a legal defense for States.[91] If FFIC was unsuccessful in proving expropriation had occurred, any of the exemptions under Article 1410(1) would be irrelevant and member states were not required to establish a legal defense under this provision.

7.3.10 Expropriation Claim under Article 1110

The Claimant argued that Mexico's denial of BanCreer's request to offer

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[88] Id. at ¶ 164, quoting Olin L Wethington, *Financial Market Liberalization*, § 5.07 (Sheppard's McGraw Hill 1994).

[89] Id. at ¶ 74.

[90] Id. at ¶ 77.

[91] Id.

Claimant the same deal as it did with Mexican investors but using a dollar-denominated transaction constituted an expropriation of its investment. Under Article 1110, a member state shall not "directly or indirectly nationalize or expropriate an investment of an investor of any Party in its territory, or take a measure tantamount to nationalization or expropriation of such investment."[92] This provision does not apply to measures taken:

> (a) for a public purpose;
> (b) on a non-discriminatory basis;
> (c) in accordance with due process of law and Article 1105(1); and

[92] NAFTA Article 1110 (Expropriation and Compensation) provides:

> 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
>
> (a) for a public purpose;
>
> (b) on a non-discriminatory basis;
>
> (c) in accordance with due process of law and Article 1105(1); and
>
> (d) on payment of compensation in accordance with paragraphs 2 through 6.
>
> 2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.
>
> 3. Compensation shall be paid without delay and be fully realizable.
>
> 4. If payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.
>
> 5. If a Party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.
>
> 6. On payment, compensation shall be freely transferable as provided in Article 1109.
>
> 7. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, or to the revocation, limitation or creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with Chapter Seventeen (Intellectual Property).
>
> 8. For purposes of this Article and for greater certainty, a nondiscriminatory measure of general application shall not be considered a measure tantamount to an expropriation of a debt security or loan covered by this Chapter solely on the ground that the measure imposes costs on the debtor that cause it to default on the debt.

(d) on payment of compensation in accordance with paragraphs 2 through 6.

In essence, the member states agreed not to expropriate the investment of investors from another member state. But if any did so, the state would be liable for damages to investors, unless it could prove the existence of one of the four exceptions listed above.

The term "expropriation" is not defined in NAFTA, but it allows tribunals to interpret its provisions under the treaty and international law. In fact, there were ten NAFTA tribunal decisions prior to this case pertaining to expropriation, but the definition of expropriation varied in each of those cases. In light of the facts alleged by FFIC in this case, Mexico sought to limit the Tribunal's analysis to the four corners of the treaty. On the other hand, the Claimants implored the Tribunal to consider a wide array of other international arbitration decisions beyond NAFTA arbitration decisions that found state expropriation. Armed with an extensive body of international law, the Claimants submitted a lengthy brief that detailed other tribunal rulings on expropriation. On behalf of FFIC, Daniel Price, a former USTR Principal Deputy General Counsel and the lead U.S. drafter of Chapter 11, and Stephen M. Schwebel, a prominent international law scholar and former judge, wrote the brief.[93] In an eighty-two page in-depth analysis, they made compelling and persuasive arguments to show expropriation should be viewed as a broader concept than the mere physical takings by states.[94]

The tribunal was careful not to heavily rely upon prior international arbitration

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[93] Judge Schwebel served for over twenty years in the Office of Legal Advisor at the U.S. Department of State between 1961-1981 and he was a member of the United Nations International Law Commission (1977-1980). Schwebel also served as a judge on the International Court of Justice between 1981-2000, online at http://www.cceia.org/people/data/stephen_m__schwebel.html (visited Oct. 18, 2009).

[94] Claimant's Memorial on the Merits (June 25, 2004), online at http://NAFTAclaims.com/Disputes/Mexico/Fireman/FiremanInvestorMemorialMerits.pdf (visited Oct. 18, 2009).

decisions for several reasons.[95] First, the facts in each case vary, and decisions may be based on a treaty that differs in its provisions from NAFTA. Second, even for NAFTA cases, the treaty specifically provides that tribunal awards are only binding on the parties in a particular case.[96] Tribunals are not bound to follow the legal analysis or awards of other NAFTA tribunals. However, the arbitrators in this case believed certain principles developed in those case, "to the extent that they cover the same matters as the NAFTA, may advance the body of law, which in turn may serve predictability in the interest of both investors and host states."[97]

After extensive deliberation, the Tribunal identified the following elements of expropriation that it applied to this case:[98]

(a) Expropriation requires a taking (which may include destruction) by a government-type authority of an investment by an investor covered by the NAFTA.

(b) The covered investment may include intangible as well as tangible property.

(c) The taking must be a substantially complete deprivation of the economic use and enjoyment of the rights to the property, or of identifiable distinct parts thereof (i.e., it approaches total impairment).

(d) The taking must be permanent, and not ephemeral or temporary.

(e) The taking usually involves a transfer of ownership to another person (frequently the government authority concerned), but that need not necessarily be so in certain cases (e.g., total destruction of an investment due to measures by a government authority without transfer of rights).

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[95] Tribunal Final Award, ¶ 172.

[96] Article 1136 (Finality and Enforcement of an Award) states: "An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case."

[97] Tribunal Final Award, ¶ 172.

[98] Id at ¶ 176.

(f) The effects of the host State's measures are dispositive, not the underlying intent, for determining whether there is expropriation.

(g) The taking may be *de jure* or *de facto.* The taking may be "direct" or "indirect."

(h) The taking may have the form of a single measure, or a series of related or unrelated measures over a period of time (the so-called "creeping" expropriation).

