

INTERNATIONAL LAW AND NATIONAL SOVEREIGNTY: THE NAFTA AND THE CLAIMS OF MEXICAN JURISDICTION*

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I. THE DISILLUSIONMENT OF THE DIALOGUE

The new international economic order is not a widespread concept in the political language of the 1990s. Today's language is far removed from the statements uttered a quarter century ago. Our contemporary reality has progressed from the system of negotiations established under the umbrella of the so-called North-South dialogue. The 1970s witnessed a political event of great importance whose main objective was to end an anachronistic system in the sphere of relations among states and established a new regime in which international economic justice would prevail.

Conditions were ideal for the emergence and consolidation of a political revolution which purported to amend the structure of the entire international economic system—a phenomenon which is recorded historically as the South-North dialogue. These discussions seem to have currently fallen into total disuse—remaining alone as a relic of the past. The process of decolonization is one of the reasons for this revolution. During the first twenty-five years of the post-war era, a large number of former colonies became new members of the international community, establishing themselves as free and independent states. These newly independent states were characterized by a political will reaffirming the full exercise of their sovereignty. However, they lacked the economic or political development attributable to a colonial power. Instead, they brought many of the enormous shortcomings of developing nations, including weak political institutions, primitive agricultural economies, social problems, and insufficient industrial sectors. The widespread existence of such common problems among these states created a united demand to negotiate with the industrialized countries for a more equitable economic relationships. In the long run these states were attempting to redefine the rules of the game, which they hoped would yield tangible benefits for what was, in that epoch, referred to as the Third World.

The initial driving force to create a new international economic order was to allow the developing countries the means to defend their legitimate interests. But as a political phenomenon, it also had other distinctive effects. One important feature allowed States to directly participate in the

development of a world system which could adjust itself and respond to the needs of the group of non-industrialized countries. Another equally important aspect related to the necessity of joint action as a political formula to defend the interests of the non-industrialized world. During that time, political forces such as the Movement of the Non-Aligned Countries, the Organization of Oil Producing Countries (OPEC) and other groups of producers of raw materials gained power. At the same time, developing countries began forming associations based upon common interests. These groupings permitted developing states to exercise genuine political influence in the decision-making process of international organizations.

Another feature of the new economic order concerns the real power exercised by various developing countries. One example is OPEC's show of power during the oil crisis in the early 1970s. During that crisis, the sudden increase in the price of oil touched a vital nerve in international economic relations and clearly showed the industrial world's addiction to energy. That vulnerability has translated, throughout the years, into a capability for political and economic pressure on the part of a group of oil producing countries. OPEC's show of power during that time forced a realization that similar collective action would result in all cases. One might have concluded that this type of joint action would have permitted the Third World to increase its share of the existing world wealth. It might also have accomplished a political objective—thus providing an immediate benefit to the non-industrialized nations: under the concept of *pleno jure*—the sovereign exercise of the use and enjoyment of their national patrimony—one might have concluded that the states would be able to control their natural resources and to actively participate in defining a new international order in commerce, finances, investment, money, and aid to development.

The joint action organized by the developing world had unquestionable political effects which marked the relationships among the states during the 1970s. Their collaborative efforts increased the importance of their roles in many international organizations. Occasionally the effects were reflected in a climate of continuous confrontation between the industrialized nations and the developing countries. These tensions were addressed during negotiations held in Paris in 1975 which aimed to settle or mitigate the economic controversy and begin a North-South dialogue. The conference was of vital importance because it created a forum of discussion for the great international economic topics of that time. However, besides succeeding in raising global consciousness of the problem's nature and magnitude, the conference did not result in substantive improvements to the situation. In October 1981, negotiators made a final attempt to revive the discussions by holding a series of global negotiations. Twenty-two Heads of State, representing both developed countries and non-industrialized nations, gathered in Cancun, Mexico, to discuss these issues. Similar to the 1975 conference, the summit meeting of Cancun also produced dismal results. History will remember these efforts to reach

political understandings on economic consequences between the developed North and the developing South as the last attempt before the Twenty-first Century.

II. THE FRUSTRATION OF THE CHARTER

The political undertakings related to the establishment of a new international economic order also had important juridical manifestations. Perhaps the most complete legal instrument incorporating the ambitious postulates of a new order is the Charter of the Economics Rights and Duties of the States approved by the General Assembly of the U.N. on December 12, 1974:¹ the day of our Lady of Guadalupe. Of the 136 participating states, 120 voted in favor of this instrument—including all the developing countries, every one of the Socialist block countries, and six developed, market economy countries.² Ten countries abstained from voting and six countries voted against the Charter.³

The political importance of those who abstained and those who voted against the Charter is obvious. Apart from the debate about its juridical reaches and its capability to crystallize the developing world's economic aspirations, the Charter is a declaration of the U.N. General Assembly—which is neither necessarily binding nor in the nature of a treaty. However, it represented an expression of what, at the time, was judged as essential to the shaping of a new international economic order. It was also agreed that such a Charter was an essential ingredient to rebuilding the relations among the members of the international community and a natural complement to other political and juridical instruments, such as the U.N. Charter, the Declaration on Decolonization,⁴ the Declaration on the Principles of International Law concerning Friendly Relations and Co-operation among States in Accordance with the U.N. Charter,⁵ or to international social agreements, such as the Universal Declaration of Human Rights.⁶

To more clearly appreciate the nature of the prevailing pre-occupations in the 1970s, it is necessary to briefly review of some normative principles contained in the Charter of Economics Rights and Duties of the States. The central theme relates to the concept of sovereignty. Article 2 of the Charter states in its first paragraph that “[e]very State has and shall

1. G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 50, U.N. Doc. A/9631 (1975) [hereinafter Charter]. The text of the Charter can also be found at Charter of Economic Rights and Duties of States, Dec. 12, 1974, 14 I.L.M. 251, 251–65 (1975).

