Vanderbilt Journal of Transnational Law

Volume 17
Issue 2 *Spring 1984*

Article 4

1984

Special Project – Legal Issues Arising from the Mexican Economic Crisis

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SPECIAL PROJECT

LEGAL ISSUES ARISING FROM THE MEXICAN ECONOMIC CRISIS*

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* The invaluable assistance of Stephen J. Foley, Vice President — International Banking Department, Commerce Union Bank (Nashville, Tennessee) is gratefully acknowledged.

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The economic crisis in Mexico, which profoundly altered the financial and political course of that nation, has also had a significant impact on persons and corporations having business ties to Mexico. Foreign investors and businesses now are required to follow new Mexican rules that often differ dramatically from those previously in effect. The impact of the crisis has not been confined to changes in Mexican law. A substantial number of issues have arisen that will have significant bearing on United States and international law.

The Special Project discusses the changes in the legal environment following the crisis, with its focus upon issues confronting private persons, principally foreign businesses and investors. The Introduction and Overview summarizes the history and structure of Mexico's regulation of foreign investment and recounts the events of the crisis. The first section of the Special Project examines the problems faced by foreign lenders and creditors. Specifically, it addresses the following: (1) the Mexican regulations that set forth the schedules for repayment of amounts owed to foreign creditors; (2) the possibilities for relief should the obligations be dishonored; (3) the efficacy of leading proposals for the restructuring of Mexican and international debt; and (4) the recently promulgated laws and regulations that will govern future international lending activity by United States banks. The second section explores the problems of investors in devalued peso-denominated accounts and the applicability of United States securities laws to those obligations. Section three addresses the immigration problem now exacerbated by the economic crisis and discusses the scope, effect, and wisdom of the proposed Simpson-Mazzoli Bill. The fourth section studies transborder environmental issues that recently have arisen as a result of Mexico's desire for rapid industrial development.

I. Introduction and Overview

A. A Brief History of Mexican Regulation of Foreign Business

Regulation of foreign business has been a major issue in Mexico since the Revolution of 1910-1920.[1] The Revolution, partially rooted in resentment of the perceived exploitation by foreign enterprises of Mexican resources,[2] led the public to demand restric-

1. *See infra* notes 2-9 and accompanying text. Foreign investment in Mexico had its real beginning during the Presidency of Porfirio Diaz (1876-1910). H. Wright, Foreign Enterprise in Mexico: Laws and Policies 51 (1971). Diaz opened wide the door to foreign investment. In the 1880s Great Britain and the United States began investing substantial amounts of capital into Mexico for mineral production and transportation. By 1911 foreigners had invested $1.7 billion in Mexico, $1.4 billion of which was direct investment. R. Newfarmer & W. Mueller, Report to the Subcomm. on Multinat'l Corp. of Senate Comm. on Foreign Relations, 94th Cong., 1st Sess., Multinational Corporations in Brazil and Mexico: Structural Sources of Economic and Noneconomic Power 46 (Comm. Print 1975) [hereinafter cited as Multinational Report]; *see also* H. Wright, *supra*, at 53.

2. During the late years of the Diaz Government, Mexicans grew increasingly fearful that excessive foreign influence in the economy of Mexico and lives of its

tions on investment by outsiders.[3] Article 27 of the Mexican Constitution of 1917,[4] an important product of the Revolution, provided for the nation's direct ownership of all subsurface mineral deposits,[5] eliminated private property rights in petroleum, and significantly extended the regulations that govern the production of petroleum.[6] Article 27 also included a "Calvo clause"[7] prohibiting foreign owners of Mexican land, waters, or concessions for mineral or water rights from invoking the protection of their governments in matters concerning that property. The penalty for violating this clause was possible forfeiture of the property to the Mexican Government.[8] In addition, Article 27 precludes foreigners from acquiring direct ownership of land or water within a zone of one hundred kilometers along the land borders and fifty kilometers along the coast.[9]

During the years following the Revolution, the Mexican Government took a more conciliatory attitude toward foreign busi-

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citizens might lead to a peaceful conquest by the United States. H. WRIGHT, *supra* note 1, at 59-60. One Mexican historian has written that "the foreigner felt himself owner of the country. All of the industry and affairs of importance were granted to foreigners; the Mexicans were discriminated against. Their defense was that of those who cannot do anything—anecdotes and sarcasm." J. CARPIZO, LA CONSTITUCIÓN MEXICANA DE 1917 27 (2d ed. 1973).

3. For example, the slogan "Mexico for the Mexicans" became prevalent. H. WRIGHT, *supra* note 1, at 60.

4. LA CONSTITUCIÓN MEXICANA DE 1917, art. 27, *reprinted in* J. CARPIZO, *supra* note 2, at 139-45. The current Mexican Constitution can be found in 1 CONSTITUCIÓN POLITICA MEXICANA 1 (Ediciones Andrade 1977). For an English translation of the Constitution, see *Mexico*, in 10 CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (A. Blaustein & G. Flanz eds. 1982).

5. LA CONSTITUCIÓN MEXICANA DE 1917, art. 27, *supra* note 4, *reprinted* at 139.

6. *Id.*; *see also* H. WRIGHT, *supra* note 2, at 63.

7. Carlos Calvo, an Argentine diplomat, asserted two principles: (1) sovereign states should be free from interference from other states, and (2) foreigners are entitled only to the privileges of nationals and may seek redress of grievances only before local authorities. H. WRIGHT, *supra* note 1, at 99.

8. LA CONSTITUCIÓN MEXICANA DE 1917, art. 27, cl. I, *supra* note 4, *reprinted* at 141.

9. *Id.* The constitutional limitations against foreign ownership were loosened somewhat by the Presidential decree of April 29, 1971, which permits, with governmental approval, a national credit institution to hold lands in trust for foreign investors for a period not to exceed thirty years. *See* Decree of April 29, 1971, DIARIO OFFICIAL [D.O.] (Mex.) (Apr. 30, 1971), *reprinted and translated in* Brinsmade, *Mexican Law—An Outline and Bibliography of English Source Materials Relating to Certain Aspects Thereof*, 6 INT'L LAW. 829, 859 (1972).

ness[10] until the nationalistic President Lázaro Cárdenas[11] again attempted to loosen the hold of foreign investors on the Mexican economy.[12] Following a lengthy labor dispute, President Cárdenas nationalized the petroleum industry on March 18, 1938.[13] The nationalization ended significant foreign investment in and domination of the oil industry, a major sector of the Mexican economy.[14]

The Emergency Decree of June 29, 1944,[15] ostensibly a temporary measure necessitated by the outbreak of World War II,[16] shaped subsequent policies governing foreign investment. The 1944 Decree reflected fears that wartime "flight" capital might be used to displace Mexican investment and monopolize portions of the economy, only to be withdrawn later.[17] To prevent that result the 1944 Decree required foreign-owned enterprises to obtain per-

10. Mexican Governments before 1930 treated private capital with deference, both to avoid problems with the United States and to avoid the possibility of a clash with social elites. Comment, *The Regulation of Foreign Business in Mexico: Recent Legislation in Historical Perspective*, 7 N.C.J. INT'L L. & COM. REG. 383, 389 (1982).

11. Cárdenas was President of Mexico from 1934 to 1940.

12. *See generally* N. WEYL & S. WEYL, THE RECONQUEST OF MEXICO: THE YEARS OF LÁZARO CÁRDENAS (1939).

13. *See* Decreto que expropia a favor del patrimonio de la Nación, los bienes muebles e inmuebles pertenecientes a las compañiás petroleras que se negaron a acatar el laudo de 18 de diciembre del 1937, del Grupo número 7 de la Junta Federal de Conciliación y Arbitraje, D.O. (Mar. 19, 1938), *reprinted in* 2 CONSTITUCIÓN POLITICA MEXICANA 314bis 9a (Ediciones Andrade 1977). In his speech announcing the expropriation decision, President Cárdenas declared that "the government would be in great danger" if foreign companies were permitted to refuse to comply with the laws of the nation. N.Y. Times, Mar. 7, 1938, at 1, col. 3. *See generally* H. WRIGHT, *supra* note 1, at 68-70.

14. *See* H. WRIGHT, *supra* note 1, at 70.

15. Decreto que establece la necesidad transitoria de obtener permiso para adquirir bienes a extranjeros, y para la constitución ó modificación de sociedades mexicanas que tengan ó tuvieran socios, D.O. (July 7, 1944), *reprinted in* 1 CONSTITUCION POLITICA MEXICANA 262bis 2a (Ediciones Andrade 1977) [hereinafter cited as 1944 Decree].

16. The 1944 Decree states that it is to be applied "during the time the suspension of guarantees decreed June 1, 1942 remains in effect." *Id.; see* H. WRIGHT, *supra* note 1, at 102. The June 1, 1942, suspension ended October 1, 1945. *See* Decreto que levanta la suspensión de garantías decretada el 10 de junio de 1942, y restablece el orden constitucional, ratificando y declarando vigente las disposiciones que el mismo especifica, D.O. (Dec. 28, 1945 & Jan. 21, 1946), *reprinted in* 1 CONSTITUCIÓN POLITICA MEXICANA 156-59 (Ediciones Andrade 1977).

17. H. WRIGHT, *supra* note 1, at 101-02.

mits before beginning operations within Mexico and allowed the Ministry of Foreign Relations to impose a requirement that Mexican nationals have majority control of enterprises and represent a majority of the directors.[18]

Immediately after the Second World War, particularly during the Presidency of Miguel Alemán,[19] the policies of the Mexican Government generally favored foreign investment. The 1944 Decree, although still in effect, rarely was enforced.[20] The administrations of Adolfo López Mateos[21] and Gustavo Díaz Ortiz,[22] however, reversed the trend toward relaxed regulation. Those administrations embarked upon a policy of nationalizing or restricting foreign ownership of "essential" industries.[23] For example, the Government purchased the foreign-owned sector of the electric power and telephone industry.[24] The Government also promulgated a new mining law that prohibited new concessions for mining or metallurgical operations to companies if foreigners controlled the majority of the stock. In addition, the law granted substantial tax breaks to mining companies that increased Mexican ownership of its shares to a majority.[25] A law enacted in 1965 prohibited the ownership of Mexican banks and insurance companies by "foreign governments or official agencies, financial entities from abroad or groups of foreign entities, whether individuals or legal entities."[26] A decree on July 2, 1970, required a minimum of

18. 1944 Decree, *supra* note 15, art. 3, *reprinted* at 262bis 3a.

19. President Alemán served from 1946 to 1952.

20. MULTINATIONAL REPORT, *supra* note 1, at 48.

21. President López Mateos served from 1958 to 1964.

22. President Díaz Ortiz served from 1964 to 1970.

23. *See* H. WRIGHT, *supra* note 1, at 80-92.

24. *Id.* at 80-82.

25. Ley Reglamentaria del artículo 27 Constitucional en Materia de Exploitación y Aprovechamiento de Recursos Minerales Minera, D.O. (Feb. 6, 1961); *see* H. WRIGHT, *supra* note 1, at 133-37. The current version of the law is Ley Reglamentaria del Articulo 27 Constitucional en Materia Minera, D.O. (Dec. 22, 1975) [hereinafter cited as 1975 Law], *reprinted in* 2 AGUAS-BOSQUES COLONIZACIÓN MINAS Y PETROLES 467 (Ediciones Andrade 1967). The prohibition against concessions to foreigners is included in Article 11 of the new law. 1975 Law, *supra*, art. 11, *reprinted* at 471-72; *see also* H. WRIGHT, *supra* note 1, at 82-83; Gordon, *The Joint Venture as an Institution for Mexican Development: A Legislative History*, 1978 ARIZ. ST. L.J. 173, 196-97.

26. *See* Nueva Ley General de Instituciones de Crédito y Organizaciones Auxiliares y sus reformas, art. 8 § IIbis, D.O. (Dec. 30, 1965) *reprinted in* 1 CÓDIGO DE COMERCIO REFORMADO 618-8 (Ediciones Andrade 1976).

fifty-one percent domestic capital in the steel, cement, glass, fertilizers, cellulose, and aluminum industries.[27] There was, however, one major exception to the tendency toward nationalistic economic policies during the years from 1958 to 1970. In 1965, the Mexican Government initiated the *maquiladora* program. That program permits foreign enterprises to obtain one hundred percent ownership of companies that process or assemble imported material and parts for reexport to other countries.[28]

In the 1970s two major laws were enacted that codified and extended Mexican regulation of foreign investment. The 1973 Law on the Promotion of Foreign Investment (Foreign Investment Law)[29] brought together in a single law a number of principles that had been scattered throughout different laws and administrative provisions. The Foreign Investment Law also emphasized limits on ownership and control of a business.[30] The 1972 Law on the Transfer of Technology[31] was designed to control the flow of technology into Mexico and to overcome its subordinate position

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27. Decreto por el que la Secretaría de Relaciones Exteriores podrá conceder licencias ó autorizaciones relativas a la constitución ó modificación del acto constitutive ó estatuos de sociedades que se citan, D.O. (July 2, 1970) [hereinafter cited as 1970 Decree], *reprinted in* 1 CONSTITUCIÓN POLITICA MEXICANA 262bis 9a (Ediciones Andrade 1977). Corporations in the categories affected by the legislation were required to issue two series of shares, one exclusively for Mexicans or Mexican corporations and the other for general circulation. 1970 Decree, *supra*, art. 1(b), *reprinted* at 262bis 9a vta.

28. The maquiladora program was titled Programa Fronterizo de Industria and was established by the Mexican Government to alleviate the chronic unemployment and general economic depression along Mexico's border. *Developments in Mexican Border Industrialization,* 5 TEX. INT'L L.F. 164, 164 (1969). For a discussion of the maquiladora program, see *infra* notes 65-69 and accompanying text.

29. Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera, D.O. (Mar. 9, 1973) [hereinafter cited as Foreign Investment Law], *reprinted and translated in* MEXICAN FOREIGN INVESTMENT AND TRANSFER OF TECHNOLOGY LAWS 6 (CCH ed. 1973) (Spanish-English edition) [hereinafter cited as MEXICAN FOREIGN INVESTMENT]. For another translation, see 12 I.L.M. 643 (1973).

30. Gordon, *The Contemporary Mexican Approach to Growth with Foreign Investment: Controlled but Participatory Independence,* 10 CAL. W.L. REV. 1, 34 (1973).

31. Ley Sobre el Registro de la Transferencia de Tecnologia y el Uso y Explotación de Patentes y Marcas, D.O. (Dec. 30, 1972) [hereinafter cited as 1972 Transfer of Technology Law], *reprinted and translated in* MEXICAN FOREIGN INVESTMENT, *supra* note 29, at 28. This law was replaced recently with a newer, more rigorous version. *See infra* notes 75-80 and accompanying text.

as the transferee of needed information.[32] These laws, which will be examined in the next subsection of the Special Project,[33] were the cornerstone of Mexican regulation of foreign investment until the economic crisis.

Since 1979, Mexican trade policy with the United States has assumed greater importance to both nations. In that year, Mexico, which was not a signatory to the General Agreement on Tariffs and Trade (GATT),[34] began negotiations toward membership in the GATT.[35] Ultimately, a tentative agreement was reached pursuant to which Mexico agreed to become a signatory of the GATT but retained the right to continue certain nationalistic policies.[36] Many believed that President López Portillo would approve the GATT negotiations agreement,[37] but two considerations apparently prevented approval. First, a strong belief that United States pressure was the principal reason for the tentative agreement offended Mexican nationalist sentiment.[38] Second, influential segments of Mexican society, including domestic manufacturers and intellectuals, opposed the treaty.[39] President López Portillo announced his intention not to participate in the GATT on March 18, 1980.[40]

Following the rejection of the GATT negotiations, Mexican trade policy became substantially more protectionist. Mexico's increasingly unfavorable trade position during the international

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32. Gordon, *supra* note 30, at 27.

33. *See infra* notes 50-74 and accompanying text.

34. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. pts. 5-6, T.I.A.S. No. 1700, 55 U.N.T.S. 188.

35. Several Latin American nations less developed than Mexico have joined the GATT. Among the larger and more advanced Latin American countries only Mexico and Venezuela are nonmembers. Story, *Trade Politics in the Third World: A Case Study of the Mexican GATT Decision*, 36 INT'L ORG. 767, 769-70 (1982).

36. Mexico was offered numerous concessions, including twelve years to eliminate import permits, incorporation of bilateral tariff concessions negotiated in the Tokyo Round, acceptance of the new Mexican system of tariff valuation, allowance of continued export subsidies, and the right to ignore GATT provisions relating to nontariff trade barriers that were incompatible with existing Mexican legislation. *Id.* at 773.

37. *Id.* at 767.

38. *Id.* at 775-76.

39. *Id.* at 781-86.

40. *Id.* at 767. This date was the forty-second anniversary of the nationalization of the oil industry. *Id.*

glut of oil, which began in 1981, accelerated the trend.[41] The number of items requiring import permits, which had gradually been reduced in the years up to 1980,[42] were increased.[43] The Government imposed arbitrary "official valuations" on imported items for tariff purposes.[44] After the 1982 economic crisis, even more stringent controls were issued requiring import permits on virtually all goods entering the country.[45] The Mexican Government encouraged countertrade, a barter system in which imported goods were exchanged for Mexican-made goods,[46] and joined other GATT nonsignatories in assailing the allegedly biased nature of the GATT.[47] Mexican officials asked that Mexico be granted the same privileges from the United States that signatories of the GATT enjoy and called for a bilateral trade agreement with the United States.[48] Although negotiations for a trade

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41. *See infra* note 101 and accompanying text.

42. President López Portillo began to revise protectionist policies in 1977 by starting to replace the prior import permit system with import tariffs. By the summer of 1980, over 70% of Mexico's imported items were freed from the import license requirement. Story, *supra* note 35, at 770.

43. In 1981 goods coming into Mexico under an import license constituted 83% of the total value of all imports. Comment, *supra* note 10, at 391.

44. *See* Tower, *Changed Conditions Face U.S. Exporters to Mexico,* BUS. AM., Oct. 4, 1982, at 2.

45. Import rates of exchange distinguished between essential and nonessential items. Essential imports, including basic foodstuffs and goods necessary either for industry or for increasing exports, received a "preferred" exchange rate. Nonessential items, like luxury items and most consumer goods, paid a penalty of a higher exchange rate. For a time, Mexico effectively barred nonessential imports by refusing to issue import permits for anything but essentials. Turner, *Practical Advice on Exporting to Mexico,* BUS. AM., Nov. 15, 1982, at 18.

46. *See Countertrade: Commerce Seminar Reviews Growing Areas of Barter and Countertrade,* 19 U.S. EXPORT WEEKLY 326, 328 (1983).

47. Peruvian and Mexican delegates attacked United States countervailing and dumping laws that apply to non-GATT signatories. *U.S. Trade Practices Criticized by OAS Foreign Ministers at General Assembly,* 18 U.S. EXPORT WEEKLY 445, 445 (1982).

48. *Mexican Economic Recovery Requires 'More Open-Minded' U.S. Attitude, Seminar Told,* 19 U.S. EXPORT WEEKLY 754, 754 (1983). Gutierrez Kirchner, a former Mexican trade official and an official of Pemex, Mexico's state oil company, expressed his hope that Mexico could reach a bilateral trade agreement with the United States and explained why Mexico would not join GATT:

> We always have viewed GATT as too neutral in its conception of international trade, as if all countries were trading industrial products among themselves. We see trade between North and South as a different issue. It is not so much trading among equals but trading among very different

agreement between the two countries have begun, no final pact has been reached.[49]

B. The Structure of Mexican Regulation of Foreign Business

1. *Restrictions on Business Entry by Foreigners*

Although recognizing the importance of foreign investment and avoiding radical measures, the Mexican Government closely regulates participation in the economy by non-Mexicans. As a result, it is very difficult for a foreigner lawfully to gain majority control of a Mexican enterprise,[50] except by forming an in-bond *maquiladora* enterprise.[51] Moreover, existing enterprises controlled by outsiders may well be subject to restrictions designed to encourage Mexican ownership.

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levels of economic development.
Id.

49. *Reagan, de la Madrid Discuss Trade, But No Accord Expected Anytime Soon,* 19 U.S. EXPORT WEEKLY 798, 798 (1983). Considerable progress was reported in the spring of 1984 in trade negotiations between the United States and Mexico. On the other hand, United States Trade Representative William Brock stated in May 1984 that the United States will not sign a bilateral trade agreement while the new Mexican decree on the pharmaceutical industry, *see infra* note 90, remains in effect. *Mexico: Decree Altering Pharmaceutical Industry Defended by Government, Protested by Firms,* 1 INT'L TRADE REP. 245, 247 (1984). An arrangement circulating among private sector advisors and Congress called for allowing Mexico the benefit of an injury test in countervailing duty decisions, in exchange for Mexico's agreement to phase out subsidy programs, and begin liberalizing its foreign investment rules. *De la Madrid, Reagan Talk Politics, Economics During Most Recent Meeting,* 20 U.S. EXPORT WEEKLY 976, 976 (1984).

50. *See infra* notes 51-74 and accompanying text. Exceptions to Mexican ownership requirements are theoretically available from the Foreign Investment Commission. *See* PRICE WATERHOUSE, DOING BUSINESS IN MEXICO 18-19 (1984). These permissions rarely have been granted, but the current administration has granted more than did the previous administration.

51. *See infra* notes 65-69 and accompanying text. For general descriptions of the Foreign Investment Law, *supra* note 29, see A. HOAGLAND, COMPANY FORMATION IN MEXICO B-11 to 24 (1980); PRICE WATERHOUSE, *supra* note 50, at 24-32. *See generally* Gordon, *The Joint Venture as an Institution for Mexican Development: A Legislative History,* 1978 ARIZ. ST. L.J. 173; Gordon, *The Contemporary Mexican Approach to Growth with Foreign Investment: Controlled but Participatory Investment,* 10 CAL. W.L. REV. 1 (1973). Regulations implementing the Law were issued on December 28, 1973. *See* D.O. (Dec. 28, 1973), *reprinted in* 1 CONSTITUCIÓN POLITICA MEXICANA 262bis 22 (Ediciones Andrade 1977).

Under the Foreign Investment Law, the economy is divided into three sectors.[52] In the first sector, all activities are reserved to the Government.[53] This sector includes petroleum, hydrocarbons, nuclear power and utilities.[54] In the second sector, activities are reserved to Mexicans or to Mexican companies that prohibit ownership of their shares by foreigners.[55] This sector includes radio, television, automotive transportation, airways, forestry, distribution of gas, and ownership of water near the border and coastlines.[56] In the third sector, foreign investment is permitted up to specified percentages, usually not exceeding forty-nine percent.[57] The National Commission on Foreign Investment is empowered to designate areas appropriate for foreign investment and the permissible percentage of foreign control.[58] The Commission also approves investments in existing enterprises exceeding twenty-five percent of capital or forty-nine percent of assets.[59]

Some foreign businesses, reluctant to turn over fifty-one percent control to Mexican shareholders, have attempted to circumvent the Foreign Investment Law using both legal and illegal methods. A formerly popular, if questionable, tactic was to sell fifty-one percent of the shares of the enterprise on the Mexican Bolsa (Stock Exchange), effectively leaving foreigners in control of the enterprise.[60] The Mexican Government, however, specifically prohibited this practice.[61] Another popular strategy is to set up a pyramid of companies and obtain control of the company at

52. Foreign Investment Law, *supra* note 29.

53. *Id.* art. 4, *reprinted and translated* at 6-9.

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.* art. 5, *reprinted and translated* at 8-11. The maximum ownership percentage is 40% for secondary petrochemicals and 34% for "special concessions for the exploitation of national mineral reserves." *Id.*

58. *Id.* art. 11-12, *reprinted and translated* at 12-15. The National Commission on Foreign Investment has published a number of its rulings. *See* Resoluciones Generales de la Comision Nacional de Inversiones Extranjeras, D.O. (Nov. 5, 1975), *reprinted in* 1 CONSTITUCIÓN POLITICA MEXICANA, 265bis 35 (Ediciones Andrade 1977).

59. Foreign Investment Law, *supra* note 29, art. 8, *reprinted and translated* at 10-13.

60. *See Latin Labyrinth: In Mexico Operations Foreign Concerns Face Reams of Red Tape,* Wall St. J., Feb. 16, 1982, at 1, col. 1, at 12, col. 3 [hereinafter cited as *Latin Labyrinth*].

61. *Id.*

the bottom.[62] A far more dangerous scheme is to use a Mexican "straw man."[63] This strategy is clearly illegal and risks blackmail by the "straw man."[64] The principal legal means for a foreigner to gain majority control of a Mexican enterprise is through the use of an in-bond or *maquiladora* program.[65] Under the maquiladora program[66] foreign investors, with approval from the supervising Mexican agency SECOFIN, may import goods into Mexico for assembly by Mexican workers and subsequent export.[67] The establishment of a maquiladora company offers several advantages: (1) duty-free entry into Mexico of equipment necessary to establish the enterprise; (2) duty-free entry of foreign product components; (3) no restrictions on the amount of a particular item that can be produced, except textiles and apparel; (4) a low minimum wage; and (5) authorization to lease land and plant facilities within areas where foreigners usually may not own land.[68] According to the revised regulations, it is sometimes possible for up to twenty percent of the production from the maquiladora program to be sold in Mexico.[69]

The 1973 Foreign Investment Law was modified twice in 1984. In February, the Mexican Government announced a new "system-

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62. *Id.; see also* A. HOAGLAND, *supra* note 51, at B-14. First, the foreign company acquires a 49% interest in a Mexican holding company. The holding company then acquires 51% of an operating subsidiary, with the foreigners obtaining the remaining 49%. Because the foreigners have a 49% stake in the holding company, as well as 49% of the operating company, they own more than 50% (approximately 73%) of the subsidiary and usually have control. *Latin Labyrinth, supra* note 60, at 12, col. 3.

63. *Latin Labyrinth, supra* note 60, at 12, col. 3. The use of "a straw man" is punishable by up to nine years in jail, although no one has been convicted of this offense. *Id.*

64. *Id.*

65. For a good overview of the maquiladora program prior to recent changes, see Inman & Ortiz Tirado, *A Mexican Dividend:* "Las Maquiladoras," 9 INT'L LAW. 431 (1975).

66. *See* Fomento de Industrias Maquiladoras, D.O. (Aug. 15, 1983), *reprinted in* 43 EL MERCADO DE VALORES 467 (1983).

67. *See* Turner, *Mexico Turns to Its In-Bond Industry as a Means of Generating Exchange,* BUS. AM., Nov. 28, 1983, at 27.

68. *Id.*

69. *Id.* at 29. For the 20% option to become effective, the production must satisfy the following conditions: (1) there can be no similar Mexican production that could be damaged by in-bond sales in Mexico; (2) if there is local production of the item, Mexican production must be insufficient; and (3) production must be consistent with Mexican foreign investment priorities. *Id.*

atic and selective policy" that allowed direct foreign investment in industries in which " 'the technological factor is decisive in achieving levels of international competitiveness and exports will result and where the project is highly capital intensive and where imports will be eliminated.' "[70] Under the new policy, the Government would permit foreign investors to own a majority of capital in nine specified "priority industrial activities."[71] In August, following repeated expressions of skepticism by the business community concerning the effectiveness of the new investment policies,[72] the Government published new rules designed to accelerate

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70. *Mexico Opens Several Key Industrial Sectors to Direct Participation by Foreign Capital,* 20 U.S. EXPORT WEEKLY (BNA) 667 (Feb. 21, 1984) (statement by Adolpho Hegewisch, Undersecretary of Foreign Investment Regulation and Technology Transfer at the Trade and Industrial Development Secretariat (SECOFIN)). The press release announcing these changes is reprinted in 44 EL MECADO DE VALORES 211 (1984).

71. The priority industrial activities are:

1. Machinery and nonelectrical equipment: farm machinery and tools; woodworking machinery; food and drink processing machinery; petroleum and petrochemical industry equipment; numerically controlled machine tools; textile industry machinery; plastic molding and extrusion machinery; graphic arts machinery; and cranes, pulleys, and similar items.
2. Electrical machinery and equipment: high power electrical generators and motors; processing industry turbines; and high power turbocompressors.
3. Metal-mechanics: high technology metallurgy equipment and systems; high precision microfoundry; and specialized tools.
4. Electronic equipment and accessories: telecommunications equipment; magnetic computer discs and tapes; computer equipment, parts, and components; process control equipment and instrumentation; diverse electronic components, parts, and materials; scientific and engineering electronic equipment; and consumer electronics.
5. Transport equipment and material: motorcycles and similar vehicles of more than 350 cc.; internal combustion engines for locomotives and ships; and ship repair and construction.
6. Chemical industry: raw materials and substances for the pharmaceutical industry; and synthetic resins and plastics specialty chemicals.
7. Other manufacturing industries: precision and measurement apparatus; medical instruments and equipment; photographic material and equipment; and new high technology materials.
8. Advanced technology services: biotechnology.
9. Hotel industry: construction and operation of hotels.

Mexico Opens Key Sectors, supra note 70, at 668; *see* 44 EL MERCADO DE VALORES at 212.

72. *See Mexico's Investment Rules Raise Skepticism,* Wall St. J., June 12, 1984, at 35, col. 2. Foreign investors complained about delays in obtaining ap-

the processing of foreign investment applications.[73] The new rules limit the time that the Foreign Investment Commission can spend considering applications and direct other participating ministries to expedite their communications with the Commission.[74]

2. *Transfer of Control of Technology*

Pursuant to the 1981 Transfer of Technology Law,[75] Mexico requires governmental approval and registration with the National Registry on the Transfer of Technology of most sales and licenses of trademarks, patents, engineering and "technology," and related administrative and managerial services.[76] The law strongly encourages the presentation of a contract for registration within sixty days of its formation. A contract not registered within sixty days has no legal effect until the actual date of registration, which may be months after presentation.[77] The law requires the registration of technology transferred and of all documents related to the transfer.[78] Mexican law and regulations list numerous standards against which agreements are measured. A technology agreement may be rejected in any one of seventeen instances.[79]

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proval and continued hostility toward foreign capital. *Id.* In addition, they expressed concern about the investment climate in light of the recent decrees limiting foreign investment in the automobile and pharmaceutical industries. *See Mexico: U.S. Exports Increase as Adjustments Continue,* BUS. AM., Aug. 20, 1983, at 25; *see also infra* notes 81-86 and accompanying text.

73. *Mexico Issues New Rules on Foreign Investment,* Wall St. J., Aug. 31, 1984, at 12, col. 1.

74. *Id.*

75. Ley sobre Control de la Transferencia de Tecnologia, D.O. (Jan. 11, 1982) [hereinafter cited as 1981 Transfer of Technology Law], *reprinted in* 42 EL MERCADO DE VALORES 75 (1982). This law replaces the law of December 28, 1972, *supra* note 31. For a section-by-section analysis of the new law, see Hyde, *1981 Mexican Transfer of Technology Act,* 15 LAW. AM. 37 (1983). *See also Mexico Tightens Controls on Foreign Technology,* BUS. AM., Mar. 8, 1982, at 32.

76. 1981 Transfer of Technology Law, *supra* note 75, art. 2, *reprinted* at 76.

77. *See id.* art. 10, *reprinted* at 77. This provision is essentially the same as the corresponding article of the 1972 Transfer of Technology Law, *supra* note 31, art. 4, *reprinted and translated* at 30-31, which provided a similar incentive for early registration. *See* Hyde, *supra* note 75, at 10; *see also* A. HOAGLAND, *supra* note 51, at B-28 (describing 1972 law).

78. 1981 Transfer of Technology Law, *supra* note 75, art. 10, *reprinted* at 77.

79. The seventeen instances are:

1. When the agreement permits the supplier of the technology to intervene directly or indirectly in the administration of the technology;

Nevertheless, a contract otherwise objectionable under the 1981 Law may be approved if an exception is determined to be of ben-

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2. When the agreement establishes the obligation to cede or grant the technology to the supplier;
3. When the agreement imposes limitations upon the acquirer in investigation or technological development;
4. When the agreement requires the acquirer to purchase goods available elsewhere;
5. When the agreement prohibits or limits the exportation of goods or services produced by the acquirer in a manner contrary to the national interest;
6. When the agreement prohibits the use of complementary technology;
7. When the agreement requires the acquirer to sell the goods produced to a client of the supplier on an exclusive basis;
8. When the agreement requires the recipient to use, in a permanent form, the personal mark of the supplier of the technology;
9. When the agreement limits the volume of production or imposes on the acquirer sale or resale prices for Mexican production or export goods;
10. When the agreement obligates the acquirer to enter into sales or representation contracts with the supplier unless, in the case of exports, the acquirer accepts the terms and demonstrates to the satisfaction of the Secretary of Patrimony and Industrial Development that the supplier has a better distribution mechanism and commercial prestige to market the goods than does the acquirer;
11. When the agreement requires the acquirer to keep technical information secret for a longer period than the contract term or the period provided by applicable law;
12. When the agreement does not expressly provide that the supplier assumes responsibility for the invasion of third party property rights;
13. When the agreement does not guarantee the quality and result of the technology;
14. When the agreement transfers foreign technology already available in Mexico;
15. When the contract price bears no relation to the acquired technology or constitutes a grave injury or excess to the national economy;
16. When the agreement establishes excessive terms of duration. In no case may an agreement establish an obligation of more than ten years;
17. When the agreement permits foreign tribunals to take cognizance of, or render judgments relating to, the interpretation or completion of the acts, covenants, or contracts, except in cases of exportation of technology or express subordination to private international arbitration if the arbitrator applies Mexican substantive law to the controversy in accordance with any treaty or convention to which Mexico is a party.

1981 Transfer of Technology Law, *supra* note 75, art. 15 & 16, *reprinted* at 78. The earlier version provided fourteen grounds for mandatory rejection. 1972 Transfer of Technology Law, *supra* note 31, art. 7, *reprinted and translated* at 32-33; *see* Hyde, *supra* note 75, at 44.

efit to the nation.[80]

3. *Special Restrictions on Motor Vehicle Manufacturers*

Foreign manufacturers who produce automobiles in Mexico have been regulated particularly heavily, and the importation of automobiles has been prohibited for many years.[81] In accordance with the newly promulgated Decree for the Rationalization of the Automotive Industry,[82] the Government now requires that manufacturers compensate for imported components with corresponding exports.[83] Because of this requirement, some manufacturers have been required to export Mexican products that are completely unrelated to automobiles.[84] The new Decree requires automobile manufacturers to limit drastically the number of lines and models they manufacture. As of November 1984, no eight-cylinder automobiles may be manufactured in Mexico for domestic consumption.[85] In addition, the Decree includes a domestic content requirement of fifty percent for 1984 and 1985 models, fifty-five percent for 1986 models and sixty percent for later models.[86]

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80. 1981 Transfer of Technology Law, *supra* note 75, art. 17, *reprinted* at 78. Other significant differences between the 1972 Law and the 1981 Law are: (1) the 1981 Law expands the registration requirement to include advisory, consulting and supervisory services, industrial copyrights, and computer programs; (2) pursuant to the 1981 Law the registration requirement is extended to the maquiladora program; and (3) pursuant to the 1981 Law contracts may be rejected if agreements do not assign liability expressly to the supplier of technology for invasion of industrial property rights or do not quantify the quality and results of the technology acquired. *See* Hyde, *supra* note 75, at 38-45.

81. The Government banned automobile importation in the 1960s. *See How Carmakers are Trimming an Import Surplus*, Bus. Wk., Jan. 30, 1984, at 36.

82. Decreto para la racionalización de la industria automotriz, D.O. (Sept. 14, 1983) [hereinafter cited as Automotive Decree], *reprinted in* 43 El Mercado de Valores 965 (1983). The preamble to the decree declares that it is "indispensible that the automotive industry cease being a charge against the commercial balance of the country and in the future to generate all the foreign money necessary for its operation." Automotive Decree, *supra*, preamble, *reprinted* at 965.

83. Automotive Decree, *supra* note 82, art. 14, *reprinted* at 968.

84. For example, Volkswagen of Mexico is shipping so much Mexican coffee overseas that the Mexican Government is worried that Volkswagen will upset the world coffee market. *How Carmakers are Trimming an Import Surplus*, *supra* note 81, at 36. Nissan Mexico is shipping, in addition to coffee, other products including horsemeat, chickpeas, and honey. *Id.*

85. Automotive Decree, *supra* note 82, art. 9, *reprinted* at 967.

86. *Id.* art. 5, *reprinted* at 967.