(i) To distinguish between a compensable expropriation and a noncompensable regulation by a host State, the following factors (usually in combination) may be taken into account: whether the measure is within the recognized police powers of the host State; the (public) purpose and effect of the measure; whether the measure is discriminatory; the proportionality between the means employed and the aim sought to be realized; and the bona fide nature of the measure.

(j) The investor's reasonable "investment-backed expectations" may be a relevant factor whether (indirect) expropriation has occurred.

The Tribunal carefully reviewed the facts in this case against the elements of expropriation noted above.

In the end, the arbitrators ruled against FFIC, and held that the investor failed to prove that Mexico's measures constituted expropriation under Chapter 11. In doing so, the arbitrators rejected each of the Claimant's arguments. Their decision focused on speculative risks assumed by FFIC from the inception of their investment, the lack of evidence to prove actual regulatory approval of FFIC's proposed peso debenture repurchase transaction, and insufficient evidence to show that Mexico misled FFIC in holding onto its investment despite the deteriorating financial condition of the bank.

Specifically, the Tribunal determined the actions or measures of the Mexican government did not rise to the appropriate levels to constitute expropriation. First, the arbitrators strongly believed FFIC had knowingly and voluntarily made a speculative

investment in BanCrecer and assumed a substantial financial risk of loss as a means to enter the personal lines insurance business in Mexico.[99] In their eyes, the investment was equivalent to the investment of "junk bonds" because FFIC was fully aware of BanCrecer's dire financial condition during a major financial crisis in Mexico at the time of its investment.[100] It was undisputed that the bank was seeking cash from foreign investors, such as FFIC, to recapitalize its floundering balance sheets. Nevertheless, there was insufficient evidence to show that the Working Group had actual regulatory authority to approve or deny such transactions. The transaction was also never formally presented to the applicable Mexican regulators for approval. Hence, the Claimant failed to prove that Mexico took a measure to deprive them of its use of and value of its investment.

The Tribunal was also not convinced Mexico had established any reasonable "investment-backed expectations" that it would preserve FFIC's investment. Although there was some indication that Mexican regulators had participated in certain discussions concerning the peso debenture repurchase program, the evidence was insufficient to prove Mexico led FFIC to believe, or established reasonable expectations that the government would rescue the Claimant from its high-risk investment.

7.3.11 Mexico Found to Have Engaged in Discriminatory Treatment but Their Actions Were Insufficient to Constitute an Expropriation Under NAFTA.

Interestingly, the Tribunal found that Mexico had engaged in discriminatory

[99] Id. at ¶ ¶ 179 and 180.

[100] Id. at ¶ 182.

treatment, but it still rejected FFIC's argument that "the Government discriminated against FFIC by refusing to authorize the repurchase of FFIC's Dollar Debentures at face value, as the Government had done for the Mexican investors of the Peso Debentures" as a basis to establish expropriation. This aspect of the Tribunal's decision is controversial because FFIC had introduced evidence showing the Mexican government's involvement in BanCreer's financial decision-making, and their regulators reluctance to support the bank's request to the Working Group to offer FFIC a substantially similar deal that Mexico had approved for Mexican investors.

In addition, FFIC even alleged that Mexico, which denied the allegation, had pressured some of its witnesses who were located in Mexico not to testify at the hearing. For example, a relevant piece of evidence for FFIC was the testimony of J.P. Morgan's representative in Mexico who had personal knowledge of the Mexican government's involvement in the transaction. He also received assurances from Mexican officials that the government had approved the recapitalization of BanCrecer, which was subsequently repudiated by Mexico.[101] Although this witness initially submitted an affidavit to key facts in the case, he subsequently refused to testify at the arbitration even though the Tribunal entreated him to testify at the hearing.[102] Absent this testimony, the arbitrators could not consider the purported facts related to the Mexican government's approval of a recapitalization plan.[103]

The arbitrators did not mince words in expressing their displeasure with Mexico's

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[101] Id at ¶ 153.

[102] Id.

[103] Id at ¶ 37.

tactics in implementing the peso debenture repurchase program. The Tribunal noted the Mexican regulators' refusal to authorize the repurchase of FFIC's Dollar Debentures at face value, as the Government had done for the Mexican investors of the Peso Debentures, was "**more troubling"** than the other facts in this case, but it did "not constitute a taking under Article 1110 of the NAFTA either."[104] (Emphasis added). As part of its decision, the Tribunal determined the "Peso Debentures repurchase **discriminated** against FFIC."[105] (Emphasis added). It also found Mexico's rationale for not offering similar relief to FFIC to be "**inexplicable**" when it subsequently authorized the bank to repurchase all Peso Debentures at face value.[106] (Emphasis added).

They also noted "[I]t is **unconvincing**, as Mexico alleges, that it was impossible to distinguish between '*sin contrato*' ["without subscription"] and '*con contrato*,' ["with subscription"] having also regard to the large amount and number of purchasers involved."[107] (Emphasis added). The Tribunal was further **"troubled"** that the "repurchase of the Peso Debentures was organized by means of a trust set up, controlled and financed by BanCrecer, a subsidiary of GFB" and it was not "temporal."[108] (Emphasis added). "**Worse even**," they wrote, was "the whole repurchase scheme, as it evolved, was not disclosed to FFIC, which discovered it accidentally in April 1998" when nearly two-thirds of transactions with Mexican investors were completed.[109]

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[104] Id at ¶ ¶ 200 and 202.

[105] Id at ¶ 201.

[106] Id at ¶ 201.

[107] Id.

[108] Id.

[109] Id.