2. See Charter, *supra* note 1, at 265.

3. See *id.* The countries were United States, the Federal Republic of Germany, Great Britain, Belgium, Luxembourg, and Denmark. See *id.*

4. G.A. Res. 1514, U.N. GAOR, 15th Sess., Supp. No. 16, at 66, U.N. Doc. A/4684 (1961).

5. G.A. Res. 2625, U.N. GAOR, 25th Sess., Supp. No. 28, at 121, UN Doc. A/8028 (1970).

6. G.A. Res. 217, U.N. GAOR 3d Comm., 3d Sess., pt. 1, 183d plen. mtg. at 71, U.N. Doc. A/810 (1948).

freely exercise full permanent sovereignty, including possession, use and disposition, over all its wealth, natural resources, and economic activities.”⁷

Once this fundamental political principle is established, the following statement explains the state’s powers to regulate foreign investment. In fact, the second paragraph of Article 2 indicates that every state has the right “[t]o regulate and exercise authority over foreign investment within its national jurisdiction in accordance with its laws and regulations and in conformity with its national objectives and priorities. No State shall be compelled to grant preferential treatment to foreign investment.”⁸

Discussing this rule, one of the Charter’s principal negotiators and drafters correctly points out that

the investing countries have always maintained that they have the right of claiming for their nationals a more favored treatment than that which the guest state grants to its own nationals when the latter receive treatment inferior to that called “minimum standard.” The developing countries maintain that the “minimum standard” is a jeopardized notion that has not been satisfactorily defined, and that governmental practice and legal and doctrinal precedents do not have the necessary uniformity and generality so that such a notion could be considered as true juridical custom constituting an international norm. In any event, and above all, to claim unequal treatment, preferential in favor of the foreigners, is contrary to the principle of the sovereign equality of all the States. Nobody forces us to invest in other States. Whoever does it, establishes by that fact only a “community of fortune” between that country and the guest country; therefore, it must accept the risks as well as the benefits that are derived from its investment.⁹

Additionally, as an expression of the state’s sovereign competence, the Charter contains a complementary rule to the provisions regarding foreign investment. The Charter reaffirms every states’ right to

regulate and supervise the activities of transnational corporations within its national jurisdiction and take measures to ensure that such activities comply with its laws, rules and regulations and conform with its economic and social policies. Transnational

7. *Id.*

8. Charter, *supra* note 1, at 254–55.

9. Jorge Castañeda, *La Carta de los Derechos y Deberes Económicos de los Estados desde el punto de vista internacional*, in K. WALDHEIM, ET AL., JUSTICIA ECONÓMICA INTERNACIONAL 97–98 (1976). This commentary should be recalled in reading later sections, when I examine the exception regime in favor of the foreign investor that has been established by the North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., 32 I.L.M. 289, 605 [hereinafter NAFTA]. The NAFTA is referred to as TLC in Spanish.

corporations shall not intervene in the internal matters of a host State.¹⁰

Additionally, the Charter reaffirms the primacy of sovereignty and national jurisdiction. The last paragraph of Article 2 recognizes the state's right to "nationalize, expropriate or transfer ownership of foreign property."¹¹ It is clear that a state adopting those measures must pay proper compensation "taking into account its relevant laws and regulations and all circumstances that the State considers pertinent."¹² Controversies over compensation will be resolved pursuant to the laws of the domestic state which has nationalized the property—unless the interested states decide to resort to other peaceful means.¹³

The reading of this series of rules illustrates the general principles applicable to the relations between the states. First, the Charter recognizes a State's exclusive competence to regulate economic matters within its national jurisdiction and to issue the rules related to the operation of foreign investment and the multinational enterprises installed within its territory. Another principle reiterates the concept of the primacy of the laws and courts of the State in which the foreign investment is made. Finally, a fundamental addition to the argument, developed *infra*, relates to the imperative of granting equal treatment to nationals and foreigners, excluding privileges and preferences in favor of foreigners.

III. THE TURNING POINT—THE NORTH AMERICAN FREE TRADE AGREEMENT

Twenty years later, Mexico, which originated the initiative and was the most vigorous proponent of the Charter of the Rights and Duties of the States, has left behind some of the concepts established in that declaration. Mexico is currently embracing the concept of economic liberalism—as evidenced by a radical opening in its foreign commerce in favor of foreign investment by introducing a system of deregulation and privatization. As part of that turning point, Mexico has signed the North American Free Trade Agreement (NAFTA) and is concluding a series of agreements to protect foreign capital.

The new recipes are not a product of chance. They are perhaps the result of a collective trauma which originated in a successive series of crises and economic catastrophes suffered by Mexico from the early 1970s on. Additionally, they follow the general recognition to adopt new ideologies in the face of the failure of the past policies—although the new ones have yet to prove their value. This shift in policy is consistent with a highly competitive international system undergoing a significant transformation. The result has each state boldly fighting to collect foreign capital flows,

10. Charter, *supra* note 1, at 255.

11. *Id.*

12. *Id.*

13. *See id.*

assets, and technology—knowing that those flows will stay in whichever country provides the highest returns.

This competition for international resources should not lead us to dismiss the duties of the state and its sovereign attributes. To decrease national jurisdiction by delegating essential powers, originally belonging to the national state, in favor of an external body (*i.e.*, an international arbitration court) risks the view that the NAFTA will be considered of no use to Mexico.

The political and legal tradition historically sponsored and defended by Mexico has taken a new direction with the entry into force of the NAFTA in 1992. The essence of Article 27 of the Mexican Constitution¹⁴ and the principles declared in the Calvo doctrine¹⁵ are now being reconsidered because the provisions of this commercial agreement. The NAFTA frustrates one of the aspects of the Calvo doctrine—contained in Article 27 and specified both in customary international law and conventional law—requiring a foreigner to exhaust all local legal avenues as a prerequisite to pursuing international remedies against the host state. This principle was obviated by the NAFTA's establishment of international arbitration procedure to solve controversies between Mexico and a Canadian or American investor. NAFTA's ratification, along with the entry into force of other agreements providing for the reciprocal promotion and protection of investments, has introduced a novel element in the Mexican juridical order, the consequences of which are still undetermined.