In February 1984 a similar decree was announced, which increased the regula-

4. *Trade Restrictions*

Foreigners seeking to export to Mexico face heavy regulation. As of November 16, 1982, all commercial imports into Mexico worth 5,000 pesos or more require a license or prior import permit (PIP)[87] with very limited exceptions. Items exempted from this requirement include only items specifically exempted by the Secretary of Commerce and other government agencies, certain spare parts up to a designated quantity per importer, shipments for maquiladora industries, and goods destined for the *articulos ganchos*[88] program.[89] Permits rarely are granted to import products for which Mexican goods can be substituted,[90] and the Government may deny permits for nonessential goods.[91] "Essential" imports include basic foodstuffs and materials necessary for their production; capital, intermediate goods, and raw materials needed to sustain industry or increase exports; and capital goods necessary for the continuance of essential government programs.[92]

Mexico imposes *ad valorem* duties on admissible imports, with rates determined by either the "normal customs value" or the

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tion of the pharmaceutical industry and favored Mexican-owned firms. *See* Decreto para el fomento y la regulación de la industria farmaceutica, D.O. (Feb. 14, 1984), *reprinted in* 44 EL MERCADO DE VALORES 238 (1984); *see also Decree Altering Pharmaceutical Industry Defended by Government, Protested by Firms,* 1 INT'L TRADE REP. (BNA) 245 (Aug. 29, 1984); *Mexico's Investment Rules Raise Skepticism,* Wall St. J., June 12, 1984, at 35, col. 2. The decree sets goals for domestic production in 1988 of 98% of medicine consumption and at least 60% of basic ingredient requirements. *Decree Altering Pharmaceutical Industry, supra,* at 245. The pharmaceutical industry has challenged the decree in Mexican courts, alleging that it violates the Mexican Constitution, and a number of companies have successfully restrained its enforcement. *Id.* One foreign executive of the drug industry explained, "No one wants to see a showdown in the Supreme Court, and we have maneuvered the government into a dialogue with us." *Id.*

87. *Mexico,* 2 INT'L TRADE REP. EXPORT SHIPPING MANUAL, (BNA) 113:11 (Mar. 6, 1984). Although the Mexican Government announced in January 1984 that 1700 items could be imported without a prior import permit, these items only accounted for about five percent of Mexican imports. Presti, *Mexico: U.S. Exports Increase as Adjustment Continues,* BUS. AM., Aug. 20, 1983, at 25, 26. *See generally* Turner, *Practical Advice on Exporting to Mexico,* BUS. AM., Nov. 15, 1982, at 18.

88. Border area department stores.

89. Turner, *supra* note 87, at 18.

90. *Mexico, supra* note 87, at 113:12.

91. Turner, *supra* note 87, at 18.

92. *Id.*

"official value" of merchandise.[93] The "normal customs value" equals the invoice price plus handling charges from the United States side of the border to Mexican customs, plus ten percent of the insurance and freight to the port of export.[94] The "official valuation" depends upon an official price listed in the tariff schedule and the weight of the goods.[95] The use of official valuations has become increasingly common in recent years; official valuations ostensibly ensure that underinvoicing does not occur and that a fair market value is charged.[96]

C. The Mexican Economic Crisis of 1982

From 1978 to 1981 the Mexican economy experienced one of the world's highest growth rates.[97] The discovery of oil in 1976 and the subsequent seller's market for oil significantly contributed to this growth.[98] Another factor, however, was the Mexican Government's ambitious program of social spending and subsidies,[99] which produced extremely large deficits and foreign indebtedness.[100] Even after international petroleum prices declined

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93. *Id.* at 20.

94. *Id.*

95. *Id.* If the official value is greater than the normal customs value, the official value is used as the basis for the tariff. *Id.*

96. *Id. See generally Mexico, supra* note 87, at 113:8 (Jan. 3, 1984)-13:9 (June 14, 1983).

97. *See U.S. Dep't of State,* Mexico's Political/Economic Situation 2 (Feb. 10, 1983) (briefing paper). Average economic growth in the 1978-81 period was in excess of 8%. *Mexico Adjustment Program Aimed at Correcting Disequilibria and Establishing Basis for Sustainable Economic Growth,* BUS. AM., Aug. 8, 1983, at 23.

98. Officially proven oil and gas reserves grew to 72 billion barrels in 1982, a twelve-fold increase from 1977. *See Southern Storm: Mexico Is Weathering the Float of the Peso, but Problems Persist,* Wall St. J., Mar. 19, 1982, at 1, col. 6 [hereinafter cited as *Southern Storm*]. "Revenue from oil and gas exports soared to about $14 billion [in 1981] from under $2 billion in 1978." *Id.*

99. *See* U.S. DEP'T OF COMMERCE, PUB. No. 83-002, FOREIGN ECONOMIC TRENDS AND THEIR IMPLICATIONS FOR THE UNITED STATES 4 (Jan. 1983) (prepared by the United States Embassy in Mexico) [hereinafter cited as FOREIGN ECONOMIC TRENDS]. Mexican Government expenditures increased from 285.52 billion pesos in 1977 to 750.2 billion pesos in 1980. INT'L MONETARY FUND, INTERNATIONAL FINANCIAL STATISTICS 310 (Jan. 1984). The level of economic activity resulting from government spending created new jobs in excess of government targets for the 1978-81 period. FOREIGN ECONOMIC TRENDS, *supra,* at 4.

100. Mexico's annual deficit increased from 61.13 billion pesos in 1977 to 133.68 billion pesos in 1980. INT'L MONETARY FUND, *supra* note 99, at 310. Mexi-

in mid-1981, Mexico increased its public sector borrowing by arranging short-term loans from international capital markets.[101] By August 1982, the debt had reached approximately $81 billion of which approximately $21 billion consisted of short-term obligations maturing in a year or less.[102] Nevertheless, until 1982 there was little public attention to the Mexican debt and financial problems. The apparent strength of the Mexican economy, which was initially unaffected by the worldwide recession that began in 1981, fostered confidence in Mexico's ability to meet its financial obligations.[103]

In February 1982, the seriousness of the Mexican economic situation first became apparent. Mexico's central bank, which apparently was unable to retain reserves of foreign currency sufficient to maintain the peso's official rate of exchange, permitted the currency to "float" in the world currency markets.[104] The value of the peso immediately plummeted twenty-eight percent to an exchange rate of thirty-eight pesos per dollar.[105] The devaluation, which was accompanied by price controls on certain goods[106] and announced cuts in spending,[107] exacerbated the Mexican eco-

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can public sector indebtedness to foreign entities increased from 22.9 billion in 1977 to 52.0 billion in 1981. *Mexican Outlook: Banks are Wary,* N.Y. Times, Aug. 17, 1982, at D1, col. 4 (chart).

101. FOREIGN ECONOMIC TRENDS, *supra* note 99, at 4. The decision to increase public sector borrowing along with the increased spending resulted in an additional debt of $18 billion in 1981. *Id.*

102. *Bankers Pressured to Assist Mexico,* N.Y. Times, Aug. 21, 1982, at 32, col. 1.

103. Mexico experienced 8% growth in both 1980 and 1981. *See* U.S. DEP'T OF STATE, PUB. No. 7865, BACKGROUND NOTES: MEXICO 4 (June 1983). United States businesses continued to maintain an optimistic attitude toward Mexico until early 1982. For example, a United States businessman stated that "Mexico is like a hot stock—something that companies feel that they have to have." *Latin Labyrinth, supra* note 60, at 1, col. 1 (quoting David White, President of Tork, Inc.).

104. Rout, *Mexicans Start Picking Up the Pieces After Last Week's 30% Devaluation,* Wall St. J., Feb. 23, 1982, at 38, col. 1.

105. *Mexican Peso Plunges 28% Against Dollar,* Wall St. J., Feb. 19, 1982, at 4, col. 1.

106. *See Mexico Freezes Prices of Some Items to Curb Effects of Devaluation,* Wall St. J., Feb. 25, 1982, at 38, col. 1.

107. Although the Government had mentioned budget cuts, *see Mexico May Face Inflation Explosion, Second Peso Devaluation, Analysts Warn,* Wall St. J., Mar. 26, 1982, at 30, col. 2, it did not announce a specific plan to reduce debts until April 20. By waiting, it hoped to allay public fears about Mexico's eco-

nomic situation. The devaluation touched off a major new wave of inflation.[108] Many Mexicans, fearing another devaluation, purchased dollars and invested them out of the country.[109] In May 1982, Finance Minister Jesus Silva Herzog predicted that Mexico would register two to three percent growth over the next year.[110] The Government, faced with sharply lower international reserves, requested and received a $1 billion advance on a bank loan to shore up its financial reports.[111]

In August, the country faced another liquidity crisis. Substantial capital flight followed an announcement on August 1 that prices would increase for electricity, gasoline, tortillas, and bread.[112] Once again, Banco de Mexico could not sustain its foreign currency reserves.[113] On August 5, the central bank announced a dual exchange system under which the dollar would have two values, one preferential and one at market rates.[114] The

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nomic future. *See Mexico Unveils Plans to Narrow Budget Deficit,* Wall St. J., Apr. 22, 1982, at 32, col. 1. Under the seventeen-point plan promulgated by the Government, the public sector of the gross domestic product was to decline 14.5% in 1981 to 11.5% in 1982; net public sector external borrowing was not to exceed $11 billion; and the current account deficit was to be about $10 billion. FOREIGN ECONOMIC TRENDS, *supra* note 99, at 4. In addition, the program included strict money creation targets by the central bank. *Id.*

108. Many observers remained skeptical whether the budget cuts would be implemented. *See Mexico May Face Inflation Explosion, Second Peso Devaluation, Analysts Warn, supra* note 107, at 30, col. 2; *Mexico Unveils Plan to Narrow Budget Deficit, supra* note 107, at 32, col. 1. The skeptics were correct; the budget reduction plan was never fully implemented. *See* FOREIGN ECONOMIC TRENDS, *supra* note 99, at 5.

109. The Mexican inflation rate was 30% in 1981. *Southern Storm, supra* note 98, at 1, col. 6. In the first four months of 1982, however, consumer prices rose at about a 70% compound annual rate. Wall St. J., May 19, 1982, at 33, col. 2, col. 3.

110. *See Mexican President Lopez Portillo Urges Citizens to Stop Selling Pesos, Buying American Dollars,* Wall St. J., May 13, 1982, at 30, col. 1.

111. *See* Wall St. J., May 25, 1982, at 34, col. 1; Wall St. J., June 2, 1982, at 28, col. 3.

112. FOREIGN ECONOMIC TRENDS, *supra* note 99, at 5. Economists said the Government could not afford the subsidies necessary to maintain lower prices on consumer goods. Wall St. J., Aug. 3, 1982, at 1, col. 3.

113. FOREIGN ECONOMIC TRENDS, *supra* note 99, at 5.

114. The decree announcing the dual exchange rate stated that the foreign exchange formula was based on foreign exchange "for the most urgent economic and social uses in accord with the nation's priority." *Economic and Social Conditions in Mexico,* COMERCIO EXTERIOR DE MEXICO, Dec. 1982, at 417, 420 (English version). The dual rate decision was made "because of recent pressures of a

preferential rate of about fifty pesos to the dollar was applied to payment of public sector external debt operations, private sector interest obligations, and the imports of "basic goods."[115] The market rate, which floated between sixty-five and eighty-five pesos to the dollar, was applied to all other transactions.[116] Because the Mexican Government directly receives seventy percent of Mexico's foreign exchange, principally through exports of oil, the new rates were the equivalent of seventy percent exchange controls.[117] On August 12, the Government announced that funds invested in dollar-denominated accounts could be withdrawn only in pesos[118] at an artificially low exchange rate,[119] and the foreign exchange market was closed temporarily.[120] Apparently, these actions became necessary after several European banks refused to refinance loans that were falling due.[121] These measures, however, failed to arrest an even more serious crisis. When the foreign exchange market reopened, the peso had slipped to an exchange rate of 115 pesos to the dollar.[122] Meanwhile, officials of the Mexican Government met with its creditors to reschedule the repayment of at least a portion of the country's indebtedness.[123]

The international financial community and the United States Government, finally realizing the seriousness of the situation in Mexico, acted to assist Mexico through the crisis.[124] A financial

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highly speculative character, which have been affecting the exchange market." *Id. See generally Assessing Mexico's Peso Devaluation,* Wall St. J., Aug. 9, 1982, at 17, col. 1.

115. FOREIGN ECONOMIC TRENDS, *supra* note 99, at 5-6.

116. *Id.* at 6.

117. *Mexico Reopens Exchanges with High Rate for the Dollar,* N.Y. Times, Aug. 20, 1982, at D15, col. 1.

118. *Peso Problems: Economy of Mexico, Already in Bad Health, May Face Further Ills,* Wall St. J., Aug. 16, 1982, at 1, col. 1 [hereinafter cited as *Peso Problems*].

119. *Id.; see also* Wall St. J., Aug. 18, 1982, at 28, col. 1.

120. *Peso Problems, supra* note 118, at 1, col. 1. Banks were permitted to buy dollars, but not to sell them. *Id.*

121. *Mexico Seeking Postponement of Debt,* N.Y. Times, Aug. 20, 1982, at A1, col. 1, D15, col. 3.

122. *Mexico Reopens Exchanges with High Rate for Dollar, supra* note 117, at D15, col. 1.

123. *Loans and Credits for Aiding Mexico Are Mapped by U.S.,* N.Y. Times, Aug. 21, 1982, at 1, col. 6. Finance Minister Silva Herzog also had a series of unannounced negotiations in Washington, D.C., with United States Treasury and Federal Reserve officials. *Id.*

124. *See Crisis in Mexico Economy Is Triggering a Major International*

package was arranged that included: (1) $1 billion in crop-export loans extended by the United States and guaranteed by the Commodity Credit Corporation;[125] (2) $1 billion in advance payments by the United States Government for Mexican crude oil;[126] (3) short-term credits of $1.85 billion guaranteed by central banks of developed countries;[127] (4) $5 billion in loans contingent upon adoption of austerity measures from the International Monetary Fund;[128] and (5) additional credit and loans from commercial banks from $500 million to $1 billion and a moratorium on the repayment of principal.[129] Although disaster was averted, capital flight continued across the border with large amounts of pesos and dollars deposited in United States banks.[130]

On September 1, President López Portillo acted dramatically. In his final State of the Nation address,[131] López Portillo announced the implementation of full exchange controls[132] and the nationalization of the private banks.[133] These actions, although popular among substantial segments of the Mexican people,[134] shocked the domestic and international financial communities.[135]

The Mexican economic picture has remained unsettled since September 1982, although the pace of events is not so dramatic as

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Rescue Operation, Wall St. J., Aug. 19, 1982, at 2, col. 3; *Loans and Credits for Aiding Mexico Are Mapped by the U.S., supra* note 123, at 1, col. 6.

125. *How Mexico Lined Up Credits,* N.Y. Times, Aug. 31, 1983, at D1, col. 3 (chart) [hereinafter cited as Credit Chart].

126. *Id.* Mexico was to increase its sales to the United States Petroleum Reserve to 190,000 barrels a day from 50,000 barrels a day. *Id.*

127. *Id.; see also BIS Increases Mexican Credit to $1.85 Billion,* Wall St. J., Aug. 26, 1982, at 25, col. 5.

128. Credit Chart, *supra* note 125.

129. *Id.*

130. *Economic and Social Conditions in Mexico, supra* note 114, at 423.

131. López Portillo's presidential term expired on December 1, 1982. *See* Wall St. J., Sept. 2, 1982, at 2, col. 2.

132. Decree Establishing the Generalized Control of Exchange, D.O. 5 (Sept. 1, 1982) [hereinafter cited as Exchange Control Decree], *reprinted in* 28 COMERCIO EXTERIOR DE MEXICO 352 (1982).

133. Decree Establishing the Nationalization of Private Banks, D.O. 3 (Sept. 1, 1982) [hereinafter cited as Nationalization Decree], *reprinted in* 28 COMERCIO EXTERIOR DE MEXICO 350 (1982). The President charged that the private banks had "betrayed" Mexico by facilitating speculation against the peso. Wall St. J., Sept. 2, 1982, at 2, col. 2.

134. 300,000 Mexicans rallied in support of President López Portillo's decree on September 3. N.Y. Times, Sept. 4, 1982, at A3, col. 1.

135. *See infra* sec. II.

in the summer of that year.[136] A number of observers have praised the efforts of the new Mexican President, Miguel de la Madrid,[137] toward reducing budget deficits,[138] eliminating corruption,[139] and improving the country's balance of payments.[140]

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136. A long period of confusion and anxiety followed the imposition of exchange controls and bank nationalization. *See Mexico Seems Calm But Fiscal Crisis Stirs Deep Fear, and Hope,* Wall St. J., Sept. 17, 1982, at 1, col. 4. These changes were no doubt exacerbated by the lame duck status of López Portillo, who remained in office until December 1, 1982. Peso withdrawals and devaluation rumors were rampant in late 1982, and there was substantial labor unrest. *See Mexicans Swap Pesos for Dollars, Hurting Banks,* Wall St. J., Nov. 5, 1982, at 37, col. 1. Nevertheless, in 1983, Mexico's economic picture appeared to brighten, *see infra* notes 138 and 140. Mexico signed a $21 billion package to reschedule its public sector debt between August 1982 and December 1984, preventing a recurrence of the acute debt emergency of 1982. *See* N.Y. Times, Sept. 30, 1983, at 32, col. 1. The $1.85 billion loan guaranteed by the central banks, *see supra* note 127 and accompanying text, was repaid. *Mexico Repays Loans from U.S. and BIS, Plans to Restructure $20 Billion in Credit,* Wall St. J., Aug. 25, 1983, at 18, col. 1. Mexico borrowed about $5 billion; and it sought, and will likely receive, an additional $4 billion loan. Labich, *The So-Far, So-Good Mexican Recovery,* FORTUNE, Jan. 9, 1984, at 97, 98; *see also* N.Y. Times, Dec. 8, 1983, at 37, col. 5.

Mexico also announced plans to let the value of the so-called free market peso slip gradually against the dollar. *See Mexico's Gradual Drop in 'Free Peso' Rate Is Intended to Help Struggling Economy,* Wall St. J., Sept. 26, 1983, at 27, col. 2. This "mini-devaluation" was designed to head off selling of the peso before speculative pressures could push the currency even lower. *Id.*

In September 1984 Mexico reached agreement with a negotiating committee representing foreign creditor banks calling for Mexico to postpone about $20 billion of principal payments due between 1985 and 1990, for banks to soften previous restructuring pacts, and for improved terms on $5 billion in loans made to Mexico in 1983. At the time of the announcement the agreement had yet to be approved by the country's approximately 550 foreign creditors. *See Mexico Reports Accord to Ease Debt Payments,* N.Y. Times, Sept. 8, 1984, at 1, col. 5; *Mexico Accord Could Bolster U.S. Currency,* Wall St. J., Sept. 10, 1984, at 31, col. 1.

137. President de la Madrid assumed office on December 1, 1982.

138. The budget deficit, which had reached 18% of the country's economic output, was halved. Labich, *supra* note 136, at 98.

139. The most dramatic government attack against alleged corruption was the arrest on fraud charges of Jorge Díaz Serrano, a former director of Pemex, the State oil company. *See As Mexico Pumps Its Oil, the Graft Flows Freely,* N.Y. Times, Jan. 18, 1984, at 4, col. 3, col. 6.

140. The 1983 trade figures were expected to show a $12 billion trade surplus. Labich, *supra* note 136, at 98. For optimistic views of the Mexican situation, see *id.* and *Mexico Under the IMF: The Neighbourhood Starts to Pick Up,* THE ECONOMIST, Aug. 20, 1983, at 19.

Other observers are less sanguine.[141] Undoubtedly included in the legacy of the crisis, however, are numerous unresolved issues that continue to be of vital importance to Mexicans and to persons doing business in Mexico.

II. The Impact of the Crisis on Foreign Lenders, Creditors, and Suppliers

A. Introduction

The Mexican economic crisis of 1982 had a particularly significant impact upon foreign lenders, creditors and suppliers doing business in Mexico. In addition to being directly affected by the nationalization of the banks, and the imposition of currency controls, foreigners have been required to cope with the Mexican Government's complex program for restructuring short-term private sector indebtedness into long-term debt. These programs are designed to preserve Mexico's foreign exchange reserves while providing consistent long-term repayment of foreign indebtedness. United States lenders are also affected by legislation recently enacted by Congress that restricts international lending by United States credit institutions in order to protect the United States economy from the consequences of foreign default. Finally, foreign lenders, creditors, and suppliers are all potentially affected by a number of recent proposals for extricating Mexico and its lenders from their current dilemma.

B. Developments in Mexican Law Affecting Lenders, Creditors, and Suppliers

1. *The Nationalization Decree*

The nationalization of the Mexican private banking system was an attempt by the Mexican Government to regain complete control over Mexico's banking services and credit policies by centralizing all banking functions in the Ministry of Finance and Public Credit.[1] The nationalization of the banks did not alter signifi-

141. For pessimistic views of the Mexican situation, see *Mexico's Money Miracle: The Sober Truth,* Latin American Times, Oct. 1983, at 9; Weiner, *Back from the Brink: Mexico's Miracle of Mirrors,* N.Y. Times, Jan. 15, 1984, at F3, col. 1; *De la Madrid Must Face Political Fallout of Mexico's Scattered and Feeble Recovery,* Wall St. J., Aug. 31, 1984, at 12, col. 1.

1. *See* Nationalization Decree, *supra* sec. I, note 133, at 3-4, *reprinted* at 350-51.

cantly the administration of banking services in Mexico.[2] The decree, however, did expropriate the property rights[3] of all privately owned credit institutions as well as their assets and holdings in other companies.[4]

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2. The operation, function, and power of the Mexican banking system was established in the Organic Law of the Banco de Mexico of 1941. A. HOAGLAND, COMPANY FORMATION IN MEXICO, J-1 (2d ed. 1980). The administration of Mexican banking and finance laws already was highly centralized prior to the Nationalization Decree. The Secretariat of Finance and Public Credit (SFPC) not only defined and implemented monetary and financial policies of the Government, but also coordinated and controlled the activities of the Banco de Mexico. *Id.* at J-2. The National Banking Insurance Commission (NBIC) and Banco de Mexico, in conjunction with the SFPC, were the principal coordinators in regulating the growth, development, and operation of the banking system of Mexico. The three organizations were responsible for granting and refusing bank charters, establishing minimum capital and legal reserve requirements, making rules for asset and liability valuation, and maintaining control of the money supply and interest rates. *Id.* at J-2 to J-3. Banco de Mexico was specifically authorized to do the following: (1) regulate the issue and circulation of currency and foreign exchange; (2) operate as a reserve bank and clearing house for the credit institutions associated with it; (3) establish and manage the required reserves; (4) review decisions of the NBIC in regard to these matters; (5) serve as financial agent of the Government in foreign and domestic credit operations and in the issue and marketing of public loans, and act as treasurer to the Government; and (6) participate as Mexico's representative in, and cooperate with the International Monetary Fund, the International Bank for Reconstruction and Development, and the Inter-American Development Bank. *Id.* at J-4 to J-5. The NBIC regulated, through Banco de Mexico, the investment and financing policies of private credit institutions by manipulating both qualitative and quantitative controls such as the discount rate and the reserve requirements. The NBIC regulations imposed an obligatory deposit system and established quotas for the investment of a portion of the private banking system's resources. *Id.* at J-11; *see also* Nationalization Decree, *supra* sec. I, note 133, at 4, *reprinted* at 351.

3. Nationalization Decree art. 1, *supra* sec. I, note 133, at 4, *reprinted* at 351. At the time of the Nationalization Decree, Mexico had 25 privately owned commercial banks and 34 credit institutions in which the Mexican Government held minority ownership. The Mexican economy was dominated by two private banks, Banco Nacional de Mexico (Banamex) and Banco de Comercio (Bancomer). At the end of May 1982 Bancomer's assets totaled 629 billion pesos, and Banamex's assets totaled 598 billion pesos, with a combined total of 1,227 billion pesos. The exchange rate at that time was approximately 47 pesos to the dollar. At the end of 1981 the total assets reported by all private banks were 1,771 billion pesos, while state-owned banks had assets of 995 billion pesos. At the time the exchange rate was approximately 25 pesos to the dollar. Bennett, *Takeover Pleases U.S. Bank*, N.Y. Times, Sept. 2, 1982, at D6, col. 4.

4. Nationalization Decree, art. 1, *supra* sec. I, note 133, at 4, *reprinted* at 351. Unlike United States banks, Mexican banks owned major assets of compa-

President López Portillo believed that shareholders of private banks had been exploiting Mexico's economic situation by "facilitating speculation" against the peso and encouraging the flow of capital out of Mexico for personal financial gain.[5] The President considered the operation of private banks by shareholders to be a revocable privilege granted by the Mexican Government for only as long as the Government chose not to perform those banking services and credit functions for economic, administrative, or social reasons.[6] Faced with a deteriorating situation in the summer of 1982, López Portillo nationalized the Mexican banking system[7]

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nies in nonbanking industries such as tourism, real estate, manufacturing, and grocery retail. *Mexico's Businessmen Enraged at Bank Seizure*, N.Y. Times, Sept. 3, 1982, at A2, col. 6.

It was reported that the Mexican Government planned to return the expropriated nonbank assets to the former shareholders of private banks during the first quarter of 1984. *Bank Indemnification Information Revealed to MS*, 3 INT'L REP. [IR] MEX. SERV., Dec. 27, 1983, at 5, 6. The nonbank assets consist primarily of shares in 100 companies listed on the Mexican stock exchange and 300 unlisted companies. The goal of the Government is to allow the "former majority shareholders of banks [to] remain majority owners of everything, except the banks, that they owned previously." *Id.* The Government will return the nonbank assets in "packages" of both "good" and "bad" companies, so the former shareholders will receive some blocks of stock in which they may not be interested. The Government hopes this will induce trade among shareholders attempting to acquire "desirable" stock and cause a "substantial increase in block-trading activity on the stock market in the first half of 1984." *Id.* The ultimate goal of the Government in returning the expropriated nonbank assets to private ownership is to encourage the "development of a parallel financial market to compete with the nationalized banking system through the brokerage system." *Id.*

5. *Mexico Seizing Banks to Curtail Flight of Capital*, N.Y. Times, Sept. 2, 1982, at Al, col. 2, D6, col. 4. Some commentators considered the nationalization decree to be a final attempt by President López Portillo to shift the blame for the economic crisis from his administration to the private banks. *See* Bennett, *supra* note 3. For an analysis of the economic and political factors behind the nationalization, see Murphy, *Expropriation and Aftermath: The Prospects for Foreign Enterprise in the Mexico of Miguel de la Madrid*, 18 TEX. INT'L L. J. 431, 438-42 (1983).

6. Nationalization Decree, *supra* sec. I, note 133, at 3, *reprinted* at 350.

7. *See id.* The Mexican Government's nationalization and expropriation of private banks was upheld by the Mexican judiciary in a fourth district appellate court decision. A group of ex-bankers and former shareholders of the private banks had sued to overturn the Government's action. In his decision, the judge stated that the public benefits of nationalizing the banks were well-known. He also examined the factors that militated against the private banks and favored the expropriation decree. Excelsior (Mexico City), Apr. 30, 1983, at 5, col. 4.

in order to stem the flow of foreign currency out of the country, to ensure adoption of the fiscal policies he believed necessary to alleviate the economic crisis, and to facilitate future national economic development.[8]

2. *The Currency Exchange Control Decree*

The Mexican Government's decision to impose currency exchange controls had a far more direct impact on United States creditors and suppliers than the decision to nationalize Mexican banks. At the time the Mexican Government issued the nationalization and currency control decrees, Mexico's $80 billion foreign debt was the largest among the world's developing countries.[9] United States creditors alone had provided approximately seventy percent of all outstanding loans—$60 billion to the Mexican Government and $20 billion to individual debtors.[10] The nine largest United States banks held outstanding Mexican loans accounting for forty-four percent of their 1981 capital.[11] The Exchange Control Decree[12] froze all United States dollar deposits in Mexico and effectively ended all private foreign exchange transactions.[13] Not only were Mexican businesses sealed off from traditional sources of financing in the United States, but they also were unable to make interest payments or to reduce the principal of their outstanding debt after August 1982.[14] As the end of 1982 approached, United States banks faced the prospect of being forced to declare in arrears the $1 billion of interest due on those

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8. Nationalization Decree, *supra* sec. I, note 133, at 3-4, *reprinted* at 350.
9. Cline, *Mexico's Crisis, The World's Peril*, 49 FOREIGN POL'Y 107, 107 (1982-1983).
10. Kane, *Behind Mexico's Financial Crisis*, USA TODAY, Jan. 1983, at 29.
11. *Id.* The nine United States banks faced the possibility that one-third of their annual net profits would be eliminated if Mexico were unable to pay the interest due on the loans. *Id.*
12. *Supra* note 2.
13. Kane, *supra* note 13, at 30. *See generally* Barrera & Velasco, *Fundamentals of Doing Business With Mexico: After the Exchange Control*, 14 ST. MARY'S L.J. 683, 700-02 (1983) (explaining and defining the Exchange Control Decree).
14. Wobeser, *Mexico's Exchange Control Regulations*, INT'L FIN. L. REV., July 1983, at 16, 17. The Mexican Government did allow special peso accounts by which United States parent companies theoretically could receive dividend and royalty payments. A Mexican subsidiary could deposit pesos in a nationalized Mexican bank, which would then issue a check denominated in dollars to the United States parent company. *Id.*

loans and to reclassify the private sector Mexican debt as nonperforming.[15]

a. Immediate plan for economic reordering

In December 1982, the new Mexican administration of President Miguel de la Madrid Hurtado assumed office. President de la Madrid recognized that structural weaknesses in the Mexican economy coupled with depressed global economic conditions had diminished Mexico's capacity to guide its economic destiny.[16] In an effort to reestablish a sound economic development policy for Mexico, President de la Madrid instituted the Program for Immediate Economic Reordering[17] which modified the Exchange Control Decree of September 1, 1982.[18]

President de la Madrid intended the modified Exchange Control Decree to stabilize the Mexican foreign exchange market by instituting an exchange rate policy that would respond to global

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15. Pritchard, *The Mexican Crisis Blurred the Lines Between Public and Private Sector Debt*, EUROMONEY, Mar. 1983, at 28.

16. de la Madrid, *General Economic Policy Guidelines for the Revenue Bill and the Proposed Federal Expenditures Budget for 1983, reprinted in* 28 COMERCIO EXTERIOR DE MÉXICO 446 (Dec. 1982) (document submitted to the Congress of the Union of Mexican States by President de la Madrid on Dec. 7, 1982).

17. *Id., reprinted* at 450-52.

18. Major modifications provided that:

> [I]mports of goods on a preferred list, all exports and payments of principal and interest on [outstanding] debt to foreign suppliers and credit institutions [were to] take place at a 'controlled rate'. All other transactions [were] carried out at the free market rate. There [were] no longer any limitations on possessing or bringing foreign currency into or out of [Mexico]. There [was] a special conversion rate for foreign currency-denominated obligations payable by Mexican financial institutions in Mexico.

Tower, *Mexico: New Administration Outlines Its Strategy for Recovery*, BUS. AM., Feb. 21, 1983, at 51; *see* Barrera & Velasco, *supra* note 13, at 703-06.

The purpose of the program, which took effect December 20, 1982, was to institute structural reforms in those areas of the economy that were essential to Mexican economic revitalization. In addition to the modified Exchange Control Decree, which was intended to stabilize the foreign currency exchange market and to combat the shortage of foreign exchange reserves, President de la Madrid outlined policies and programs to be implemented in three other areas of the Mexican economy. These policies were intended to increase domestic savings, combat inflation, promote job creation, and protect productive plants. de la Madrid, *supra* note 16, *reprinted* at 452.

economic realities. The decree established a dual foreign currency exchange system that contained both a free market rate and a controlled rate.[19] The controlled rate was to be fixed by the Central Bank of Mexico and applied to exports, principal and interest on outstanding public and private foreign debt, certain specified imported goods, Mexican nationals' foreign travel expenses, expenses of the Mexican foreign service, and all payments made by in-bond companies (*maquiladoras*) in Mexico.[20] The free market rate was intended to be used in individual transactions by parties not subject to the controlled rate.

b. The repayment programs

The interdependence of the United States and Mexican economies,[21] coupled with the important role that Mexico plays in the stability of United States banks, prompted the Mexican Government to begin negotiations with United States banks to plan the eventual repayment of the approximately $15 billion in Mexican private sector foreign indebtedness.[22] After several months of dis-

19. Wobeser, *supra* note 14, at 16.

20. *Id.*

21. In 1982 Mexico provided the United States with its third largest export market, purchasing goods valued at a total of $11.8 billion. Mexican exports to the United States totalled $15.6 billion in 1982. Tower, *supra* note 18, at 51.

22. Although Mexican financial authorities recognized both the ramifications of the economic crisis and the critical need to restructure the private sector's foreign debt, they had been unable to agree on a procedure for restructuring that debt. As an attempted solution, Mexican financial authorities established five economic principles that would form the foundation of the restructuring plan: (1) The Mexican Government would not assume any private sector debt. Private Mexican debtors would restructure their debt through individual negotiations with United States creditors. Foreign lenders would continue to bear all commercial risk from restructuring. (2) Private Mexican debtors would restructure their debt through individual negotiations with United States creditors. According to guidelines set forth by government financial authorities, the Mexican Government would offer foreign exchange risk coverage for principal and interest on outstanding debts. (3) All private sector rescheduling would have to comply with Mexico's ability to repay its medium- and long-term public debt, and allow for the inability to commit to any short-term payments of that debt. (4) The program would have to be accessible to all private Mexican debtors, including those firms that had severe short-term cash flow problems due to the difficult economic environment in Mexico. (5) The economic effects of the program could not worsen the financial position of the Mexican Government by increasing the fiscal deficit. Presentation by Ernesto Zedillo Ponce de Leon, Director of FICORCA, to United States financial institutions, The Program for Coverage of

cussion with representatives from private Mexican businesses, United States banks, and the international financial community,[23] financial authorities in the Mexican Government announced two separate programs to assist private sector repayment of outstanding debt to both foreign suppliers and foreign credit institutions.

(i) *Foreign suppliers*—The Program for Payment of Overdue Indebtedness to Foreign Suppliers was first announced on February 28, 1983.[24] The program applied only to foreign-denominated debts that had been contracted prior to December 20, 1982, and that would have matured before June 30, 1983.[25] In addition, the Mexican Government required these debts to be registered between March 3 and July 15, 1983 with the Ministry of Finance and Public Credit or the Ministry of Commerce and Industrial Development.[26] Under the program, Mexican debtors deposited pesos with Banco de Mexico sufficient to cover the amount of their foreign currency debt. The total amount deposited was limited to the total registered debt plus a maximum of six percent interest on that outstanding debt. If the parties originally had agreed to a higher interest rate, the debtor was responsible for obtaining the difference by purchasing additional foreign currency on the open market.[27] Banco de Mexico then paid foreign currency to the foreign creditors according to the availability of

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Exchange Risks—A General Description and Financial Aspects 2-3 (July 1983) (copy of the presentation material on file at offices of VAND. J. TRANSNAT'L L.) [hereinafter cited as General Description of FICORCA]; *see FICORCA And Other Private Sector Subsidy Schemes—Progress So Far*, 3 IR MEX. SERV., Aug. 18, 1983, at 19, 19 [hereinafter cited as *FICORCA*].

23. A number of schemes were proposed in early 1983 to assist private Mexican companies in meeting their debts to both United States banks and private foreign suppliers. Of the $15 billion in private sector debt, $10 billion was owed to foreign credit institutions, and $5 billion to foreign suppliers. *Id.* at 20-21. Among the plans suggested and ultimately rejected were: (1) payment of "premiums" by Mexican debtors who wished to receive United States dollars at some future date; (2) establishment of a "sinking fund" in which pesos would be collected for the amortization of debt; (3) delivery of pesos in exchange for future delivery of United States dollars pursuant to three amortization options of six, seven, or eight years; and (4) payment of a "premium" based on a complex formula that recognized Mexican interest rates and LIBOR, *see infra* note 60, and weighted according to the amortization schedule selected. *Id.* at 19.

24. Wobeser, *supra* note 14, at 17; General Description of FICORCA, *supra* note 22, at 4-5.

25. Wobeser, *supra* note 14, at 17.

26. *Id.* General Description of FICORCA, *supra* note 22, at 5 n.1.

27. Wobeser, *supra* note 14, at 17.

dollars in the Banco de Mexico.[28] Banco de Mexico announced on July 18, 1983, that all deposits made under the program would be paid to foreign suppliers in two separate installments of United States dollars, fifty percent in September 1983 and the balance in March 1984.[29]

(ii) *Foreign credit institutions*—On April 5, 1983, Banco de Mexico announced a program to assist private sector debtors in repaying their debt to foreign credit institutions.[30] The Program for Coverage of Foreign Exchange Risks Derived from Debts Incurred Abroad (the Program)[31] embodied proposals to stabilize the Mexican foreign exchange market that President de la Madrid had outlined in his Immediate Program for Economic Reordering.[32] The repayment program operates through a federally established trust known as FICORCA (*Fideicomiso para la*

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28. *See FICORCA, supra* note 22, at 20. At the time the program was announced, Banco de Mexico had promised to pay the foreign supplier creditors within twenty-four months. *See* Wobeser, *supra* note 14, at 17.

29. *See FICORCA, supra* note 22, at 20. At the time of the repayment announcement only $400 million of the $5 billion foreign supplier debt had been registered under this program. The plan was extended subsequently to include all debtors who had not registered in the first program. *Id.*

30. *See FICORCA, supra* note 22, at 19.