(Emphasis added). Furthermore, the arbitrators believed there was clear evidence demonstrating that "the Government authorities were, at a minimum, aware of the repurchase program and its financing as from its inception."[110]

The Tribunal also challenged the Mexican government's assertions for failing to notify FFIC regarding its financial programs, and not offering a Dollar Debenture repurchase. The arbitrators wrote:

> The understandable reaction of FFIC was to ask for equal treatment by the Mexican authorities. On various occasions, the Mexican authorities refused to allow FFIC via GFB to have the Dollar Debentures repurchased at face value. While the Tribunal does not pass judgment on Mexican law or its interpretation and application, it is not convinced by the justification offered by Banco de México[111] that "anticipated payment" of convertible debentures is not allowed under Mexican law."[112]

Moreover, the fair treatment of national and foreign investors was a prevalent theme throughout the Tribunal's written decision.

The arbitrators reiterated their perspective that this case was a "clear case of discriminatory treatment of a foreign investor."[113] They strongly believed that "[I]f there is a "haircut" for holders of debentures, all should be shaven. Conversely, if one is allowed to escape the hands of the barber, the other should be allowed to escape as well."[114] In their opinion, if this claim had been subject to Articles 1102 (National Treatment), Article 1105 (Minimum Standard of Treatment), or Article 1405 (National

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[110] Id at ¶ ¶ 200 and 201.

[111] Banco de Mexico is Mexico's central bank which is a similar governmental entity to the Federal Reserve in the United States.

[112] Tribunal Final Award, ¶ 202.

[113] Id at ¶ 203.

[114] Id.

Treatment) of the NAFTA, the investors would have proven their claim against Mexico. However, the Tribunal lamented that it lacked jurisdiction to decide FFIC's claim under those provisions.[115]

7.3.12 Final Analysis of Tribunal Decision

Despite the fact the Tribunal determined that "Claimant FFIC [had] clearly demonstrated injury—indeed loss of its investment," the arbitrators held there was insufficient evidence to establish "expropriation as understood in the NAFTA and in international law in general."[116] They focused on the financial risk assumed by FFIC when it invested in a failing financial institution in the middle of a major national financial crisis. In their view, "the NAFTA, like other free trade agreements and bilateral investment treaties, does not provide insurance against the kinds of risks that FFIC assumed, and Chapter 14 addressed to cross-border investment in financial institutions, places further limits on the scope of investor-State arbitration."[117]

In rejecting the claim, the Tribunal also stated it "does not mean to suggest that Claimant was not subject to discriminatory and perhaps inequitable treatment" by Mexican officials, rather the arbitrators were not convinced FFIC proved its case under Article 1110 of the NAFTA. Accordingly, the Tribunal entered a Final Award denying the claim and ordering the parties to pay for their own legal fees and arbitration expenses.

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[115] Id.

[116] Id. at ¶ 218.

[117] Id. at ¶ 202.

CHAPTER 8

CONCLUSION

The following sections summarize some of the key findings to be derived from this study and its implications for future research.

8.1 Investor Protections and Global Governance

The current global economic turmoil has created greater uncertainty in the stability of major financial institutions as well as for the governmental institutions that regulate the financial markets. During the past year, President Obama and his administration have indicated at least a limited willingness to increase trade protectionism and renegotiate the NAFTA side agreements on labor and environmental issues. This position has sparked an outcry from Canada, Mexico and other countries that oppose any significant U.S. protectionist actions. Thus, the historical background regarding the drafting of NAFTA and the 160-year history of U.S.-Mexican arbitration claims explored in this thesis are important in the enhancement of existing knowledge about the utility and even necessity for NAFTA's Chapter 11 investor-state dispute settlement mechanism.

When states seek to compete in a globalized financial market and increase foreign

investment flows, investors demand protection from "unfair" state action in exchange for their investments. As regulatory activities and investment transactions increase, so does the volume of disputes between public and private actors.[1] The result of this occurrence is the need for a strong and effective investor-state dispute settlement mechanism. This procyclicality of investor protections and global governance issues is therefore a significant area for present and future research.

The role that private actors, such as MNCs and individual investors, play in stabilizing global finance, minimizing negative impact on the environment, and promoting public health safety in this turbulent world has increased under the current global governance framework. Moreover, as states continue to delegate their regulatory functions to private actors, the authority exercised by this group becomes an even more important component of global governance.

8.2 Expansion of Private International Law Through Delegation of Sovereignty

This study demonstrates that states will delegate varying levels of their sovereignty to private actors through structures that benefit investors, such as NAFTA's Chapter 11. NAFTA, as a supranational institution, and its Chapter 11 investor-state dispute settlement mechanism has expanded the field of private international law. A new legal norm has emerged as private actors have been empowered over states to render final

[1] United Nations Conference on Trade and Development, *Investor-State Dispute Settlement and Impact on Investment Rulemaking* 2007, Geneva UNCTAD/ITE/IIA/2007/3.

and binding claims decisions. Consequently, private actors operate in a win-win environment. They benefit from having direct access to states regarding their activity for which states compete, and they maintain an effective method of recourse against states for any economic harm they may suffer related to their investments.

Historically, the lack of deterrence from expropriations and the inability of the states to provide adequate compensation to aggrieved investors aggravated conflict between states and firms. For the U.S. and Mexico, the use of tribunals as the preferred dispute settlement mechanism is a continuation of their long history of claims arbitration dating back to the 1840's. Chapters Three and Six detailed this history to show the evolution of investor-state arbitration rules and norms starting from the U.S.-Mexican Claims Commission of 1848 to the refined mechanism implemented under NAFTA in 1994. A certain trajectory of relationships of states and private actors has gradually developed that will almost certainly continue to shape the future choice of the parties to NAFTA.