IV. THE PRIVILEGES OF THE NAFTA

A. *Circumventing the Domestic Legal System Through Arbitration*

The NAFTA has opened a new juridical avenue by consecrating a collection of rights allowing foreign investors to directly institute legal actions against the host country—whether Canada, the United States or Mexico.¹⁶ Through these rights, the NAFTA grants individuals, who are subject to the new international law, the ability to initiate litigation against a state.

14. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS art. 27, § I, para. 1.

15. The Calvo Doctrine arose as a result of abuses by foreign investors in Latin American countries, following those countries' extensions of certain diplomatic protections to foreign investment. The Doctrine called for the elimination of any and all preferential treatment of foreign investors and their investments in Latin America. See Jane L. Volz & Roger S. Haydock, *Foreign Arbitral Awards: Enforcing the Award Against the Recalcitrant Loser*, 21 WM. MITCHELL L. REV. 867, 882–83 (1996).

16. For example, "La Ley sobre la celebración de tratados," D.O., 2 de enero de 1992, introduces in Article 80 a matter completely outside the object of the law. In fact, through a strange procedure, that legislation fixes the bases to conclude agreements that contain certain international mechanisms for the solution of controversies. This juridical formulation opened the doors to Chapter 11 of the NAFTA, which accepted that a Canadian or American investor has the ability to submit the Mexican government to an arbitral trial, in direct form. Under the principle of reciprocity, the NAFTA grants the same ability to the Mexican investor in relation to the American or Canadian governments.

This concept is completely unknown within the Mexican legal tradition and political system. Additionally, investors are empowered to obtain legal satisfaction through international arbitration, against the host State for possible violations of the rules relating to the treatment of investments. In this manner, foreign investors are granted a privileged right, not enjoyed by Mexican nationals, to submit their controversy to a binding international arbitration proceeding—which can be final and binding against the host state. Among other results, such a proceeding eliminates the necessity to exhaust local remedies provided by the host country's administrative or judicial courts.

Chapter 11 of the NAFTA, titled "Investment,"¹⁷ regulates the optimum treatment which a member state must grant to foreign capital. The provisions also state that, should a state violate that duty, recourse may be obtained through international arbitration.¹⁸ The Chapter's object is to establish "a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and the due process before an impartial tribunal."¹⁹ For Mexico, the introduction of this objective has relatively little virtue. It is difficult to imagine a real benefit for Mexico by invoking a rule that requires the equal treatment between investors when Mexico is not a capital exporter, but rather an important recipient of Canadian and American investment. The guarantee of the mechanism's due process before an impartial court does not show a great deal of confidence in the Mexican legal system.

The general principle of the NAFTA provision allows a private investor of a member state—by its own initiative or as an enterprise representative—to submit an arbitration claim against another member state for violations of certain contractual investment obligations. To pursue this remedy the investor or enterprise must prove it has suffered loss or damage resulting from the violation. Other prerequisites for submitting a claim to the arbitral proceeding include: 1) the investor accepts that particular method of dispute resolution according to the treaty terms; and 2) the investor waives the right to initiate or continue any proceeding before an administrative or judicial court for that particular claim.²⁰ Thus, a foreign investor who opts for arbitration cannot solicit the protection of his government, through a diplomatic claim, to obtain compensation for the damage.

The arbitration court resolves the controversies submitted for its consideration according to the NAFTA and the applicable rules of international law.²¹ This disposition eliminates the application of the Mexican (or Canadian or American) juridical order and replaces it with an international

17. See NAFTA, *supra* note 10, at 639.

18. See *id.*, art. 1117, at 643.

19. *Id.* art. 1115, at 642.

20. See *id.* art. 1121(2)(a)–(b), at 643.

21. See *id.* art. 1131, at 645.

law whose limits remain undefined. The arbitral award is binding on the contending parties. When the award is unfavorable to a state party, the arbitral court may award the foreign investor pecuniary damages or order the return of the property, but cannot award punitive damages.²²

To initiate the international arbitration mechanism, the foreign investor must base its demand on the host state's violation of a duty.²³ However, not every breach of an obligation results in the activation of the arbitration mechanism. The following is a description of obligations whose violation can instigate an international arbitration proceeding.

1. *Duties Under the NAFTA*

a. *National Treatment*

Each state is obligated to offer another member state's investors and investments "treatment no less favorable than that it accords, in like circumstances, to its own investors [and investments]."²⁴ For example, none of the three member states may force an investor to agree that a certain minimum level of stock be held by host state nationals.²⁵ Nor may it compel an investor from the other two parties to sell the investment made in that host state, due simply to his nationality.²⁶

b. *Treatment of Most-Favored-Nation*

Each member state of the NAFTA shall give the investors and investments of another member state "treatment no less favorable than that it accords, in like circumstances, to investors [and investments] of any other Party or of a [country that is] a non-Party."²⁷

c. *Minimum Standard of Treatment*

Next, states must grant the investors of the other two member states the best treatment which, according to the NAFTA, is a "treatment in accordance with international law, including fair and equitable treatment and full protection and security."²⁸ Furthermore, if an investor suffers losses as a consequence of armed conflicts or civil disputes, each member state is obliged to grant non-discriminatory treatment with respect to any measure adopted regarding those forfeitures.²⁹

22. *See id.* art. 1135, at 646.

23. *See id.* arts. 1116–1117, at 642–43.

24. *Id.* art. 1102(1), at 639.

25. *See id.* art. 1102(4)(a).

26. *See id.* art. 1102(4)(b).