31. The Program was available to private sector debtors from early May 1983 until October 25, 1983. It was understood, however, that late applications would be "treated with understanding" if a Mexican credit institution and a debtor had reached an agreement in principle by October 25 subject only to document drafting. *Id.* at 21. For the results of the Program, see *infra* note 65.

32. *See* de la Madrid, *supra* note 16, at 456. In his address to the Congress of the Union of Mexican States, President de la Madrid stated:

> The development of the exchange market beyond the financial institutions muddies the situation regarding quotations and results in insecurity, as well as working to the detriment of the regulatory action of the Central Bank in the exchange market. As a consequence what is proposed will be a realistic exchange-rate policy so as to ensure the return of operations to [Mexico's] credit institutions.
>
> Exchange rates must respond to economic realities, with timely adjustments being made as conditions demand, bearing in mind, among other considerations, the fact that nothing is more inflationary than the non-availability of foreign exchange. However, there is an imperative need to protect companies from immediate exchange losses deriving from debts previously contracted, which might lead to the collapse of such companies . . . . It is also necessary to protect the international transactions which are of the greatest importance for the functioning of our productive machinery from violent exchange-rate movements.

Id.

Cobertura de Riesgos Cambiarios or Trust for Covering Exchange Risks).[33] FICORCA operates through the nationalized Mexican banking system, with the Mexican Government acting as trustor and Banco de Mexico, through the individual Mexican banks, as trustee. The Mexican Government as trustor committed itself to provide private sector debtors participating in the Program with all the financial resources required to cover the risk of fluctuation in foreign exchange rates.[34] As trustees for FICORCA, Banco de Mexico and the individual national banks manage the following elements of the Program: all pesos paid to them by participants in the program, all rights derived from credits granted by FICORCA, all foreign currency obtained by FICORCA for service of its obligations, and all extraordinary contributions of the Mexican Government.[35] Under Mexican law, all assets entrusted to FICORCA in performance of its obligations under the trust must be applied exclusively to those obligations derived or assumed from the operation of the Program.[36] The entrustment of assets to FICORCA by private sector debtors implies a transfer of title to the respective national Mexican banks; therefore, the entrusted assets are encumbered for the sole and exclusive purpose of repaying the debtors' outstanding foreign debt.[37] As trustees, the Mexican banks are liable for any damage to the assets, yields, and

33. General Description of FICORCA, *supra* note 22, at 4. A Presidential decree of March 11, 1983, constitutionalized FICORCA. The purpose of FICORCA as stated in the decree was to execute programs that would remove exchange risks to companies established in Mexico relative to their foreign currency indebtedness. As a public administrative entity, FICORCA has access to the controlled Mexican foreign exchange market equal to that of all of the public entities. The Mexico Ministry of Programming and Budget, in conjunction with Banco de Mexico, executed the FICORCA indenture on March 14, 1983, in compliance with the Presidential decree of March 11. Opinion Paper by Roberto del Cueto Lagaspi, Manager for Central Banking Regulations, Banco de Mexico. Legal and Operating Aspects of the FICORCA and the Program for Coverage of Exchange Risks 1 (1983) (discussion of the juridical and operational aspects of the program) (copy on file at offices of VAND. J. TRANSNAT'L L.) [hereinafter cited as Legal and Operating Aspects of FICORCA]. FICORCA also was designated to administer the Program for Payment of Overdue Indebtedness to Foreign Suppliers. *See supra* text accompanying note 31.

34. Legal and Operating Aspects of FICORCA, *supra* note 33, at 2-3.

35. *Id.* at 2.

36. *Id.* at 3. (citing General Law of Credit Instruments and Operations (GLCIO) art. 357).

37. Legal and Operation Aspects of FICORCA, *supra* note 33, at 3 (citing GLCIO arts. 349, 351, 356).

proceeds thereof entrusted to their care, and for any failure to comply with the terms, conditions or commitments of the trust agreement.[38] Once a private sector debtor has elected to purchase one of the systems available under the Program, it retains a right of action against FICORCA and the Mexican banks only for events related to its participation in the Program.[39]

Under the Program, private Mexican corporations (Purchasers) with outstanding debt to United States lending institutions (Creditors) may elect to contract with individual Mexican national banks (Trustees) for protection against future fluctuations in the foreign exchange rate.[40] The only two parties that are required to sign an agreement under the Program, therefore, are the Purchasers, as buyers of the foreign currency, and FICORCA, as vendor of the foreign currency.[41] To qualify for the Program, companies domiciled in Mexico must have incurred their indebtedness prior to December 20, 1982. The debt must have been denominated in foreign currency and payable outside Mexico to a Mexican credit institution or a foreign financial entity.[42] The debt also must have been registered previously at the Ministry of Finance and Public Credit and must be long-term debt or have been restructured to become long-term debt.[43] Any accrued interest or unpaid penalty interest due the Creditor can be capitalized and included in the principal of the indebtedness.[44]

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38. Legal and Operating Aspects of FICORCA, *supra* note 33, at 3. *Id.* (citing General Law of Credit Institutions and Auxiliary Organizations (GLCIAO) art. 45, fr. 7).

39. For a general discussion of the rights of the parties to the coverage agreement, see *infra* notes 66-74 and accompanying text.

40. Legal and Operating Aspects of FICORCA, *supra* note 33, at 3-4.

41. *Id.* at 4. Creditors were not required to execute the agreement, nor did their failure to do so prevent the creation of certain rights in their favor by the implementation of the agreements. *Id.*

42. *Id.*

43. *Id.* For purposes of the Program, long-term debt meant that the relevant purchase agreement was repayable to the Creditor in equal successive quarterly installments of not less than six years with a three-year grace period for the repayment of principal, or not less than eight years with a four-year grace period. Unofficial translation by the Mexican Ministry of Finance, United Mexican States Program to Cover Exchange Risks Derived from External Indebtedness 3-4 (Apr. 5, 1983) (provided to participating United States banks by the Mexican Ministry of Finance) (copy on file at offices of VAND. J. TRANSNAT'L L.) [hereinafter cited as Unofficial Translation].

44. Unofficial Translation, *supra* note 43, at 3.

The Program offers four different systems of coverage:

System One—Under the first system, Purchasers pay a prearranged fee[45] to FICORCA in exchange for the right to receive the dollars necessary to repay the principal of their loan. Once the Purchaser has paid FICORCA in Mexican pesos, FICORCA becomes obligated to deliver successive equal quarterly installments of dollars immediately available in New York City. Delivery would commence one quarter after the expiration of the grace period. The Purchaser retains the obligation to make any interest payments due the Creditor with foreign currency purchased at the controlled rate of exchange in effect on the date of purchase.[46] The Purchaser must also issue irrevocable instructions to FICORCA to deliver to the Creditor the dollars acquired under the agreement in repayment of the principal amount of the Purchaser's indebtedness.[47] Under Mexican monetary law, FICORCA cannot discharge its obligations by delivering the peso equivalent of the foreign currency owed, but instead must make dollars immediately available in New York City when payment is due.[48] The irrevocable instructions constitute a stipulation in favor of the Creditor[49] that can be neither revoked nor amended without its prior consent.[50] The stipulation perfects both the right of the Creditor to receive payment in dollars from FICORCA, and the right of the Purchaser to require FICORCA to deliver those dollars to the Creditor.[51]

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45. The price of the agreement was determined according to the repayment program selected by the Purchaser and the monthly exchange rate established by FICORCA. For example:

Repayment Term	Grace Period	Price in Pesos Per Dollar 4/5/83	Price in Pesos Per Dollar 7/5/83
8 years	4 years	$75	$82
7 years	3 years	$81	$91
6 years	3 years	$84	$94

Id. at 4.

46. General Description of FICORCA, *supra* note 22, at 7.

47. Legal and Operating Aspects of FICORCA, *supra* note 33, at 4.

48. Legal and Operating Aspects of FICORCA, *supra* note 33, at 5 (citing MONETARY LAW OF THE UNITED MEXICAN STATES art. 8 (interpreted *a contrario sensu*)).

49. Legal and Operating Aspects of FICORCA, *supra* note 33, at 5 (citing MEX. CIV. C. art. 1868 (Gordon trans. 1980)).

50. Legal and Operating Aspects of FICORCA, *supra* note 33, at 5 (citing MEX. CIV. C. art. 1871).

51. Legal and Operating Aspects of FICORCA, *supra* note 33, at 5-6 (citing

System Two—System Two contains terms identical to those in System One plus additional provisions providing the Purchaser with an extension of credit from FICORCA.[52] The credit extension is denominated in Mexican pesos in an amount equal to the price of the United States dollars to be purchased, and provides additional credit for a portion of the interest that would accrue on the dollar credit.[53] The Purchaser must repay the peso credits in monthly installments over the same term as that agreed to for the repayment of the restructured foreign debt.[54] Although it is providing a peso credit to enable the Purchaser to participate in the Program, FICORCA does not assume the commercial risk of the foreign indebtedness under any system. This qualification substantially modifies the rights and obligations of the parties if the Purchaser defaults on the repayment of its peso credit to FICORCA.[55] If the Purchaser defaults,[56] the Creditor may elect to pursue one of four options:

1) The Creditor assumes the Purchaser's peso payments to FICORCA to ensure that the Creditor will receive the face amount of the coverage agreement. Under this option, the Creditor is entitled to collect from the Purchaser the sum of such payments made to FICORCA.

2) A third-party other than the Purchaser or the Creditor as-

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MEX. CIV. C. art. 1869). FICORCA requires that a Creditor notify FICORCA of an intent to take advantage of any stipulation by certified letter or confirmed telex prior to the authorized execution of a coverage agreement. Draft notices were provided in every draft agreement. Legal and Operating Aspects of FICORCA, *supra* note 33, at 5. The liabilities of FICORCA and the irrevocable stipulation in favor of the Creditor are applicable to all systems of the exchange coverage program. *Id.* at 6.

52. Legal and Operating Aspects of FICORCA, *supra* note 33, at 6 (citing GLCIO art. 291).

53. Legal and Operating Aspects of FICORCA, *supra* note 33, at 6. Peso credits granted to the Purchaser by FICORCA are not guaranteed. General Description of FICORCA, *supra* note 22, at 7 n.2.

54. Legal and Operating Aspects of FICORCA, *supra* note 33, at 6. The interest rate applied to the unpaid balance of this credit is equal to the arithmetical average of the maximum authorized rate to be paid on three- and six-month peso deposits as determined on the first business day of each month in which payments are made. General Description of FICORCA, *supra* note 22, at 7.

55. General Description of FICORCA, *supra* note 33, at 6.

56. The Purchaser is declared in default under System Two when it fails to pay FICORCA three successive monthly installments of its peso credit. At that time the credit institution acting on behalf of FICORCA will notify the creditor that it refuses to receive any further payment from the Purchaser. *Id.*

sumes the Purchaser's peso payments to FICORCA to ensure that the Creditor will receive the face amount of the coverage agreement.

3) FICORCA delivers to the Purchaser the redemption value of the purchase agreement in pesos. FICORCA's authorization for this payment is required.

4) FICORCA delivers to the Creditor the redemption value of the purchase agreement in dollars to be paid in equal successive quarterly installments on the dates specified in the original payment schedule.[57]

In the event that FICORCA either pays the redemption value of the coverage agreement to the Purchaser in pesos, or becomes obligated to deliver to the Creditor the equivalent in dollars, all further obligations of FICORCA and the Purchaser established in the coverage agreement are extinguished.[58] At that point, the Purchaser reassumes its prior obligation to repay its foreign indebtedness to the Creditor and will be forced to return to the controlled exchange market in order to obtain the requisite foreign currency.

System Three—Under this option the Purchaser pays Mexican pesos to FICORCA in exchange for the United States dollars necessary to repay the principal amount of its foreign indebtedness. The transaction is governed by the controlled rate of exchange on the effective date of the coverage agreement. The Purchaser simultaneously makes an eight-year dollar loan to FICORCA in an amount equal to the United States dollars purchased from FICORCA. The loan includes a four-year grace period on the repayment of the principal, with an obligation to make equal successive quarterly installment payments of immediately available dollars to be placed in New York City.[59] During the term of the loan, FICORCA must include in its quarterly payments any interest accrued on the outstanding balance of the loan at a rate equivalent to the three-month London Interbank Offered Rate (LIBOR)[60] for United States dollars.[61] The Purchaser must also

57. *Id.* at 6-7. Within 30 business days following the receipt of notice of the Purchaser's default, the Creditor must advise FICORCA, by certified letter or confirmed telex, of the option it has elected. If the Creditor fails to do so, it is deemed to have elected the fourth option. *Id.*

58. *Id.* at 7.

59. *Id.* at 8.

60. LIBOR is the interest rate major international banks charge each other for large volume loans of Eurodollars (dollars on deposit outside the United

issue irrevocable instructions to FICORCA to deliver to the Creditor all installment payments of the principal in addition to any ordinary and penalty interest.[62] Unlike Systems One and Two, in which the only right acquired by the Purchaser under the coverage agreement was its ability to enforce payment of future dollars to its Creditor in an amount equivalent to the principal of its indebtedness, under Systems Three and Four the Purchaser has the right to require the repayment of both the principal and the amortized interest on its foreign indebtedness.

System Four—System Four incorporates the purchase and loan agreements used in System Three with an additional option—the Purchaser may elect to receive a peso credit from FICORCA to acquire the United States dollars under the purchase agreement.[63] System Four also offers identical party rights and obligations with regard to the peso credit offered under System Two.[64] If the Purchaser defaults on its peso obligation to FICORCA by failing to pay three successive installments, the Creditor may elect any of the four options available upon default under System Two.[65]

(iii) *Rights of the parties under the repayment pro-*

States). J. ROSENBERG, DICTIONARY OF BANKING AND FINANCE 316 (1982).

61. General Description of FICORCA, *supra* note 22, at 8. The three-month LIBOR will be calculated using the arithmetical average (rounded upward to the nearest 1/16) of the interest rates offered by six of the primary banks in the Eurodollar market on the first business day of each quarter. Unofficial Translation of Program, *supra* note 43, at 7.

62. Legal and Operating Aspects of FICORCA, *supra* note 33, at 8. For a discussion of the implications of the Purchaser's irrevocable instructions to FICORCA, *see supra* notes 47-51 and accompanying text.

63. General Description of FICORCA, *supra* note 22, at 9.

64. *See supra* notes 53-55 and accompanying text.

65. *See supra* notes 56-58 and accompanying text. On November 10, 1983, Miguel Mancera, Director of the Banco de Mexico, announced that approximately 1,200 companies had registered 4,800 coverage agreements with 300 foreign banking institutions and 200 suppliers under the Program. *Latest FICORCA Results Announced*, 3 IR MEX. SERV., Nov. 28, 1983, at 7. Forty-three percent of these companies had debts of less than one million U.S. dollars. *Id.* Ninety-four percent of all coverage agreements were under System Four, resulting in a total credit from Mexican banks to private debtors of 1.6 trillion pesos—"equivalent to all credit granted to Mexican companies by the Mexican commercial banking system." *Id.* The minimum term for repayment of these loans was eight years, with a four-year grace period on payments of principal, but almost forty percent of all the coverage agreements had longer repayment terms. *Id.*

grams—Each coverage agreement entitles the Purchaser to receive from FICORCA at any time the paid-in redemption value of the agreement in Mexican pesos. The Purchaser's right, however, is subject to the prior authorization of both the Creditor and FICORCA.[66] All rights and obligations under the coverage agreement of both FICORCA and the Purchaser terminate when the Purchaser receives the agreement's redemption value.[67]

If, within five business days after the specified date of payment, the Creditor fails to receive from FICORCA the United States dollars pursuant to the coverage agreement, the Creditor is authorized to accelerate the term granted FICORCA to meet its obligations under the coverage agreement. In addition, the Creditor can require FICORCA to place, within thirty days and in funds immediately available in New York City, either the full outstanding principal amount of a coverage agreement executed under System One or Three, or the peso or dollar value equivalent of a coverage agreement executed under System Two or Four.[68] All coverage agreements entitle both Purchaser and Creditor to encumber their rights granted under the agreement.[69] In addition, because FICORCA has acknowledged its legal obligations by formally executing the coverage agreements, creditors of FICORCA may obtain "executive commercial action"[70] if they desire.[71] Participation in the coverage agreements also insulates the Purchaser from any additional payments to FICORCA in the event of future variances in the peso-dollar exchange rate.[72] Finally, because the coverage agreements are governed by and must comply with Mex-

66. Legal and Operating Aspects of FICORCA, *supra* note 33, at 9 (citing MEX. CIV. C. art. 1939 (Gordon trans. 1980)).

67. Legal and Operating Aspects of FICORCA, *supra* note 33, at 9.

68. *Id.*

69. *Id.* A party seeking to encumber its rights under the coverage agreement is required to give notice of its action to FICORCA. *Id.*

70. The coverage agreement is evidence of the Purchaser's debt to the Creditor. Under Mexican law, "'executive commercial action' [is available] for the rapid enforcement of debts documented by . . . certain formalized contracts. The executive commercial action . . . has the important advantage of permitting the [C]reditor to attach assets of the [Purchaser] at the beginning of the proceedings instead of waiting for judgment, thus preventing the debtor from concealing or wasting assets during the litigation." A. HOAGLAND, *supra* note 2, at J-27.

71. Legal and Operating Aspects of FICORCA, *supra* note 33, at 10 (citing MEX. CIV. C. art. 1391, fr. 7).

72. Legal and Operating Aspects of FICORCA, *supra* note 33, at 10.

ican law, the contracting parties[73] are required to submit to Mexican jurisdiction for interpretation and enforcement of the coverage agreements.[74]

(iv) *Bankruptcy of a purchaser*—The bankruptcy of a Purchaser or a third-party attachment action against the paid-in fund under the agreements would raise several questions regarding the legal relationships established by the various coverage agreements. The contract between the Purchaser and FICORCA may be construed as either a purchase agreement[75] or a loan agreement[76] in which the Purchaser is guaranteed future payment in dollars of its indebtedness to the Creditor.[77] The coverage agreement does not supplant any existing contractual relationship between the Purchaser and the Creditor, nor does it represent a payment-in-kind or prepayment of the Purchaser's obligation to the Creditor.[78] The Purchaser merely obtains the right to require FICORCA to deliver to the Creditor the dollars designated in the coverage agreement if the Purchaser has complied fully with its obligations as specified in the agreement.[79] Because the Purchaser is never entitled to receive the redemption value of the agreement in dollars, and cannot receive the redemption value in pesos without the prior express authorization of both FICORCA and the Creditor, the financial resources received by FICORCA under an agreement are the property of FICORCA.[80] The bankruptcy of the Purchaser, therefore, would affect the coverage agreement only if the agreement had been executed within a period of time in which the Purchaser had failed to pay its other outstanding obligations.[81] If, however, the Purchaser were to default on its ob-

73. *See supra* notes 40-41 and accompanying text.
74. Legal and Operating Aspects of FICORCA, *supra* note 33, at 10.
75. *Id.*; MEX. CIV. C. art. 2248 (Gordon trans. 1980).
76. Legal and Operating Aspects of FICORCA, *supra* note 33, at 10; MEX. CIV. C. art. 2384 (Gordon trans. 1980).
77. Legal and Operating Aspects of FICORCA, *supra* note 33, at 10.
78. *Id.* at 10-11.
79. *Id.* at 11.
80. *Id.*
81. *Id.* at 12 (citing LAW OF BANKRUPTCIES AND SUSPENSION OF PAYMENTS (LEY DE QUIEBRAS Y DE SUSPENSION DE PAGOS) art. 15, fr. 9, art. 118 (1943)). Mexican law states that a debtor's failure to comply with its obligations as they become due and payable constitutes the cessation of payments. Thus, if the Purchaser entered into the coverage agreement with the intent to defraud the rights of its other creditors, the coverage agreement would be considered null and void. It must be emphasized that the coverage agreements entered into with

ligations subsequent to execution of a coverage agreement, the estate of the bankrupt Purchaser would acquire no rights that could be attached.[82] This result follows because the Purchaser possesses only the right of enforcement, and not a right to receive either the dollar payments from, or the redemptive value of, the coverage agreement.[83]

3. *Rights of Creditors Against FICORCA in the Event of a Government-Managed Default*

Although each of the coverage agreements clearly establishes a creditor's rights in the event of a breach of the coverage agreement by the Purchaser or FICORCA, it remains uncertain whether a creditor holds a potential cause of action if the Mexican Government, in its capacity as the trustor of FICORCA or through the trustee nationalized banks, forces FICORCA to default on a coverage agreement. It is important to remember that a creditor has no contractual relationship with FICORCA.[84] Because the coverage agreements are governed by Mexican law, a creditor must submit to the jurisdiction of the Mexican courts to determine its enforceable rights under an agreement.[85] If instead, a creditor seeks judicial relief in United States courts, its cause of action may be dismissed for lack of subject matter jurisdiction under the Foreign Sovereign Immunities Act, or its recovery might be precluded by the act of state doctrine.

a. The Foreign Sovereign Immunities Act

The nature of a creditor's participation in the FICORCA program suggests that United States courts may lack subject matter jurisdiction to hear an action arising from a breach of a coverage agreement under the Foreign Sovereign Immunities Act of 1976 (FSIA).[86] The FSIA grants to foreign states, their agencies, and

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FICORCA are not actions that Mexican law considers to be fraudulent because they are not actions in rem in favor of the Creditor, gratuitous actions, or prepayments or payments-in-kind of the purchaser's outstanding foreign indebtedness. Legal and Operating Aspects of FICORCA, *supra* note 33, at 12, *construing* LAW OF BANKRUPTCIES AND SUSPENSION OF PAYMENTS art. 170 (1943).

82. Legal and Operating Aspects of FICORCA, *supra* note 33, at 12.

83. *Id.*

84. *See supra* note 41 and accompanying text.

85. *See supra* note 74 and accompanying text.

86. 28 U.S.C. §§ 1330, 1602-1611 (1982). The FSIA codified the "restrictive"

their instrumentalities immunity from the jurisdiction of United States courts,[87] subject to certain specified exceptions.[88] Nationalization of the Mexican banking system[89] qualifies the individual banks that serve as trustees for FICORCA as agencies or instrumentalities of the Mexican Government.[90] In order for a United States court to have jurisdiction over a creditor's claim against the Mexican Government or a Mexican bank for an alleged breach by FICORCA of a coverage agreement, the actions of the Government or the bank would have to fall within one of the FSIA's enumerated statutory exceptions. A creditor probably would urge the court to apply the exception set forth in section 1605(a)(2) of the FSIA.[91] This "commercial activity" exception[92]

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theory of foreign sovereign immunity, which prevents United States courts from exercising jurisdiction over foreign states. Letter from Jack B. Tate, Acting Legal Advisor of the U.S. Dep't of State, to Philip B. Perlman, Acting Attorney General, (May 19, 1952), *reprinted in* 26 DEP'T ST. BULL. 984 (1952); *see* Alfred Dunhill of London, Inc. v. Republic of Cuba, 425 U.S. 682, 711 app. (1976). For general discussions of the background and purposes of the FSIA, see the legislative history of the FSIA set forth in H.R. REP. No. 1487, 94th Cong., 2d Sess. 6, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 6604.

87. Section 1602 provides that "[c]laims of foreign states to immunity should henceforth be decided by courts of the United States and of the States in conformity with the principles set forth in this chapter." Section 1603(a) defines a " 'foreign state,' . . . [to] include a political subdivision of a foreign state or an agency or instrumentality of a foreign state." Section 1603(b) defines "[a]n agency or instrumentality of a foreign state . . . [as] any entity (1) which is a separate legal person, . . . and (2) which is an organ of a foreign state . . . or a majority of whose shares or other ownership interest is owned by a foreign state . . . and (3) which is neither a citizen of a State of the United States . . . nor created under the laws of any third country."

88. Section 1605(a)(1) provides that a foreign state is not immune from the jurisdiction of United States courts if that "foreign state has waived its immunity either explicitly or by implication." Section 1605(a)(2) further limits the immunity of a foreign state from United States courts in those cases in which "the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere; . . . and that act causes a direct effect in the United States." Section 1330(a) grants subject matter jurisdiction to United States courts for those claims that fall within the statutory immunity exceptions.

89. *See supra* notes 1-11 and accompanying text.

90. *See supra* note 87.

91. 28 U.S.C. § 1605(a)(2) (1982); *see supra* note 91; *see also* Texas Trading & Milling Corp. v. Federal Republic of Nig., 647 F.2d 300, 308 (2d Cir. 1981), *cert. denied*, 454 U.S. 1148 (1982) (if the act is a "commercial activity" under § 1603(d) and bears a sufficient nexus to the United States as required by §

has enabled numerous private parties to litigate in United States courts actions involving the commercial activities of foreign states that do not risk "serious diplomatic repercussions."[93]

In the instant scenario, however, the interdependence of the Mexican and United States economies[94] suggests potentially serious diplomatic, political, and economic consequences if a United States court were to hold the Mexican Government liable for forcing FICORCA to breach a coverage agreement because of changed economic circumstances. Keeping in mind that the primary purpose of the FSIA is to restrict the immunity of a foreign state to suits arising from a foreign state's public acts,[95] it seems unlikely that a United States court would define the nature of the FICORCA program to be a "commercial activity."[96] Recently, in

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1605(a)(2), then the foreign state fits within the statutory exception to the FSIA and United States courts would have subject matter jurisdiction under § 1330(a)).

92. The code defines "commercial activity" as "either a regular course of commercial conduct or a particular commercial transaction or act. The commercial character of an activity shall be determined by reference to the *nature* of the course of conduct or particular transaction or act, rather than by reference to its purpose." 28 U.S.C. § 1603(d) (emphasis added). Section 1603(e) states that " 'commercial activity carried on in the United States by a foreign state' means commercial activity carried on by such state and having substantial contact with the United States." For an in-depth discussion and critique of the "commercial activity" exception to the FSIA, see Note, *Foreign Sovereign Immunity and Commercial Activity: A Conflicts Approach*, 83 COLUM. L. REV. 1440 (1983). The legislative history of the FSIA indicates that in determining if an act was "governmental" or "commercial" in nature for purposes of the sovereign immunity exception, courts should focus on the nature of the act rather than its purpose. Congress intentionally afforded the courts "a great deal of latitude in determining what is a 'commercial activity' for purposes of [the statute]." H.R. REP. No. 1487, 94th Cong., 2d Sess. 16, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 6604, 6615.

93. *See* Note, *supra* note 92, at 1443. The majority of those cases have arisen from either breaches of contract or activities by foreign states within the United States. *Id.* at 1443 & n.19.

94. *See supra* note 21 and accompanying text.

95. *Texas Trading*, 647 F.2d at 308 (citing H.R. REP. No. 1487, *supra* note 92, at 7, *reprinted* at 6605).

96. The Mexican Government assumed no commercial risk under the FICORCA program for the debts of the purchasers. *See supra* note 22. The only role of the Government was to assume any risk of future fluctuation in the foreign exchange market. *See* General Description of FICORCA, *supra* note 22, and accompanying text.

Frankel v. Banco Nacional de Mexico (Banamex),[97] plaintiffs brought suit to recover payments allegedly due under a certificate of deposit issued by the defendant Mexican bank. The certificate of deposit had been issued prior to the nationalization and currency exchange control decrees implemented by the Mexican Government.[98] The Mexican Government prohibited Banamex from making dollar interest payments due on the certificate of deposit. The district court ruled that although Banamex's failure to pay the plaintiffs in dollars was a breach of the terms of the certificate of deposit, the nature of that failure was the promulgation of the currency exchange control decree, a public act performable only by a sovereign, and therefore, precisely the type of governmental activity shielded from judicial scrutiny by the doctrine of sovereign immunity.[99] Thus, because Banamex was immune from suit under the FSIA, the district court ruled that it lacked subject matter jurisdiction.[100]

A creditor could argue that Banco de Mexico, as an instrumentality of the sovereign state of Mexico, had waived its sovereign immunity[101] by conducting commercial activities within the United States[102] when it accepted terms in the coverage agreements that provided for payments to be made in immediately available dollars in New York City.[103] New York courts, however, have held consistently that a foreign corporation's mere maintenance of a bank account in New York is insufficient contact to invoke New York's long-arm statute.[104] Banco de Mexico's con-

97. No. 82-6457 (S.D.N.Y. May 31, 1983) (copy on file at offices of VAND. J. TRANSNAT'L L.).

98. *Id.* slip op. at 2.

99. *Id.* slip op. at 4.

100. *Id.*

101. *See* 28 U.S.C. § 1605(a)(1) (1982).

102. *See Texas Trading*, 647 F.2d 300, 310 (Nigeria's cement contracts and letters of credit with New York banks qualified as "commercial activities" for the purposes of section 1605(a)(2), and thus, the court had subject matter jurisdiction); *c.f. infra* note 109 and accompanying text.

103. *See supra* text accompanying notes 47-48.

104. In New York, "an action . . . against a foreign corporation may be maintained by another foreign corporation of any type or kind . . . only: . . . (5) [w]here the defendant is a foreign corporation doing business or authorized to do business in this state." N.Y. BUS. CORP. LAW § 1314(b) (McKinney Supp. 1983-1984); *see* Grove Valve & Regulator Co. v. Iranian Oil Servs., Ltd., 87 F.R.D. 93, 95 (S.D.N.Y. 1980) (the defendant foreign corporation's maintaining a bank account in New York City did not by itself constitute "doing business" in

sent under the coverage agreements to pay United States dollars to a New York bank appears to be a decision of convenience and not part of a commercial transaction or an effort to avail itself of United States law. It is probable, therefore, that any suit brought by a creditor under a waiver of immunity theory would be dismissed for lack of subject matter jurisdiction.

In a case factually similar to *Frankel*,[105] a district court ruled that subject matter jurisdiction could not be based on section 1605(a)(2), because Banco Central's maintenance of foreign exchange rates through the regulation of foreign currency transactions constituted actions that were governmental rather than commercial in nature.[106] The court concluded, however, that it did have jurisdiction on two alternative grounds. The court ruled that Banco Central had engaged in commercial activities by maintaining an account in a United States commercial bank and, therefore, was subject to the court's jurisdiction under section 1605(a)(3) of the FSIA.[107] In addition, the court held that it had jurisdiction under section 1605(a)(5) of the FSIA[108] because

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the state; therefore, the court lacked subject matter jurisdiction); Verlinden B.V. v. Central Bank of Nig., 103 S. Ct. 1962 (1983) (defendant's use of a New York bank which acted in an advisory capacity with respect to the defendant's credit was not sufficient contact to establish subject matter jurisdiction); National Am. Corp. v. Federal Republic of Nig., 425 F. Supp. 1365, 1370 (S.D.N.Y. 1977) (defendant's credit payable to the plaintiff in New York through a New York bank did not establish subject matter jurisdiction).

105. Najarro de Sanchez v. Banco Central de Nicar., 515 F. Supp. 900 (E.D. La. 1981). The dispute arose when the plaintiff, a Nicaraguan citizen, attempted to withdraw her savings in United States dollars from a nationalized Nicaraguan bank by presenting a check drawn in her favor by Banco Central on its account with an American commercial bank. Banco Central refused payment on the account because of newly promulgated foreign currency exchange regulations. *Id.* at 901.

106. *Id.* at 907-09.

107. *Id.* at 910-12. Section 1605(a)(3) provides that a foreign state is not immune from the jurisdiction of United States courts in any case in which:

> rights in property taken in violation of international law are in issue and that property or any property exchanged for such property is present in the United States in connection with a commercial activity carried on in the United States by the foreign state; or that property or any property exchanged for such property is owned or operated by an agency or instrumentality of the foreign state and that agency or instrumentality is engaged in a commercial activity in the United States.

28 U.S.C. § 1605(a)(3)(1982).

108. Section 1605(a)(5) states in pertinent part that a foreign state will be

Banco Central's wrongful retention of the proceeds of plaintiff's account constituted a tortious act of conversion.[109] The unique circumstances surrounding the institution of the FICORCA program seem to distinguish the facts of *Najarro de Sanchez* from any potential suit by a creditor under the FICORCA program. The program itself is not commercial in nature, nor is its purpose to make a profit for either Banco de Mexico or the Mexican Government. By assuming the risk of future fluctuations in the foreign exchange market, the Mexican Government stands to lose money in the event of unfavorable market fluctuations. The program, therefore, appears to be a good faith effort by the Mexican Government to provide private sector debtors with the opportunity to restructure their foreign debt within the framework of the Immediate Plan for Economic Reordering.[110]

The apparent discrepancy between the *Frankel* and *Najarro de Sanchez* decisions highlights the conceptual difficulty many courts experience when attempting to apply the commercial activities exception of the FSIA[111] in cases of significant overlap between the governmental and commercial ramifications of a transaction or series of transactions. If the Mexican Government ever requires FICORCA to breach its obligations with creditors due to changed economic or political circumstances, a creditor would have to examine closely its own situation, the other commercial activities of Banco de Mexico, and the prevailing economic circumstances to determine if the immunity exceptions applied in *Najarro de Sanchez* would be available. Even if the FSIA exemptions applied, however, the *Frankel* decision indicates that United States courts may choose to avoid involving themselves in such a politically and economically sensitive issue as that of the Latin American foreign debt crisis.[112]

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subject to the jurisdiction of United States courts in any case "in which money damages are sought against a foreign state for . . . damage to or loss of property, occurring in the United States and caused by the tortious act . . . of that foreign state." 28 U.S.C. § 1605(a)(5).

109. *Najarro de Sanchez*, 515 F. Supp. at 912-13.

110. *See supra* notes 16-19 and accompanying text.

111. *See supra* notes 105-08 and accompanying text.

112. *See* Note, *supra* note 92, at 1492-94 & nn.251-60. There is a key factual difference, however, between the *Frankel* and *Najarro de Sanchez* cases. In *Frankel*, Banamex was an instrumentality of the Mexican Government because of the nationalization of the Mexican banking system. *See* Frankel v. Banco Nacional de Mex., No. 85-6457, slip op. at 2-3 (S.D.N.Y. May 31, 1983). The bank

b. The Act of State Doctrine

The complexity and intricacy of the FICORCA program; the interrelationship between private parties, commercial credit institutions, foreign sovereigns, and foreign instrumentalities; and the lack of substantive objective criteria within the FSIA upon which to evaluate the public and commercial effects of such a program suggest that any cause of action initiated against the Mexican Government in a United States court should be denied recovery under the act of state doctrine.[113] Mexico's debt crisis, as part of a greater third-world debt crisis, is a politically and economically sensitive issue that affects Mexican-United States diplomatic relations. United States courts should approach it with caution. Balancing the competing interests in the area of foreign debt restructuring requires courts to assess and evaluate issues "beyond the scope of [their] judicial expertise and duties."[114] Recent deci-

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in *Najarro de Sanchez* had to rely on the central bank of Nicaragua for foreign currency exchange transactions, but the bank itself was not an instrumentality of the Nicaraguan Government within the meaning of the FSIA. 515 F. Supp. at 907-09.

113. The act of state doctrine is not formally codified in international law, but has been adopted by United States courts to avoid adjudicating politically sensitive disputes that would require the court to evaluate the validity or legality of the sovereign act of a foreign state. *See* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §§41-43 (1965).

In Underhill v. Hernandez, 168 U.S. 250 (1897), the Court stated:

> Every sovereign State is bound to respect the independence of every other sovereign State, and the courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.

Id. at 252. More recently, the Court recognized the constitutional underpinnings of the act of state doctrine that arise from the separation of powers between branches of government:

> The doctrine as formulated in past decisions expresses the strong sense of the Judicial Branch that its engagement in the task of passing on the validity of foreign acts of state may hinder rather than further this country's pursuit of goals both for itself and for the community of nations as a whole in the international sphere.

Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 423 (1964).

114. Note, *Judicial Balancing of Foreign Policy Considerations: Comity and Errors Under the Act of State Doctrine*, 35 STAN. L. REV. 327, 329 (1983). For additional discussion of the need for judicial balancing and for alternative approaches under the act of state doctrine, see *id.* at 328 n.5 (citing additional

sions have recognized that United States courts with jurisdiction over a foreign sovereign may be forced to apply the act of state doctrine out of considerations of comity or separation of powers, regardless of the commercial extent of the transaction in question.[115] In *Allied Bank Int'l v. Banco Credito Agricola de Cartago*,[116] a syndicate of United States banks brought suit against three nationalized Costa Rican banks for default on the interest and principal due on a series of promissory notes. The defendant banks were forced to default on the notes when the Costa Rican Government, in response to an internal economic crisis, imposed restrictions on foreign transactions executed by Costa Rican banks. Costa Rica prohibited its banks from making any payments on outstanding foreign debt until the country's entire external debt situation had been resolved.[117] The court ruled that the actions of the Costa Rican Government to prevent repayment of the notes responded to a serious economic crisis and were intended to serve a public, not a commercial, purpose.[118] The court held that this action clearly was a governmental function, and that any judgment which would put the United States judicial branch at odds with the Government of Costa Rica over the implementation of critical economic policies would risk embarrassing the executive branch in the conduct of foreign relations.[119] The court ruled, therefore, that the act of state doctrine required dismissal of the syndicate's motion for summary judgment.[120]

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articles).