During the nineteenth century, Mexican history was characterized by revolution and conflicts with the U.S. and Europe related to claims of their citizens against the young nation. Investors incurred substantial losses as a result of Mexican officials expropriating their investments and property, and their national states demanded that Mexico pay restitution for the claims of citizens. The U.S. had high expectations its treaties with Mexico would resolve the claims of its citizens once and for all.[2] However,

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[2] In his second annual message to Congress in 1838, President Martin Van Buren stated:

> I am happy to be now able to inform you that an advance has been made toward the adjustment of our differences with [Mexico] and the restoration of the customary good feeling between the two nations. This important change has been effected by conciliatory negotiations that have resulted in the conclusion of a treaty between the two Governments, which, when ratified, will refer to the

as discussed in Chapter Three, most of the claims were never adjudicated, nor were many of the awards ever paid to the claimants. For example, several U.S. presidents, including Andrew Jackson, James Polk and Zachary Taylor, pointed to the outstanding claims as a key reason for supporting proposals or actual executive orders for use of American military force against Mexico. Invariably, the fact Mexico consistently failed to pay outstanding claims weighed heavily on the United States' decision whether or not to recognize several Mexican administrations from the 1840's through the 1930's. Thus, the political recognition of Mexican administrations was often conditioned upon their willingness to agree to claims commission that would bring an effective resolution of American claims. At the same time, the proliferation of U.S. citizens' claims against Mexico helped fuel the nationalization of several major industries as protection from "yanqui" expansion, or control of Mexican natural resources, communications, and financial services.

Under NAFTA, investors can exercise their right to protection and assert control over their claim by directly instituting mandatory arbitration against a member-state. Chapters Six and Seven examined the delicate balance of societal need for government regulation and the protection of private investments within regional markets. This study drew heavily upon primary source documents and private in-depth interviews by the author with former senior U.S. and Mexican government officials. It is also the first

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> arbitrament of a friendly power all the subjects of controversy between us growing out of injuries to individuals. There is at present also reason to believe that an equitable settlement of all disputed points will be attained without further difficulty or unnecessary delay, and thus authorize the free resumption of diplomatic intercourse with our sister Republic.

Miller Center on Public Affairs, University of Virginia, *President Martin Van Buren's Second Annual Message to Congress* (Dec. 3, 1838), http://millercenter.org/scripps/archive/speeches/detail/3591 (visited January 9, 2010).

known to make use of formerly classified top-secret White House and National Security Council documents that were not publicly released by the U.S. National Archives until early 2010. It is also the first known research to analyze in comparable detail the internal memos, strategy books, and handwritten notes of key decision-makers related to NAFTA and United States' policies during the Bush/Clinton period regarding the protection of American investments in Mexico.

As this research demonstrates, the results of the negotiation and implementation of NAFTA's Chapter 11 should not be underestimated. Since the effective date of NAFTA on January 1, 1994, this mechanism has resulted in the full adjudication of claims that were actively pursued by investors, including the award of monetary damages for investors where a tribunal found a treaty violation. The three major differences between the current and prior systems include: (1) the U.S. and Mexico have not resorted to any form of armed conflict to resolve investment claims; (2) politicians have not hampered the submission and adjudication of claims; and (3) all tribunal awards have been paid by the losing NAFTA member state. Unlike its predecessor dispute settlement systems, NAFTA's investor-state dispute settlement mechanism achieved its goals of fully adjudicating claims to protect investors and avoiding dangerous conflict between the member states.

There continues to exist some concern NAFTA has caused its member states to lose parts of their sovereignty. As explained in Chapter Six of this paper, the three members states authorized the development of Chapter 11's private arbitration mechanism through the signing of NAFTA, and it was by this act that these states actually exercised their sovereignty to create the private tribunals. The arbitrators derive

their limited authority from the treaty, a state-created multilateral agreement. Under this treaty, the states remain fully sovereign entities, but they have bestowed the responsibility on private arbitrators to examine and decide on investor claims filed against the states in accordance with specific rules defined in NAFTA. Chapter 11 arbitrators may only enter an award, if any, solely for monetary damages. The states have reserved elsewhere in the NAFTA the exclusive right to exercise traditional remedies, such as trade countermeasures against member states in response to unfair trade measures.

Of course, NAFTA is a treaty between its member states and international law does not prohibit the parties from amending their own treaties as they see fit. Under NAFTA's Article 1131(2), the parties may clarify any of the provisions of the agreement. In 2000 and 2001, there were two issues regarding tribunal opinions that precipitated public debate on the fairness of NAFTA arbitrations: (1) transparency; and (2) the interpretation of the concepts of "fair and equitable treatment" and "full protection and security" under Article 1105. In response to this unwanted negative attention to the treaty, the NAFTA Free Trade Commission issued "Notes of Interpretation of Certain Chapter 11 Provisions" to clarify the preference for public access to arbitration information, and what the states meant by the two phrases noted above from Article 1105.