27. *Id.* art. 1103(1)–(2).

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

29. *See id.* art. 1105(2).

d. Performance Requirements

According to the NAFTA, no member state can impose any obligation on a foreign investor regarding the entrepreneurial operating conditions, other than those specified in the actual agreement.³⁰ Thus state's are prohibited from imposing requirements on: exportation, substitution of imports, national content, technology transfer, compensation of imports related to currency income, exclusivity in the assets supplied to a specific market, and other similar requirements.

e. Nationality of the Directors

The NAFTA prohibits states from mandating that the senior management of a foreign enterprise be of any particular nationality.³¹

f. Transfer of Resources

The NAFTA obliges states to permit the free flow of financial resources between the member states.³²

g. Expropriation and Compensation

Parties may not, directly or indirectly, nationalize or expropriate another party's investment unless it is for the public benefit, not discriminatory, and executed while adhering to legality and indemnity principles. The text of the NAFTA specifies the compensation criteria in detail.³³

B. The Guarantees to Foreign Capital

Other capital-exporting states with important economic interests in Mexico have responded to the NAFTA by lobbying the Mexican government for a regime equivalent to that established in the NAFTA. Thus, the Mexican government executed, or is in the process of concluding, a series of bilateral and multilateral agreements aimed at the reciprocal promotion and protection of foreign investments, other than those of the United States and Canada. To this end, Mexico has signed two treaties of that nature: 1) Spain on June 22, 1995³⁴ and 2) with the Helvetic Confederation (Switzerland) on July 10, 1995.³⁵

30. *See id.* art. 1106, at 640.

31. *See id.* art. 1107(1).

32. *See id.* art. 1109, at 641.

33. *See id.* art. 1110.

34. *See* "Decreto por el que se aprueba el Acuerdo para la Promoción y Protección Recíproca de Inversiones entre los Estados Unidos Mexicanos y el Reino de España," D.O., 20 de diciembre de 1995 (decree ratifying the treaty with Spain).

35. *See* "Decreto por el que se aprueba el Acuerdo entre los Estados Unidos Mexicanos y la Confederación Suiza para la Promoción y Protección Recíproca de Inversiones," D.O., 20 de diciembre de 1995 (decree ratifying the treaty with Switzerland).

a. *Differences Between the NAFTA and the Bilateral Treaties*

The content of these two bilateral treaties is very similar to Chapter 11 of the NAFTA. Naturally, certain differences exist—some of which are worthy of notice.

(i) *Clarity of Provisions and Obligations*

An observer will immediately note an obvious distinction between the texts of the NAFTA and the bilateral treaties, especially the one signed with Spain. The latter have clearly been formulated with greater legal clarity, more concise drafting, and a better understanding of the treaty's legal scope. Those characteristics are noticeably absent in the NAFTA's text. The explanation certainly lies in the obstacles which NAFTA negotiators faced—consequently resulting in the ambiguous and confusing language contained in the text of the NAFTA.

The original elements of the two bilateral treaties provide that:

- 1) The privileges granted by a member state to the investors of a third state by virtue of its association in a free commerce zone, custom union, common market, or economic and monetary union, shall not be extended to the other member state.
- 2) The treaty with Spain does not contain a specific clause prohibiting the use of performance requirements.
- 3) The treaty with Spain states that the "arbitration court will issue its opinion based on the respect of the law, the procedures contained in the present agreement or in other legally effective agreements between the contracting parties, and the universally recognized principles of international law."³⁶ This clause seems to widen the arbitral court's field of applicable law. However, the method used by the court in determining which law applies when an ambiguous question exists remains uncertain. Will the court apply Spanish law or Mexican law?

(ii) *Duration*

The bilateral treaties generally remain valid for ten years.³⁷ The treaty with Switzerland, however, will continue to remain in force for an undefined period unless one party provides written notification of its termination twelve months in advance.³⁸ Even in the event of termination, the

36. Acuerdo para la Promoción y Protección Recíproca de Inversiones, June 22, 1995, Mex.-Spain (on file with author) [hereinafter Mexico-Spain Treaty].

37. See *id.*; Acuerdo para la Promoción y Protección Recíproca de Inversiones, July, 10, 1995, Mex.-Switz. (on file with author) [hereinafter Mexico-Switzerland Treaty].

38. See Mexico-Switzerland Treaty, *supra* note 37.

treaty will continue to protect investments made before the treaty's termination for ten years after the date of cessation. The treaty with Spain indicates that "it will stay in force for an initial period of ten years, and will be renewed by tacit extension for consecutive periods of two years."³⁹ This agreement also continues to protect to investments made before the treaty's denouncement for ten years.⁴⁰

b. Similarities Between the NAFTA and the Bilateral Treaties

The most important issue addressed in both the NAFTA and the two bilateral treaties involve provisions for the submission of disputes to international arbitration when controversies between a foreign investor arise and the state. Violations of the agreements giving rise to arbitration are practically identical in all three international instruments.

V. THE PRIMACY OF NATIONAL JURISDICTION

For multiple reasons, Mexico has been reluctant to accept an international jurisdiction as a method to settle differences with foreign parties or as a formula to resolve controversies with private citizens. Historically, the Mexican experience in arbitration courts has not been positive. One of Mexico's successes resulting in an arbitral award in Mexico's favor is *The Chamizal Case*⁴¹ which took half a century to be carried out and fulfilled. Arbitrations decided adversely to Mexico included the *Fondo Piadoso de las Californias*⁴² (also called *The Pious Fund Case*) and the *Isla de La Pasi3n*⁴³ (also called Clipperton Island). In the *Isla de La Pasi3n*, there are

39. Mexico-Spain Treaty, *supra* note 36.

40. *See id.*

41. 11 REP. INT'L ARB. AWARDS 309 (1911). *Chamizal* dealt with a dispute between the United States and Mexico over ownership of a tract of land between El Paso, Texas in the United States, and Ciudad Juarez, Chihuahua in Mexico. *See id.* at 313. The international arbitration board eventually awarded a piece of the land to the United States, but awarded the remainder of the tract to Mexico. *See id.* at 333.