115. *See, e.g.*, International Ass'n of Machinists v. OPEC, 649 F.2d 1354, 1358-60 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982) (labor union sought injunctive and monetary relief against the oil cartel for alleged fixing of oil prices in violation of the Sherman Act). The court recognized the involvement of the executive and legislative branches of the United States Government and the significant foreign policy implications any judicial action might have. *Id.* at 1361. The court also noted that "[w]hile purely commercial activity may not rise to the level of an act of state, certain seemingly commercial activity will trigger act of state considerations . . . [and] the act of state doctrine remains available when . . . caution is appropriate, regardless of any commercial component of the activity involved." *Id.* at 1360.

116. 566 F. Supp. 1440 (S.D.N.Y. 1983).

117. *Id.* at 1442.

118. *Id.* at 1443.

119. *Id.* at 1444.

120. *Id.* In dicta to the *Frankel* decision, Judge Gagliardi stated that if plaintiffs had been able to establish subject matter jurisdiction, the court would have dismissed the suit under the act of state doctrine. Frankel v. Banco Na-

An attempt to hold the Mexican Government liable for its private sector debts because of national economic policy decisions would have complex and extensive effects on United States diplomatic relations with both Mexico and the entire third world. In *Arango v. Guzman Travel Advisors Corp.*,[121] the Fifth Circuit concluded that the invocation of the act of state doctrine "does not preclude judicial resolution of all commercial consequences stemming from the occurrence of [governmental] acts."[122] The court believed that claims arising from governmental interference in private commercial transactions were not intended for judicial evaluation, but instead, for a determination of who should bear "the risk of loss following such . . . [government action] and whether there existed a duty on the part of any defendant to protect [the plaintiff] from, or to warn of, the possibility of its occurrence."[123] Thus, it would seem that the judiciary can neither effectively nor efficiently evaluate the economic consequences of a foreign government's breach of a debt restructuring agreement such as the FICORCA program. Furthermore, the judiciary is not equipped to make decisions determining the best interest of United States economic and diplomatic foreign policy. The power to enforce such a decision lies only with the executive branch. It seems clear, therefore, that the principles of comity and the separation of powers,[124] which together form the foundation of the act of state doctrine, should be recognized in the event of future interference by the Mexican Government in the operation of the FICORCA program.[125] The economic and political consequences of such an action will be resolved most effectively through diplomatic negotiations among Mexican debtors, United States creditors, and the governments of both nations, without interference

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cional de Mex., No. 82-6457, slip op. at 4 n.4 (S.D.N.Y. May 31, 1983).

121. 621 F.2d 1371 (5th Cir. 1980). In *Arango,* the court rejected the defense that the act of state doctrine precluded judicial resolution of the damages incurred as a result of plaintiff's contract and tort claims against the national airline of the Dominican Republic. *Id.* at 1380-81 (citation omitted).

122. *Id.; see also,* Note, *supra* note 92, at 1450 n.46.

123. 621 F.2d at 1380.

124. *See supra* note 113.

125. "If the act of state doctrine is a principle of decision binding on federal and state courts alike . . . its continuing vitality depends on its capacity to reflect the proper distribution of functions between the judicial and political branches of the Government on matters bearing upon foreign affairs." Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 427-28 (1964).

by United States courts.

C. Restricting International Lending by United States Banks: The International Lending Supervision Act of 1983

Mexico's struggle with its immense foreign indebtedness contributed substantially to the widespread perception in the United States that domestic banks had been excessively hospitable to loan requests by Third World governments, including Mexico. In response to this belief, Congress enacted the International Lending Supervision Act (ILSA) of 1983.[126] The ILSA was appended to a supplemental appropriation that included 8.3 billion dollars for the International Monetary Fund.[127]

The ILSA represents the combination of several proposals debated in Congress during 1983.[128] It does not, however, undertake an innovative restructuring of the foreign lending regulatory scheme; rather, it is the product of a comprehensive congressional reappraisal of the four-part method adopted in 1979 as a guide in evaluating domestic bank participation in foreign lending.[129] To

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126. Pub. L. No. 98-181, §§ 901-913, 1983 U.S. CODE CONG. & AD. NEWS (97 Stat.) 1153, 1278-84 (to be codified at 12 U.S.C. §§ 3901-3912) [hereinafter cited to 12 U.S.C.A. §§ 3901-3912 (West Supp. 1984)].

127. Supplemental Appropriations Act, 1984; Domestic Housing and International Recovery and Financial Stability Act, Pub. L. No. 98-181, § 802, 1983 U.S. CODE CONG. & AD. NEWS (97 Stat.) 1267, 1268-70 (to be codified at 22 U.S.C. §§ 286e-1i, 286e-2, 286z); *see also* H.R. REP. No. 175, 98th Cong., 1st Sess., *reprinted in* 1983 U.S. CODE CONG. & AD. NEWS 1898.

128. S. 502, 98th Cong., 1st Sess., 129 CONG. REC. S1234-36 (daily ed. Feb. 16, 1983) [hereinafter cited as the Heinz-Proxmire Bill], *reprinted in Proposed Solutions to the International Debt Problems: Hearings on S. 502 and S. 695 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 1st Sess. 97 (1983) [hereinafter cited as *April 1983 Hearings on International Debt*]; *International Debt: Hearings on Proposals to Increase IMF Resources Before the Subcomm. on International Finance and Monetary Policy of the Senate Comm. on Banking, Housing, and Urban Affairs*, 98th Cong., 1st Sess. (1983) [hereinafter cited as *February 1983 Hearings on the IMF*]; H. R. 2930, 98th Cong., 1st Sess., 129 CONG. REC. H2697 (daily ed. May 5, 1983).

129. For a thorough summary of the four-part method, see *February 1983 Hearings on the IMF*, *supra* note 128, at 323-28 (statement of Federal Reserve Bank Chairman Paul A.Volcker). *International Bank Lending: Hearings Before the Subcomm. on Financial Institutions Supervision, Regulation, and Insurance of the House Comm. on Banking, Finance, and Urban Affairs*, 98th Cong., 1st Sess. 17-19 (1983) (statement of Charles A. Bowsher, Comptroller General of the United States) [hereinafter cited as *House Hearings on International Lending*].

reduce the risk of overextended foreign debt, the ILSA transforms the current system by: (1) imposing a system of allocated transfer risk reserves;[130] (2) increasing the public disclosure requirements of international lenders;[131] (3) requiring the amortization of fees on international loans;[132] (4) strengthening the examination and supervision procedures in international lending;[133] and (5) imposing a system of minimum capital adequacy requirements for international lenders.[134]

1. *Imposing a System of Reserves*

Prudent banking practice requires banks to recognize the diminished value of an underperforming asset.[135] It is unrealistic to record an underperforming asset at full face value,[136] but under pre-ILSA practices, banks were limited to two alternative means of treating underperforming assets. First, a bank could make a discretionary charge against current earnings to increase the bank's allowance for potential loan losses.[137] The severe impact on short-term profits, however, discouraged international lenders from using this approach regularly.[138] Second, if bank examiners determined that the loan was a loss, a bank was required to write off the entire value of the loan.[139] But a loan was never written off

130. 12 U.S.C.A. § 3904 (West Supp. 1984); *see infra* notes 135-65 and accompanying text.

131. 12 U.S.C.A. § 3906; *see infra* notes 166-90 and accompanying text.

132. 12 U.S.C.A. § 3905; *see infra* notes 191-231 and accompanying text.

133. 12 U.S.C.A. § 3903; *see infra* notes 232-40 and accompanying text.

134. 12 U.S.C.A. § 3907; *see infra* notes 241-54 and accompanying text.

135. *See April 1983 Hearings on International Debt, supra* note 128, at 29 (memorandum proposing a Program for Improved Supervision and Regulation of International Lending, prepared by C. T. Conover, Comptroller of the Currency, William M. Isaac, Chairman of the Federal Deposit Insurance Corp. (FDIC), and Paul A. Volcker, Chairman of the Board of Governors of the Federal Reserve System [hereinafter cited as Regulators' Memorandum]). Prudent banking practice requires recognition of a troubled loan's diminution in value because, if the loan becomes less than fully collectible, the bank's capital could be impaired. *See, e.g., id.* at 81 (statement of Chairman Volcker).

136. *See* Banks, *Write Down Loans? Perish the Thought*, FORBES, May 9, 1983; at 57, 57-58.

137. *April 1983 Hearings on International Debt, supra* note 128, at 40 (Regulators' Memorandum).

138. *Id.* at 29, 40; *see* Banks, *supra* note 136, at 58.

139. *House Hearings on International Lending, supra* note 129, at 21 (statement of Comptroller General Bowsher).

when a sovereign nation was a borrower because, unlike private corporations, nations never become bankrupt in the traditional sense,[140] and it was assumed that loans to them eventually would be repaid.[141] Because the write off was used rarely, the pre-ILSA international banking practice was characteristically inconsistent in charging reserves to offset potential loan losses.[142]

To ensure realistic and uniform treatment of troubled foreign loans and to discourage bankers from making risky international loans,[143] the ILSA and the regulations promulgated thereunder[144] impose a system of "allocated transfer risk reserves" (ATRR).[145] Section 3904(a) of the ILSA requires that a bank establish an ATRR when certain federal regulatory agencies have determined that the value of a bank's loan has been impaired by a foreign country's continued inability to make payments on the loan.[146] The statute lists three actions by the debtor country that may indicate debt impairment: (1) a failure to make full interest payments; (2) a failure to adhere to the terms of a restructured indebtedness; and (3) a failure to comply with an IMF adjustment program. An ATRR is also required when the regulatory agencies determine that the debtor country has no definite plan for the

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140. *Id.*; *April 1983 Hearings on International Debt, supra* note 128, at 40 (Regulators' Joint Memorandum).

141. *See April 1983 Hearings on International Debt, supra* note 128, at 40 (Regulators' Memorandum); *House Hearings on International Lending, supra* note 129, at 21 (statement of Comptroller General Bowsher).

142. *April 1983 Hearings on International Debt, supra* note 128, at 40 (Regulators' Memorandum).

143. *See id.* at 29.

144. International Lending Supervision Regulations, 49 Fed. Reg. 5586, 5590-93 (1984) (to be codified at 12 C.F.R. pts. 20, 211, 351) [hereinafter cited to their future location at 12 C.F.R. pts. 20, 211, 351 (1984)].

145. 12 U.S.C.A. § 3904(a) (West Supp. 1984); 12 C.F.R. §§ 20.8(a), 211.43(a), 351.1(b)(1) (1984). "Transfer risk" is the possibility that the borrower may be unable to continue debt service in the currency in which the debt is to be paid (usually dollars) because of a lack of foreign exchange. A bank's exposure to transfer risk, therefore, consists of all cross-border claims regardless of whether a borrower is sovereign or private. *See April 1983 Hearings on International Debt, supra* note 128, at 25 (Regulators' Memorandum). Because the ILSA's treatment of private and sovereign borrowers is indistinguishable, loans to private foreign borrowers are included in loans to debtor countries.

146. 12 U.S.C.A. § 3904(a)(1)(A). The federal regulatory agencies in question are the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation. *Id.* § 3902(1).

orderly restoration of debt service.[147] The regulations require the federal regulatory agencies to meet annually to determine which, if any, international loans present either of the conditions triggering the ATRR requirement.[148] Section 3904(b) of the ILSA requires regulatory agencies assessing the reserve positions of foreign loans to consider whether rescheduling of the debt has been planned or negotiated.[149] The provision reflects legislators' belief that a troubled loan often is characterized by the borrower's need to reschedule the indebtedness.[150]

Section 3904(a)(2) provides that an ATRR will be created by a charge against current income.[151] The amount charged cannot be considered bank capital or surplus to meet capital ratio requirements.[152] The regulations require the regulatory agencies to consider the duration of the loan's impairment,[153] the debtor's efforts toward restoring debt service, prospects for restored debt service, and any other factors the agency deems relevant in determining the amount of the ATRR that should be charged against a specific loan.[154] The regulations indicate that during the first year in which a troubled loan requires an ATRR, the charge should equal ten percent of the principal amount.[155] If in subsequent years the troubled loan requires an ATRR, the charge will increase annu-

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147. 12 U.S.C.A. § 3904(a)(1)(A).

148. 12 U.S.C.A. § 3904(a)(1)(B).

149. 12 C.F.R. §§ 20.8(b)(1), 211.43(b)(1), 351.1(b)(2)(i) (1984).

150. 12 U.S.C.A. § 3904(b) (West Supp. 1984).

151. The legislators' reasoning is questionable. In hearings before Congress, Chairman Volcker argued that there is nothing inherent in the nature of a rescheduling that, standing alone, justifies the need for a reserve. *April 1983 Hearings on International Debt, supra* note 128, at 81 (statement of Chairman Volcker). Section 33 of the Heinz-Proxmire Bill flatly required the imposition of reserves every time that a rescheduling would be necessary. Heinz-Proxmire Bill, *supra* note 128, § 33, at S1235. The Regulators' Memorandum ignored rescheduling as a factor in determining the need for reserves. *April 1983 Hearings on International Debt, supra* note 128, at 29-30. (Regulators' Memorandum). Section 3904(b) appears to be a compromise between the two extremes. The need for rescheduling does not trigger the imposition of reserves, but it is a factor that must be considered in the overall context of evaluating the adequacy of reserve positions.

152. 12 U.S.C.A. § 3904(a)(2) (West Supp. 1984); 12 C.F.R. §§ 20.8(c)(1), 211.43(c)(1), 351.1(b)(3)(i) (1984).

153. 12 U.S.C.A. § 3904(a)(2); 12 C.F.R. §§ 20.8(c)(1), 211.43(c)(1), 351.1(b)(3)(i) (1984).

154. 12 C.F.R. §§ 20.8(b)(2)(ii)(A), 211.43(b)(2)(ii)(A), 351.1(b)(2)(ii)(B)(1).

155. 12 C.F.R. §§ 20.8(b)(2)(ii)(B), 211.43(b)(2)(ii)(B), 351.1(b)(2)(ii)(B)(2).

ally by fifteen percent of the principal amount.[156] When appropriate, however, the regulatory agencies may establish an ATRR of a larger or smaller percentage.[157] The regulations require that an ATRR be kept separate from the bank's general "allowance for potential loan losses" (APLL).[158] A separate reserve must be set aside for each loan requiring an ATRR.[159] The regulations provide an alternative accounting method for an ATRR.[160] A separate charge against current income for the ATRR is not required in three situations: (1) when a bank writes down the subject loan; (2) when a bank applies interest payments or other nonprincipal collections to reduce the principal of the loan; and (3) when a bank, in lieu of a charge against earnings, establishes an ATRR by transferring to it any amount specifically allocated in the APLL for a loan subjected to ATRR treatment.[161] The regulations emphasize, however, that banks must replenish their APLLs to levels that will provide adequately for the losses estimated in the overall loan portfolio.[162]

The key issue in the reserve system is the decision to impose the ATRRs. When considering the system, Congress was advised to ensure that the ATRRs not be imposed too early[163] because triggering an ATRR prematurely could suffocate the crucial minimum flow of credits necessary for a distressed debtor's survival.[164] Congress rejected proposals that would impose ATRRs

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156. *Id.*

157. *Id.*

158. 12 C.F.R. §§ 20.8(c)(2), 211.43(c)(2), 351.1(b)(3)(ii).

159. *Id.* In addition, foreign bank subsidiaries are not required to comply separately with the ATRR requirements. 49 Fed. Reg. 5588-89 (1984) (supplementary information accompanying regulations for ATRRs); *see also* 12 C.F.R. §§ 20.8(c)(3), 211.43(c)(3), 351.1(b)(3)(iii). Instead, any specific reserves against or write-downs of the subsidiary's troubled international assets will be incorporated with the subsidiary's assets into the parent's consolidated financial statement. 49 Fed. Reg. 5589 (1984); *see also* 12 C.F.R. §§ 20.8(c)(3), 211.43(c)(3), 351.1(b)(3)(iii).

160. 12 C.F.R. §§ 20.8(c)(4), 211.43(c)(4), 351.1(b)(3)(iv).

161. *Id; see also* 49 Fed. Reg. 5589-90.

162. 12 C.F.R. §§ 20.8(c)(4), 211.43(c)(4), 351.1(b)(3)(iv); *see also* Fed. Reg. 5589-90.

163. *See, e.g., April 1983 Hearings on International Debt, supra* note 128, at 91 (statement of Comptroller Conover).

164. *Id.* at 81-82 (statement of Chairman Volcker); *February 1983 Hearings on the IMF, supra* note 128, at 198-99 (statement of George J. Clark, Executive Vice President, Citibank, N.A.). Some disagreement, however, arose even among those opposed to the early triggering of the reserve requirement. *April 1983*

automatically and possibly prematurely, electing instead to establish general guidelines that granted bank regulators the discretion to decide when to impose the ATRR and its amount.[165] The ILSA thus strikes a delicate balance between the need to protect the reserve positions of domestic banks and the need to provide banks with the flexibility necessary to extricate debtors who might be saved by continued funding.

2. *Increasing Public Disclosure and Reporting*

During hearings on the international debt crisis, Congress heard experts testify that market-imposed discipline is essential to prevent bankers from repeatedly undertaking risky foreign loans.[166] Witnesses insisted that the threshold requirement for effective discipline of bank risk is public disclosure of timely and thorough information on international lending activities.[167] As a

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Hearings on International Debt, supra note 128, at 71-72 (Sen. Proxmire's questioning of Comptroller Conover and Chairmen Isaac and Volcker). Chairman Isaac indicated support for a "moderate reserve" requirement—one that was triggered later than that proposed by the Heinz-Proxmire Bill and yet sooner than the reserve proposed by the Regulators' Memorandum. *Id.* at 90-91; *see also id.* at 91 (statement of Comptroller Conover supporting a similar moderate reserve requirement if it were phased in gradually over a very long period of time).

165. The ILSA does not incorporate the suggestion of Senator Heinz that the reserve requirement be triggered by an objective occurrence, such as an increase in the interest rate that the lender is charging the debtor or the debtor's receipt of a rescheduling. *Compare* 12 U.S.C.A. § 3904 (West Supp. 1984) (relying on a subjective determination of the need for reserves), *with April 1983 Hearings on International Debt, supra* note 128, at 81 (statement of Sen. Heinz urging that objective events trigger reserve requirements). An objective standard for the triggering of reserves suffers from excessive rigidity. Imposing reserves when interest rates are raised, for example, fails to distinguish between those borrowers who could afford to pay any interest rate and those borrowers who could not service their debt even if it carried no interest rate.

In addition to the discretion accorded the regulators by the terms of section 3904 and the regulations thereunder, the House Report accompanying ILSA requires that this regulatory discretion be used to effect a gradual phase-in of the ATRR requirements. H.R. Rep. No. 175, *supra* note 127, at 40, *reprinted* at 1922.

166. *February 1983 Hearings on the IMF, supra* note 128, at 385 (statement of Chairman Isaac); *April 1983 Hearings on International Debt, supra* note 3, at 28 (Regulators' Memorandum); *id.* at 64, 83 (statements of Chairman Isaac).

167. *April 1983 Hearings on International Debt, supra* note 128, at 64 (statement of Chairman Isaac).

consequence, the ILSA mandates improvements in the timeliness, thoroughness, and public accessibility of information concerning international lending activities.[168] To ensure that more timely information be available, the ILSA requires that a Country Exposure Report[169] be filed quarterly[170] and reduces the filing period from sixty to forty-five days.[171]

The ILSA and the regulations promulgated thereunder also have prompted more comprehensive bank disclosure. Section 3906(b) requires that foreign exposures be disclosed in terms of both capital and assets.[172] Previously, banks could give different information to federal bank examiners. Bank examiners required that a bank state its exposure as a percentage of the bank's total capital.[173] Public disclosure, however, was limited to stating foreign exposure as a percentage of total assets.[174] The ILSA cures this inconsistency by requiring that banks publicly express their exposure as both a percentage of assets and as a percentage of capital.[175]

A second improvement in the thoroughness of international bank disclosures was the creation of a new reporting document, the Country Exposure Information Report (CEIR).[176] The regulations require that the CEIR be filed as a supplement to the Country Exposure Report.[177] In Part A of the CEIR, banks must pro-

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168. *See* 12 U.S.C.A. § 3906 (West Supp. 1984); 12 C.F.R. §§ 20.10, 211.44, 351.3 (1984).

169. The Country Exposure Report is a required regulatory memorandum published by and submitted to the Interagency Country Exposure Review Committee (ICERC). ICERC and its parent committee, the Federal Financial Institutions Examination Council, were established in 1978 to bring greater uniformity and effectiveness to the examination and supervision activities of the three major federal bank regulatory agencies: the Office of the Comptroller of the Currency; the Federal Reserve System; and the Federal Deposit Insurance Corporation. *See* H.R. REP. No. 175, *supra* note 127, at 39, *reprinted* at 1921-22; *see also* 12 C.F.R. § 1101 (1983).

170. 12 U.S.C.A. § 3906(a); Quarterly Report of Country Exposure by U.S. Banking Organizations, 48 Fed. Reg. at 56,848, 56,849 (1983) (changes in reporting requirements mandated by ILSA).

171. 48 Fed. Reg. at 56,849.

172. 12 U.S.C.A. § 3906(b).

173. *House Hearings on International Lending*, *supra* note 129, at 22 (statement of Comptroller General Bowsher).

174. *Id.*

175. 12 U.S.C.A. § 3906(b).

176. 48 Fed. Reg. 56,848 (1983).

177. *Id.* at 56,849.

file the bank's debtor countries whose net indebtedness[178] to the bank exceeds one percent of the bank's total assets.[179] If a bank's exposure in a debtor country is concentrated to this extent, the country's indebtedness to the bank must be listed in the CEIR in the aggregate,[180] by sectors (public and private),[181] and by maturity date.[182] Previously, detailed information of this nature had not been reported.[183] Part B of the CEIR requires banks to list, but not to profile, countries whose debt is between 0.75% and one percent of the bank's total assets.[184] Under Part B, disclosure requires only a list of the qualifying debtors and the aggregate exposure of the bank in each country.[185]

Section 3906(b) of the ILSA provides for public access to information concerning international lending. The section requires that the public have access to information concerning "material foreign exposures." The standard of materiality, defined in regulations, is one percent of the bank's total assets.[186] The general public, therefore, is entitled to request and receive the information included in Part A of the Country Exposure Information Report.[187]

In deciding to enhance market discipline, Congress implicitly rejected arguments that debtor countries did not want to reveal to their electorate the extent of their United States bank indebtedness, and that detailed disclosure would give a bank's competitors an unfair advantage.[188] Congress prudently agreed with the federal regulatory authorities[189] that market pressures could not be brought to bear on bank risk-taking unless detailed bank-by-

178. All bank exposures disclosed on the CEIR are stated "after adjustments for guarantees." *Id.* at 56,850. For example, there are after adjustments for transfers of exposure. *Id.*

179. *Id.* at 56,849-50.

180. *Id.*

181. *Id.*

182. The bank exposures will be categorized into those of less than one year and those of greater than one year. *Id.*

183. *Id.* at 56,849.

184. *Id.* at 56,849-50.

185. *Id.*

186. 12 U.S.C.A. § 3906(b) (West Supp. 1984).

187. 48 Fed. Reg. at 56,849.

188. *Id.; see also* H.R. REP. No. 175, *supra* note 127, at 42, *reprinted* at 1925.

189. *February 1983 Hearings on the IMF, supra* note 128, at 392 (statement of Chairman Isaac).

bank and country-by-country disclosure was available.[190] Section 3906 and the regulations promulgated thereunder will increase the amount and quality of information available to investors trying to decide where to invest in the banking industry, thereby contributing to the discipline imposed by the market on the international lending activities of domestic banks.

3. *Requiring the Amortization of Fees*

Under pressure to increase or to sustain current earnings, international lenders have entered into and rescheduled large syndicated loans.[191] The potential earnings of loans have been increased by the staggering fees and interest charges collected in association with the loans.[192] The fees serve a variety of purposes: (1) flat fees boost the yield of the loan; (2) syndication fees cover costs associated with the loan; (3) commitment fees hold funds available on fixed terms for a designated period; (4) agency fees compensate the bank for acting as the foreign borrower's domestic agent in a syndicated loan; and (5) management fees reimburse the lead bank for out-of-pocket expenses incurred in arranging loan participation.[193] Under pre-ILSA practice, many banks rejected conservative accounting procedures and recognized the fees as current income upon the loan's inception.[194] Because fees often exceeded actual expenditures, the pre-ILSA practice increased the quarterly income of international lenders, prompting banks to enter into and reschedule more international exposures.[195] To ensure uniform accounting treatment and to remove this artificial incentive to make and reschedule foreign loans,[196] the ILSA requires that bank fees be recognized gradually over the

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190. *See id.* at 392 (statement of Comptroller Conover); *April 1983 Hearings on International Debt, supra* note 128, at 24 (Regulators' Memorandum).

191. *April 1983 Hearings on International Debt, supra* note 128, at 30 (Regulators' Memorandum).

192. Banks, *supra* note 136, at 58-59.

193. Accounting for International Loan Fees, 49 Fed. Reg. 5594, 5594 (1984) (providing supplementary background information).

194. *February 1983 Hearings on the IMF, supra* note 128, at 264 (statement of Chairman Volcker); *April 1983 Hearings on International Debt, supra* note 128, at 46 (Regulators' Memorandum).

195. *See April 1983 Hearings on International Debt, supra* note 128, at 30 (Regulators' Memorandum).

196. 49 Fed. Reg. at 5594-95 (1984).

effective life of the loan.[197] Specifically, section 3905 and the regulations proposed thereunder[198] address the accounting treatment of international loan fees in general, and of commitment, management, and agency fees in particular.[199]

As a general rule, the regulations require the deferral of fee income from new and restructured international loans until the loan's closing, and the amortization of fee income over the effective life of the loan.[200] To the extent that fee income represents a reimbursement for identifiable administrative costs incurred by the bank in processing the loan, a portion of the fee equal to those costs will be recognized currently as income.[201] The regulations limit administrative costs to those costs that may be attributed directly to the loan's processing and consummation.[202] The regulators excluded "general and non-associated overhead-type costs"[203] from the definition, but recognized legal fees and allocable employee compensation as possible administrative costs.[204] Consistent with banking practice and the objectives of the ILSA,[205] the proposed regulations permit administrative costs to be expensed as they are incurred.[206] The proposed regulations also require use of the interest method to recognize deferred fee income in relation to the outstanding loan balance during the loan period.[207] The net effect of the regulations will be to disallow current income from fee charges in international loans.[208]

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197. 12 U.S.C.A. § 3905(b) (West Supp. 1984).

198. Accounting for International Loan Fees, 49 Fed. Reg. 5594-99 (1984) (to be codified at 12 C.F.R. pts. 20, 211, 351) (proposed Feb. 13, 1984) [hereinafter cited to the future code location, 12 C.F.R. pts. 20, 211, 351 (1984)]. The comment period for the proposed accounting regulations ended on March 9, 1984. By the terms of the ILSA, the regulatory agencies were required to propound final regulations by no later than March 30, 1984. 12 U.S.C.A. § 3905(b)(3).

199. 12 C.F.R. §§ 20.9(b), 211.45(b), 351.2(c) (1984).

200. 12 C.F.R. §§ 20.9(b)(1), 211.45(b)(1); 351.2(c)(1) 49 Fed. Reg. at 5595 (reconciling the statutory and regulatory definitions of the "life" of a loan).

201. 12 C.F.R. §§ 20.9(b)(3)(i), 211.45(b)(3)(i), 351.2(b)(3)(i).

202. 12 C.F.R. §§ 20.9(b)(3)(ii), 211.45(b)(3)(ii), 351.2(c)(3)(ii).

203. 49 Fed. Reg. at 5595 (summary of the proposed regulations).

204. *See* 12 C.F.R. §§ 20.9(b)(3)(ii), 211.45(b)(3)(ii), 351.2(c)(3)(ii).

205. 49 Fed. Reg. at 5596 (summary of the proposed regulations).

206. 12 C.F.R. §§ 20.9(b)(3)(i), 211.45(b)(3)(i), 351.2(c)(3)(i).

207. 12 C.F.R. §§ 20.9(b)(1), 211.45(b)(1), 351.2(c)(1).

208. In addition, Congress considered whether the fee provision might be circumvented if banks reduced the stated loan period to ninety days. *April 1983 Hearings on International Debt, supra* note 128, at 93-94 (Sen. Heinz's questioning of Comptroller Conover and J. Charles Partee, Governor, Federal Re-

Section 3905(b) and the proposed regulations also address the accounting treatment of commitment fees,[209] management fees,[210] and agency fees.[211] Commitment fees may have two components: one relating to the commitment of funds on fixed terms and one relating to the lending of money.[212] Because these components typically cannot be separated,[213] the regulations require that the fee be recognized over the combined commitment and loan periods.[214] Specifically, the fee may be recognized at the closing of the loan to the extent that the fee represents direct processing costs associated with the commitment.[215] The straight line method will be used to amortize the remainder of the commitment fee income, based on the combined duration of the commitment and loan periods over the commitment period.[216] The balance of the fee remaining unamortized at the loan's closing will be amortized over the effective life of the loan using the interest method.[217] To the extent that the loan is unfunded, the unamortized commitment fee will be recognized upon the termination of the commitment period.[218]

The proposed regulations create the presumption that a portion of a lead bank's management fees[219] increases the interest yield of the loan.[220] The percentage to be treated as increased yield will be the same as the percentage recognized as an increase in yield by the largest nonlead participant in the syndication.[221] The remain-

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serve System). By using this tactic, banks could amortize fees over the life of the loan (ninety days), comply with the statute, and still receive a boost in quarterly earnings. Federal regulatory agencies have concluded that the "effective life" of a loan, though generally identical to the term of a loan, occasionally may differ from the stated loan period. 49 Fed. Reg. at 5595. This exception, for example, might apply when a short-term loan is entered with the expectation that the loan would be rolled-over at maturity. *Id.*

209. 12 U.S.C.A. § 3905(b); 12 C.F.R. §§ 20.9(b)(2), 211.45(b)(2), 351.2(c)(2).
210. 12 U.S.C.A. § 3905(b); 12 C.F.R. §§ 20.9(b)(4), 211.45(b)(4), 351.2(c)(4).
211. 12 U.S.C.A. § 3905(b); 12 C.F.R. §§ 20.9(b)(5), 211.45(b)(5), 351.2(c)(5).
212. 49 Fed. Reg. at 5596.
213. *Id.*
214. 12 C.F.R. §§ 20.9(b)(2), 211.45(b)(2), 351.2(c)(2).
215. 12 C.F.R. §§ 20.9(b)(3)(i), 211.45(b)(3)(i), 351.2(c)(3)(i); 49 Fed. Reg. at 5596.
216. 12 C.F.R. §§ 20.9(b)(2), 211.45(b)(2), 351.2(c)(2).
217. *Id.*
218. *Id.*
219. *See supra* notes 201-06 and accompanying text.
220. 12 C.F.R. §§ 20.9(b)(4)(ii), 211.45(b)(4)(ii), 351.2(c)(4)(ii).
221. *Id.; see also* 49 Fed. Reg. at 5595-96.

der of the lead bank's fees—the portion in excess of agency, commitment, and boost in yield fees—is treated as a syndication fee by the proposed regulations.[222] Syndication fees may be recognized as income at the loan's closing only to the extent that they represent administrative costs directly associated with the syndication's processing.[223] Again, these administrative costs will be expensed as they are incurred.[224] The remainder of the syndication fee, along with the increase in the interest yield, will be deferred and amortized over the effective life of the loan using the interest method.[225]

Agency fees compensate a bank for acting as a foreign borrower's domestic agent, which is often required by international syndication agreements.[226] The regulations require that this income be recognized at the loan's closing or upon the performance of the agent's services, whichever is later.[227]

Bankers and regulators have endorsed the accounting treatment set out in section 3905 of the ILSA and the regulations proposed thereunder.[228] The provisions constitute a comprehensive reform of the accounting treatment traditionally afforded international loan fees,[229] assuring that international lenders will no

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222. 49 Fed. Reg. at 5595-96.

223. *Id.;* 12 C.F.R. §§ 20.9(b)(3)(ii), 211.45(b)(3)(ii), 351.2(c)(3)(ii).

224. 12 C.F.R. §§ 20.9(b)(3)(i), 211.45(b)(3)(i), 351.2(c)(3)(i); *see supra* note 208.

225. 49 Fed. Reg. at 5595-96.

226. *Id.* at 5596.

227. 12 C.F.R. §§ 20.9(b)(5), 211.45(b)(5), 351.2(c)(5); *see supra* note 208.

228. *See February 1983 Hearings on the IMF, supra* note 128, at 197 (statement of George J. Clark, Executive Vice President, Citibank, N.A.); *April 1983 Hearings on International Debt, supra* note 128, at 50 (Regulators' Memorandum).

229. The keystone of section 3905 is subsection (b). A survey of the House Report, congressional transcripts, and regulations concerning the ILSA, discloses no meaningful purpose for section 3905(a). The agencies promulgated a regulation implementing the terms of section 3905(c) without any substantive change or additions. *Compare* 12 C.F.R. §§ 20.9(a), 211.45(a), 351.2(b), *with* 12 U.S.C.A. § 3905(a). On its face, section 3905(a) adds nothing to the substance of section 3905(b). Section 3905(b), in requiring the amortization of all loan fees that exceed costs incurred, applies to both restructured and "new" loans. *See supra* notes 191-227 and accompanying text. Section 3905(a), on the other hand, addresses only *restructured* loan fees and in that setting prohibits any fee in excess of cost incurred unless the excess is amortized. 12 U.S.C.A. § 3905(a). The only practical distinction between the two subsections lies in their effective dates: section 3905(b) will be implemented on the date of the regulations' final

longer increase their short-term earnings by making or rescheduling an international loan. The benefits will be twofold. First, by ensuring that income is recognized as it is earned, the ILSA will add uniformity and realism to the banking industry's accounting treatment of international loan fees.[230] Second, the ILSA's prevention of increases in short-term earnings will remove a dangerous and artificial incentive for lenders to enter into risky syndications of foreign loans.[231]

4. *Strengthening Country Risk Examination and Supervision*

Section 3903 of the ILSA requires closer examination and supervision of international lending[232] and more careful evaluation of a bank's financial exposure within particular countries.[233] Although no regulations were promulgated under section 3903, the legislative history of ILSA describes the purpose underlying enhanced examination and supervision.[234] Congress intended to define situations in which a bank would be warned about its foreign exposure[235] and to ensure that these warnings be considered by the bank's policymakers.[236] Country risk evaluations were made more comprehensive to compel regulating agencies to consider the concentration of a bank's international portfolio when evaluating the adequacy of the bank's capital position.[237] If a bank concentrates its credits in a single country, it is more dangerously exposed than another bank with the same aggregate amount of

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promulgation; section 3905(a) became effective on November 30, 1983, the date of ILSA's enactment. *See* 12 U.S.C.A. § 3905(a)(2)(B). Because the effect of the two sections is practically identical, and because the regulations have given no independent effect to section 3905(a), it seems safe to say that section 3905(a) will add nothing to the solution of the loan fee amortization dilemma.

230. *See generally* Banks, *supra* note 136, at 58-60; Steinberg, *How the Debt Bomb Might Be Defused*, FORTUNE, May 2, 1983, at 128, 133-34.

231. *See April 1983 Hearings on International Debt, supra* note 128, at 30 (Regulators' Memorandum); *see also* H.R. REP. No. 175, *supra* note 127, at 42, *reprinted* at 1925.

232. 12 U.S.C.A. § 3903(a) (West Supp. 1984).

233. 12 U.S.C.A. § 3903(b).

234. *See* H.R. REP. No. 175, *supra* note 127, at 39-40, *reprinted* at 1921-23.

235. H.R. REP. No. 175, *supra* note 127, at 39, *reprinted* at 1921-22.

236. H.R. REP. No. 175, *supra* note 127, at 39-40, *reprinted* at 1921-23; *see also April 1983 Hearings on International Debt, supra* note 128, at 27 (Regulators' Memorandum); *id.* at 58 (statement of Comptroller Conover).

237. H.R. REP. No. 175, *supra* note 127, at 39-40, *reprinted* at 1921-23.

credit spread over a number of countries.[238] Requiring the concentration element in a bank's country risk evaluation encourages the diversification of international loan portfolios. By increasing capital ratio requirements proportionally to a bank's concentration in individual countries, the ILSA creates an incentive for bankers to avoid making a large number of loans to a single country.[239] The resulting diversity will lend stability to the international banking system.[240]

ILSA section 3903, therefore, seeks to improve the quality of information available to bank policymakers and emphasizes the importance of diversifying international portfolios. The provision should improve the banks' ability and motivation to avoid dangerously unbalanced portfolios.

5. *Imposing Minimum Capital Adequacy Requirements*

Section 3907 of the ILSA calls upon banks to bolster their capital bases.[241] Although the provision does not require the promulgation of regulations, Congress indicated its strong preference for regulatory provisions establishing specific minimum capital ratios for all categories of banks.[242]

Under prior law, federal regulatory agencies required minimum capital-to-asset ratios of either five or six percent, depending on the size and nature of the institution.[243] The regulators' failure to impose these requirements on the largest international lenders, however, was a primary concern of the congressional drafters of the ILSA.[244] The capital ratios of large international lenders gen-

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238. *See* Cohen, *U.S. Regulation of Bank Lending to LDCs: Balancing Bank Overexposure and Credit Undersupply,* 8 YALE J. WORLD PUB. ORD. 200, 210-11 (1982).