These "notes" spurred additional negative comments from various sectors complaining that the states had amended *de facto* the treaty without the appropriate authority from their own legislatures, which are entrusted with the power to ratify any

such agreements.[3] Some interpreters argue private investors only have rights that are afforded to them under the treaty, and they must rely solely on the text that was in fact drafted to benefit them. Others insist the relationship between investors and the treaty should result in investors being treated formally as third party beneficiaries to NAFTA.[4] Under that argument, states should not be allowed to amend NAFTA without appropriate due process. Still other legal scholars reject this concept because NAFTA is a treaty, not a commercial contract between states and investors.[5]

This author accepts Brower's view that "[t]o the extent that the Notes prevent the direct incorporation of free-standing treaty obligations into the minimum standard, one may greet them as a reasonable interpretation, as most tribunals have done."[6] Once again, states have not lost a significant part of their sovereignty, but they have merely delegated varying degrees of their sovereign powers to private actors for governance purposes. The interpretative notes in question were prompted by public outcry for change.[7] Hence, it is probable Congress would most likely have agreed to them anyway,

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[3] See Charles Brower, *Why the FTC Notes of Interpretation Constitute a Partial Amendment of NAFTA Article 1105*, ABA, 5 International Arbitration News 6-7 (Summer 2005).

[4] Telephone interview with Andrea Bjorklund, Professor of Law, University of California-Davis School of Law (Dec. 11, 2009). See Andrea Bjorklund, *Mandatory Rules of Law and Investment Arbitration*, 18 Am. Rev. Int'l Arb. 175, 189 (2007) ; and Andrea K. Bjorklund, *Private Rights and Public International Law: Why Competition Among International Courts and Tribunals is Not Working*, 59 Hastings L. J. 241, 265-70 (2007).

[5] Interview with Andreas Lowenfeld, Professor of Law, New York University School of Law, in New York, New York. (Dec. 17, 2009).

[6] See Brower, *FTC Notes* at 9 (cited in note 3).

[7] See generally Anthony DePalma, *NAFTA's Powerful Little Secret*, N.Y. Times, Mar. 11, 2001; Patricia Hansen, *Transparency, Standards of Review, and the Use of Trade Measures to Protect the Global Environment*, 39 Va. J. Int'l L. 1017, 1058 (1999); Ruth Teitelbaum, Privacy, *Confidentiality and Third Party Participation: Recent Developments in NAFTA Chapter Eleven Arbitration*, 2 Law & Practice of International Courts & Tribunals 249 (2003); and International Federation of Journalists, Press Release, *Journalists Condemn Secrecy in American Trade Talks: 'Threat to the Foundations of Democracy*,' Apr.

if they had been proposed as amendments, because they benefited the states by limiting their liability.[8]

8.3 Investor-State Tribunal Awards Prompt Corrections in Regulatory Framework Not Regulatory Chill

The Chapter 11 tribunal awards have expanded private international law, but they have also unintentionally generated concern about their potential effect on the laws or regulations of the member states. As discussed in Section 2.10, NAFTA critics argue that the investor-to-state claim arbitration tribunals act as an "anonymous government," influencing state transactions and policy, and "undermining public policy."[9] Although they acknowledge the limitation in a tribunals' authority to render only awards for monetary damages, if any, the critics contend arbitration decisions in favor of corporations "would have a devastatingly chilling effect on all such future laws and standards because of the belief they would not stand up to challenge."[10] Moreover, the on-going debate whether to expand the NAFTA beyond the current three-state region has generated a fury of opposition by those who perceive the regional trade system as a "sinister process of secrecy."[11]

12, 2001. http://africa.ifj.org/en/articles/journalists-condemn-secrecy-in-american-trade-talks-threat-to-foundations-of-democracy (visited Dec. 12, 2009).

[8] Bjorklund interview (cited in note 4).

[9] DePalma, *NAFTA's Powerful Little Secret* (cited in note 7).

[10] Id.

[11] International Federation of Journalists, Press Release, *Journalists Condemn Secrecy in American Trade Talks* (cited in note 7).

There is scholarship promoting the concept that the "mere assertion of [Chapter 11 investor] claims may have a drastic impact upon the willingness and ability of state and local governments" to promulgate and enforce regulations that interfere with foreign investments.[12] According to this literature, "[t]he threat posed by potential claims may serve to chill" future regulations. The oft-cited cases in support of this proposition are the *Metalclad* and *Ethyl* cases.[13] In the former case discussed earlier, a tribunal ruled against Mexico and in favor of an American investor who had obtained federal Mexican permits and started construction of a hazardous waste landfill in a municipality until a local permit was denied.

In that case, the tribunal found the municipality had violated Article 1110 (Expropriation) and issued an award in favor of *Metalclad* in the amount of $16.7 million in 2000. In the *Ethyl* case, the Canadian government imposed restrictions only on the import of a certain fuel additive for gasoline manufactured by the claimant, which was the only foreign manufacturer shipping this chemical to Canada. Equally important was the fact this chemical would not have been banned from being distributed within Canada it if had been manufactured in the country. After Canada lost preliminary motions regarding the tribunal's authority to take jurisdiction of the claims, they settled with the claimant for approximately US$16.6 million.

This author is not persuaded by the allegations of a potential regulatory chill. The critical literature does not cite any empirical data to support its position, nor have these

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[12] 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, 542 (2001).

[13] *Metalclad Corp. v. Mexico*, 40 I.L.M. 36, 47 (2001); and *Ethyl Corp. v. Canada*, 38 I.L.M. 708 (1999).

commentators identified specific instances where the NAFTA states and their local governments have avoided enacting laws or have reduced regulatory standards because of being sued under NAFTA Chapter 11. It is highly unlikely most municipalities are even aware of these Chapter 11 cases and the potential investor claims when they are making local decisions.