42. 9 REP. INT'L ARB. AWARDS 1 (1902). *Pious Fund* originated as a \$1,700,000 trust fund established in the last half of the seventeenth, and first half of the eighteenth centuries by Spanish subjects for the promotion of the missions of the Society of Jesus. *See id.* at 5. Following Mexico's independence from Spain, the Mexican government took control of the trust, and established that the interest earned on the fund should be used for the promotion of the original Jesuit mission. *See id.* When the land, which is now upper California, was ceded to the United States in 1848, this left a large section of the Church outside the borders of Mexico. *See id.* This section of the Church, believing that it was still entitled to support from the trust, petitioned the U.S. State Department for assistance in securing this money from the Mexican government. *See id.* The case was eventually submitted to international arbitration, at which time the arbiter decreed that the Mexican government owed the U.S. government, on behalf of the Archbishop of San Francisco a sum of \$1,420,682.67 to satisfy money owed from the trust. *See id.* at 6 In addition, the arbiter decreed that beginning on February 2, 1903, the Mexican government should owe the U.S. government an annual payment of \$43,050.99, to be forever paid on February 2 of each following year. *See id.*

43. 2 REP. INT'L ARB. AWARDS 1105 (1931) (*translated in* 26 AM. J. INT'L L. 390 (1932)). *Clipperton* involved a dispute between Mexico and France over an unpopulated island ostensibly

serious doubts concerning the legal foundation of the decision of the Italian arbitrator, King Victor Emanuel II, in favor of France.⁴⁴ For perfectly valid political reasons, Mexico has accepted with reservations the compulsory jurisdiction of the International Court of Justice. This is not a capricious act; rather, it flows from Mexican political experience with the realities of power and an understanding of the consequences of committing matters affecting national interest to the whims of international arbitrators.

Mexico's best option seems to be to avoid allowing an international arbitral judge to decide issues regarding the kind of treatment owed to a foreign investor. Mexico has its own juridical order capable of giving full satisfaction to the obligations contained in the NAFTA—including, of course, those in Chapter 11. As it will be argued in the following pages, the national jurisdiction must retain priority. Applying this criterion would avoid the granting of a preferential position to a foreigner. Clearly a Mexican investor will have the same preferential treatment in Canada, Spain, the United States, or Switzerland. Still, it must be recognized that the ability to actually take advantage of that preference is remote because Mexican investment is relatively insignificant or null in those countries.

The primacy of domestic laws and national courts is one of the necessary expressions of sovereignty. However, the issue has become controversial because countries which export capital have claimed a system of exceptions resulting in the removal of foreign interests from the jurisdiction of the national legal order. The abuses derived from this claim led to the creation of a political and legal trend tending to protect the hierarchical priority of national jurisdiction.

The countries receiving foreign capital adopted the Calvo Doctrine⁴⁵ created by the Argentine jurist Carlos Calvo in 1870. The doctrine's essential meaning reaffirms national jurisdiction and discredits the idea that foreigners should receive different treatment than nationals. Implemented as a mechanism for defending sovereign authority, the Latin American States included the doctrine's foundations in their juridical systems. For example, several Latin American constitutions incorporate the Calvo Doctrine's thesis and many contracts contain a stipulation, designated the Calvo Clause, requiring foreigners to submit to the laws and courts of the host state and prohibiting the invocation of their own government's diplomatic protection.

In Mexico, the Constitution, promulgated in 1917, states in the first section of Article 27:

discovered by a French ship in 1858. *See* 26 AM. J. INT'L L. at 391. Following a submission to international arbitration, the island was declared the property of France in 1931. *See id.* at 394.

44. For a wider examination of these problems, see ANTONIO GOMEZ ROBLEDO, *MEXICO y el ARBITRAJE INTERNACIONAL* (1965); AVELAR M. GONZÁLEZ, *CLIPPERTON ISLA DE MÉXICO* (1992).

45. *See* Volz & Haydock, *supra* note 16, at 882–83.

Only Mexicans by birth or naturalization and Mexican companies have the right to acquire ownership of lands, waters, and their appurtenances, or to obtain concessions for the exploitation of mines or waters. The State may grant the same right to foreigners, provided they agree before the Ministry of Foreign Relations to consider themselves as nationals in respect to such property, and bind themselves not to invoke the protection of their governments in matters relating thereto; under penalty, in case of noncompliance with this agreement, of forfeiture of the property acquired to the Nation.⁴⁶

This constitutional provision has produced a series of important results in the course of its historical application. One of the distinctive notes of this constitutional norm is that foreigners are given the same rights as Mexicans with regards to the acquisition of certain types of assets and are required to abide, as are the Mexican nationals, by the laws and courts of Mexico. All individuals, whether national or foreign, enjoy the Constitution's guarantees but must comply with the obligations emanating from it: obey Mexico's laws and submit to its courts.⁴⁷ The rule contained in Article 27, reaffirming the State's sovereign authority, presupposes the availability and existence of a national jurisdiction able to settle conflicts originating within its borders and relate to the matters regulated by that norm. This is similar to the general legal principle instituting the exhaustion of local remedies as the primary route to resolve the legal differences concerning a foreigner.

VI. THE GOLDEN RULE: TO EXHAUST LOCAL REMEDIES

The rule mandating the exhaustion of local proceedings has over time undergone tests of its validity and durability. However, despite attempts to scrutinize it, the general consensus of the international legal community considers the rule a customary norm of international law⁴⁸ as well as an element of all international treaties signed by Mexico.⁴⁹

46. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS art. 27, § I.

47. *See id.* art. 33 (granting foreigners the same rights and imposing the same duties as Mexican citizens enjoy).