239. Section 3903 does not call for the promulgation of regulations and none have been issued thereunder. Thus, there are no precise formulae for calculating diversification ratios. Furthermore, it is unclear whether the regulatory agencies will ever develop precise, mechanical formulae for implementing section 3903's focus on diversification. Comments of the regulators indicate the possibility that the focus on a bank's concentration could be left to bank examiners' judgment in the evaluation process. *April 1983 Hearings on International Debt, supra* note 128, at 73-74 (statement of Chairman Volcker).

240. *Id.*

241. 12 U.S.C.A. § 3907(a) (West Supp. 1984).

242. H.R. REP. No. 175, *supra* note 127, at 45-46, *reprinted* at 1928-29.

243. H.R. REP. No. 175, *supra* note 127, at 45, *reprinted* at 1928.

244. H.R. REP. No. 175, *supra* note 127, at 45-46, *reprinted* at 1928-29.

erally fell between four and five percent, while most banks maintain capital levels between six and eight per cent.[245] Generally, large international banks were not held to a specific minimum capital standard but negotiated their capital levels individually.[246] The justification offered for the inconsistent treatment within the banking industry was the difference in size and asset diversification between the large international lenders and other members of the banking community.[247] Congressional drafters of the ILSA rejected that argument, believing there was no reason to favor the largest banks.[248] The legislative history of the ILSA cites the events of 1982-1983 as evidence that no internationally diversified portfolio, no matter how large, is free from the systemic risks associated with worldwide financial conditions.[249] As a result, section 3907(a)(1) provides minimum capital adequacy requirements.[250] Section 3907(a)(2), however, may soften the impact of this new directive on the large banks. It grants regulatory agencies the discretion to establish capital requirements for large banks individually, when warranted by a particular set of circumstances.[251] The enforcement provisions of section 3907(b)[252] authorize the regulatory agencies to compel noncomplying institutions to submit and adhere to a plan for achieving the necessary capital requirement.[253]

Section 3907 admirably endorses the universal need for banks to adhere to established capital standards, but the section lacks specific language and neglects to direct that specific regulations be promulgated. The lack of forcefulness may undermine the ultimate effectiveness of the statutory directive. The provision allowing discretionary individual determination of capital requirements compounds the uncertainty. If regulatory agencies too freely or too carelessly use this discretionary alternative, section

245. H.R. REP. No. 175, *supra* note 127, at 45, *reprinted* at 1928.

246. H.R. REP. No. 175, *supra* note 127, at 45-46, *reprinted* at 1928-29. *See generally Proposal to Set Country Lending Limits on International Loans Finds No Favor Outside of Congress and Regulatory Agencies*, WASH. FIN. REP. (BNA), No. 40, at 664 (Mar. 28, 1983).

247. H.R. REP. No. 175, *supra* note 127, at 45-46, *reprinted* at 1928-29.

248. H.R. REP. No. 175, *supra* note 127, at 46, *reprinted* at 1929.

249. H.R. REP. No. 175, *supra* note 127, at 45-46, *reprinted* at 1928-29.

250. 12 U.S.C.A. § 3907(a)(1) (West Supp. 1984).

251. 12 U.S.C.A. § 3907(a)(2).

252. 12 U.S.C.A. § 3907(b).

253. 12 U.S.C.A. § 3907(b)(2)(B)(i).

3907 will have added nothing to the capital adequacy dilemma.

6. *Summary*

Throughout the congressional hearings on the foreign debt crisis Congress faced two conflicting concerns: implementing disciplinary measures on the banking community in order to minimize and diversify the risks of foreign lending, and maintaining the flexibility necessary to deal effectively with the crisis. The most conservative proponents predicted that a crucial flow of funds to Mexico and other Third World debtors would be discontinued unless Congress adopted a hands-off policy toward international lending.[254] More radical proponents deemphasized the potential impact on the flow of credit to the Third World and focused instead on setting an absolute limit on the aggregate exposure of domestic banks in foreign countries.[255] Moderate proponents, led by the chairmen of the federal banking agencies, tried to encourage cautious lending without abolishing the bankers' ability to provide crucial credit flows to Mexico and Third World debt-

254. *See February 1983 Hearings on the IMF, supra* note 128, at 197-215 (statement of George J. Clark, Executive Vice President, Citibank, N.A.).

255. *See* Heinz-Proxmire Bill, *supra* note 128. Section 32 of the Heinz-Proxmire Bill called for the promulgation of regulations setting specific limits, stated as a percentage of bank capital, on the aggregate amount of credit extended to each foreign country by United States banks. The limits would vary by country according to criteria thought by the regulators to be indicative of the debtor country's ability to repay. *Id.* at S1235.

This radical restructuring of the regulatory scheme had four flaws. First, had the limits been imposed objectively, the system would be too inflexible; no allowance would be made in such a system for differences between countries that affect the debtor's ability to repay. *April Hearings on International Debt, supra* note 128, at 9, 18 (statements of Chairman Volcker). Second, had the limits been imposed subjectively, the system would be dangerously volatile: precipitous impacts on the flow of funds to debtors could arise; foreign relations might suffer from the inevitable disclosure of regulators' "blacklisted" countries; and questions could arise regarding any bank examiner's ability to make accurate, subjective forecasts. *Id.* at 2, 18, 66 (statements of Sen. Garn and Chairmen Volcker and Isaac). Third, the extended phase-in period necessary to avoid sudden impacts on the flow of funds to debtor countries would seriously undermine the proposal's creditability. *Id.* at 66 (statement of Chairman Isaac). Last, the Heinz-Proxmire Bill operates primarily to allocate credit, putting the United States Government in the awkward position of deciding how much of a valuable resource (capital) to provide to each foreign country. *Id.* at 83 (statement of Chairman Isaac). In short, the proposal is wrought with serious complications for United States foreign relations.

ors.[256] The ILSA and the regulations promulgated thereunder incorporate the suggestions of these more moderate proponents.[257]

D. Proposals for Extricating International Lenders from the Mexican Economic Crisis

In addition to the legislation recently enacted by Mexico and the United States and discussed in preceding sections of the Special Project, the numerous proposals offered by authorities in international finance to extricate Mexico and its lenders from their current dilemma are also of substantial importance to foreign lenders, creditors, and suppliers. If enacted, many of these proposals could alter radically the prospect for transacting business in Mexico. In general, the proposals to restructure lending to Mexico can be categorized as: (1) free market proposals;[258] (2) creditor liens on a proportionate share of debtor exports;[259] (3) insurance of debtor interest payments by Western governments;[260] (4) bank credits exchanged for World Bank bonds;[261] and (5) maintenance of the status quo.[262]

The proposals are not the product of purely altruistic concerns for a neighbor's domestic conditions nor for the problems of individual lenders. Because sixty percent of the capital of the major United States banks is at risk,[263] the illiquidity associated with

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256. *April 1983 Hearings on International Debt, supra* note 128, at 24-33 (Regulators' Memorandum).

257. *Compare id. with* 12 U.S.C.A. §§ 3903-3907 (West Supp. 1984). With the exception of section 3907, the ILSA and the Regulators' Memorandum are almost identical. *Compare, e.g., April 1983 Hearings on International Debt, supra* note 128, at 28-29, 37-39 (Regulators' Memorandum) (requiring detailed quarterly country exposure disclosure by sector and maturity date, and in the "greater than 1% of capital" and "between 0.75% and 1% of capital" categories) *with* 12 U.S.C.A. § 3906 *and* 49 Fed. Reg. 56,848-50 (1983) (initiating disclosure regulations under section 3906 that are identical to the requirements of the Regulators' Memorandum *except* that the disclosure under section 3906 must be stated not only as a percentage of assets but also as a percentage of capital).

258. *See infra* notes 270-95 and accompanying text.

259. *See infra* notes 296-302 and accompanying text.

260. *See infra* notes 303-09 and accompanying text.

261. *See infra* notes 310-14 and accompanying text.

262. *See infra* notes 315-28 and accompanying text.

263. *February 1983 Hearings on the IMF, supra* note 128, at 367 (tabular data of Comptroller Conover). Chemical Bank, N.A., had the largest proportionate commitment in 1983 with 77% of its capital committed to Mexican expo-

the Mexican crisis may require costly intervention by the Federal Reserve.[264] Political radicalization caused by protracted economic deprivation in Mexico could translate into significant problems for the United States.[265] Continued Mexican indebtedness may result in loss of jobs in the United States. Mexico spent sixty-one percent of its 1982 income to service debts owed to international lenders.[266] This huge expense was one factor forcing Mexico to reduce its purchases from United States businessmen by 6.3 billion dollars,[267] costing an estimated 150,000 United States workers their jobs.[268] The debt crisis' permanent impairment of the international trading system also threatens the United States standard of living.[269] The debt service burden on the Mexican Government, therefore, must be reduced to assure the continued vitality of the United States banking system, to prevent political destabilization of Mexico, and to facilitate the United States' own economic recovery.

1. *The Free Market Approach*

A number of authorities have made proposals that rely on the ability of the marketplace to correct the Mexican financial crisis.[270] For example, Sir Alan Walters, adviser to British Prime Minister Margaret Thatcher, has suggested that the private banking community participate in a growing secondary market in for-

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sures. Steinberg, *supra* note 230, at 128.

264. *See* Steinberg, *supra* note 230, at 146.

265. *See* Brimelow, *Why the U.S. Shouldn't Fill the IMF's Till*, FORTUNE, Nov. 14, 1983, at 58, 58 (quoting James D. Robinson III, Chairman, American Express).

266. *February 1983 Hearings on the IMF, supra* note 128, at 251 (statement of Chairman Volcker); *id.* at 376 (tabular data of Comptroller Conover).

267. *Id.* at 132 (tabular data of Lionel H. Olmer, Undersecretary for International Trade, Dep't of Commerce), 85 (tabular data of Donald T. Regan, Secretary of the Treasury).

268. A loss of $1 billion in United States exports results in the loss of approximately 24,000 jobs. *Id.* at 37 (statement of Treasury Secretary Regan); *id.* at 83 (tabular data of Treasury Secretary Regan). Multiplying 6.3 times 24,000 yields approximately 150,000.

269. *Id.* at 170, 175 (statements of Richard A. Debs, President, Morgan Stanley International, Inc., on behalf of the U.S. Chamber of Commerce).

270. *See* Brimelow, *supra* note 265, at 59 (comments of Sir Alan Walters, adviser to British Prime Minister Margaret Thatcher); Champion, *Foreign Debts: A Proposal for U.S. Banks*, Wall St. J., Jan. 11, 1983, at 34, col. 3 (George Champion was Chairman of Chase Manhattan Bank from 1961 to 1969).

eign sovereign bank loans.[271] A privately operated secondary market, one of which has been operating in London, provides an outlet for international lenders who have liquidity difficulties or who seek to enhance their loan portfolios.[272] The difficulty, however, is that loans carried at face value on the balance sheets of United States lenders have far less market value due to the constant repayment problems of the sovereign debtors. For example, in late 1983, Latin American loans traded at between seventy-five and eighty-seven percent of face value.[273] This phenomenon epitomizes the practice of United States lenders who keep their portfolio values and earnings levels artificially high by continuing to lend money to struggling debtors in order to sustain a flow of interest payments, and thereby avoid writing off loans as losses.

Walters is not the only advocate of a partial write-down of the foreign sovereign credits.[274] The proponents, however, disagree about the amount of write-down that is required to pull the debtors out of the crisis. The proposed amounts for write-downs vary from twenty-five[275] to fifty percent.[276] The forces of supply and demand determine the appropriate amount by which the risk factor of the individual debtor should be discounted.

To cushion the impact that a write-down will have on a lender's earnings, George Champion, former Chairman of the Chase Manhattan Bank, has argued that the write-down should be grad-

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271. *See* Brimelow, *supra* note 265, at 59.

272. *Id.* at 59-60.

273. *Id.* at 60.

274. *See* Champion, *supra* note 270; *February 1983 Hearings on the IMF, supra* note 128, at 168 (statements of Mr. Champion and Martin P. Mayer, economist).

An almost identical proposal was made by Pedro-Pablo Kuczynski, President, First Boston International. *See* Kuczynski, *Latin American Debt: Act Two*, 62 FOREIGN AFF. 17 (1983). Like the other market resolutions, the Kuczynski proposals avoid the use or creation of international agencies. His nongovernmental response, however, hinges not on a partial write-down of principal, but on temporary interest rate concessions by the lenders. *Id.* at 33-34. Kuczynski would reduce the burden of debt service by reducing interest rates to a level just above the lenders' cost of funds. *Id.* at 34.

275. Brimelow, *supra* note 265, at 60.

276. Champion, *supra* note 270, at 34, col. 6. Other commentators advocate the need for a partial write-down but have not predicted how large a write-down would be required in the typical case. *See, e.g.*, Banks, *supra* note 136, at 57-58 (quoting Paul C. Roberts, former Assistant Secretary of the Treasury in the Reagan Administration); *February 1983 Hearings on the IMF, supra* note 128, at 168-69 (statement of Mr. Mayer).

ual.[277] Again, authorities disagree about the amount of earnings that should be committed to increasing loan loss reserves. Champion advocates the use of up to fifty percent of pretax earnings;[278] other authorities insist on more conservative increases in reserves.[279] The dispute centers upon the value of the underlying credit. In the case of Mexico, a strong argument can be made that the enormous oil assets of the debtor[280] transform the problem into one of illiquidity, not insolvency.[281] The write-downs and increases in loss reserves, therefore, may not need to be as high as the fifty percent of pretax earnings write-down that Champion has proposed.

Martin P. Mayer, a New York economist and author,[282] suggests that the United States Government follow the lead of other governments and abolish existing tax provisions that discourage banks from recording foreign loans on bank balance sheets at realistic values.[283] One European country has used tax benefits successfully. In West Germany, the Government sacrificed tax revenues to increase bank loan loss reserves on foreign sovereign debts.[284] The West German Government has coaxed its banks to write-down LDC credits to approximate economic values by maintaining liberal tax regulations that allow German banks to take large deductions against taxable income for increasing their loan write-downs.[285] United States lenders, however, generally have denied that problems exist with Latin American credits and

277. Champion, *supra* note 270, at 34, col. 6 (write-down should be spread over five years).

278. *Id.*

279. *See, e.g., February 1983 Hearings on the IMF, supra* note 128, at 168 (statement of Mr. Mayer); Brimelow, *supra* note 265, at 60.

280. Reportedly, Mexico has a 72 billion barrel cache of proven oil and gas reserves. Stuart, *Opportunity Knocks*, FORTUNE, Aug. 23, 1983, at 146, 148. *But see Mexico to Lower Oil, Gas Reserve Estimates Soon*, Wall St. J., Oct. 7, 1983, at 3, col. 1 (indicating that the 72 billion barrel estimate could be overstated by at least 17% and perhaps as much as 30%). Mexican officials continue to estimate reserves at 72 billion barrels. *Oil Reserve Estimate Will Not Be Reduced Mexican Aides Say*, Wall St. J., Oct. 12, 1983 at 42, col. 3.

281. Brimelow, *supra* note 265, at 59.

282. Mayer also served in the Kennedy, Johnson, and Reagan administrations. *February 1983 Hearings on the IMF, supra* note 128, at 153-54.

283. *Id.* at 155 (statement of Mr. Mayer); *see id.* at 168-69 (statements of Mr. Mayer and Mr. Champion).

284. Banks, *Judgment? Or only accounting?*, FORBES, May 9, 1983, at 59.

285. *Id.*

have preferred to increase dividends rather than loan loss reserves.[286] Mayer suggests that the Internal Revenue Service should relax its limitations on the amount that a bank can deduct from taxable income when it increases loan loss reserves.[287] The limit currently is 0.6% of loans outstanding.[288] Champion suggests that reserves of between three and five percent of loans outstanding would be more realistic.[289]

Abolishing the tax disincentive to writing down loans would increase domestic lenders' willingness to increase their reserves gradually. This, in turn, would encourage the lenders to sell the written-down loans in the growing secondary markets and would enhance lenders' liquidity, strengthen their portfolios, diversify their debt exposure, and temporarily reduce their earnings.

More important, however, is the effect that the reform would have on the financially troubled debtors. Once a loan has been partially written down the lender or, if the loan is sold in the secondary market, the transferee, can make principal and interest concessions to the debtor and still earn a profit on the asset.[290] Reducing the burden of debt service is crucial to the economic recovery and growth of Mexico and other less developed countries.

There are significant advantages to the market approach described above. First, it could be implemented rapidly because it does not require the consent of foreign governments or the creation of an administrative bureaucracy. All that is required is the relaxation of an Internal Revenue Code provision and the uninhibited operation of the forces of the marketplace. Second, the approach is inexpensive to implement. No government guarantee or subsidy would be necessary, and the United States tax system would be affected only to the extent that larger deductions for bank loan loss reserves reduce taxable revenues. Third, allowing larger deductions for loan loss reserves would be equitable. Debtors with the most serious problems would command the highest discount rates in the secondary markets and would receive the

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286. *Id.*

287. *February 1983 Hearings on the IMF, supra* note 128, at 168-69 (statement of Mr. Mayer).

288. *Id.*; I.R.C. § 585(b)(2) (1982). This limit was reduced gradually from a 1976 high of 1.8% down to the current 0.6%. *Id.*

289. Champion, *supra* note 270, at 34, cols. 6-7.

290. *See* Brimelow, *supra* note 265, at 60; *February 1983 Hearings on the IMF, supra* note 128, at 158 (statement of Mr. Mayer).

largest proportionate reduction of their debt service burden. Fourth, although the reductions in current account deficits caused by principal and interest payment concessions would reduce debtor demand for new capital, a continued flow of credit would remain available to debtors. Last, a crucial advantage of the market approach is that its effectiveness does not depend on a global economic recovery. Reducing Mexico's debt service burden should itself help revive the world economy.

From the bankers' point of view, however, the market resolution is not without its disadvantages. At least one bank executive insists that the foreign sovereign loans should not be written down because the loans eventually will be repaid,[291] and he argues that increased loan loss reserves would cause the foreign sovereign loans to become so unprofitable that commercial banks will refrain from making loans that are vital to United States economic interests.[292] Other critics contend that because United States taxpayers are some of the prime beneficiaries of Mexico's recovery, taxpayers should bear a significant part of the cost of the write-down. Mayer sets forth two reasons why the United States Government should absorb part of the cost: (1) the banks' recycling of capital to Mexico's development program was a function that the government should have performed, but did not; and (2) Mexico's deficit situation was exacerbated by the dollar's appreciation in value, the result of United States domestic policies aimed at curbing inflation.[293] Treasury Secretary Donald T. Regan, however, insists that it was the banks who were "wrong, wrong, wrong" in approving loans to less developed countries on the assumption that the rate of inflation would remain con-

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291. *February 1983 Hearings on the IMF, supra* note 128, at 198 (statement of George J. Clark, Executive Vice President, Citibank).

292. *Id.* at 198-99. Critics of the market approach also cite other factors. In reference to the increased reserves necessary for a write-down, Mr. Champion has said, "It [would] mean cutting down on the published earnings of the banks very materially, and that is what they [bankers] object to. It would mean a lot of those fellows who have been getting big bonuses would be without them." Banks, *supra* note 136, at 58 (quoting Mr. Champion) (alterations in original). George J. Clark suggests yet another consideration encouraging bankers to resist any concessions: "We may still be showing these loans at full value and not writing them off against revenues. But look at our stock prices. Our multiples are at 5 to 6 times earnings. I'm feeling considerable pain through my stock options." *Id.* (quoting Mr. Clark).

293. *February 1983 Hearings on the IMF, supra* note 128, at 166-67.

stant.[294] From either perspective, raising the limit on loss reserve deductions enhances the equity of the free market approach. Increasing deductions would force taxpayers to assume a part of the financial burden associated with a partial write-down—a financial burden which, as Mayer conceded, United States taxpayers rightly should assume. Deciding whether to spread the loss among taxpayers thus turns on whether, in the words of Champion, "management has to be held accountable"[295] for their less than provident investments or whether they may share the misfortune with other taxpayers.

2. *Creditor Liens on a Proportionate Share of Debtor's Exports*

Former investment banker and university professor Norman A. Bailey has suggested that the central banks of the debtor nations replace the existing amortization schedules with newly issued "exchange participation notes" ("EPNs").[296] The new instruments are essentially equity claims on the foreign exchange earnings of the debtor nation. The proposal attempts to preserve the debtor's creditworthiness and the quality of the lender's assets. Bailey suggests that the best way to achieve these goals is to coordinate the debtor's obligation to repay the principal with the debtor's ability to pay. The debtor government would retain the ultimate obligation to pay all external debts in full, but would set up a repayment mechanism using central banks to coordinate the collection and disbursement of the government's export proceeds. Bailey suggests that principal repayment obligations be deferred until austerity programs imposed by the IMF and the debtor or a global economic recovery enhance the debtor's ability to repay. Interest payments on the notes, made with the aid of "official rescue efforts,"[297] would ensure the continued liquidity of the lender. Bailey's proposal allows the debtor to retain a reasonable minimum amount of foreign exchange earnings free of principal re-

294. *The Banks Have Been Wrong, Wrong, Wrong,* FORTUNE, May 2, 1983, at 146.

295. Banks, *supra* note 136, at 60.

296. Bailey, *A Safety Net for Foreign Lending,* BUS. WK., Jan. 10, 1983, at 17. Bailey, a former investment banker and university professor, is senior director of national security planning for the National Security Council. *Id.*

297. *Id.*

payment obligations.[298]

The short-term relaxation of the debt service burden is essential to the recovery of the Mexican economy and the security of international bank exposures in Mexico because it would allow Mexico to redirect a portion of its exchange earnings to domestic investments. This approach will work, however, only if the Mexican economy stabilizes and Mexican foreign exchange earnings accumulate before foreign and multilateral "official rescue efforts" have exhausted their willingness to give or loan Mexico the funds it needs to meet the interest payments due on its debt.[299]

The obvious advantage of this plan is that it does not require any significant sacrifice by any party. The banks continue to receive acceptable returns on their investment, and although they do defer recovery of principal under this approach, the banks do not have to write down the face value of the loan or reduce the interest rate. Mexico, on the other hand, receives a minimum level of crucial foreign exchange. The United States taxpayer is not involved at all. The plan also avoids complicated multilateral agreements between governments because it involves only Mexico and its creditors.

The greatest disadvantage of the plan is that its effectiveness is inextricably tied to the assumption that a world economic recovery will materialize in the near future.[300] Without some measure of economic recovery, Mexico's own foreign exchange earnings will remain insufficient to meet its interest payments, and "official rescue efforts" to help Mexico make interest payments might soon be exhausted. Nor will the EPN approach solve the current illiquidity problem. Another disadvantage of the EPN approach is that it implicitly invites creditors to meddle in the domestic policies of the Mexican Government. If the private bankers have a vested interest in the economic growth of Mexico, they may acquire oversight privileges in the EPN negotiation process sufficient to insist that Mexico maximize its exports rather than divert its resources to the legitimate needs of its citizens.[301] Because the IMF already has difficulty performing its function to super-

298. *Id.*

299. Bailey assumes that the EPN approach will work until economic recovery programs have produced results. *Id.*

300. *See id.*

301. *Cf. Politics of Nations Are Intruding in Arena of International Debt*, Wall St. J., Oct. 7, 1983, at 1, col. 1.

vise the domestic economies of debtor nations,[302] it would be unwise for the parties to increase the importance of domestic supervision by relying on a plan the success of which depends on whether Mexico can achieve some measure of economic recovery.

3. *Insurance of Debtor's Interest Payments by Western Governments*

Lord Harold Lever, former British Labour Government adviser, also proposes to relieve the international banking system's burden of carrying large amounts of non-performing credits while maintaining the flow of a minimum number of credits to debtor countries.[303] At present, each of the major Western governments operates insurance agencies that encourage the exportation of goods by insuring a limited amount of the exports going to a particular country.[304] Lord Lever has suggested that the authority of these export credit agencies be expanded to insure not only exported goods, but also exported capital, thereby providing insured credit for the debtors' trading deficit and the debtors' interest payments on external debt. To synchronize this approach, Lever suggests that the various export credit agencies create a cooperative bureau, which would consult with the IMF and would establish maximum export insurance levels as a percentage of annual current account deficit. A debtor's participation and progress in an IMF austerity program would govern the decision. In addition, the central bureau would monitor the total amount of insured credit extended to each country to ensure that it stays within the established limits, and would notify the individual export credit agencies if a debtor approached its aggregate limit.[305]

If Mexico were funded with insured credit, and could keep its current account deficit within the established limits, the insured credit program would provide a steady minimum flow of funds for the IMF stabilization program and would promote Mexican eco-

302. *Brazil's Congress Defeats Measure to Limit Wages*, Wall St. J., Oct. 20, 1983, at 2, col. 2 (Brazil's refusal to accept IMF-suggested wage increase limitations).

303. Lever, *The International Debt Threat*, ECONOMIST, July 9, 1983, at 14. Lever was a senior adviser as Chancellor of the Duchy of Lancaster to the British Labour Governments of 1974-1979. *Id.*

304. *Id.* at 15-16.

305. *Id.* at 16.

nomic recovery.[306] By increasing future bank credits to Mexico, the program also would increase total international bank exposure in Mexico, but it would also reduce the risk of the exposure in three ways. First, as long as Mexican current account deficits remained reasonable, the banks would be guaranteed receipt of their interest income from the Mexican loans. Thus, all Mexican loans would be fully-performing assets. Second, the aggregate amount of Mexican exposure would be limited to a level deemed reasonable under the IMF stabilization program. Presumably, uninsured credit sources would quickly evaporate, effectively limiting increases in Mexico's indebtedness to reasonable amounts. Third, as the Mexican exposure is rescheduled, the benefit of insured credit might encourage the lenders to grant more long-term financing. By further reducing Mexico's annual debt service burden, the program would free more capital for use in the IMF stabilization program in Mexico.[307]

Lord Lever's insured credit proposal offers three important potential advantages. First, it would improve liquidity in the international banking system without significantly affecting the balance sheets or income statements of the banks. Second, it would foster growth and political stability in Mexico by guaranteeing minimum future funding and insuring of Mexican interest payments. In short, the two major problems of the Mexican crisis would be resolved without any real increased cost to either the debtor or the lenders. Third, the success of this proposal does not depend on growth in the Mexican or world economies. The interest payments and the minimum future funding would continue regardless of the results of the IMF-imposed stabilization program.

There are, however, three disadvantages to the insured credit proposal. First, Western taxpayers bear its entire cost. United States taxpayers, as insurers, may be called upon to pay the interest on the Mexican debt. Second, the proposal is politically unworkable. Congressional authorization would be required to expand the authority of government export credit agencies. In view of Congressional concerns for budgetary restraint, liberal cries of "bank bailout," and conservative cries of "Third World bailout," the program's lopsided allocation of costs to United States taxpayers would be impractical. Even if a compromise were possible,

306. *See id.*
307. *See id.*

delays in Congress and in the export credit agencies of the other countries would limit the available short-term relief. Third, the insured credit program allows the IMF to maintain a central credit agency for determining credit allocation. Under the plan the IMF would establish through the central credit agency a country-by-country apportionment of available credit based on the debtor's adherence to the IMF austerity program.[308] Although banks currently conduct an informal allocation of this type, their allocation decisions are based on economic rather than political factors. Inevitably, the politicization of IMF decisions, apparent already in Brazil's October 1982 refusal to accept wage limitations,[309] would increase.

In sum, the insured credit proposal of Lord Lever would be relatively effective relief in theory for bank illiquidity and Mexican debt burdens. As a practical matter, however, it may be too controversial to attract widespread support. Thus, political unworkability will delay the program's implementation and compromise its efficacy.

4. *Bank Credits Exchanged for World Bank Bonds*

Richard S. Weinert has suggested that the international banking crisis could be solved by expanding the role of the World Bank (the "Bank").[310] The expansion would entail a 700% increase in the capital of the Bank, achieved by gathering unpaid subscriptions from various governments. Using the subscriptions as security, the Bank would issue long-term, low interest bonds in exchange for the foreign loans of private banks.[311] The bonds' interest rates, set annually, would be be below commercial levels and keyed to the quality of debt for which the bonds were swapped. After acquiring the debt, the Bank would set interest

308. *Id.*

309. *See Brazil's Congress Defeats Measure to Limit Wages*, Wall St. J., Oct. 20, 1983, at 2, col. 2. Brazil's liberal opposition party led the forces that defeated the wage limitation law. *Brazil's Hopes for Compromise on Debt Suffer Severe Setback: Opposition Rejects Wage Plan*, Wash. Post, Oct. 18, 1983, at E1, col. 3. The limits were a major point in Brazil's IMF loan agreement. *Id.; see also Politics of Nations Are Intruding in Arena of International Debt*, Wall St. J., Oct. 7, 1983, at 1, col. 1.

310. Weinert, *Banks & Bankruptcy*, FOREIGN POL'Y, Spring 1983, at 138. Weinert is a director of a New York-based investment banking firm that specializes in developing countries. *Id.* at 138.

311. *Id.* at 145. The term of the bonds would be 15-20 years. *Id.* at 146.

rates and repayment periods based on the debtor's ability to pay. If the interest rate paid on the bonds exceeded the rate paid by the debtor, or if, despite the generous reschedulings, a debtor had insufficient funds to pay principal or interest, the Bank would draw upon its reserves and subscribed capital to continue bond payments until the debtor could reconcile its arrears.[312] Weinert's proposal allows the banks to choose the debts of less developed countries that they want to exchange for bonds.[313] To ensure that the banks retain a continuing interest in the debtor country's performance, and thereby reduce protectionist tendencies and encourage a continued flow of trade financing, a bank could not exchange more than eighty percent of its exposure in a given country.[314]

If Weinert's proposal were implemented, debtor relief would be quick and certain. Debtor interest payments would remain at manageable levels, and principal repayment would extend over a long period of time. The taxpayers of the industrialized world would only feel the impact of its guarantee gradually, as unfunded payments on Bank bonds came due. The exchange would improve the quality of private banks' investment portfolios because the bonds are backed by the treasuries of the industrialized world. Like taxpayers, the banks would feel the impact of the exchange gradually through reduced interest receipts. The program would not affect bank balance sheets because the bonds could be carried at their face value.

There are three advantages to the Weinert proposal. First, it would achieve its stated goals of increasing bank liquidity and reducing Mexican debt service. Unlike some of the other proposals, however, it could do this without burdening one party with all of the losses. Furthermore, the shared costs of the international banks, Western taxpayers, and Mexico would be borne gradually, rather than in a lump sum over a short period of time. Second, to the extent that taxpayers are called upon to pay Mexican debts, the Weinert proposal would be effective regardless of Mexican economic growth. Third, by transferring to the taxpayers of the industrialized world a large portion of the risk of Mexican exposures, the Weinert proposal, unlike most of the other proposals,

312. *Id.* The interest rate paid on the bonds would be high enough to ensure the banks that level of income required to remain sound. *Id.*

313. *Id.* at 147.

314. *Id.*

would produce a meaningful diversification of the banks' exposures.

The Weinert proposal, however, is not a panacea. It is unlikely that the private banking system would be willing or able to continue providing the minimum number of new credits necessary to meet Mexican current account deficits. The continued illiquidity of the banking system caused by the low interest rates on the Bank bonds, and the probable hesitancy of bankers to resume their Mexican exposure may leave Mexico unable to budget even the minimum amount of capital necessary for trade financing. The Weinert proposal also faces insurmountable practical obstacles. For instance, who will decide how much World Bank capital should be subscribed by each country? In times of budgetary austerity, how long will it take to acquire a sufficient number of capital subscriptions and what oversight authority might individual subscribers require to ensure that the debtors do not carelessly use the safety net of government capital subscriptions? What if the banks of one country refuse to exchange their high interest loans, preferring to hold them until the concessions granted by bankers who exchanged their debt bring about the eventual return of the debtor's liquidity?

The Weinert proposal is laudable and equitable in its theoretical handling of the Mexican crisis. An equitable result, however, is likely never to be realized because the proposal would be too impractical to implement and operate.

5. *Maintenance of the Status Quo*

The final approach for resolving the Mexican financial crisis is in essence simply a means of weathering the storm. Paradoxically, while many proposals require the United States taxpayer or the United States banks to bear the costs associated with reducing the Mexican debt, the Mexican Government has strongly supported the retention of the existing system.[315] Although there are leftist elements within and without the ruling Partido Revolucionario Institutional that advocate unilateral repudiation of the total external indebtedness, their proposals have been unequivo-

315. Interview with Clemente Ruiz, Professor, Universidad Nacional Autónomo de Mexico, on the occasion of his participation in the *International Conference on Models of Political and Economic Change in Latin America*, at Vanderbilt University, Nashville, Tenn. (Nov. 4, 1983) [hereinafter cited as Ruiz Interview].

cally rejected by the party's leadership.[316] Instead, the Mexican Government and some United States bankers have proposed that the parties continue to reschedule Mexico's debts as they come due, to adhere to the stabilization policies and targets of the IMF-imposed austerity program, and to maintain the minimum flow of credits necessary to fund current account deficits.[317]

Success depends on the continued flow of credits. The projected credit requirement for 1984 is four billion dollars,[318] and the funds will have to come primarily from further commercial bank loans to Mexico.[319]

The maintenance approach also depends on the Mexican Government's adherence to the IMF-imposed austerity program, designed to contract the Mexican economy by slashing the federal budget deficit.[320] In 1982, the deficit reached 17.9% of the gross domestic product.[321] The IMF target for 1983 was 8.5%.[322] Mexico met that target,[323] but its ability to meet future deficit targets turns on factors largely beyond the control of the Mexican Government—oil prices, interest rates, and food production.[324] If the world economy recovers too slowly, reductions in oil prices and increases in interest rates could cause the austerity program to founder. Furthermore, a drought would increase the already large volume of food imports for which Mexico must pay, diverting capital from investment and debt service.[325] Therefore, if global economic recovery is not forthcoming, or if Mexican food production decreases significantly, the ability of the Mexican Government to stifle social unrest might soon be exhausted. Unless the

316. Interview with Kevin Middlebrook, Professor, Indiana University, on the occasion of his participation in the *International Conference on Models of Political and Economic Change in Latin America*, at Vanderbilt University, Nashville, Tenn. (Nov. 4, 1983).

317. Ruiz Interview, *supra* note 315; *February 1983 Hearings on the IMF*, *supra* note 128, at 200, 205, 206, 212 (statement of George J. Clark, Executive Vice President, Citibank).

318. *Mexican Minister Assesses Economy*, Wall St. J., May 23, 1983, at 39, col. 1 (projection of Jesus Silva Herzog, Mexican Minister of Finance).

319. *Id.*

320. N.Y. Times, May 31, 1983, at D9, col. 5.

321. *See supra* note 318; Gall, *Can Mexico Pull Through?*, FORBES, Aug. 15, 1983, at 70, 74.

322. Gall, *supra* note 321, at 74.

323. Fin. Times (London), Jan. 5, 1984, at 4, col. 1; *see also supra* note 318.

324. Fin. Times (London), *supra* note 323.

325. Gall, *supra* note 321, at 73.

Mexican economy rebounds as part of a larger economic recovery, the maintenance approach will be ineffective.

The ability and willingness of commercial bankers to grant longer reschedulings of the Mexican debt underlies the maintenance approach. Paradoxically, it is precisely because of the global dimensions of this crisis that the banks are willing to proceed with rescheduling rather than bear the cost of more austere proposals.[326] The direct relationship between the Mexican economy and United States jobs,[327] the problems associated with the illegal immigration of disgruntled Mexicans into the United States, the banks' central role in the international trading system, and the national security implications of Mexico's political destabilization have led the banks to believe that the United States Treasury would be forced to provide whatever funds are necessary to avert catastrophe.[328] The major banks, therefore, appear undaunted by the prospect of becoming further entrenched in their Mexican exposures.

Unfortunately, the maintenance approach contributes nothing new to resolving the dilemma. The approach relies almost exclusively on the IMF austerity programs to stabilize the situation until the arrival of the allegedly impending world economic recovery. Undisputably, global economic recovery would ensure the Mexican recovery. Unlike some other proposals, however, the status quo approach provides no impetus to spur the global economic recovery upon which it relies so heavily, nor does it suggest an alternative if the world economic recovery is not soon forthcoming.