It is useful to re-emphasize that NAFTA Chapter 11 was designed to be an investor-state dispute settlement system. In any claims system involving sovereign states, the claims tend to highlight flaws in their national systems and regulatory decision-making. The notice of claim identifies these issues, and the parties attempt to resolve their differences prior to commencing litigation before an arbitration tribunal. For example, in three recent Chapter 11 cases (known as the "Sugar Cases"), four major U.S. manufacturers of high fructose corn syrup (HFCS) filed claims against Mexico for imposing an excise tax on their products as a countermeasure to an unrelated sugar trade barrier established by the U.S. [14] The first liability award was issued in January 2008, and the tribunal held Mexico's countermeasure to U.S. sugar policy was not a defense to NAFTA's Article 1102 (National Treatment). Subsequently, three separate panels ruled in favor of the claimants and entered awards that reportedly totaled over $130 million in 2009.[15] Shortly after the first liability award was issued, Mexico repealed its HFCS excise tax.

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[14] HFCS is a sugar-alternative sweetener made from yellow corn and used in the food and beverage industry. See *Archer Daniels Midland and Tate & Lyle Ingredients Americas v. Mexico* (ICSID Case No. ARB(AF)/04/05); *Cargill v. United Mexican States* (ICSID Case No. ARB(AF)/05/2); and *Corn Products International v. Mexico* (ICSID Case No. ARB(AF)/04/1).

[15] Elizabeth Whitsitt, *Tribunal rejects the Defense of Countermeasures in recently published Corn Products International Inc. v. The United Mexican States Award*, Investment Treaty News (Apr. 28, 2009);

NAFTA critics maintain the Sugar Cases are additional examples of tribunal awards impacting governmental decision-making and laws. In the author's opinion, these types of awards, including those in *Ethyl* and *Metalclad*, should be viewed from a different perspective. A parallel analysis can be made of persons who file lawsuits against the U.S. government or any other public entity alleging violations of their constitutional rights such as those under the Fifth Amendment of the U.S. Constitution. These cases go to trial, the litigation frequently continues through the appellate process all the way to the U.S. Supreme Court. In these cases, a final decision is made and the government wins some and loses some. If the government loses a case, should we amend the Constitution to avoid claims? Or should the court system be revamped to avoid another state loss? The author believes neither of these changes should ever occur because court decisions are part of an on-going democratic process for addressing issues in our society in accordance with due process concepts and established principles of law. Furthermore, judicial findings of constitutional violations often prompt changes to the offender's behavior, which is a beneficial consequence for society as a whole.

NAFTA tribunal awards may penalize states for their treaty violations, but surely that it is not necessarily a bad thing. In *Metalclad*, Mexican government officials had approved the construction and operating permits, and they advised the claimant they had all the permits necessary to operate the new facility. However, local municipal officials issued a "stop work" order for the facility without citing any specific regulations the claimant had allegedly violated. The lack of published rules was inconsistent with

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Elizabeth Whitsitt, *Claim by Cargill leads to Another Loss for Mexico*, Investment Treaty News (Oct. 2, 2009), online at www.investmenttreatynews.org (visited Jan. 24, 2010).

NAFTA's requirement for transparency of regulations. In this case, one can view the tribunal award in favor of the claimant as a remedy for the losses it incurred as a result of the wrongful action of the municipality. If the award prompted the municipality to subsequently adopt and publish specific standards or requirements, the indirect consequence of the award resulted in a societal benefit, or a "correction" of noncompliant activity.

The same thing could be said for the Sugar Cases. NAFTA clearly does not contain a defense for states to implement trade countermeasures that violate Chapter 11. Mexico inappropriately adopted the HFCS excise tax as a countermeasure to U.S. sugar policy. In this context, the tribunal awards for monetary damages were appropriate. The fact Mexico repealed the HFCS excise tax shortly after the first tribunal issued its award on liability should not be misinterpreted as having a regulatory chilling effect on Mexican regulation. Overall, the NAFTA provisions were drafted to deter inappropriate state action under the terms of the treaty. If a violating state changes its behavior to comply with its treaty obligations, society benefits from this compliant behavior and it achieves the underlying principles of Chapter 11 regarding investor protection.

Finally, the proponents of the regulatory chill position tend to cite Chapter 11 claims as the primary reason Latin American states were reluctant to expand NAFTA into a Free Trade Area of the Americas (FTAA). In this view, NAFTA cases such as *Metalclad* convinced other states not to subject their regulatory authority or sovereignty to private actors. Since several Latin American states still adhere to the Calvo Doctrine, there may be some truth to this, but it is not the primary reason for NAFTA states' failure to achieve a FTAA. According to former senior White House and USTR officials who

worked on the FTAA initiative during the Clinton and Bush (43) Administrations, there were other significant factors that prevented the implementation of an expanded free-trade zone.

First, there is a long history behind Latin America's concern the FTAA could "swallow up" individual states under the control of the United States. Second, this initiative was a vision and, as a former senior USTR official describes it, "incredibly ambitious." As the negotiations unfolded, the negotiators began to recognize the likelihood of completing the FTAA was remote due to diverse political and economic agendas of the participating states. Third, there were key events that side tracked this initiative. For example, the Mexico peso crisis in 1994-1995 was a shock to Mexico, and it caused President Clinton to avoid promoting the expansion of the regional trade agreements early on in his first term.[16] On the trade policy front, the U.S. was unable to resolve agricultural and intellectual property issues with Brazil and Argentina. In fact, Brazil was reluctant to slip into second place as the largest economy in Latin America, nor did it desire to build up Mercosur. Over the past decade, the European Union has become Brazil's major trading partner, not Mexico or the United States.