48. For an extensive study on the topic including an examination of the recent practice of the states and the international court decisions, see C.F. AMERASINGHE, LOCAL REMEDIES IN INTERNATIONAL LAW (1990).

49. For example, the International Covenant Civil and Political Rights establishes in Article 41, section c, that to inform itself of a matter, the committee shall make sure "that all the recourses of internal jurisdiction that were available, according to general principles of international law, have been presented and exhausted." International Covenant on Civil and Political Rights, Dec. 19, 1966, 999 U.N.T.S. 172, 6 I.L.M. 368. On the other hand, the American Convention on Human Rights reiterates the same principle before the Commission will admit a petition. The American Convention on Human Rights, Nov. 22, 1969, 1144 U.N.T.S. 123.

In the international courts arena, the outcomes have been favorable to the primacy of national jurisdiction. For example, in the 1920s, claims commissions between Mexico and other states were established to determine Mexico's responsibility for damages to foreigners resulting from the Revolution of 1910. A commission between Mexico and the United States also existed to investigate the general claims by the citizens of each country against the other. This commission considered the case of the *North American Dredging Co.*⁵⁰ In this case, the claimant enterprise entered into a contract with the Mexican government to dredge a port. The U.S. government requested compensation for damage the North American Dredging Co. allegedly suffered which had derived from violations committed by Mexican officials. The contract, however, specified that:

The contractor and all persons who, as employees or in any other capacity, may be engaged in the execution of the work under this contract either directly or indirectly, shall be considered as Mexicans in all matters, within the Republic of Mexico, concerning the execution of such work and the fulfillment of this contract. They shall not claim, nor shall they have, with regard to the interests and the business connected with this contract, any other rights or means to enforce the same than those granted by the laws of the Republic to Mexicans, nor shall they enjoy any other rights than those established in favor of Mexicans. They are consequently deprived of any rights as aliens, and under no conditions shall the intervention of foreign diplomatic agents be permitted, in any matter related to this contract.⁵¹

In light of this clause, the Commission rejected the petitioner's claim, pointing out in its judgment that the article's purpose was to keep the claimant subject to Mexican law and employ only the existing proceedings under Mexican law. The decision in the *North American Dredging Co.* case serves as favorable precedent for Mexico when litigating cases involving contracts which stipulate that if domestic appeals have not been exhausted one cannot present an international claim.

Latin American jurisprudence is not alone in requiring the exhaustion of local remedies before attempting to invoke international solutions. The Court of International Justice has determined that this rule is part of international custom. Thus, in the 1959 *Interhandel* case,⁵² involving a controversy between Switzerland and the United States, the International Court of Justice decided:

The rule of that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of

50. *North American Dredging Co. of Texas (U.S.A.) v. United Mexican States*, 4 REV. INT'L ARB. AWARDS 26 (1927).

51. *Id.* at 26-27.

52. *Interhandel Case (Switz. v. U.S.)*, 1959 I.C.J. 6 (Mar. 21).

customary international law; the rule has been generally observed in cases in which a State has adopted the cause of its national whose rights are claimed to have been disregarded in another State in violation of international law. Before resort may be had to an international court in such a situation, it has been considered necessary that the State where the violation occurred should have an opportunity to redress by its own means, within the framework of its own domestic legal system.⁵³

In the *Ambatielos* case,⁵⁴ an arbitration commission established to settle a controversy between Greece and the United Kingdom, reaffirmed that same thesis in 1956:

The rule requires that 'local remedies' shall have been exhausted before an international action can be brought. These 'local remedies' include not only reference to the courts and tribunals, but also the use of the procedural facilities which municipal law makes available to litigants before such courts and tribunals. It is the whole system of legal protection, as provided by municipal law, which must have been put to the test before a State, as the protector of its nationals, can prosecute the claim on the international plane.⁵⁵

The general doctrine of law harmonizes the rule of exhaustion with the concept that a sovereign state is competent to assume its own responsibilities and, in each specific case, to indemnify the aggrieved foreigner. As Eduardo Jiménez de Arechaga points out,

otherwise, the foreigner would be a privileged individual for whom neither the internal law nor local courts would exist, and who would interpose at once the political influence of the State of his nationality upon the emergence of the slightest difficulty with another government. A premature diplomatic intervention of this type would constitute an affront to the independence of the local sovereign and to the competence of its laws and courts over all the people submitted to its authority.⁵⁶

Under this principle, the validity of an international claim depends on the existence of a final judgment from the highest competent authority within a state. Thus, to be effective, the exhaustion of local legal proceedings requires that a foreigner not only have access to the substantive remedies available, but also that he take advantage of procedural facilities

53. *Id.* at 27.

54. *Ambatielos Case* (Greece v. U.K.), 1952 I.C.J. 28 (July 1) and 1953 I.C.J. 10 (May 19).

55. Counter-Case of the United Kingdom Government, para. 109, *Ambatielos Case*, (I.C.J. 1952), reprinted in *Exhaustion of Local Remedies*, 8 *Whiteman Digest* § 6, at 803.

56. E. JIMENEZ DE ARECHAGA, *EL DERECHO INTERNACIONAL CONTEMPORÁNEO* 37 (1991).

within his reach under the state's domestic law. There are several fundamental reasons for the rule of exhaustion. They include, among others, the following:

- (1) requiring a resident foreigner in a state to make use of the domestic courts before seeking the aid of his government;
- (2) allowing a state the opportunity to make amends, through its own means and pursuant to its own legal system, any damage that a foreigner may have suffered before being haled into an international tribunal;
- (3) demanding that a violation of a state's obligation shall not be established, even in cases where an international obligation compels a certain course of action, until the state has been requested to rectify the non-compliance and the petition has failed;
- (4) reserving the specification of the nature and extent of the damage suffered by a foreigner until the local proceedings have been exhausted;
- (5) permitting the proceedings and initial investigations of the controversy to correspond to the local courts until the highest judicial body has been utilized.⁵⁷

The rule mandating the use of domestic means to resolve controversies is based on the necessity of allowing a state to avoid violations of its international obligations through a timely rectification.