6. *Summary*

There will be no return to the halcyon days of international bank security and Mexican stability without a sharp turn of events. To restore stability, Mexico, United States taxpayers, and United States banks must balance a number of opposing concerns: theoretical equity and political practicality; the need to relieve Mexico's indebtedness and to maintain a crucial flow of continued credits; the need to preserve Mexican sovereignty and to impose creditor-conceived domestic policy against the wishes of

326. Steinberg, *supra* note 230, at 146.
327. *See supra* note 268 and accompanying text.
328. Steinberg, *supra* note 230, at 146.

the debtor country; the need to allocate the financial burden between the parties directly concerned and society at large; the need to reduce quickly the Mexican debt service burden and to maintain the liquidity of the banking system; and the need to limit the aggregate debt assumed by Mexico and to avoid the danger of creating a politically volatile system of credit allocation. Because of the immense economic and national security implications of a prolonged Mexican crisis, a resolution cannot wait and should not depend upon the fickle pace of the elusive world economic recovery. Maintenance of the status quo will not, therefore, provide a long-term solution, making it incumbent upon the banking community to promptly close ranks behind one or more of these proposals.

III. The Application of United States Securities Law to Mexican Bank Deposits After Wolf v. Banco Nacional de Mexico, S.A., 739 F.2d 1458 (9th Cir. 1984)

A. Facts and Holding

Plaintiff R. J. Wolf, a California resident, brought suit against Banco Nacional de Mexico, S.A. (Banamex)[1] to recover damages for substantial financial losses suffered during the 1982 devaluation of the Mexican peso. Plaintiff alleged that Banamex had violated both United States[2] and California securities laws by selling

1. At the time Wolf made his deposits and subsequently brought suit, Banamex was a private banking institution incorporated and operating in accordance with the laws of Mexico. Brief for Appellant at 4, Wolf v. Banco Nacional de Mexico, 739 F.2d 1458 (9th Cir. 1984). All Mexican banks, including Banamex, were nationalized on or after September 1, 1982. *Id.* at 4 n.8.

2. 739 F.2d at 1459. Specifically, Wolf charged that Banamex violated the Securities Act of 1933 (1933 Act) by selling him unregistered securities. The section reads as follows:

> Any person who . . .
>
> (1) offers or sells a security in violation of section 77e of this title . . . shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 77*l*(1) (1982); *see also* 15 U.S.C. § 77e (prohibiting the sale of unregistered securities). Wolf also charged that by sending him misleading information concerning the securities, Banamex violated § 77q(a)(2) of the 1933 Act, which reads as follows:

> (a) It shall be unlawful for any person . . .

the plaintiff unregistered securities in the form of Mexican time deposit accounts or certificates of deposit.[3] After reading a California newspaper advertisement[4] in which Banamex offered time deposit accounts at an annual interest rate of over thirty percent on peso-denominated accounts,[5] Wolf had requested and received from Banamex additional information regarding these accounts.[6] In three separate transactions, Wolf had sent Banamex's Tijuana branch a total of $60,000 to be converted into pesos and deposited into one six-month and two ninety-day peso-denominated time deposit accounts. Shortly thereafter, Banco de Mexico[7] suddenly discontinued its practice of manipulating the money market

. . . .

> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . .

15 U.S.C. § 77q(a)(2).

3. The accounts were uninsured, nonnegotiable, and not withdrawable. 739 F.2d at 1459.

4. The precise language of the advertisement and the name of the publication in which it appeared are not included in the record. Brief for Appellee at 2.

5. The bank also offered dollar-denominated accounts with an interest rate substantially lower than that on their peso-denominated accounts, but equivalent to the rate offered by United States banks. *Id.* at 2-3.

6. 739 F.2d at 1459. The information consisted of a brochure entitled "Mexico's Other Great Climate . . . Investment," which included the following:

> A bright future is forecast for Mexico and for investors in general. One of the best ways to participate in this prosperity is by investing your money lucratively through Banamex Time Deposits.
>
> High yielding Bank Time Deposits have led the way for many years for foreign investors. Analyze the benefits of Mexican Bank Time Deposits and join many thousands of satisfied investors throughout the world, by investing in Banamex Time Deposits . . .
>
> The Mexican peso, like the U.S. dollar, is a floating currency which means that the rate of exchange between the peso and the currency you request your interests and principal to be paid to you in could vary upwards or downwards between the time you purchase your Time Deposit and maturity. However, since 1977 the Banco de Mexico, Mexico's Central Bank, has maintained a stable peso-dollar parity by intervening in the money market . . .
>
> Since Mexico has absolutely no exchange controls, the Mexican Monetary Authorities are understandably careful of maintaining an advantageous and competitive investment environment and a healthy money market.

Brief for Appellee at 6.

7. Mexico's central bank, Banco de Mexico, is the equivalent of the United States Federal Reserve Bank. 739 F.2d at 1459.

to maintain the value of the peso against the dollar, and the value of the peso plummetted.[8] At maturity, the pesos that Wolf received converted into only $35,536, a fraction of the value of his initial investment.[9] The case before the district court[10] raised an issue of first impression when Banamex moved for summary judgment, asserting that *Marine Bank v. Weaver*[11] was controlling authority[12] and arguing that because the certificates of deposit had been issued by a federally regulated bank, they were not securities within the meaning of the federal securities laws.[13] The district court rejected Banamex's arguments[14] and granted Wolf's cross motion for summary judgment because the certificates of deposit did not fall within one of the six established exceptions to the securities laws.[15] On the second appeal[16] to the Court of Ap-

8. For several years prior to the time plaintiff made his deposits, Banco de Mexico had intervened in the money market in order to maintain the value of the peso against the dollar. The bank discontinued this practice without warning on February 18, 1982. Brief for Appellant at 5, n.17.

9. 739 F.2d at 1459.

10. Wolf v. Banco Nacional de Mexico, 549 F. Supp. 841 (N.D. Cal. 1982).

11. 455 U.S. 551 (1982).

12. 549 F. Supp. at 845.

13. *Id.* at 843, 845.

14. The district court completely rejected the argument that *Weaver* controlled the *Wolf* case. Emphasizing the language in *Weaver* that exempted from application of the federal securities laws all "deposits in federally regulated banks . . . protected by the . . . requirements of the federal banking laws," 455 U.S. at 558, the court deduced that the Supreme Court did not intend this language to apply to foreign banks. 549 F. Supp. at 845. The court also held that *Weaver* had not involved the risks of devaluation and bank insolvency. *Id.* Because the risks were present in the *Wolf* case, plaintiff's certificates were not virtually risk-free, as required by the Supreme Court. *Id.* at 845-46.

15. Having determined that *Weaver* did not control the case, the court systematically evaluated and rejected application of each one of the established tests for determining the scope of the securities laws. *Id.* at 846-50. The court found it instructive that in *Weaver*, the first Supreme Court case to address whether a debt instrument is a security, the Court had not applied the *Howey* test. *Id.* at 846 (referring to the test articulated in SEC v. W.J. Howey Co., 328 U.S. 293 (1946)). The district court concluded that although the *Howey* test essentially eliminates all debt instruments from the scope of the securities laws, application of the test should be limited to equity instruments. 549 F. Supp. at 847. In addition, the court held that the "commercial-investment" test and the "risk-capital" test were equally inapplicable to the instant facts. *Id.* at 847-50. Instead, the district court took a negative approach: it synthesized established judicial exceptions to the application of the securties laws and held that an instrument is a security unless it falls within one of several well-established excep-

peals for the Ninth Circuit, *reversed. Held*: When government regulation of a domestic or foreign bank is so stringent that the holder of a certificate of deposit is virtually guaranteed repayment in full, the certificate is not a security within the meaning of the federal securities laws.

B. Legal Background

A proper understanding of this decision and its implications first requires information on the rules governing foreign exchange, the differences and similarities between United States and Mexican certificates of deposit, and the history of cases construing the definition of a security and addressing whether ordinary United States certificates of deposit constitute securities. It also is important to think of Wolf's transaction in two parts: the purchase of foreign money and the purchase of certificates of deposit.

Although regulation of foreign exchange falls within the power of Congress,[17] Congress has delegated to the Securities Exchange

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tions. *Id.* at 850-53. The test set forth by the district court reads as follows:

> [A] transaction in which one person ("the investor") provides funds to another with the expectation of a financial or economic benefit is a security *unless*:
>
> (a) the benefit derives largely from the managerial efforts of the investor; or
>
> (b) the investor receives something of intrinsic value which he intends to use or consume; or
>
> (c) the provider of funds is in the business of lending funds in such transactions; or
>
> (d) the person to whom the investor provides funds is merely the investor's agent; or
>
> (e) the transaction is virtually risk-free to the investor by reason of governmental regulation.

Id. at 850-52 (footnotes omitted). Having determined that the *Wolf* case could fit into only the final category, the court decided that the risk of devaluation prevented plaintiff's case from falling within the exception. *Id.* at 852-53.

16. On the first appeal, the Ninth Circuit remanded the case on procedural grounds. Wolf v. Banco Nacional de Mexico, 721 F.2d 660 (9th Cir. 1983). The court determined that the lower court had granted only a partial summary judgment because the lower court had entered summary judgment on only one of three claims for relief. *Id.* at 661-62. The partial judgment was not appealable under 28 U.S.C. § 1291. *Id.* at 662. On remand, Banamex petitioned the district court to grant an interlocutory appeal under 28 U.S.C. § 1292(b). The district court granted the motion, and the Ninth Circuit heard the case on the merits. 739 F.2d at 1460.

17. Perry v. United States, 294 U.S. 330 (1935).

Commission (SEC) the responsibility for regulating purchases of foreign currency on the national securities exchanges[18] and to the Commodity Futures Trading Commission (CFTC) responsibility for regulating purchases on a board of trade.[19] Otherwise, transactions in currency are specifically exempted from application of the United States securities laws.[20] It is generally understood that the citizen who exchanges United States dollars for foreign currency bears the risk of devaluation.[21]

The Uniform Commercial Code defines a certificate of deposit as "an acknowledgment by a bank of receipt of money with an engagement to repay it."[22] By purchasing a certificate of deposit, a depositor contracts with the bank to receive on demand or at a specified future date the principal plus monthly interest payments at a rate upon which the parties agree.[23] Even though a certificate of deposit is considered a special kind of deposit, it is governed by the same rules and regulations that apply to ordinary

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18. In 1982 Congress amended the definition of a security in § 77b(1) of the Securities Act to include: "any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency . . . ." 15 U.S.C. § 77b(1) (1982). The purpose for the amendment was to include "options" specifically in the definition of a "security" and to resolve jurisdictional conflicts between the Securities Exchange Commission and the Commodity Futures Trading Commission. H.R. REP. No. 626, 97th Cong., 2d Sess. 2, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 2780, 2780.

19. The Commodity Exchange Act, 7 U.S.C. §§ 1-26 (1982), gives the Commodity Futures Trading Commission the power to regulate the trade of commodities in the form of futures contracts. *Id.* § 2a. Foreign currency is considered a commodity and therefore subject to the Commodity Exchange Act only if it involves "the sale thereof for future delivery conducted on a board of trade." SEN. REP. No. 1131, 93rd Cong., 2d Sess., *reprinted in* 1974 U.S. CODE CONG. & AD. NEWS 5843, 5870.

20. The Securities Exchange Act of 1934 (1934 Act) defines a "security" as follows: "The term 'security' means any note, stock, treasury stock, . . . or in general, any instrument commonly known as a 'security'; . . . but shall not include currency . . . ." 15 U.S.C. § 78c(10) (1982). Even though the language differs slightly from the definition in the 1933 Act, the Supreme Court has ruled that the definitions are virtually identical. Tcherepnin v. Knight, 389 U.S. 332, 335-36 (1967).

21. *See* Brief for Appellant at 10, *Wolf*, 739 F.2d at 1458.

22. U.C.C. § 3-104 (1978).

23. For example, Wolf deposited $60,000, which the bank converted into pesos. The bank promised that three to six months later it would pay him this principal plus a guaranteed return of more than 30%. 739 F.2d at 1459.

bank deposits.[24] Mexican certificates of deposit are essentially equivalent to those in the United States; although deposits in Mexican banks are not insured,[25] the banks are regulated so stringently[26] that none has failed within the last fifty years.[27]

During the last decade, almost every court that has considered whether domestic or foreign certificates of deposit are securities within the meaning of the United States securities laws has begun its analysis by reviewing the purpose of the securities laws and the statutory definition of a security.[28] Congress enacted the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act) to regulate all sales of securities to raise capital for profit-making purposes.[29] Both Acts sought to protect investors from the serious abuses attendant to a largely unregulated securities market.[30] To effect this goal Congress chose a broad definition of the term "security" when drafting the 1933 Act: "The term 'security' means any note, stock, . . . evidence of indebtedness, . . . investment contract, . . . certificate of deposit

24. U.C.C. § 4-102.

25. 549 F. Supp. at 845. The Federal Deposit Insurance Corporation (FDIC) insures United States certificates of deposit up to $100,000 per depositor against the bank's insolvency.

26. 739 F.2d at 1463. Banco de Mexico, the National Banking Commission, and the Ministry of Finance and Public Credit supervise all Mexican banks and enforce the following regulatory procedures: paid-in capital and reserve requirements; regulation of advertising; publication of monthly financial statements; and annual audits of the bank. *Id.* Furthermore, were a bank to fail, all deposits, including certificates of deposits, would be given preferred status over all other obligations. *Id.*

27. *Id.*

28. *See, e.g.*, Marine Bank v. Weaver, 455 U.S. 551 (1982); Meason v. Bank of Miami, 652 F.2d 542 (5th Cir. 1981) (court addressed whether certificates of deposit issued by a bank of the Cayman Islands constituted a security); Bellah v. First Nat'l Bank, 495 F.2d 1109 (5th Cir. 1974) (court addressed whether ordinary certificates of deposit issued for currency were securities); Brockton Sav. Bank v. Peat, Marwick, Mitchell & Co., 577 F. Supp. 1281 (D. Mass. 1983) (even if the funds acquired through the sale of certificates of deposit were put to a risky use, certificates of deposit were not securities).

29. United Housing Found., Inc. v. Forman, 421 U.S. 837, 849 (1975).

30. Although it is well established that the securities laws are remedial in nature and therefore are to be broadly construed, *see, e.g.*, Tcherepnin v. Knight, 389 U.S. 332, 336 (1967), courts also recognize that Congress did not intend the securities laws to be the cure-all for every sort of fraud nor to insulate the investor from every kind of risk. *See, e.g.*, Marine Bank v. Weaver, 455 U.S. 551, 556 (1982); Bellah v. First Nat'l Bank, 495 F.2d 1109, 1114 (5th Cir. 1974).

for a security, . . . or, in general, any interest or instrument commonly known as a 'security' . . . ."[31] Because the definition is so comprehensive, courts have recognized that an instrument may fall within the literal terms of the statute, but still may not be considered a security because it lies outside the spirit and intent of the 1933 Act.[32] Courts have stressed consistently that the economic realities surrounding the instrument, not the literal application of the statutory definition, will determine whether the instrument is a security.[33] As a consequence, the courts have developed their own tests for determining the scope of the term "security." Thus, even though a certificate of deposit falls within the literal terms of the definition as an "evidence of indebtedness," it still may not be considered a security.

In *S.E.C. v. Howey*,[34] the immediate issue before the Supreme Court was the definition of an "investment contract," but the language of the Court's opinion has become the general definition of a security.[35] The Court established the following touchstone to determine the scope of the term "security": A transaction results in the issuance of a security within the meaning of the federal securities laws if it is "an investment of money in a common enterprise with profits to come solely from the efforts of others."[36] Although the *Howey* test may be applied easily to equity instruments, courts have had more difficulty applying it to debt instruments.[37] Consequently, circuit courts struggling to categorize debt

31. 15 U.S.C. § 77b(1) (1982).

32. This general principle of statutory construction was addressed in Church of the Holy Trinity v. United States, 143 U.S. 457, 459 (1892). In United Housing Found., Inc. v. Forman, 421 U.S. 837 (1975), the Supreme Court emphasized the importance of the principle when interpreting the securities laws. *Id.* at 849.

33. *See, e.g.*, International Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 558 (1979); *Forman*, 421 U.S. at 849-52; *Tcherepnin*, 389 U.S. at 336.

34. 328 U.S. 293 (1946).

35. In *Forman* the Court stated: "We perceive no distinction, for present purposes, between an 'investment contract' and an 'instrument commonly known as a security.' " 421 U.S. at 852. Thus, the Court strongly suggested that the *Howey* test, *infra* note 36 and accompanying text, is *the* test for determining whether an instrument is a security.

36. *Howey*, 328 U.S. at 301. The Court continued: "If that test be satisfied, it is immaterial whether the enterprise is speculative or nonspeculative . . . ." *Id.*

37. In *Wolf*, for example, the district court observed that many courts have held debt instruments not to be securities because the return—interest on the principal—is fixed and unrelated to the efforts of others. 549 F. Supp. at 846-47. The court noted that because the fixed return is present in all debt instruments,

instruments have developed two additional tests to assist the analysis: the "commercial-investment" test and the "risk-capital" test. The commercial-investment test requires a court to compare the particular instrument in question to short-term commercial loans or commercial paper, which are not securities, and to stocks, which are securities.[38] If the instrument more closely resembles a short-term commercial loan or commercial paper, it is not a security.[39] If, on the other hand, the instrument more closely resembles stock, the court classifies it as a security.[40] Alternatively, under the risk-capital test developed in the Ninth Circuit, classification as a security turns on whether the lender faces a risk of financial loss that depends on the skill of the borrower.[41] The court of appeals subsequently distilled a six-factor analysis to aid courts in applying its test.[42] The validity of the risk-capital test is

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strict application of the *Howey* test would exclude all debt instruments from application of the securities laws. *Id.* at 847. Noting that neither Congress nor the Supreme Court contemplated such a result, the court decided that the *Howey* test should be limited to equity instruments. *Id.* Similarly, in Meason v. Bank of Miami, 652 F.2d 542 (5th Cir. 1981), the Fifth Circuit chose to apply an "economic realities" approach instead of the *Howey* test to decide whether certificates of deposit should be considered securities. *Id.* at 548. The Second Circuit, in an opinion by Judge Friendly, likewise has rejected the *Howey* test, as well as the other established tests, in assessing the nature of a debt instrument in favor of an approach that applies the Securities Acts more literally. Exchange Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126, 1136-38 (2d Cir. 1976).

38. *See* C.N.S. Enter. v. G. & G. Enter., 508 F.2d 1354, 1359 (7th Cir. 1975).

39. *Id.*

40. *Id.*

41. *See* El Khadem v. Equity Sec. Corp., 494 F.2d 1224 (9th Cir. 1974). In *El Khadem*, the plaintiff followed the advice of her investment counselor and helped to capitalize a business by supplying it with cash, securities, and the use of her credit through an assignable promissory note. *Id.* at 1225-26. In consideration, the plaintiff received tax benefits and investment leverage. *Id.* at 1226. Because the plaintiff faced a risk of loss that was "interwoven" with the success of the company, the court determined that the plan was a security. *Id.* at 1229-30. In applying the risk-capital test, a court essentially replaces the part of the *Howey* test requiring that all profits from the transaction result solely from the efforts of others.

42. The factors are: (1) the length of time the money is at risk (the longer the time period the more likely the instrument will be considered a security); (2) the existence of collateral (the more collateral, the less dependence on the borrower's managerial skills); (3) the form of the obligation; (4) the number of people to whom the obligations were issued (the greater the number of people, the greater chance of classification as a security); (5) the relative amount borrowed compared to the size of the business (the larger the relative amount, the greater

subject to some doubt, however, because the Supreme Court, while never expressly rejecting the risk-capital approach, has declined to follow it.[43]

When applying any test to determine the status of certificates of deposit, the courts uniformly have refused to characterize a certificate of deposit as a security.[44] The courts, however, have recognized that a different characterization would be possible should the issue arise in different, but unspecified circumstances. In *S.E.C. v. Fifth Avenue Coach Lines, Inc.*,[45] one of the earliest cases to consider whether a certificate of deposit should be treated as a security, the District Court for the Southern District of New York noted that a certificate of deposit is essentially equivalent to a time deposit, which is considered cash under most circumstances.[46] The court, therefore, treated a certificate of deposit as a cash item and not as a security.[47] Several years later in *Bellah v. First National Bank*,[48] the Fifth Circuit relied on the approach in *Fifth Avenue* when it held that a certificate of deposit issued solely in exchange for currency was not a security.[49] Two years later in *Burrus, Cootes and Burrus v. MacKethan*,[50] the Fourth Circuit followed *Bellah* and determined that certificates of deposit were not securities,[51] adding the following reasons for its decision. First, the definition of a "security" in the 1933 Act includes a "certificate of deposit for a security."[52] In the view of the court of appeals, the definition implied that a certificate of deposit issued for currency is not a security.[53] Second, using the "commercial-investment" dichotomy the court decided that cer-

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the risk to the lender and the more the obligation looks like a security); (6) whether the contemplated use of the proceeds is an "essential ingredient of enterprise formation" or is merely "to maintain current financial position." Great W. Bank & Trust v. Kotz, 532 F.2d 1252, 1257-58 (9th Cir. 1976).

43. *Forman*, 421 U.S. at 857 n.24.

44. *See, e.g.*, Canadian Imperial Bank of Commerce Trust Co. v. Fingland, 615 F.2d 465 (7th Cir. 1980); Bellah v. First Nat'l Bank, 495 F.2d 1109 (5th Cir. 1974).

45. 289 F. Supp. 3 (S.D.N.Y. 1968).

46. *Id.* at 31.

47. *Id.*

48. 495 F.2d 1109 (5th Cir. 1974).

49. *Id.* at 1114.

50. 537 F.2d 1262 (4th Cir. 1976).

51. *Id.* at 1264-65.

52. 15 U.S.C. § 77b(1) (1982).

53. 537 F.2d at 1265.

tificates of deposit were more comparable to commercial paper than to stock.[54] Third, the court found unpalatable the prospect of imposing securities regulations on the already heavily regulated banking industry.[55] Congress did not intend for these sets of regulations to overlap; the opposite construction would only invite interagency conflict and contravene the generally accepted belief that securities regulations are not designed or intended "to reach instruments evidencing ordinary banking and like accounts."[56]

Courts relying primarily on the *Howey* test have also concluded that an ordinary certificate of deposit is not a security. For example, a Florida district court held that the depositor's receipt of interest at the prevailing rate did not render his transaction a security because this return was not based on the managerial efforts of others.[57] Similarly, the Seventh Circuit flatly rejected the argument that a fixed rate of interest fell within the *Howey* concept of profits[58] because to rule otherwise would obliterate any distinction between commercial and investment transactions.[59] Concerned with maintaining the distinction between banking and securities transactions, the court of appeals observed that federal law prohibits banks from issuing securities.[60] Thus, it concluded that general banking operations, which include the issuance of ordinary certificates of deposit, logically cannot constitute the issuance of securities.[61]

In 1982, the Supreme Court considered whether a certificate of deposit may be considered a security and therefore be subject to regulation by the United States securities laws. In *Marine Bank v. Weaver*,[62] the Court held that a certificate of deposit and a business agreement pledging the certificate to guarantee a loan did not rise to the status of securities.[63] The plaintiffs had purchased a $50,000 certificate of deposit with a six-year maturity date from the defendant, a bank insured and regulated by the

54. *Id.*
55. *Id.*
56. *Id.*
57. Hendrickson v. Buchbinder, 465 F. Supp. 1250, 1252 (S.D. Fla. 1979).
58. Canadian Imperial Bank of Commerce Trust Co. v. Fingland, 615 F.2d 465, 470 (7th Cir. 1980).
59. *Id.*
60. *Id.* at 469.
61. *See id.*
62. 455 U.S. 551 (1982) (reversing 637 F.2d 157 (3d Cir. 1980)).
63. *Id.* at 559-60.

federal government.[64] The plaintiffs alleged that the bank had subsequently persuaded them to pledge the certificate in order to guarantee a $65,000 loan by the bank to a company that the bank knew to be on the verge of financial disaster.[65] In consideration for their pledge, the plaintiffs had contracted with the company to receive fifty percent of the company's profits, plus other consideration.[66] After the company declared bankruptcy four months later, the plaintiffs immediately sued the bank, claiming that it had violated § 10(b) of the 1934 Act and had committed common law fraud by actively seeking investors to guarantee a loan to a company known to be in precarious financial condition.[67] The Third Circuit concluded that the disputed certificate of deposit was analogous to the withdrawable capital shares of a savings and loan association that the Supreme Court had held to be securities in *Tcherepnin v. Knight*.[68] The court of appeals held, therefore, that both the certificate and agreement in *Weaver* were securities.[69] Rejecting the Third Circuit's analogy and reversing the decision, the Supreme Court distinguished the instruments from

64. *Id.* at 552-53.

65. *Id.* at 553. The plaintiffs claimed that the bank completely misrepresented the intended use of the loan. The bank allegedly told the plaintiffs that the loan would be used as working capital. *Id.* Instead, a large percentage of the loan was applied immediately to satisfy a previous loan from the bank and the company's overdrawn account. *Id.* The bank used all but a small amount of the remaining funds to satisfy other creditors and to pay overdue taxes. *Id.*

66. *Id.* The plaintiffs also were to receive $100 per month while they guaranteed the loan and the use of a barn at the discretion of the company's owners. *Id.*

67. *Id.* at 554. Plaintiffs also charged the bank with violations of the Pennsylvania securities laws. *Id.*

68. 389 U.S. 332 (1967). In *Tcherepnin*, co-defendant City Savings allegedly mailed to potential investors advertisements representing the organization as a "financially strong institution." *Id.* at 334. The solicitations, however, did not disclose several major problems: an individual who had been convicted of mail fraud in connection with savings and loan associations controlled the organization; the organization's risky financial policies had resulted in its being denied federal insurance; and the institution had found it necessary to limit withdrawals by owners of withdrawable capital shares. *Id.* at 334. The shares did not pay a fixed rate of interest, but a dividend based on the profit of City Savings. *Id.* at 338-39. Having determined that the withdrawable capital shares met the *Howey* test, *id.* at 339, and that the investors needed the protection of the securities laws, *id.* at 345-46, the Court held that the withdrawable capital shares were securities. *Id.* at 346.

69. 637 F.2d at 164-65; *see* 455 U.S. at 557.

those in *Tcherepnin* on two grounds. First, the withdrawable capital shares at issue in *Tcherepnin* had paid dividends, not a fixed rate of interest.[70] Second, the purchasers in *Tcherepnin* had enjoyed voting rights associated with their shares.[71] In *Weaver*, the Supreme Court ignored the *Howey* test, the risk capital test, and the commercial-investment test. Instead, the Court established two new controlling considerations: (1) the level of risk associated with the investment and (2) the degree to which the depositor already was protected by federal regulations other than the securities laws.[72] Enumerating the various banking regulations and emphasizing that the Federal Depositors Insurance Corporation (FDIC) rarely failed to reimburse depositors for lost investments—even above the amount insured[73]—the Court concluded: "It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws."[74]

The Court's emphasis on preexisting federal regulation to determine an instrument's status as a security initially surfaced almost as an afterthought in its earlier decision, *International Brotherhood of Teamsters v. Daniel*.[75] In *Daniel*, the Court found that a noncontributory, compulsory pension plan did not constitute a security for purposes of the federal securities laws.[76] Applying the *Howey* test strictly, the Court had held that the employer's payment to the fund did not constitute an "investment of money"[77] and that the earnings on the fund's assets did not

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70. 455 U.S. at 557.

71. *Id.*

72. *Id.* at 558-59.

73. In the Court's view the following measures adequately protected holders of certificates of deposit and rendered further regulation useless: the reserve, reporting, and inspection requirements of the federal banking laws; rules concerning the advertisement of interest paid on accounts; and insurance on deposits by the FDIC, which generally had paid depositors in failing banks the entire amount of sums deposited—even above the insured amount. *Id.*

74. *Id.* at 559.

75. 439 U.S. 551 (1979). The Fourth Circuit also had expressed concern with preexisting federal banking regulation when it held in *Burrus* that a certificate of deposit issued by a savings and loan corporation did not constitute a security. 537 F.2d at 1265; *see supra* notes 50-56 and accompanying text.

76. *Id.* at 570.

77. *Id.* at 559-61. The plaintiff argued that an employee invested money within the meaning of *Howey* by working and thereby triggering the employer's

amount to "profits" resulting "solely from the efforts of others."[78] As further evidence that the pension plan should not be considered a security, the Court reasoned that it was unnecessary to extend the securities laws to cover pension plans because Congress already had enacted the Employee Retirement Income Security Act (ERISA) to regulate these funds.[79]

> The existence of this comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. . . . Whatever benefits employees might derive from the effect of the Securities Acts are now provided in more definite form through ERISA.[80]

In *Weaver*, therefore, the Court elevated *Daniel's* concern for alternate regulation from secondary significance, making it the primary reason for excluding certificates of deposit from the scope of the securities laws. The Court, however, failed to address whether the *Weaver* rule applies to foreign as well as domestic banks and to clarify the precise relationship between the requirements that an instrument be federally regulated and risk-free.

C. Instant Opinion

The instant court reversed the district court opinion by holding that *Weaver* extended to the facts presently before them.[81] It re-

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contribution to the pension fund. *Id.* at 559.

78. *Id.* at 561-62. Because employer's contributions made up the vast majority of the fund, the Court dismissed the argument that earnings on the assets of the fund amounted to "profits" derived from the efforts of others. *Id.* at 562. Observing the "economic realities" of the fund, the Court noted that an employee works in return for a compensation package that bears little if any resemblance to what is commonly considered a security. *Id.*

79. *Id.* at 569-70.

80. *Id.*

81. 739 F.2d 1458, 1462-63. In addition to deciding whether *Weaver* controlled *Wolf*, the court addressed two other arguments. First, Banamex asserted a defense of sovereign immunity based on Mexico's recent nationalization of all banks. 739 F.2d at 1460. Banamex presented the defense in a motion to stay proceedings to enforce the summary judgment of the district court. *Id.* When the court of appeals remanded the case, the district court first considered the defense and denied the motion to stay. *Id.* It determined that selling certificates of deposit fell within the "commercial activity" exception to the Foreign Sovereign Immunities Act, 28 U.S.C. § 1605(a)(2) (1982). *Id.* The court of appeals agreed with this conclusion. *Id.* Second, each party argued that the 1982 amendments to the Security Acts, changing the definition of a security, supported a

jected the district court's holding that the alternate federal regulations referred to in *Weaver* must be limited to United States regulations.[82] According to the Ninth Circuit, the issuing bank's status as a foreign bank is irrelevant if the bank's own government adequately regulates its operations.[83] Rejecting the lower court's conclusion that the risk of devaluation in *Wolf* rendered *Weaver* inapplicable, the court of appeals observed that the risk of devaluation occurs anytime one purchases a certificate of deposit with foreign currency.[84] For example, the court noted that if a resident of Germany in 1970 had purchased from Marine Bank a dollar-denominated account with deutsche marks, that person would have suffered from the devaluation of the United States dollar in 1971 and in 1973.[85] Because neither FDIC insurance nor federal regulations would have prevented this loss, the court reasoned that the status of an instrument as a security should not "turn on the currency with which it is purchased or in which it is payable."[86] Proof of adequate regulation, in the view of the Ninth Circuit, would be an affirmative defense for banks defending securities claims based on the sale of certificates of deposit for cash.[87] Because the parties had conceded that the Mexican Gov-

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decision in their favor. *Id.* at 1462-63. The relevant part of the amendments reads as follows: "[a "security" means . . .] any put, call, straddle, option, or privilege on any security, certificate of deposit or group or index of securities . . . ." 15 U.S.C. § 77b(1), 78c(a)(10) (1982). The House Report on the amendment had noted the Supreme Court's holding in *Weaver* that "under the circumstances of the case, a certificate of deposit issued by a bank subject to regulation by a domestic bank regulatory agency is not a security." H.R. REP. No. 626, 97th Cong., 2d Sess. 10, *reprinted in* 1982 U.S. CODE CONG. & AD. NEWS 2780, 2788. Wolf argued that this language indicated congressional intent to permit certificates of deposit issued by foreign banks to be classified as securities. *Id.* at 1462-63. Banamex argued that Congress simply codified the holding in *Weaver* and juxtaposed the terms "security" and "certificate of deposit" to distinguish them. *Id.* at 1463. The court quickly dismissed both arguments stating: "We see little in the amendments or their legislative history to guide us in determining the outcome in the context before us." *Id.*

82. *Id.* at 1462.

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.* at 1463. The court made federal regulation an affirmative defense because the foreign bank would have better access to proof of regulation. *Id.* Thus, the foreign bank is responsible for offering evidence to the trial court demonstrating the degree to which the federal regulations protect the depositor against

ernment regulates all of its banks and that a depositor assumes virtually no risk of insolvency, the court of appeals ruled that the depositors of Banamex were indistinguishable from the depositors of Marine Bank in *Weaver* and held that the Banamex certificates of deposit were not securities.[88]

D. Comment

The instant case is the first to apply *Weaver* to certificates of deposit denominated in a foreign currency and issued by a foreign bank. The Ninth Circuit's decision to overrule the district court by excluding foreign instruments from the scope of the United State securities laws confirms the distinctions between banking and the sale of securities that Congress has endeavored to maintain.[89] As the court in *Fifth Avenue* emphasized, certificates of deposit essentially are the equivalent of time deposits.[90] Time deposits differ from passbook savings accounts only to the extent that a time deposit endures for a specified period of time.[91] The certificates at issue in *Wolf* were nonwithdrawable until the agreed date of maturity,[92] but this fact seemed of little consequence to the district court,[93] which had emphasized that the risk of devaluation is borne equally by the depositor of a certificate of deposit account and the depositor of a passbook savings account.[94] As a consequence, the bank servicing the accounts logically would be subject to United States securities laws for both accounts. The district court's holding would erode significantly the distinctions between ordinary banking transactions and the sale of securities.

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insolvency. *Id.* If the trial court deems the regulatory structure adequate, then a certificate of deposit issued in an ordinary banking transaction will not be considered a security. *Id.*

88. *Id.* at 1463-64.

89. *See supra* notes 53-56, 58-59 and accompanying text.

90. *Fifth Avenue,* 289 F. Supp. at 31; *see also supra* notes 45-47 and accompanying text.

91. *See, e.g., Burrus,* 537 F.2d at 1263-64 (discussing the similarities between a certificate of deposit, a certificate of investment, a passbook savings account, and a Christmas Club account).

92. *See supra* note 3.

93. The district court had simply mentioned that the money could not be withdrawn, 549 F. Supp. at 842, but this fact was not brought out as part of the analysis.

94. *See* 549 F. Supp. at 845, 853.

Although the Ninth Circuit's result is laudable, the opinion leaves several questions unanswered. First, it remains unclear what degree and character of regulation will suffice to insulate foreign certificates of deposit from application of United States securities laws. The court had little difficulty determining that Mexican banks meet the test because banking regulations in Mexico fairly approximate those in the United States.[95] Unfortunately for banks in countries where the regulatory framework is not the near equivalent of that in the United States, *Wolf* offers little guidance to determine whether they are safe from application of the United States securities laws. Although the Ninth Circuit sets out the procedural steps for establishing in court whether a government regulates its banks sufficiently, it remains silent concerning the extent and form of regulation that a trial court might find acceptable. The lack of direction for assessing the status of foreign banks and their operations is particularly distressing in light of the potentially large number of United States citizens patronizing foreign banks, and the tremendous potential for liability under the United States securities laws.[96]

Second, some confusion persists regarding both the precise role of alternate federal regulation in determining whether an instrument is a security, and the precise relationship between the theories of risk and alternate regulation in *Weaver*.[97] The language in *Daniel* concerning alternate regulation is scarcely sufficient to use as precedent for a holding based exclusively on the theory that extensive alternate federal regulation renders application of the securities laws inappropriate.[98] The Supreme Court in *Weaver* and the Ninth Circuit in *Wolf* refrained from indicating that al-

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95. *See supra* note 88 and accompanying text.

96. The Securities Act of 1933 provides that anyone who offers or sells securities in violation of the securities laws:

> shall be liable to the person purchasing such a security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 77*l* (1982). Had the plaintiff prevailed, Banamex presumably would have been liable for the difference between what the plaintiff paid in dollars and what he received in dollars. Thus, Banamex would have become a guarantor to all its United States customers for fluctuations in the exchange rate.

97. *See Weaver*, 455 U.S. at 557-58.

98. *See supra* notes 79-80 and accompanying text.

ternate federal regulation alone could effectively preempt application of the securities laws. Both courts emphasized that the alternate federal regulation must also protect investors from any appreciable risk of loss,[99] but after these decisions it remains unclear whether a court should categorize as a security an instrument that is less than risk-free but subject to alternate federal regulation.

Last, the Ninth Circuit made no attempt to clarify the status of the *Howey* test as applied to debt instruments. The usefulness of the *Howey* test in evaluating debt instruments was opened to question when the Supreme Court did not mention, much less apply, the test in *Marine Bank*. In *Wolf*, the court of appeals left uncontradicted the lower court's statement that the *Howey* test is limited to equity instruments.[100] It appears, therefore, that presently the *Howey* test will be limited to equity instruments and that the courts will develop new tests or rules for debt instruments as issues concerning them arise.