And, of course, the 9/11 terrorist attacks on the U.S. immediately changed American foreign policy priorities. As former White House Press Secretary Ari Fleischer points out when comparing NAFTA and FTAA, the national leadership in Latin America changed over the years, and the U.S. was focused on fighting two wars simultaneously.[17]

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[16] In off-the-record interviews, several former White House officials noted that Clinton took so much political heat in the NAFTA ratification process from Congress and labor unions that "NAFTA" became a "bad word" in the White House and it was dropped from many of the president's speeches.

[17] Interview with Ari Fleischer, former White House Press Secretary for President George W. Bush (2000-2003), in Jersey City, New Jersey (Nov. 2008).

FTAA was no longer high on the foreign policy agenda. This period also saw the rise of more emboldened and radical leaders such as President Hugo Chavez of Venezuela and President Evo Morales of Bolivia, raising the threat of more expropriations of foreign investments.

8.4 States Reassert Power and Private Actors Seek to Protect Investments During a Financial Crisis

In 2009 the tension between public and private authority reached new heights as the global financial market crisis escalated to proportions unseen since the Great Depression. As a result of this crisis, the United States and other states have proposed imposing new trade protectionist measures and revamping their regulatory frameworks for financial markets and structures of corporations across a gambit of industries, including financial services and automotive manufacturing industries. These trends seem to confirm Louis Pauly's contention that states will "reassert their ultimate regulatory power" in response to a financial crisis, or "if they truly cannot, markets collapse."[18] Yet, another outcome, equally as important, is the potential creation of a new wave of investor claims and litigation under NAFTA related to regulatory takings.

The current global economic turmoil has created greater uncertainty in the stability of major manufacturing companies and financial institutions. It has also magnified the inefficiency or ineffectiveness of the public governance systems that

[18] R. Bruce Hall and Thomas J. Biersteker, *The Emergence of Private Authority in Global Governance* 87 (Cambridge University 2002).

regulate the financial markets. Over the past eighteen months, a series of events has brought to question long-standing U.S. trade policies and their commitment to free trade and investor protection under NAFTA. During the 2008 presidential campaigns, then-Senators Obama and Hillary Clinton supported renegotiating NAFTA to strengthen its labor and environmental side agreements by establishing actual standards and providing "teeth" to the enforcement provisions.

On February 17, 2009, President Obama signed into law the financial stimulus legislation known as the American Recovery and Reinvestment Act (ARRA). Despite widespread opposition by the U.S. business community, ARRA contains a strong "Buy American" provision mandating that all iron, steel, and manufactured products used in ARRA-funded public building and works projects be produced in the U.S. Needless to say, U.S. foreign trade partners, especially Mexico and Canada, viewed this type of legislation and proposed NAFTA revisions as a major U.S. policy shift away from free trade toward protectionism.[19] Comparisons can be drawn between these protectionist

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[19] The Buy American legislation deeply troubled Canada that it extensively lobbied the U.S. to provide some relief to Canadian companies. In February 2010, the two governments finally announced that they had ratified a new agreement on government procurement in which the U.S. waived the Buy American provisions for certain types of infrastructure projects within the U.S. See U.S.-Canada Joint Statement on Government Procurement (Feb. 5, 2010), online at http://www.ustr.gov/about-us/press-office/press-releases/2010/february/us-canada-joint-statement-government-procurement (visited Feb. 28, 2010).

According to Peter Van Loan, Canadian Minister of International Trade:

> The Government of Canada recognizes the deeply connected nature of our economies. This speaks to the need for a coordinated approach to enhance the economic prosperity of citizens, businesses and communities on both sides of the border.
>
> Under the agreement, the United States has waived the Buy American provisions, allowing Canadian companies to participate in a number of infrastructure projects being funded under the Recovery Act…

Press Release, *Minister Van Loan Marks Coming-into-Force of Canada-U.S. Agreement Waiving Buy American Provisions*, Canadian Department of Foreign Affairs and International Trade (Feb,. 16, 2010), online at http://www.international.gc.ca/media_commerce/comm/news-communiques/2010/069.aspx?lang=eng (visited on Feb. 28, 2010). On the other hand, USTR's

activities and the failed U.S. trade policy of the early 1930's in response to the financial crisis during the Great Depression.

Undoubtedly, the decrease of available credit, investment liquidity, and foreign investment flows between NAFTA member states combined with the rise of protectionism results in a dangerous situation for the regional economy. Although, of course, we are unable to foretell the future these events may well give rise to new Chapter 11 investor claims related to regulatory takings. Will U.S. bailout or TARP program impact a Mexican or Canadian financial institution in manner that trigger an investor-state claim against the U.S.?[20] Perhaps. A search of the U.S. Treasury's TARP information does not indicate a Mexican or Canadian financial institution affiliate has applied for TARP funds, or that its application was rejected by the U.S. Department of Treasury. In light of the onerous executive compensation restrictions and oversight imposed under TARP, it is not surprising most financial institutions have shied away from taking TARP money, which only invites potential ownership and micromanagement by the U.S. government of the institution's operations and financial management until the

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announcement focused on the reciprocity requirement under the agreement. Specifically, USTR Ron Kirk stated:

> This Administration made clear to Canada from the outset that any agreement to provide Canada with expanded access to U.S. procurement absolutely must provide guaranteed reciprocal access for U.S. exporters to supply goods and services to Canada through provincial and territorial procurement contracts. USTR has won that access for American firms…

Office of the U.S. Trade Representative, *Kirk comments on US-Canada procurement agreement*, online at http://www.ustr.gov/about-us/press-office/press-releases/2010/february/kirk-comments-us-canada-procurement-agreement (visited on Feb. 28, 2010).