Exhausting local proceedings entails making the entire legal defense system offered by the state available to those with grievances—whether they be nationals or foreigners. Essentially, in the terms of Jimenez de Arechaga, the rule demands that the claim be submitted

not only to the regular courts, but also to the administrative agencies, and, in general, to all the internal authorities that could provide an effective and sufficient remedy without any difference between ordinary and extraordinary proceedings, except only for those remedies that are grace measures, and whose objective it is to obtain a favor and not to assert a right. If the foreigner does not promote those proceedings or if he does not appeal within the legal terms after the damage is caused, he has not taken pains to obtain justice in the demanded State, and, therefore, he has lost the possibility that his case will be heard before an international court and decided there.⁵⁸

It must remain clear that the signing of a treaty or arbitration agreement establishing an international process for dispute resolution cannot entail, as an automatic and necessary consequence, a tacit renunciation the state's requirement of exhaustion of local legal proceedings. For example,

57. *See id.*

58. *Id.* at 349.

a state subscribing to the optional clause of Article 36 of the Statute of the International Court of Justice,⁵⁹ obliging itself to accept the binding jurisdiction of the Court, is not, by that fact, repudiating the rule that foreigners must first utilize the state's domestic legal system. Similarly, a bilateral or multilateral covenant requiring a state to submit to arbitration when disputes involving investment matters between a state and nationals of other states arise, does not preclude a state's ability to require the exhaustion of local administrative or judicial remedies as a condition to grant its consent to the arbitration. Certainly these principles are no longer effective if a state waives, in an international juridical instrument, the imperative of exhausting the domestic proceedings. Consequently, one must determine whether the state can satisfy its own national interest more effectively through its own processes. To waive a law of such importance would entail obtaining an extraordinary political benefit.

It is also necessary to define the nature and extent of the international responsibility of a state and note the consequences of its failure to keep its obligations. The simple violation of a contract signed between a state and a foreign citizen must be considered a violation of domestic law—not a state's failure to uphold an international obligation. From this perspective, it is necessary to distinguish between the contractual obligations of a state and its international obligations. A state's incapacitation or inability to satisfy a contractual obligation should not automatically result in an international claim. The state must be allowed to afford the injured party a collection of judicial remedies which allow him to rectify the infringement or indemnify him for the consequences of the breach.

VII. THE VINDICATION OF THE MEXICAN LEGAL SYSTEM

The conclusion of the NAFTA and the bilateral agreements concerning the reciprocal promotion and protection of investments has imposed a straight jacket on national jurisdiction. The ability to submit the Mexican State to binding international arbitration has not been put to the test by a foreign investor claiming a violation of the national treatment agreement. However, the risk clearly exists. It is the responsibility of the Mexican authorities to make use of all proceedings legitimately available to channel such controversies towards their natural and primary field of resolution: the Mexican juridical order.

Two arguments should be considered when examining these new rules. The first concerns the discriminatory treatment which, as a consequence of the endorsement of those agreements—the NAFTA and the bilateral treaties—affects Mexican nationals. This results because Mexican nationals are unable to settle possible controversies in investment matters with Mexican authorities by way of international arbitration. Therefore, this provision grants privileged treatment to foreign investors, who clearly

59. June 26, 1945, art. 36, 59 Stat. 1055, 1060, 3 Bevens 1153, 1186.

have the power to submit to arbitration a claim against the Mexican State. Thus, the principle of equality between national and foreign is violated.

The second argument deals with the derogation of the Mexican juridical order. This foreign investment protection provision essentially eliminates the duty of all individuals, whatever their nationality, to observe and respect the legal system in Mexico. Therefore, the duty of citizens to submit themselves to the laws and judicial proceedings in Mexico is eliminated due to the illusion of the competence of Mexican law to settle certain types of controversies related to the treatment of foreign capital. The general rule must require the resolution of all controversies by the courts of Mexico to ensure that nationals and foreigners enjoy the full extent of guarantees which the Constitution grants, but also so that they submit themselves to the obligations that emanate from it. To grant the foreign investors a preferential regime, effectively removing them from national jurisdiction when pursuing claims against the Mexican State, diminishes the validity of this country's juridical order, or alternatively, derogates it for the benefit of foreign investors. Respect and application of a state's legal system is one of the essential elements of sovereignty, recognized by international law. The authority of that juridical order depends on the exhaustion of the domestic appeals process, afforded by the Mexican legal system to all individuals, before that individual seeks other appeals, such as submitting the dispute to international arbitration.

The subscription to agreements which protect foreign investments appears to be aimed at attracting foreign capital. However, experience indicates that the simple granting of guarantees has not historically been enough of an attraction and, in fact, can prove to be politically self-defeating. Factors which actually induces foreign investment to settle into a country are: 1) political stability; 2) the existence of a rule of law; 3) favorable economic conditions of the host country; 4) a positive fiscal regime; 5) employment regulations; 6) communication and transportation infrastructure; 7) high profitability from investments; 8) free transfer of financial flows; and 9) a favorable "climate of investment." Consequently, if all these factors are favorable, foreign capital will flow to Mexico independently of the agreements concluded to guarantee protection against intangible risks.

If foreigners are protected from political or economic risks, then Mexican nationals will remain in an inferior position. This policy would clearly be inequitable and is an infringement of the Mexican constitutional provisions. Traditional Mexican foreign policy leads one to question this system of capitulation which is both detrimental to Mexican nationals and unproven in its ability to benefit to Mexico by successfully attracting a greater flow of foreign investment into the country.