Even though the *Wolf* opinion left several important issues unanswered, the court of appeals firmly established that the currency in which a bank performs an ordinary banking transaction cannot be the basis to apply United States securities laws.[101] The significant risk of loss that accompanies many exchanges in foreign currency cannot alone render *Weaver* inapplicable, nor convert into securities ordinary certificate of deposits issued for cash by well-regulated banks.[102] As several courts previously have emphasized, the securities laws were not meant to protect investors from every variety of fraud or from every form of risk.[103] When the risk of financial loss stems directly from the devaluation of a foreign currency, a matter wholly separate from the purchase of certificates of deposit, that risk of loss properly rests with the purchaser of the foreign currency, not with the bank that makes the exchange or the sale of the certificates of deposit.

99. *See supra* notes 72, 88 and accompanying text.
100. *See* 549 F. Supp. at 847.
101. 739 F.2d at 1462.
102. *See supra* notes 85-87 and accompanying text.
103. *See supra* note 30.

IV. Immigration Issues After the Crisis

A. Introduction

Mexico's economic crisis has exacerbated the immigration problem along the southwestern border of the United States. For the migrant worker, Mexico's economic problems and the subsequent devaluations of the peso have increased the temptation to work in the United States.[1] In the early part of 1982, salaries in the United States averaged ten times more than those in Mexico; after the economic crisis and devaluation of the peso, the disparity increased by another fifty percent.[2] As a result, the number of unauthorized immigrants has reached an unprecedented level. In some areas along the Texas border, the increase in the number of immigration apprehensions in 1982 ranged between fifty-six and eighty-six percent above 1981 figures.[3] In 1983, the number of apprehensions increased an additional fifty percent over the 1982 figures.[4] The surge of illegal immigration has also increased drastically the pressure on United States border patrol officials.[5]

Besides creating problems for border officials, the immigration crisis troubles United States legislators and policymakers. According to Attorney General William French Smith, "[s]imply put, we have lost control of our borders. . . . [W]e need new immigration laws—and we need them now."[6] Proposed responses to the United States immigration problems have included temporary

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1. Schmitt, *Desperate Journey: Hard Times at Home Cause More Mexicans to Enter U.S. Illegally*, Wall St. J., Nov. 17, 1982, at 1, col. 1; *see also* King, *Mexico Money Crisis Impels New Surge of Aliens to Texas*, N.Y. Times, Mar. 19, 1983, at 1, col. 2.

2. Schmitt, *supra* note 1, at 20, col. 2; *see also* Teitelbaum, *Peso Refugees*, N.Y. Times, Sept. 28, 1982, at 23, col. 1.

3. Schmitt, *supra* note 1, at 1, col. 1.

4. King, *supra* note 1 at 1, col. 2.

5. Strout, *How Mexican Economic Crisis Affects U.S. Immigration Issue*, Christian Sci. Monitor, Aug. 24, 1982, at 1, col. 1. In response to the influx of immigrants, the chief border patrol agent in Del Rio, Texas exclaimed, "I've been through every peso devaluation for the past 29 years . . . . There's always been a ripple effect. But this time is the worst." Schmitt, *supra* note 1, at 1, col. 1.

6. *Immigration Reform and Control Act of 1983: Hearings on H.R. 1510 Before the Subcomm. on Immigration, Refugees and International Law of the House Comm. on the Judiciary*, 98th Cong., 1st Sess. 151 (1983) (statement of William French Smith, United States Attorney General) [hereinafter cited as *Hearings—1983 Bill*].

worker programs,[7] amnesty proposals,[8] more frequent border patrols,[9] national identification cards,[10] enlarged immigration quotas,[11] employer sanctions,[12] and many other proposals. The most significant proposal is the Immigration Reform and Control Act of 1983 (the "Bill"), commonly known as the Simpson-Mazzoli Bill.[13] This section will focus on legal responses to the immigration problem, with particular emphasis on the provisions of the Simpson-Mazzoli Bill of greatest interest to private business: the employer sanctions provision,[14] the amended H-2 Visa program, a streamlined temporary worker program,[15] and the House bill's H-2(P) foreign guestworker program.[16] Because any future legislation to reform immigration law is likely to include provisions from each of the House, Senate, and conference proposals, an employer of Mexican nationals should acquire an understanding of the Simpson-Mazzoli Bill as an ordinary part of doing business.

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7. *See infra* notes 160-93 and accompanying text.

8. *See infra* note 60 and accompanying text.

9. As an alternative to H.R. 1510, *infra* note 13, Hispanic leaders recommended that the United States increase the resources of the Immigration and Naturalization Service (INS) and the border patrol. *See infra* note 79.

10. *See infra* notes 112-13 and accompanying text.

11. *See infra* note 55 and accompanying text.

12. *See, e.g., infra* notes 83-96 and accompanying text.

13. S. 529, 98th Cong., 2d Sess., 130 CONG. REC. H6166 (1984) [hereinafter cited as H.R. 1510]; S. 529, 98th Cong., 1st Sess., 129 CONG. REC. S6970 (1983) [hereinafter cited as S. 529]. The Senate has passed its version of the Bill. After initially blocking the House version from reaching the floor, Speaker of the House Thomas P. O'Neill announced that the House would reconsider the Bill in 1984. Cohodas, *House Action Likely in 1984: Hispanics Seeking Alternative Immigration Reform Measure*, 41 CONG. Q. WEEKLY 2806 (1983); *see also Psst! About That Immigration Bill. . . ,* N.Y. Times, Jan. 20, 1984, at 26, col. 1 (editorial) [hereinafter cited as *Editorial*]; *infra* notes 77-79 and accompanying text. On June 20, 1984, the House passed H.R. 1510 by a margin of only five votes. Cohodas, *House Passes Immigration Bill by Five Votes*, 42 CONG. Q. WEEKLY REP. 1493 (1984). The House of Representatives renamed its bill, formerly H.R. 1510, using the Senate's number S. 529 as a courtesy to the Senate, which gave it the initiative in seeking conferees to consider the Bill in conference. *House Barely Enacts Its Version of Simpson-Mazzoli Bill*, 61 INTERP. REL. 487 (1984).

14. *See infra* text accompanying notes 83-154.

15. *See infra* text accompanying notes 194-238.

16. *See infra* text accompanying notes 239-50.

B. The Illegal Immigration Problem: Its Scope and Effects

According to most estimates, between three and six million "illegal aliens"[17] are currently in the United States,[18] and between one and one and one-half million aliens are expelled annually.[19] Ninety-three percent of the illegal aliens are Mexicans.[20] Studies of illegal Mexican immigrants indicate that the typical entrant is married,[21] from a rural area,[22] enters the United States two or three times in his life, stays about six months each time,[23] and

17. The term "illegal aliens" includes: (1) individuals who enter the United States without undergoing any kind of control; (2) persons who illegally extend their legally allotted period of stay; (3) individuals who work without authorization during their stay; or (4) persons who have been authorized to work, but who work beyond their allotted period or take unauthorized work. *The Knowing Employment of Illegal Immigrants: Hearings on Employer Sanctions Before the Subcomm. on Immigration and Refugee Policy of the Senate Comm. on the Judiciary*, 97th Cong., 1st Sess. 204 (1981) (prepared statement of Mark Miller, Professor, University of Delaware) [hereinafter cited as *The Knowing Employment of Illegal Immigrants*].

18. The INS estimates that between four and twelve million illegal aliens are within the United States borders. These figures, however, are probably inflated. *See* Greenwood, *The Economic Consequences of Immigration for the United States: A Survey of the Findings*, in INTERAGENCY TASK FORCE ON IMMIGRATION POLICY: STAFF REPORT COMPANION PAPERS, 1, 5 (1979); *see also* Corwin, *¿Quien Sabe? Mexican Migration Statistics*, in IMMIGRANTS—AND IMMIGRANTS: PERSPECTIVES ON MEXICAN LABOR MIGRATION TO THE UNITED STATES, 108, 129 (A. Corwin ed. 1978) (estimating the total number of illegal aliens to be between 5,451,600 and 5,989,900 in early 1976) [hereinafter cited as IMMIGRANTS—AND IMMIGRANTS].

19. Dep't of Justice Release, *U.S. Immigration and Refugee Policy* (July 30, 1981), *reprinted in Reagan Administration Unveils Its Immigration Proposals*, 58 INTERPRETER RELEASES [INTERP. REL.] 379, 386 app. I (1981) [hereinafter cited as Dep't of Justice Release].

20. Stelzner, *Precis of Wayne Cornelius's "Mexican Migration to the United States—Causes, Consequences, and United States Responses,"* in THE PROBLEM OF THE UNDOCUMENTED WORKER 15, 15 (R. Landmann ed. n.d.). In absolute terms, the number of Mexicans apprehended for illegal entry range from 348,178 in 1971 to 954,778 in 1977. Corwin & McCain, *Wetbackism Since 1964: A Catalogue of Factors*, in IMMIGRANTS—AND IMMIGRANTS, *supra* note 18, at 67, 93.

21. Almost 54% of Mexican illegal immigrants are married, but less than 1% take their spouses or children with them into the United States. Stelzner, *supra* note 20, at 15.

22. *Id.*

23. The average total amount of time an illegal alien spends in the United States is 13 months. *Id.* at 16.

generally takes low-wage, low-skill jobs[24] as a farm or manual worker.[25] Unanticipated Mexican immigrants, aptly described as "economic refugees,"[26] usually reside in the border areas of the United States and the large interior urban areas.[27] One study reported that most illegal aliens who are apprehended work in businesses employing fewer than six illegal coworkers.[28]

Immigration from Mexico to the United States is the natural consequence of "push" and "pull" forces. Several social and economic problems constitute Mexico's "push" forces: (1) a burgeoning population, (2) pervasive poverty, and (3) high unemployment.[29] The United States "pull" factors include: (1)

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24. Tienda, *Socioeconomic and Labor Force Characteristics of U.S. Immigrants: Issues and Approaches*, in U.S. IMMIGRATION AND REFUGEE POLICY 211, 217 (M. Kritz ed. 1983); *see also* Wachter, *The Labor Market and Immigration: The Outlook for the 1980's*, in INTERAGENCY TASK FORCE ON IMMIGRATION POLICY: STAFF REPORT COMPANION PAPERS 163, 209 (1979) (only 30% of immigrant workers earn wages above the minimum wage). *But see Temporary Workers: Hearings on a New Temporary Worker Program With Mexico Before the Subcomm. on Immigration and Refugee Policy of the Senate Comm. on the Judiciary*, 97th Cong., 1st Sess. 17 (1981) (statement of Alan C. Nelson, Deputy Commissioner, INS) (estimating that 60% of illegal aliens are paid at rates above the minimum wage) [hereinafter cited as *Hearings—Temporary Workers*].

25. In 1975, 15.6% of the apprehended aliens worked as farmers or farmworkers, 17.5% as service workers, and 60% as manual workers. M. PIORE, BIRDS OF PASSAGE: MIGRANT LABOR AND INDUSTRIAL SOCIETIES, 22 (1979).

26. Stelzner, *supra* note 20, at 16.

27. The ten cities affected most by immigration are: New York, Los Angeles, Chicago, Miami, San Francisco, Honolulu, Houston, Newark, El Paso, and Philadelphia. Greenwood, *Regional Economic Aspects of Immigrant Location Patterns in the United States*, in U.S. IMMIGRATION AND REFUGEE POLICY 233, 242-43 (M. Kritz ed. 1983).

28. P. MARTIN, GUESTWORKER PROGRAMS: LESSONS FROM EUROPE 39 (Bureau of Int'l Labor Affairs Monograph No. 5, 1980). According to Martin, "most apprehended aliens are concentrated in the smallest of the low-wage firms." *Id.*

29. Mexico's population is growing so rapidly that if fertility rates remain unchanged, its population will double in 28 years. Moreover, its citizens are very poor when compared to citizens of the United States. Mexican citizens have a per capita income of only $1,290 (measured in 1978 United States dollars). *Final Report of the Select Commission on Immigration and Refugee Policy: Joint Hearings on the Final Report of the Select Commission on Immigration and Refugee Policy Before the Subcomm. on Immigration and Refugee Policy of the Senate Comm. on the Judiciary and Subcomm. on Immigration, Refugees and International Law of the House Comm. on the Judiciary*, 97th Cong., 1st Sess. 382, 405 (1981) (prepared statement of Robert Taft, Jr., Population Crisis Commission) [hereinafter cited as *Hearings—Final Report*]; *see also* Briggs, *The Impact of the Undocumented Worker on the Labor Market*, in THE PROBLEM OF

relatively higher wages in the United States,[30] (2) a broader range of available jobs,[31] (3) explicit and implicit encouragement by the United States Government and businesses,[32] and (4) services provided by United States agencies to undocumented residents.[33] Since the late 1960s, however, the "push" factors have become the dominant force behind illegal Mexican immigration.[34]

The effects from the present flood of illegal immigrants are widespread, but difficult to quantify. Illegal immigration increases the population of the United States,[35] straining its natural resources. Although some citizens complain that illegal aliens drain funds from United States social spending programs, evidence indicates that, on balance, illegal aliens make a net contribution to those programs.[36] The possible effect of the illegal aliens on the

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THE UNDOCUMENTED WORKER 31, 32-33 (R. Landmann ed. n.d.).

30. Briggs, *supra* note 29, at 33.

31. *Id.*

32. Stelzner, *supra* note 20, at 16.

33. *Id.*

34. *Id. But cf.* Corwin & Cordoso, *Vamos Al Norte: Causes of Mass Mexican Migration to the United States*, in IMMIGRANTS—AND IMMIGRANTS, *supra* note 18, at 38, 59 (stating that it would be misleading to attribute the present Mexican migration solely to poverty).

35. Bouvier, *U.S. Immigration: Effects on Population Growth and Structure*, in U.S. IMMIGRATION AND REFUGEE POLICY 193, 200 (M. Kritz ed. 1983) (stating that at current fertility rates, net migration of 500,000 per year will represent 26% of this country's population growth in the 1980-1990 decade, 50% by the turn of the century, and 100% by 2020-2030); *see also Hearings—Final Report*, *supra* note 29, at 350-51 (statement of Phyllis Eisen, Public Affairs Director, Zero Population Growth, Inc.) (stating that if 1,000,000 immigrants, legal or illegal, enter the United States per year, then immigration is contributing at least 40% to 50% of the population increase of the United States).

36. In one survey of illegal aliens in San Diego County, 81% contributed some state and federal taxes. Other studies revealed that 74.4% of the illegal migrants questioned paid federal income tax and 66.7% paid social security tax. Villalpando, *Facts and Myths About the Illegal Migrant*, in THE PROBLEM OF THE UNDOCUMENTED WORKER 45, 46 (R. Landmann ed. n.d.). In San Diego, illegal immigrants contributed $83,100,000 in taxes, but only cost the municipality $4,200,000 to $6,000,000 in social services. *Id.* at 46-48. A study of illegal aliens in Los Angeles revealed that only 3.5% to 4.2% sought welfare (the national average is approximately 7%), and none of the subjects sought social security benefits. Overall, the illegal aliens were below the average use of income transfer programs. North, *Impact of Legal, Illegal, and Refugee Migrations on U.S. Social Service Programs*, in U.S. IMMIGRATION AND REFUGEE POLICY 269, 277-81 (M. Kritz ed. 1983). North attributed the illegal aliens' below average use of income transfer programs to the aliens' demographic characteristics (male,

labor market has engendered heated debate. Two hypotheses, the segmentation and the replacement hypotheses, attempt to characterize the impact of illegal aliens on the labor market. The segmentation theory posits that illegal entrants take jobs which domestic workers are unwilling to take; the replacement theory assumes that illegal aliens displace domestic workers.[37] Although experts disagree over the effect illegal aliens have on the entire United States labor market, they do reach several common conclusions. First, highly skilled domestic workers suffer very little from the entry of illegal aliens into the domestic labor market.[38] Second, low-skilled, low-wage domestic workers suffer a reduction in wages and job opportunities, with young minority workers suffering the most.[39] Third, the effects are most pronounced in large urban centers and the border regions where the greatest number of illegal alien workers reside.[40] Fourth, domestic entrepreneurs and undocumented workers benefit symbiotically from the presence of unauthorized foreign laborers in the United States.[41] Fifth, the added workers increase total gross national product.[42] Sixth, because labor costs are lower, domestic consumers enjoy a decrease in prices.[43] Last, although a shortage of unskilled male workers has been forecast for the United States within the next

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young, and working), and to California's bars to illegal aliens' acceptance of these services. *Id.* at 280.

37. Greenwood, *supra* note 18, at 49-50.

38. *Id.* at 60.

39. Briggs, *supra* note 29, at 34; Wachter, *supra* note 24, at 208, 217; *see* Johnson, *The Labor Market Effects of Immigration into the United States: A Summary of the Conceptual Issues*, in INTERAGENCY TASK FORCE ON IMMIGRATION POLICY: STAFF REPORT COMPANION PAPERS 109, 113 (1979). Although Johnson recognized the effects upon low-skilled domestic workers and minority youth, *see id.* at 127, he qualified his statements by noting that the effects probably are not serious except during recessionary periods. He argues that because demand for the jobs that immigrants are most likely to perform does not decline during recessionary periods, the negative effects that immigration has on the low-skilled domestic work force are exaggerated. *Id.* at 119.

40. *See* Greenwood, *supra* note 18, at 66-67; *see also* Killingsworth, *Effects of Immigration into the United States on the U.S. Labor Market: Analytical and Policy Issues,* in U.S. IMMIGRATION AND REFUGEE POLICY 249, 255 (M. Kritz ed. 1983).

41. *See* Wachter, *supra* note 24, at 166.

42. Johnson, *supra* note 39, at 132.

43. Greenwood, *supra* note 18, at 42. Greenwood states no conclusion regarding the effects of illegal immigration on consumers of public goods. *Id.* at 99.

few decades,[44] the evidence suggests that the displacement theory more accurately depicts the effect of illegal aliens upon the current labor market.[45] The ebb and flow of the United States economy, however, remains the salient determinant of the aliens' impact on the United States labor market.[46]

The economic crisis in Mexico and the resulting wave of illegal immigrants have led many commentators to conclude that some legislative measures are necessary.[47] Government officials fear the harm a massive influx of illegal aliens would have on government transfer programs, state facilities and budgets, and the potential exploitation of the aliens themselves.[48] Labor organizations, such as the AFL-CIO, are concerned that the flood of illegal aliens "endangers the jobs and the labor standards of U.S. workers."[49] Organizations for minority groups, including the NAACP, also worry that more illegal aliens would increase minority unemployment rates.[50] The Simpson-Mazzoli Bill[51] was Congress' principal legislative response to the burdens created by the recent surge of unauthorized immigrants.

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44. Between 1985 and 1990 there will be a growing gap between the supply and the demand for unskilled male workers. Wachter, *supra* note 24, at 194. Specifically, the United States may suffer from a shortage of male craft, nonfarm laborers, and service workers, *see id.* at 190, especially those workers under 24 years of age, *see id.* at 178.

45. Actually, low-skill domestic workers would be unaffected by illegal immigration only if the market demand for their labor services were perfectly elastic, i.e., if the demand increased to meet exactly the increased supply—an extremely implausible situation. Greenwood, *supra* note 18, at 53-54. Furthermore, displacement tends to have a ripple effect because displaced workers, when reemployed, displace other domestic workers. *Id.* at 54. Finally, the minimum wage laws enhance the displacement effect. *Id.* at 56.

46. Johnson, *supra* note 39, at 117.

47. *See generally Hearings—1983 Bill, supra* note 6, at 94-108 (reprinting articles from numerous newspapers on the United States immigration problems and the need for a solution).

48. *See, e.g., Hearings—1983 Bill, supra* note 6, at 186-87 (statement of Rep. Daniel A. Mica of Florida).

49. *Hearings—Final Report, supra* note 29, at 89 (statement of Thomas Donahue, Secretary-Treasurer, AFL-CIO).

50. *See id.* at 162 (statement of Althea Simmons, Director of the Washington Bureau of the NAACP).

51. H.R. 1510, *supra* note 13, 130 CONG. REC. at H6166; S. 529, *supra* note 13, 129 CONG. REC. at S6970.

C. The Immigration Reform and Control Act of 1983

The Simpson-Mazzoli Bill consists of numerous amendments to an existing statute, the Immigration and Naturalization Act of 1952[52] (the "1952 Act"), and includes seven major provisions. The Bill (1) sanctions employers who knowingly hire or recruit for a fee any alien not authorized to work in the United States;[53] (2) creates an Immigration Board and an independent agency within the Department of Justice to hear all appeals from the decisions of administrative law judges;[54] (3) raises the immigration ceilings for both Canada and Mexico by an additional 20,000 visas per year;[55] (4) streamlines the labor certification process for H-2 seasonal agricultural workers[56] and introduces a three-year transition program for agricultural producers; [57] (5) authorizes the State Department to establish a three-year pilot nonimmigrant visa waiver program;[58] (6) requires foreign students to return to their home countries for two years before adjusting their status or returning to the United States;[59] and (7) grants the right to apply for permanent resident status to aliens who have resided in the United States continuously since January 1, 1977.[60]

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52. Immigration and Naturalization Act of 1952, 8 U.S.C. §§ 1101-1557 (1982) [hereinafter cited as 1952 Act].

53. H.R. 1510, *supra* note 13, sec. 101(a)(1), 130 CONG. REC. at H6167 (amending the 1952 Act by adding § 274A(a)(1)). For a summary of the House version of the Bill as reported by the House committee on the Judiciary, see 129 CONG. REC. E2427-28 (daily ed., May 19, 1983) (statement of Rep. Mazzoli).

54. H.R. 1510, *supra* note 13, sec. 122(a), 130 CONG. REC. at H6171-72 (amending the 1952 Act by adding § 107).

55. *Id.* sec. 201(a), 130 CONG. REC. at H6175, (amending section 201 of the 1952 Act, 8 U.S.C. § 1151).

56. *Id.* secs. 211(a)-(g), 130 CONG. REC. at H6176-78 (amending sections 101(a) and 214 of the 1952 Act, 8 U.S.C. §§ 1101(a), 1184).

57. *Id.*

58. *Id.* sec. 213, 130 CONG. REC. at H6179 (amending sections 212, 214(a), and 248 of the 1952 Act, 8 U.S.C. §§ 1182, 1184(a), 1258).

59. *Id.* sec. 212, 130 CONG. REC. at H6178-79 (amending secs. 212(e), 244(b), and 245(c) of the 1952 Act, 8 U.S.C. §§ 1182(e), 1254(b), 1255(c)).

60. Under the House bill, aliens who have resided in the United States continuously since January 1, 1982 could seek permanent resident status in two years. Cohodas, *Conferees Near Agreement on Immigration Reform Bill,* 42 CONG. Q. WEEKLY REP. 2297, 2297 (1984). The conference committee structured a two-tier legalization program. Aliens residing in the United States continuously since January 1, 1977 may apply for permanent residence. After five years, the alien may apply for United States citizenship. *See id.* Aliens who establish their continuous residence in the United States since January 1, 1981 may seek

1. *Legislative History*

The Simpson-Mazzoli Bill is the product of a lengthy legislative process. Since 1971, various bills in both houses of Congress have included some form of employer sanctions.[61] In 1978, President Carter established the Select Commission on Immigration and Refugee Policy (the "Commission").[62] Although the Commission recommended that Congress enact employer sanctions,[63] it refused to recommend an extensive guestworker program.[64]

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permanent resident status within two years if they demonstrate familiarity with ordinary English and knowledge of United States history and government, or if they are currently attempting to acquire the requisite knowledge. *See id.*

61. For the history of employer sanctions provisions, see S. REP. No. 62, 98th Cong., 1st Sess. 22-24 (1983). In 1972 the House passed a bill containing employer sanctions, but the Senate took no action. In 1974 the House passed another bill containing employer sanctions, which was reintroduced in 1975 and received a favorable report from the full Senate Judiciary Committee but received no further attention. During 1975 the Senate worked on an omnibus reform bill that included employer sanctions for the knowing employment of illegal alien workers. The bill was never reported to the full Judiciary Committee. *Id.* at 22-23.

In January 1975 President Ford established the Committee on Illegal Aliens, which subsequently recommended employer sanctions. *Id.* at 23. In October 1977 the Carter Administration introduced its Alien Adjustment and Employment Act of 1977. The Senate held hearings in May 1978, but that was all the consideration Congress gave either bill. *Id.* at 24.

62. President Carter established the Select Commission on October 5, 1978. *See* Pub. L. No. 95-412, 92 Stat. 907 (1978). The Commission consisted of sixteen members. President Carter appointed four members, four members were cabinet officers, and the House and Senate each designated four members. The Commission conducted a 2½ year study to determine the areas of United States immigration law that were in need of revision. Gordon, *The Fall and Future of Simpson-Mazzoli*, 6 IMMIGRATION J., Jan.-Mar. 1983, at 3. The Commission issued its final report on March 1, 1981. *Id.*

63. *See* STAFFS OF SENATE COMM. AND HOUSE COMM. ON THE JUDICIARY, 97TH CONG., 1ST SESS.; U.S. IMMIGRATION POLICY AND THE NATIONAL INTEREST 61 (Comm. Print 1981) (Final Report of the Select Commission recommending that Congress enact legislation prohibiting employment of undocumented workers) [hereinafter cited as Final Report]; *see also* S. REP. No. 62, *supra* note 61, at 25-26 (summarizing the findings of the Select Commission). *See generally Hearings—Final Report, supra* note 29. The Commission suggested that Congress focus employer sanctions on larger employers. Final Report, *supra*, at 63. The Commission also suggested that Congress base the sanctions on a reliable means of verifying employment eligibility. *Id.* at 66. The Commission, however, could not decide on which specific documents the verification system should rest. *Id.* at 68.

64. Final Report, *supra* note 63, at 45; *see also* Semler, *Temporary Foreign*

In 1981, President Reagan established the Interagency Task Force on Immigration and Refugee Policy (the "Task Force").[65] The Task Force recommended sanctions against employers of more than four employees who knowingly hire undocumented aliens.[66] Members of the Task Force developed three options for a temporary worker program: (1) a program that would admit 600,000 migrant workers per year;[67] (2) a program that would admit 500,000 migrant workers per year for two years;[68] or (3) a modified H-2 visa program, the present United States program,[69] to grant producers greater access to foreign farmworkers.[70] Although the Reagan Administration adopted many of the Task Force's recommendations in its proposed legislation,[71] it rejected

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Labor: The Administration's "Guestworker" Proposal, 15 CLEARINGHOUSE REV. 642 (1981).

65. The Task Force was headed by Attorney General William French Smith and included the Secretaries of State, Defense, Education, Labor, Health and Human Services, Transportation, and the Treasury; the directors of the Federal Emergency Management Agency and the Office of Management and Budget; and Frank Hodsoll, a White House Staff Member. *Task Force on Immigration and Refugee Policy Reports to President,* 58 INTERP. REL. 340, 340 (1981).

66. The Task Force recommended fines of $500 to $1000 for violations. The employers, however, would be allowed a defense of reliance in good faith on existing documentation. *Id.* at 341.

67. *See* Semler, *supra* note 64, at 642.

68. *See id.*

69. *See infra* notes 194-206 and accompanying text.

70. Semler, *supra* note 64, at 642.

71. Attorney General Smith presented the Reagan proposals to a Joint Hearing of the Immigration Subcommittees on July 30, 1981. Gordon, *supra* note 62, at 27; *see also* S. REP. No. 62, *supra* note 61, at 27; Dep't of Justice Release, *supra* note 19, *reprinted* at 385-90; Lansing & Alabart, *The Reagan Administration Proposals on Immigration: The Problem of the Undocumented Alien in the United States,* 13 CAL. W. INT'L L.J. 1, 20 (1983).

Under the Reagan proposals, employers were allowed an affirmative defense if they made a good faith effort to determine the prospective employee's employment eligibility. The proposals required the employer to request either documentation issued by the INS or any two of the following: (a) Social Security Card, (b) driver's license, (c) Selective Service registration, (d) birth certificate, or (e) sworn statement of lawful U.S. residence. *See The Knowing Employment of Illegal Immigrants, supra* note 17, at 235 (report by Remis & Parker, *Cost Benefit Analysis of President Reagan's Employer Sanctions Proposal*); Lansing & Alabart, *supra,* at 20.

In July 1981 the Administration announced its bill, which President Reagan synthesized from his earlier proposals. The Administration submitted the bill to Congress on October 20, 1981. Senator Strom Thurmond (R-S.C.) and Representative Peter Rodino (D-N.J.) introduced the bill in their respective houses of all of the options for a temporary worker program. Instead, the Administration proposed an experimental, two-year temporary worker program to admit 50,000 Mexican nationals,[72] which it intended to be part of a larger package including employer sanctions.[73]

The Immigration Reform and Control Act was introduced in the Ninety-eighth Congress on February 17, 1983, by its sponsors, Senator Alan Simpson (R-Wyo.) and Representative Romano Mazzoli (D-Ky.).[74] The Senate passed its version of the Bill in

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Congress. *See* S. 1765, 97th Cong., 1st Sess. (1981); H.R. 4832, 97th Cong., 1st Sess. (1981); *see also Immigration Reform: Hearings Before the Subcomm. on Immigration, Refugees, and International Law of the House Comm. on the Judiciary*, 97th Cong., 1st Sess., pts. 1-2 (1981).

72. President Reagan's experimental program would allow migrant workers to stay in the United States for a period of 9 to 12 months. Each worker would be entitled to normal wages and working conditions, but would not receive unemployment insurance benefits. The workers' children and spouses would not be allowed to join them. Finally, the workers would be excluded from any federally funded programs. *See* Lansing & Alabart, *supra* note 71, at 20; *see also Hearings—Temporary Workers*, *supra* note 24, at 8-9. Under the Reagan program, state governors would decide whether to participate in the Administration's program, based on the availability of laborers in their states. *Id.* at 8. The Secretary of Labor would then allocate to each state a proportionate share of the 50,000 available workers. The Secretary would allocate the workers after considering three factors: (1) the total number of participating states, (2) the total number of foreign workers required by all of the participating states, and (3) the number of workers that each state requested. *Id.* at 9.

73. *Hearings—Temporary Workers*, *supra* note 24, at 11 (statement of Frank Crigler, Office of Mexican Affairs, Dep't of State); *see also id.* at 15 (statement of Robert W. Searby, Deputy Under Secretary for Int'l Affairs, Dep't of Labor).

74. The immediate forerunner of the Bill was the Immigration Reform and Control Act of 1982 (the "1982 Bill"), S. 2222, 97th Cong., 2d Sess. (1982); H.R. 5872, 97th Cong., 2d Sess. (1982); *see* H.R. REP. No. 115, pt. 1, 98th Cong., 1st Sess. 31 (1983), which was introduced by Senator Alan Simpson (R-Wyo.) and Representative Romano Mazzoli (D-Ky.). The Senate Judiciary Committee issued a favorable report, and the full Senate passed the 1982 Bill by an 80 to 19 vote. S. REP. No. 62, *supra* note 61, at 38 (1983). The House version, on the other hand, ran into trouble after receiving a favorable report in Committee. It came to the floor with an "unlimited amendments" rule and reached its final form 350 amendments later during the closing days of the lame duck session. *See* Gordon, *supra* note 62, at 27. To no one's surprise, the 1982 Bill died in the House. *See* N.Y. Times, Oct. 5, 1983, at 1, col. 1. *See generally Hearings—Final Report*, *supra* note 29.

On February 17, 1983, Representative Mazzoli introduced the House version of the Bill, H.R. 1510, which was essentially the same bill that the House Com-

May 1983.[75] The House Committee on the Judiciary favorably reported the Bill,[76] but Speaker of the House O'Neill initially refused to allow the full House to consider it in 1983.[77] His refusal

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mittee on the Judiciary reported in 1982. H.R. REP. No. 115, *supra*, pt. 1, at 31. The same day, Senator Simpson introduced the Senate version of the Bill, S. 529. S. REP. No. 62, *supra* note 61, at 28. The Senate bill was essentially the same as the 1982 Bill that the Senate passed in the previous session. *Immigration Reform and Control Bills Introduced*, 60 INTERP. REL. 150 (1983).

75. *Senate Passes Its Version of Simpson-Mazzoli Bill*, 60 INTERP. REL. 417 (1983). The Senate passed the bill by a margin of 76 to 18. *Id.*

76. The Committee adopted H.R. 1510 by a vote of 20 to 9. H.R. REP. No. 115, *supra* note 74, pt. 1, at 32.

77. N.Y. Times, Oct. 5, 1983, at 1, col. 1; *see also* Thomas, *Playing Politics with Immigration*, TIME, Oct. 17, 1983, at 19. The Speaker recognized that many Hispanic Americans opposed the Bill, *see infra* notes 126-34 and accompanying text, and that the Bill had no clear constituency. N.Y. Times, Oct. 5, 1983, at 1, col. 1. Furthermore, O'Neill stated that the Bill's opponents had drafted 300 amendments to it. Ehrenhalt, *The House: Adopting Senate's Bad Habits?* 41 CONG. Q. WEEKLY REP. 2155 (1983). Numerous amendments had caused the death of the 1982 Bill. *See supra* note 74. O'Neill suggested that further action on the Bill would not occur until January 1985 at the earliest. N.Y. Times, Oct. 5, 1983, at 1, col. 1. He also expressed concern that President Reagan would veto the Bill to attract Hispanic votes. *Id.*; Thomas, *supra*, at 19; *see also* Hume, *Reagan, Si?: Wooed by the GOP, Many Hispanic Voters are Likely to Say Yes*, Wall St. J., Jan. 6, 1984, at 1, col. 1. His suspicions were fueled by a letter from Attorney General William French Smith to the House Committee on the Judiciary. Letter from William French Smith, United States Attorney General, to Peter W. Rodino, Chairman of the House Committee on the Judiciary (July 27, 1983) (obtained from Hon. Edward Roybal, Representative from California) [hereinafter cited as Smith Letter]. The letter revealed the Administration's reservations about the House bill. *See id.*

The letter continued, however, stating that the Administration "looked forward to working" with the House Judiciary Committee on the Bill. *Id.* at 7. Furthermore, after O'Neill blocked the Bill, President Reagan stated in a press conference that although he had some reservations with the House bill, he "recognized" the conference process in the Congress. President Reagan stated:

> I have been supportive of some immigration legislation for a long time. This country has lost control of its borders . . . . I will admit that the House bill, I had some disagreements with some of the structure and form of that bill, but recognized that there was a process called "conference" when there was a difference between the two bills. I want to sign, as quickly as possible, immigration legislation.

President Ronald Reagan, Press Conference (Oct. 19, 1983) (ABC broadcast available in Vanderbilt University Television News Archives, film no. S-276) [hereinafter cited as Press Conference]. Thus, the Attorney General's letter may have been less a threat to veto than a "routine working paper." Thomas, *supra*, at 19.

prompted protests from both liberals and conservatives who supported immigration reform,[78] and one month later, O'Neill changed his mind, announcing that the House would consider the Bill in 1984.[79] The House passed the Bill in the summer of 1984, and both the Senate and the House appointed conferees to draft a compromise bill.[80] In October, the conference reached an impasse regarding antidiscrimination measures,[81] effectively ending any hope of final passage during the second session of the Ninety-eighth Congress. Proponents of immigration reform, however, vowed to reintroduce the legislation in the next session.[82]

2. *The Employer Sanctions Provision*

The cornerstone of the Bill is its provision for employer sanctions.[83] The Bill establishes a multi-tier penalty structure that applies to employers of four or more employees[84] who knowingly[85] employ, recruit, or refer for a fee or "other consideration"[86] any

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78. *Editorial, supra* note 13, col. 1.

79. Cohodas, *House Action Likely, supra* note 13, at 2806. After O'Neill's announcement, Hispanic leaders began working on an alternative bill that omitted any employer sanctions and used the following measures to alleviate problems with illegal aliens: enforcing immigration laws more rigidly at the United States borders, increasing the budget of the INS, and increasing the budget of the Labor Department to enable adequate enforcement of the existing wage and hour laws. *Id.*

80. The House passed the Bill by a narrow margin, 216 to 211. *See* Cohodas, *Conferees Begin Work on Immigration Bill,* 42 CONG. Q. WEEKLY REP. 2274 (1984). Each house of Congress appointed conferees who were to meet numerous times to try to forge a compromise bill. *See* Cohodas, *Immigration Reform Snagged on Issue of Discrimination,* 42 CONG. Q. WEEKLY REP. 2366 (1984).

81. *See* Cohodas, *Immigration Reform Bill Dies As Compromise Efforts Fail,* 42 CONG. Q. WEEKLY REP. 2623 (1984).

82. *See id.* (paraphrasing the statement of Sen. Smith).

83. *Hearings—1983 Bill, supra* note 6, at 146 (statement of William French Smith, United States Attorney General).

84. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(a)(1)(B), 130 CONG. REC. at H6167 (proposed addition after section 274 of the 1952 Act, 8 U.S.C. 1324).

85. The Government must meet the Bill's scienter requirement by establishing that the individual knew the employee was an unauthorized alien. *See id.* § 274A(a)(1)(A), 130 CONG. REC. at H6167.