[20] As a result of the significant economic decline in 2008, Congress passed and President George W. Bush signed into law the Emergency Economic Stabilization Act. Pub. L. 110-343 This legislation authorized the Treasury Department to purchase and insure certain types of troubled assets from financial institutions for the purposes of stabilizing the financial markets through the Troubled Asset Relief Program (TARP).

money is repaid to Treasury.[21] However, there still remains the potential for an aggrieved Canadian or Mexican company to file a Chapter 11 claim against the U.S.

Practitioners and commentators will be quick to point out that NAFTA affords member states with a defense under the "prudential measures" carve-out in the Financial Services Chapter of NAFTA, and that only expropriation claims are available under Chapter 11 related to the financial services sector. As previously discussed in Section 7.6 above, NAFTA Article 1110 specifically excludes claims based upon any "prudential measures" taken by the member states for several reasons such as the protection of investors and depositors; "the maintenance of the safety, soundness, integrity, or financial responsibility of financial institutions or cross-border financial service providers;" and "ensuring the integrity and stability of a Party's financial system."[22]

The threshold question is whether the measures taken today will still justify their existence in the future when the financial market crisis subsides and the above three exceptions no longer apply. Based upon key market indicators and statement of key public officials, the U.S. economy appears to have endured the brunt of the recession and is on an upward trend from the bleak days of early 2009. For example, in September 2009, Federal Reserve Chairman Ben Bernanke publicly stated that "from a technical perspective the recession is very likely over at this point."[23] More theoretically, does the

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[21] Deborah Solomon, Nine *Banks to Repay TARP Money*, Wall St. J. C3 (June 9, 2009); Peter Eavis, *Getting Tough with Wells*, Wall St. J. Online (Dec. 9, 2009), www.wsj.com (visited on December 12, 2009); Tomoeh Tse, *U.S. Sets Pay Rules at 4 Firms*, Washington Post (Dec. 12, 2009); and Robert Schmidt, *Barofsky Says TARP 'Almost Certainly' Will Bring Loss to U.S.*, Bloomberg.com News (Nov. 13 2009), www.bloomberg.com (visited on Dec. 12, 2009).

[22] NAFTA, Article 1405(1).

[23] *Bernake on U.S. Economic Outlook*, Reuters (Sept. 15, 2009).

substantial up tick in the stock exchanges and key economic indicators since March 2009, assuming it continues in an upward trajectory, undermine the federal government's "prudential measures" defense?[24] We do not know at this time. What we do know is that the regulatory overhauls have historically generated conflict between states and investors, and the latter are generally predisposed to resolving such conflict through litigation.[25]

Outside of the financial services sector, there is a heightened potential for investors to become emboldened and take aggressive steps in filing claims against member states that exert more regulatory power. NAFTA contains a significant number of schedules of exceptions for various industries, but it does not cover all industries or segments within those covered industries. These exceptions may not be sufficient to curtail new investor claims being filed under NAFTA Chapter 11. In light of the recent tribunal awards for over $130 million to several American corporations in the Sugar Cases against Mexico, investors may seek alternatives to the traditional national courts for redress against unfair national treatment by regulators or even the courts themselves.[26]

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[24] This author acknowledges that stock exchange indices are not the sole or even a determinative factor in assessing whether the national economy is still in a recession. However, from a litigation perspective, claimants can exploit these financial facts to challenge certain governmental measures. For example, the Dow Jones Index increased from a 13–year low of 6,440 points on March 9, 2009 to this year's high of 10,549 points on December 4, 2009, which is comparable to 10,568 points on July 1, 2005, when the U.S. economy was not considered to be in the midst of a financial crisis.

[25] On Friday, December 11, 2009, the U.S. House of Representatives passed bill H.R. 4173 entitled The Wall Street Reform and Consumer Protection Act of 2009, a series of financial regulatory measures that includes the creation of yet another financial regulator (Consumer Financial Protection Agency). The next day President Obama blasted the banks for opposing the reform bill in his Weekly Radio Address. Darlene Superville, *Obama Blasts Banks for Opposing Financial Overhaul*, Associated Press (Dec. 12, 2009).

[26] See generally *Apotex v. United States*, Notice of Arbitration (Dec. 10. 2008), online at www.state.gov. (visited on Dec. 12, 2009). In this NAFTA Chapter 11 claim, the Canadian claimant, a generic drug manufacturer, alleges that the U.S. Federal Drug Administration wrongfully denied its application for distributing the generic version of a U.S.-based pharmaceutical company's drugs. According to the State Department's website on NAFTA claims, no arbitration proceeding has yet been publicly disclosed, but "the United States intends to defend this claim vigorously."

In addition, the current trend is for individual investors to file Chapter 11 claims without assistance from lawyers, which may lead to a higher volume of claims, but also more frivolous claims being handled by the member states. As Lowenfeld observes, Chapter 11 was intended for investors and it should not be considered unusual for individuals to want to file their own claims, which is their right under NAFTA.[27]

In sum, the present study illuminated nearly two centuries of claims arbitration in the U.S.-Mexico relationship joined by Canada with the advent of the NAFTA. A gradually shifting balance between public and private authority has been the pattern in North America, and there is every likelihood that that pattern will continue in the years ahead. Different areas in the global political economy have inevitably fostered different public/private balances, and the demands of effective global governance are such that the balance will have to be regularly adjusted in the years ahead. Sterile arguments about state sovereignty plainly fail to capture the urgent real-world need to solve the problem of protecting investments in a manner that will avoid international conflicts, and be fair to investors and host societies alike. NAFTA has been a major advance in that regard, in the context of its time.

[27] Lowenfeld interview (cited in note 5).

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