The restoration of the Mexican juridical order must be an objective of the Mexican government. Mexico must eliminate exclusion clauses, such as those in the NAFTA and the bilateral agreements with Spain and Switzerland, in order to restore the exercise of its competence. Solutions to

disputes should be achieved through negotiations with the potential claimants wanting to appeal to international arbitration to pursue legal action against the Mexican State. This will notify foreign investors of the necessity to first exhaust national remedies to obtain justice. However, this solution relies on the good will of one of the parties and may be insufficient when the political and economic interests of those foreign investors or the respective states are at stake.

A better remedy—one with legal and binding effects—entails the introduction of a reservation to the NAFTA by Mexico and an interpretive statement to the two bilateral treaties already in force. Such protection could be negotiated with the interested states: Canada, the United States, Spain, and Switzerland. On the other hand, it is also possible to opt for a unilateral declaration, simply delimiting the extent of the Mexican obligation.

An important antecedent conditioning the automatic jurisdiction of a foreign court in controversies involving Mexico is found in the exception formulated by the Mexican government in 1947 which circumscribes the competence of the International Court of Justice of the U.N. The text of that reservation indicates:

the House of Senators of the Congress of the Mexican United States, in exercise of the faculty that is granted to it by section I of Article 76 of the Federal Constitution decrees:

Single article. The Executive of the Union, by the appropriate channels, will make the following statement to the General Secretary of the United Nations:

For any controversy of legal order that could arise, in the future, between the Mexican United States and any other country by later facts to the present statement, the Government of Mexico recognizes as binding “*ipso facto*,” and without necessity of special agreement, the jurisdiction of the International Court of Justice, according to Article 36, paragraph 2 of its statute, with respect to any other State that accepts the same obligation, that is to say, on the basis of strict reciprocity. This statement, which is inapplicable to those controversies emanating from matters that, in the opinion of the Government of Mexico, will belong to the internal jurisdiction of the Mexican United States, will be in effect for a period of five years, from the March 1, 1947, and thereafter will continue in force until six months af-

ter the date in which the Government of Mexico notifies that it has derogated it.⁶⁰

As can be seen, the International Court of Justice will not have binding jurisdiction in cases where the Government of Mexico considers that, according to its free will, a controversy constitutes an internal matter best resolved internally rather than before an international judicial body. This protection originated in an equivalent reservation previously set forth by the U.S. government upon signing the statute of the International Court of Justice. The Mexican government, deciding that it was necessary to protect national interests, defined due reciprocity with a potential counterpart at the International Court at the Hague.⁶¹

Mexico should limit itself to specifying that the controversies which arise in the application of Chapter 11 of the NAFTA, or equivalent dispositions in the two bilateral treaties, will have to be resolved by first going before the national courts and their respective proceedings. Once those judicial remedies have been exhausted *and* if a denial of justice has occurred in violation of due process, then the mechanism of international arbitration established in Chapter 11 of the NAFTA, or equivalent disposition in the two bilateral treaties, will then enter in operation.

The legal argument establishing and explaining the convenience of introducing this reservation is found in Article 133 of the Constitution:

This Constitution, the laws of the Congress of the Union that emanate therefrom, and all treaties that have been made and shall be made in accordance therewith by the President of the Republic, with the approval of the Senate, shall be the supreme law of the whole Union.⁶²

The issue is to decide whether Chapter 11 of the NAFTA and the similar dispositions of the other two treaties can be brought in line with constitutional Article 27—allowing foreigners the right to acquire certain assets provided they agree to be considered as nationals with respect to said assets and not to invoke the protection of their governments with respect to those assets. An interpretation of these norms leads us to conclude that, for certain conditions arising under Article 27 of the

60. "Decreto que dispone que el Ejecutivo de la Unión haga al Secretario General de las Naciones Unidas la declaración que indica, reconociendo la jurisdicción de la Corte Internacional de Justicia en las controversias que señala," D.O., 23 de octubre de 1947. It is important to note that the United States, even before Mexico made this decree, formulated a similar reservation. In fact, upon accepting the jurisdiction of the Court, the U.S. government declared that that jurisdiction would not be applicable in the case of "disputes with regard to matters which are essentially within the domestic jurisdiction of the United States of America." Statute of the Court, 12 Whiteman Digest at 1305. That declaration was deposited with the U.N. General Secretary on August 26, 1946. *See id.*

61. For a study that pleads in favor of eliminating this Mexican exception, see C. Bernal, *Hacia un mayor fortalecimiento de la Corte Internacional de Justicia*, in 47 REVISTA MEXICANA DE POLÍTICA EXTERIOR 47-63 (1995).

62. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS art. 133.

Constitution, a balance of rights and duties exists in favor of nationals and foreigners. It is, however, legally incompatible to grant foreign citizens rights which are not granted to nationals, as occurs under the application of Chapter 11 of the NAFTA. It is here that the conflict arises between the NAFTA and the constitutional text.

On the other hand, Article 13 of the Constitution indicates that “[n]o one may be tried by private laws or special tribunals. No person or corporate body shall have privileges or enjoy emoluments”⁶³ The creation of a system dispute resolution which only benefits foreigners is clearly adverse to the letter and spirit of that disposition. It is also important to recall the text of Constitutional Article 32: “Mexicans shall have priority over foreigners under equality of circumstances for all classes of concessions.”⁶⁴ This preference in favor of Mexicans is not consistent with the NAFTA stipulation in Chapter 11.

The harmony between international obligations and constitutional duties is a judicial and political imperative. Because of this, it is necessary to ensure that the NAFTA and the two bilateral treaties are consistent with the Constitution beyond a reasonable doubt. The best formula for clarifying the resulting interpretations requires Mexico to add a reservation to the three treaties in force by way of a negotiated settlement or a unilateral declaration. By clarifying the jurisdiction of Mexico’s legal system, a chain of unnecessary complications can be avoided to the benefit of all the interested parties.

63. *Id.* art. 13.

64. *Id.* art. 32, para. 1.