86. *Id.* § 274A(a)(1), 130 CONG. REC. at H6167. The House and conference bills modify the 1982 Bill by prohibiting individuals or organizations from referring illegal aliens for "other consideration." *See id.* The effect of this amendment is to include labor unions within the purview of the Bill's employer sanctions provisions. *House Subcommittee Completes Mark-Up on Simpson-*

alien who is not: (1) lawfully admitted for permanent residence; (2) authorized for employment under the Bill; or (3) authorized by the Attorney General to seek employment.[87] An employer's first violation warrants a citation from the Attorney General that is intended to notify the employer of the federal prohibition.[88] A subsequent knowing violation will result in civil fines,[89] an injunction,[90] or a criminal penalty for a "pattern or practice of violations."[91] Subdivisions of a corporation that hire and recruit inde-

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Mazzoli, 60 INTERP. REL. 265 (1983). The application of the penalties, however, is prospective from the enactment date of the Bill. *See* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(a)(2), 130 CONG. REC. at H6167. Therefore, employers who hire illegal aliens prior to the date of enactment fall outside the provisions of the Bill. H.R. REP. No. 115, *supra* note 74, pt. 1, at 40.

87. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(a)(4), 130 CONG. REC. at H6167.

88. *See House Judiciary Committee Marks Up Simpson-Mazzoli Bill*, 60 INTERP. REL. 354 (1983); H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(a)(1)(B), 130 CONG. REC. at H6167. This new provision would ease the burden on employers to verify an employee's eligibility for employment.

89. The fine is $1000 for each unauthorized alien. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(e)(1)(B)(i), 130 CONG. REC. at H6167. The next violation is punishable by a $2000 civil penalty for each unauthorized alien. *Id.* § 274A(e)(1)(B)(ii), 130 CONG. REC. at H6167-68. The second, or any subsequent civil fine, is not imposed until the previous fine is administratively final. *See* H.R. REP. No. 115, *supra* note 74, pt. 1, at 42. The employer may, on request, obtain a hearing before an administrative law judge on any civil penalty. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(e)(4)(A) 130 CONG. REC. at H6168; *see* H.R. REP. No. 115, *supra* note 74, pt. 1, at 42-43.

90. The Bill gives the federal district courts jurisdiction to enjoin employers from a "pattern or practice" of employing illegal aliens. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(e)(2), 130 CONG. REC. at H6168. The injunctive remedy is not available during the first six months after Congress enacts the Bill. H.R. REP. No. 115, *supra* note 74, pt. 1, at 43.

91. Both the House and Senate bills originally provided for criminal fines and imprisonment for employers who engaged in a "pattern or practice" of violations. The Senate bill included criminal penalties of a $1000 fine, six months imprisonment, or both. *See* S. 529, *supra* note 13, sec. 101(a)(1), § 274A(d)(1)(B). The House bill that the Judiciary Committee originally reported contained provisions for a $3000 civil fine, one year imprisonment, or both. *See* H.R. 150, 98th Cong., 1st Sess. (1983), *reprinted in* H.R. REP. No. 115, *supra* note 74, pt. 1, at 1-30. During consideration on the House floor, the members struck the provisions for the criminal penalties and the civil fine. In conference, however, the conferees adopted the penalties provided in the Senate version. *See Conference Committee Begins Action on Simpson-Mazzoli Bill*, 61 INTERP. REL. 746 (1984).

pendently are considered separate entities under the Bill.[92]

The penalty structure also sanctions employers of four or more employees who do not comply with the prescribed system for verifying an employee's eligibility for employment.[93] Under the Bill, however, a qualifying employer does not have to comply with the Bill's verification system until notified by the Attorney General that there is an unauthorized alien in his work force.[94] By complying with the verification procedure, an employer raises a rebuttable presumption that he has acted in good faith.[95] The Bill pro-

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92. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(e)(5)(B), 130 CONG. REC. at H6168. A subsidiary's violations cannot be attributed to the parent corporation. H.R. REP. No. 115, *supra* note 74, pt. 1, at 44. As with injunctions, the Attorney General may not issue a citation or impose a penalty against a corporate or individual employer until six months after the Congress enacts the Bill. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(i)(2)(A), 130 CONG. REC. at H6169; *infra* note 94.

93. *See* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(a)(1)(B), 130 CONG. REC. at H6167; *see also House Barely Enacts Its Version of Simpson-Mazzoli Bill*, 61 INTERP. REL. 488 (1984).

94. *See* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(e)(1)(A), 130 CONG. REC. at H6168; H.R. REP. No. 115, *supra* note 74, pt. 1, at 42. At the citation level, an employer's violation does not have to be a knowing one because the purpose of the citation is solely informative. *See id.* Under the bill that the House Judiciary Committee reported, a person who had incurred a civil penalty in two or more instances could be fined up to $3000, imprisoned for one year, or both. *See* H.R. 150, 98th Cong., 1st Sess. (1983), *reprinted in* H.R. REP. No. 115, *supra* note 74, pt. 1, at 1-30. During consideration on the House floor, the members passed an amendment to strike the criminal penalties and the $3000 civil fine.

95. H.R. REP. No. 115, *supra* note 74, pt. 1, at 41. The burden of proof then shifts to the Government to show otherwise. *Id.* Although the employer's "good faith defense" is an affirmative defense, it is not absolute. *Id.* Under the House bill, if an employer could show that a State employment agency referred the employee, then the employer was deemed to have complied with the bill's verification procedures. *See* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(a)(5), 130 CONG. REC. at H6167. Under the conference bill, however, agency referral does not exempt an employer from the verification requirements. *See Conference Committee Begins Action*, *supra* note 91, at 746.

To satisfy the Bill's verification requirements, an employer must attest that he verified the individual's eligibility for employment in the United States by examining the individual's United States passport *or* social security card (or certification of birth in the United States) *and* his alien documentation card (or driver's license). *Id.* § 274A(b)(1), 130 CONG. REC. at H6167; H.R. REP. No. 115, *supra* note 74, pt. 1, at 4. Finally, the employee must attest to authorization to work in the United States, H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(b)(2), 130 CONG. REC. at H6167; H.R. REP. No. 115, *supra* note 74, pt. 1, at vides a civil fine of $500 if an employer fails to satisfy the verification provisions.[96]

3. *Criticisms of the Simpson-Mazzoli Employer Sanctions*

Critics of the employer sanctions portion of the Simpson-Mazzoli Bill have raised three major complaints. They contend that the employer sanctions would be ineffective, unfair to Hispanics and small businessmen, and too costly to enforce.

a. Lack of effectiveness

Critics of the employer sanctions point out that previous experience in the United States and abroad suggests that employer sanctions are unworkable.

(i) *State and federal employer sanctions law*—Twelve states have enacted employer sanctions.[97] Each of the state statutes has

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45, but unlike its predecessor, the Bill does not require the employee to attest under penalty of perjury. *Compare* H.R. 6514, 97th Cong., 2d Sess., sec. 101(a)(1), § 274A(b)(2) (1982), *reprinted in* H.R. REP. No. 890, 97th Cong., 2d Sess. 2 (1982) *with* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(b)(2), 130 CONG. REC. at H6167.

96. *See* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(e)(3)(B), 130 CONG. REC. at H6168; H.R. REP. No. 115, *supra* note 74, pt. 1, at 45. When an employer hires a new employee, the employer has a one-day grace period in which he will not be liable for failure to complete the verification procedures. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(b)(3), 130 CONG. REC. at H6167.

97. The states with employer sanctions are: California, Connecticut, Delaware, Florida, Kansas, Maine, Massachusetts, Montana, New Hampshire, New Jersey, Vermont, and Virginia. *See* Smith & Mendez, *Employer Sanctions and Other Labor Market Restrictions on Alien Employment: The "Scorched Earth" Approach to Immigration Control*, 6 N.C.J. INT'L L. & COM. REG. 19, 42 n.127 (1980).

Some states such as California, Connecticut, Delaware, Kansas, and New Hampshire make it unlawful knowingly to employ unauthorized, undocumented workers. *See* CAL. LAB. CODE § 2805(a) (West Supp. 1984); CONN. GEN. STAT. ANN. § 31-51k(a) (West Supp. 1984); DEL. CODE ANN. tit. 19, § 705 (1979); KAN. STAT. ANN. § 21-4409 (1981); N.H. REV. STAT. ANN. § 275-A:4-a (Supp. 1981). Other states such as Florida, Vermont, and Virginia also prohibit the referral or recruitment of undocumented workers. *See* FLA. STAT. ANN. § 448.09(1) (West 1981); VT. STAT. ANN. tit. 21, § 444a(B) (1978); VA. CODE § 40.1-11.1 (1981); *see also* ME. REV. STAT. ANN. tit. 26, § 871(2) (Supp. 1982); MASS. GEN. LAWS ANN. ch. 149, § 19C (West 1982) (probably includes referral and recruitment). Virginia expressly prohibits agents of labor organizations from employing or referring an undocumented alien. VA. CODE § 40.1-11.1 (1981).

Most of the statutes require the employer to inquire whether the alien has a scienter requirement,[98] and most of the states provide both civil and criminal penalties ranging from a $100 fine for an individual[99] to a $10,000 fine for a corporation.[100] Very little information is available concerning the effectiveness of the state statutes,[101] but the size of the illegal migrant worker population in California and the other states, indicates that the sanctions are of little value as

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some form of INS document authorizing employment. *See, e.g.*, ME. REV. STAT. ANN. tit. 26, § 871(2) (Supp. 1982). In addition, some states require the employer to examine other documents such as drivers' licenses, birth certificates, or Social Security cards. Maine, however, expressly rejects Social Security cards as evidence of employment eligibility. *See id.* § 871(2)(B). In each of the states with employer sanctions laws, an employer's bona fide inquiry into an alien's eligibility for employment is an affirmative defense. *See, e.g.*, MASS. GEN. LAWS ANN. ch. 149, § 19C (West 1982).

98. *See, e.g.*, CAL. LAB. CODE § 2805(a) (West Supp. 1984); FLA. STAT. ANN. § 448.09 (West 1981).

99. VT. STAT. ANN. tit. 21, § 444(d) (1978).

100. New Hampshire makes the knowing employment of an undocumented alien a misdemeanor. *See* N.H. REV. STAT. ANN. § 275-A:4-a, :5 (Supp. 1981). The penalty for a corporation that commits a misdemeanor is a maximum fine of $10,000 per offense. *See id.* § 651:2 (IV)(b).

101. For a detailed discussion of state employer sanctions statutes, see Schwartz, *Employer Sanctions Laws, Worker Identification Systems, and Undocumented Aliens: The State Experience and Federal Proposals*, 19 STAN. J. INT'L L. 371 (1983) (concluding that the states' experiments with employer sanctions generally have been failures).

Although the efficacy of state employer sanctions laws is questionable, the Supreme Court upheld the validity and constitutionality of state employer sanctions against a challenge grounded on the asserted preemption of the state statute by the 1952 Act, 8 U.S.C. §§ 101-1157 (1982). DeCanas v. Bica, 424 U.S. 351 (1976). In *DeCanas*, petitioners brought an action against a farm labor contractor for his refusal to continue their employment, *id.* at 353, pursuant to section 2805(a) of the California Labor Code, which prohibits the knowing employment of undocumented aliens. CAL. LAB. CODE § 2805(a) (West Supp. 1984). The Court reversed the state court's holding that section 2805 was unconstitutional. "Only a demonstration that complete ouster of state power—including state power to promulgate laws not in conflict with federal laws—was " 'the clear and manifest purpose of Congress" ' would justify [the] conclusion [that Congress intended to preempt state authority]." *DeCanas* at 357 (quoting Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 146 (1963) (quoting Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)).

Both the Senate and House versions of the Simpson-Mazzoli Bill expressly preempt any state or local laws that provide sanctions for employing, recruiting, or referring an undocumented alien. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(g), 130 CONG. REC. at H6168; S. 529, *supra* note 13, sec. 101(a)(1), § 274A(f), at S6972.

deterrents.[102]

Currently, there are no general employer sanctions at the federal level. The "Texas Proviso"[103] of the 1952 Act prohibits only the harboring or concealing of any person who enters the United States unlawfully, excluding penalties for hiring.[104] The Ninety-third Congress enacted the Farm Labor Contractor Registration Act of 1963, which was later amended and entitled the Migrant and Seasonal Worker Protection Act (the "Protection Act").[105] The Protection Act prohibits any farm labor contractor from recruiting or employing any illegal alien.[106] The Protection Act, however, has achieved very limited success. Between the years 1977 and 1981, the Immigration and Naturalization Service (INS) apprehended only 10,190 undocumented alien farmworkers and 370 farm labor contractors who employed one or more illegal aliens.[107] Moreover, the Government successfully prosecuted only six cases pursuant to the Act during the same period.[108] Thus, critics assert that the "track record" for existing state and federal employer sanctions has been unimpressive—a dubious harbinger for the Simpson-Mazzoli Bill.

(ii) *Western Europe's experience with employer sanctions*—Employer sanctions are fundamental to Western European efforts to reduce its flow of illegal aliens.[109] In the Federal Repub-

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102. *See supra* note 18 and accompanying text.

103. 8 U.S.C. § 1324(a) (1982). The "Texas Proviso" prohibits smuggling, transporting, or encouraging undocumented aliens into the United States. The penalty for violating section 1324(a) is a maximum fine of $2000 and/or five years imprisonment. *Id.*; *see also The Knowing Employment of Illegal Immigrants*, *supra* note 17, at 97 (statement of Robert T. Thompson, Southeastern Regional Vice Chairman of the Board of Directors, U.S. Chamber of Commerce).

104. 8 U.S.C. § 1324(a).

105. 29 U.S.C. §§ 1801-1872 (1982).

106. *Id.* § 1816(a). The Protection Act contains a scienter requirement, but provides a farm labor contractor with an affirmative defense if: (1) he relied in good faith on documentation issued by the Secretary of Labor; and (2) he had no reason to suspect that the individual was an illegal alien. *Id.* § 1816(b).

107. *The Knowing Employment of Illegal Immigrants*, *supra* note 17, at 42 (testimony of Malcolm Lovell, Jr., Under Secretary, United States Dep't of Labor).

108. *Id.*

109. *Id.* at 202 (prepared statement of Mark Miller, Professor, University of Delaware). Other countries with employer sanctions provisions are Canada, GENERAL ACCOUNTING OFFICE, INFORMATION ON THE ENFORCEMENT OF LAWS REGARDING EMPLOYMENT OF ALIENS IN SELECTED COUNTRIES app., at 1, 3 (1982) (Rep. No. GAO/GGD-82-86), Argentina, *id.* app., at 36, 36, Greece, *id.* app., at 49, 50,

lic of Germany, employers are subject to fines of up to $20,000 and prison terms of five years.[110] The European Economic Community has expressed a desire for its other member countries to adopt sanctions similar to those in Germany.[111] France has enacted employer sanctions, but its documentation requirement is grounded on the use of a national identity card[112]—a form of documentation that the Bill expressly rejects.[113] Furthermore, French enforcement officials are free to inspect factories,[114] a practice only recently held constitutional by the United States Supreme Court.[115] A number of problems have attended employer sanctions in Western Europe. First, courts are reluctant to levy stiff penalties on employers. Second, sanctions are given a low enforcement priority. Third, prosecutors find it difficult to meet the scienter requirement of each statute.[116] Thus, critics of sanctions

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Hong Kong, *id.* app., at 52, 52, and Thailand, *id.* app., at 69, 69.

110. *The Knowing Employment of Illegal Immigrants, supra* note 17, at 208 (prepared statement of Mark Miller, Professor, University of Delaware).

111. *Id.*

112. *Id.* at 210. In France, employer sanctions are applied administratively and judicially. Each employer who receives a civil fine is also subject to criminal prosecution. *See* GENERAL ACCOUNTING OFFICE, *supra* note 109, at 4.

113. The Bill states: "Nothing in this subsection shall be construed to authorize . . . the issuance or use of national identification cards." H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(c), 130 CONG. REC. at H6167.

114. *The Knowing Employment of Illegal Immigrants, supra* note 17, at 210 (prepared statement of Mark Miller, Professor, University of Delaware).

115. Until recently, INS officials were allowed to question the entire work force at a factory without a search warrant and to detain any employees who attempted to leave. The Ninth Circuit held that the INS's "factory survey" procedures violate the fourth amendment, but the decision was subsequently reversed by the Supreme Court. *See* International Ladies' Garment Workers' Union v. Sureck, 681 F.2d 624 (9th Cir. 1982), *rev'd sub nom.* INS v. Delgado, 52 U.S.L.W. 4436 (U.S. Apr. 17, 1984) *see also Developments in the Law—Immigration Policy and the Rights of Aliens,* 96 HARV. L. REV. 1286, 1377-80 (1983).

116. In the Federal Republic of Germany, employer sanctions are not deterring illegal hirings effectively. Some employers successfully circumvent the law by "leasing" workers. Other employers only receive civil fines, which are often reduced on appeal. GENERAL ACCOUNTING OFFICE, *supra* note 109, at 3. In France, Labor Ministry officials have little confidence in the effectiveness of employer sanctions because the judges levy such light penalties. *See id.* at 4. In 1982, however, France stiffened its employer sanction by increasing the penalties and providing a new sanction: confiscation of an employer's tools and equipment. *Id.* The French experience with employer sanctions has also resulted in some side effects. The sanctions have driven many employers "underground." *See The Knowing Employment of Illegal Immigrants, supra* note 17, at 213

concede that Western European "sanctions have had *some* positive impact upon efforts to suppress illegal alien immigration and employment . . . [but] there are important transatlantic differences which could very well alter the effects of employer sanctions here in the United States."[117]

(iii) *The limited resources of the INS*—In addition to the apparent impotence of state, federal, and Western European employer sanctions, the scarcity of the funds and manpower available to the INS will severely limit the enforceability of the Bill's sanctions provisions. INS officials have promised to enforce the sanctions to the present degree of effectiveness and "within the present organizational structure of the agency."[118] Furthermore, the Department of Justice intends to develop a program heavily dependent upon voluntary compliance,[119] believing that most em-

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(prepared statement of Mark Miller, Professor, University of Delaware). With regard to the possible discriminatory effects of the employer sanctions, the French view the sanctions as having reduced discrimination by punishing employers who exploit alien employees. *Id.* at 216.

Canada also uses employer sanctions. Each employer must insure that his employees are not working illegally. GENERAL ACCOUNTING OFFICE, *supra* note 109, app., at 3. If convicted, employers face a maximum sentence of two years, a $4000 (U.S.) fine, or both. Canadian officials, however, believe that the sanctions have not reduced the size of the illegal worker population. *Id.* at 4. Canadian officials list several reasons for the dismal performance of their employer sanctions laws. First, many of the illegal workers are relatives of their employers. *Id.* app., at 4. Second, enforcement of sanctions has not been a high enforcement priority within the Royal Canadian Mounted Police. *Id.* app., at 5. Third, enforcement officials view their duty as one of educating first time offenders. *Id.* Fourth, there are considerable backlogs and legal delays, and the Government incurs the expense of holding the alien until trial. *Id.* app., at 4. Fifth, the scienter requirement for proving a violation is a difficult standard to meet. *Id.* app., at 3. Last, Canadian judges are often lenient with convicted employers. *Id.* app., at 4.

117. *The Knowing Employment of Illegal Immigrants*, *supra* note 17, at 214 (prepared statement of Mark Miller, Professor, University of Delaware) (emphasis added). One of the most important "transatlantic differences" is that many of the countries with employer sanctions have national identification cards. For example, France, Switzerland, Argentina, Denmark, Greece, Hong Kong, Luxembourg, and Sweden all have some form of national identification card or number. *See* GENERAL ACCOUNTING OFFICE *supra* note 109, app., at 22, 31, 6, 42, 49, 52, 61, 66. Furthermore, these countries' enforcement officials have broad search and seizure powers. *See supra* notes 114-15 and accompanying text.

118. *Hearings—1983 Bill*, *supra* note 6, at 249 (statement by Alan C. Nelson, Commissioner, Immigration and Naturalization Service).

119. *The Knowing Employment of Illegal Immigrants*, *supra* note 17, at 10-

ployers, as law-abiding citizens, will obey an employer sanctions law.[120] Nevertheless, it may be that the INS and the Department of Justice rely unrealistically on the voluntary compliance of employers for the sanctions to operate as a viable deterrent.

The INS has adopted its strategy on voluntary compliance out of sheer necessity—it simply cannot effectively enforce the employer sanctions. The resources of the INS are too limited, and the task of enforcement is too demanding. Furthermore, the expectation that employers will comply voluntarily with the program is overly optimistic. Because of the limited ability of the INS to enforce the sanctions, employers of illegal aliens have a substantial economic incentive to hire cheap alien labor. The incentive is especially pronounced for those small businessmen whose operations are often labor-intensive, but are the least likely to be investigated. Moreover, employers who do comply with the verification procedures will be examining documentation that is easy to counterfeit or obtain illegally. Identification documents, including social security cards, are often counterfeited or stolen;[121] and fraudulent but official birth certificates can be obtained easily.[122]

The Reagan Administration expressed its own doubts about the effectiveness of at least one aspect of the employer sanctions provided in the Bill. In a letter to House Judiciary Committee Chairman Rodino, Attorney General Smith expressed reservations about the provisions of the original House bill that render compliance with the verification procedures optional until the Attorney General has notified the employer that an illegal alien has been hired.[123] The Attorney General asserted that this provision would diminish employers' motivation to comply voluntarily with the

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14 (prepared statement of Doris Meissner, Acting Commissioner, Immigration and Naturalization Service).

120. *Id.* at 10.

121. *The Knowing Employment of Illegal Immigrants*, *supra* note 17, at 104 (statement of Robert T. Thompson, Southeastern Regional Vice Chairman of the Board of Directors, U.S. Chamber of Commerce).

122. *Id.* at 105. To alleviate some of the potential for fraud, the conference bill includes a three-year demonstration project to provide a toll-free telephone verification system for Social Security numbers. *See* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(a)(7), 130 CONG. REC. at H6167; *see also Conference Committee Begins Action*, *supra* note 91, at 747. The original Senate bill did not contain a comparable provision. *See House*, *supra* note 93, at 488.

123. *See supra* note 88 and accompanying text.

Bill's verification procedures.[124] The Administration supported the alternative approach adopted by the Senate, which commanded compliance with verification procedures for *all* employers of four or more employees without notification from the Attorney General.[125] The conference committee adopted the House bill's citation system for the first two-and-a-half years after the Bill's enactment.[126]

b. Inequity

Two major groups have voiced a third major criticism of the Simpson-Mazzoli Bill—that it is inequitable. Hispanic groups have expressed the fear that domestic employers may completely avoid hiring Hispanics. Small businesses complain that they will shoulder an unfairly heavy burden for verifying that an employee is not an illegal alien.

(i) *Discrimination against Hispanics*—Hispanic groups who oppose the Bill have expressed the fear that it will provide an opportunity for employers to discriminate on the basis of race and national origin under the guise of an apparently legitimate concern.[127] Furthermore, Hispanics argue that the Bill will require employers to discriminate according to a legal category.[128] Because of the difficulty in distinguishing lawful residents from illegal aliens,[129] Hispanics fear that law-abiding employers may refuse to hire persons with foreign physical characteristics simply to avoid any possibility of violating the law.[130] These arguments have made some headway among non-Hispanics. The American

124. Smith Letter, *supra* note 77, at 2.

125. *Id.* at 2-3.

126. *See Conference Committee Begins Action, supra* note 91, at 746.

127. *The Knowing Employment of Illegal Immigrants, supra* note 17, at 273, 278-81 (Institute for Public Representation, Georgetown University Law Center, *Discriminatory Effects of Employer Sanction Programs Under Consideration by the Select Commission on Immigration and Refugee Policy* [hereinafter cited as *Discriminatory Effect.*]).

128. Smith & Mendez, *supra* note 97, at 50.

129. *Id.* at 51.

130. For a thorough analysis of the discriminatory effects of employer sanctions, see *The Knowing Employment of Illegal Immigrants, supra* note 17, 273-308 (*Discriminatory Effect, supra* note 127); *see also* Note, *The Simpson-Mazzoli Bill and Employer Sanctions: Potential Discriminatory Impact and Its Minimization,* 19 STAN. J. INT'L L. 433 (1983).

Bar Association echoed these concerns,[131] and Attorney General Smith recognized that the verification procedures would "create the potential for . . . discrimination."[132] The Reagan Administration posited that the Senate bill was less likely to result in discrimination because it requires verification by all employers of four or more persons.[133] The House bill requires verification only by employers who have previously been notified of the presence of an illegal alien on their payroll.[134] The House bill, however, attempts to avert discrimination by requiring the President and the United States Civil Rights Commissioner to report to Congress on any discriminatory effects of the Bill.[135] It also requires employers of four or more employees not to discriminate against any individual on the basis of "national origin or alienage,"[136] creates the United States Immigration Board, and directs the Special Counsel of the Board to enforce the antidiscrimination provision.[137] The Senate rejected a similar provision.[138] Its bill, supported by the Reagan Administration, merely directs the President[139] and the Comptroller General[140] to study the problem. The Senate conferees also opposed the inclusion of the House antidiscrimination provision in the conference bill.[141] Ultimately, the conferees

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131. *Hearings-1983 Bill, supra* note 6, at 1102 (statement by Robert M. Ervin, Member of the House of Delegates, American Bar Association).

132. Smith Letter, *supra* note 77, at 2.

133. *Id.*

134. H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(e)(1)(A), 130 CONG. REC. at H6167.

135. *Id.* § 274A(h)(1)-(2), 130 CONG. REC. at H6168.

136. *See* H.R. 1510, *supra* note 13, sec. 101(a)(1), § 274A(h)(1)(A), 130 CONG. REC. at H6168; *id.* § 274A(h)(1)(B)(i).

137. *Id.* § 274A(h)(2).

138. The Senate rejected overwhelmingly an antidiscrimination provision offered for consideration by Sens. Carl Levin (D-Mi.) and Gary Hart (D-Colo.). *See House-Senate Conferees Reach Impasse on Simpson-Mazzoli Bill*, 61 INTERP. REL. 792a, 792b (1984) (M. Roberts, ed.).

139. *See* S. 529, *supra* note 13, § 401(3)(D), 129 CONG. REC. at S6985.

140. *See id.* § 404(2).

141. Senator Simpson explained the Senate conferees' opposition to the House provision by noting that antidiscrimination provisions had not been considered by the Select Commission or by Congress during the previous four years of work on the Simpson-Mazzoli Bills. *See House-Senate Conferees, supra* note 138, at 792b. Simpson recognized that it is "understandable for an employer to prefer to give a job to a U.S. citizen rather than to a citizen of another country who is here with work authority." *Id.* Moreover, Simpson argued that United States citizens would not agree "that their own government should sue them" if

agreed upon a provision that omitted the "alienage" language, but permitted aliens who attest to their intention to become United States citizens to pursue administrative remedies for alleged employment discrimination.[142]

In sum, although the Senate, House, and conference versions attempt to alleviate the discriminatory effects of the employer sanctions provisions, there is little serious dispute that the Hispanic critics are correct. Employer sanctions are to some degree inherently discriminatory. Supporters of the Bill can only argue that the problem can be minimized and that some discrimination is an evil necessary to regain control of our borders.

(ii) *Discrimination against small business*—Prior to the amendment of the House bill, the United States Chamber of Commerce, with support from the Reagan Administration, argued that the costs of the House bill would burden small businesses unfairly.[143] The Administration believed that by requiring only employers of four or more employees to comply with the verification procedures, the Senate bill created less difficulty for small businesses.[144] The conference committee subsequently adopted the Senate provision.[145]

Most of the illegal aliens apprehended by the INS, however,

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they desire to employ other United States citizens. *Id.*

In response to Senator Simpson's reservations about the antidiscrimination provision, Representative Mazzoli offered a modified version. Under Mazzoli's amendment, discrimination on the basis of alienage would pertain only to "permanent resident aliens [and] temporary aliens . . . and only for their first seven years of that status." *Id.* Mazzoli's amendment would allow United States citizens and aliens to bring suits for discrimination. Moreover, employees would be allowed to discriminate on the basis of alienage "for a business-related reason, such as a U.S. citizen work force in order to secure a U.S. Government contract." *Id.* A person who alleges employment discrimination based on national origin would be required to choose whether to file his complaint with the EEOC or the Special Counsel. *Id.*

Private rights of action under the Mazzoli amendment would be restricted to claims of a "pattern or practice" of discrimination on the basis of alienage or national origin. *Id.* at 792c. Finally, the Mazzoli provision would eliminate class actions. *Id.*

142. *See Immigration Bill Agreement Near,* 42 CONG. Q. WEEKLY REP. 2473 (1984).

143. *Hearings—1983 Bill, supra* note 6, at 345-48 (statement by Robert T. Thompson, Chairman of the Board, U.S. Chamber of Commerce; *see* Smith Letter, *supra* note 77, at 3.

144. Letter, *supra* note 77, at 3.

145. *See Conference Committee Begins Action, supra* note 91, at 746.

work in the smallest, low-wage firms.[146] Thus, the Bill would exempt from verification procedures a large number of those persons who employ illegal aliens. Attorney General Smith justified the exemption provision by noting that it would cover ninety-five percent of employees, while exempting fifty percent of employers.[147] Nevertheless, the positions taken by the Administration and Congress seem incompatible with their mutual stated goal of enacting effective employer sanctions. Small businesses, which are exempt under the Senate bill, appear to be at the heart of the problem.

c. Costliness

The final major criticism of the House bill was that enforcement would be too expensive.[148] White House press spokesman Larry Speakes declared that its cost made the House bill "unacceptable."[149] Ironically, the combined cost of the Senate bill to the public and private sectors would have been greater because *every* employer of four or more employees would be forced to comply with the verification procedures, not merely those employers to whom the Attorney General has issued a warning. The cost of the Senate bill to the federal government would be lower, but that Bill would shift an even greater proportion of the costs of enforcement to private employers. It is certainly open to question whether private business should be burdened with what is arguably the job of the INS.

4. *Possible Improvements in the Simpson-Mazzoli Employer Sanctions*

When Congress reconsiders the Simpson-Mazzoli Bill, the employer sanctions provisions should be revised to discourage more effectively the hiring of illegal aliens. Congress should (1) increase the budget of the INS in order to apprehend substantially more employers who violate the law, (2) stiffen the Bill's civil and criminal penalties[150] to increase the employer's cost of violation, and

146. D. NORTH & M. HOUSTOUN, THE CHARACTERISTICS AND ROLE OF ILLEGAL ALIENS IN THE U.S. LABOR MARKET: AN EXPLORATORY STUDY 135 (1976).

147. Smith Letter, *supra* note 77, at 3.

148. *See id.* at 4.

149. 42 CONG. Q. WEEKLY REP. 1839, 1840 (1983).

150. The conference bill adopted the Senate bill's provision for criminal penalties of a $1000 fine and a six-month prison term for violators of the hiring

(3) require mandatory sentencing. Admittedly, these suggestions may increase the discriminatory effect of the sanctions, but unfortunately, employer sanctions are to some degree inherently discriminatory in application. The United States' interest in solving its illegal immigration problem, however, outweighs the potential increase in discrimination. To alleviate some of the discriminatory effect Congress should adopt the sections of the House bill that require the President and the United States Civil Rights Commissioner to report on the discriminatory effects of the Bill. Moreover, the Bill should contain the antidiscrimination and enforcement measures of Representative Mazzoli's modified version of the House bill's provisions.[151] These steps will assure that Congress has the information necessary to adjust the employer sanctions program. Of course, the effectiveness of the monitoring process would depend upon the ardency of the Civil Rights Commission, the President, the Attorney General, the Special Counsel, and the Equal Employment Opportunity Commission.

The allocation of the costs of verification between small businesses and the federal government appeared more reasonable in the original House bill. Policing small businesses is the most expensive aspect of the present proposals. Unfortunately, exempting employers of three or fewer employees from verification procedures causes an unacceptable reduction in the effectiveness of the sanctions.[152] Fairness suggests that small businesses who have made an enforcement program necessary should pay the resulting costs. One possible approach would tax each employer according to the number of workers employed.[153] Employers able to demonstrate "voluntary" compliance[154] with the verification procedures would then receive a tax deduction comparable to the cost of ver-

provisions. *See Conference Committee Begins Action, supra* note 91, at 746. To assure a potent deterrent effect, Congress should restore the House Judiciary Committee's original penalty provision which included a $3000 fine and a one-year prison term for a "pattern or practice" of violations. *See* H.R. REP. No. 115, *supra* note 74, pt. 1, at 43.

151. *See supra* notes 135-37, 141 and accompanying text.

152. *See supra* notes 143-47 and accompanying text.

153. The tax could be added to the employer's share of the social security tax or included within an employer's income tax.

154. An employer could demonstrate compliance with the verification procedure by sending in the numbers from each employee's verification documents (i.e. driver's license, social security card, birth certificate, and INS or Dep't of Labor documents).

ification. This approach would offer four advantages: first, the tax would encourage employers to comply voluntarily with the verification procedures; second, the tax deduction would help defray the cost of verification for both large and small employers; third, the tax would help to make the enforcement of the verification procedures—and more significantly, the overall employer sanctions program—a self-supporting venture; last, because every employer would be subject to the tax, no single group of employers would achieve an undue competitive advantage.

5. *Nonimmigrant Temporary Worker Programs Under the Bill*

The Simpson-Mazzoli Bill also revises the H-2 visa program, the present nonimmigrant temporary worker program in the United States.[155] The Bill makes three major changes. First, the Senate bill streamlines the H-2 visa process for nonimmigrant, nonagricultural, temporary workers.[156] Second, the House bill requires employers to provide nonimmigrant workers benefits equal to those received under their state worker's compensation law.[157] Third, both bills establish a transitional nonimmigrant agricultural worker program that is intended to streamline the H-2 visa process for agricultural workers.[158] The conference bill, however, revamps the H-2 program, allowing employers to hire alien workers on short notice.[159]

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155. Section 1101(a)(15)(H)(ii) of the Immigration and Naturalization Act of 1952 provides certain aliens nonimmigrant status as temporary workers if: (1) the alien has a foreign residence that the alien does not intend to abandon; (2) the alien is coming to the United States only for a temporary stay; (3) the alien is going to perform *temporary* services or labor; and (4) no unemployed persons capable of performing such service or labor can be found in the United States. 8 U.S.C. § 1101(a)(15)(H)(ii) (1982).

156. *See infra* notes 207-20 and accompanying text.

157. *See infra* note 222 and accompanying text.

158. *See infra* notes 223-38 and accompanying text.

159. *See* Cohodas, *Conferees Near Agreement on Immigration Reform Bill,* 42 CONG. Q. WEEKLY REP. 2297, 2298 (1984). The new H-2(a) program proposed by the conferees would replace the H-2(P) program which was adopted by the House and would create a foreign guestworker program allowing 500,000 alien laborers to enter the United States to harvest perishable commodities. *See House, supra* note 90, 61 INTERP. REL. at 490; *see also* H.R. 1510, *supra* note 13, sec. 214, § 214, 130 CONG. REC. at 6179-81.

a. Prior temporary worker programs

The proposed changes in the present H-2 program have many antecedents. For example, the bracero program of 1942-64 permitted domestic employers in the United States to hire millions of Mexican agricultural workers.[160] The new proposals borrow from this prior program, from Western European guestworker experiments, and from the present H-2 program.

(i) *The bracero program*—Between 1942 and 1964, domestic employers hired between four and five million Mexican agricultural workers under the bracero program.[161] The program had three phases: (1) the wartime period, which began in 1942 and continued for two years after the end of the Second World War;[162] (2) the postwar transition period, which lasted from 1948 until Congress passed new authorizing legislation in 1951; and (3) the final period, which terminated in 1964.[163] During the wartime period, the United States Government approved the entry of more than 300,000 agricultural workers, 220,000 of whom were from Mexico,[164] pursuant to numerous bilateral agreements.[165] The United States Employment Service first had to certify that local workers were unavailable in a specific area before alien laborers were permitted to enter the United States.[166] In the years between the termination of the special wartime legislation in 1947 and the enactment of authorizing legislation in 1951, immigration policy was generally lax. During the initial years of the postwar transition period, 1948 and 1949, no treaty regulated the bracero program.[167] As a consequence, illegal immigration grew substantially.[168] In the middle 1950s, however, "Operation Wetback," an "intensive immigration law enforcement campaign," reduced ille-

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160. *See* H.R. REP. No. 115, *supra* note 74, pt. 2, 20-23.

161. *Id.* at 21.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.* The agreement with Mexico was formal and detailed. Agreements with some other countries were less substantial. *Id.*

166. *Id.* at 22; *see also* CONGRESSIONAL RESEARCH SERVICE, 96TH CONG., 2D SESS., HISTORY OF THE IMMIGRATION AND NATURALIZATION SERVICE: REPORT FOR USE OF THE SELECT COMMISSION ON IMMIGRATION AND REFUGEE POLICY 54 (1981) (microfiche, no. S522-1) [hereinafter cited as HISTORY OF THE INS].

167. *See* H.R. REP. No. 115, *supra* note 74, pt. 2, at 22.

168. *See id.*

gal immigration to extremely low levels.[169]

Between 1951 and 1964, the Agricultural Act of 1949[170] authorized a Mexican worker program.[171] It established the basic structure upon which the United States erected its Mexican bracero program.[172] During this period, United States employers were required to pay braceros the prevailing wage in the area. Furthermore, the program required employers to provide free housing and round trip transportation.[173] By 1959, employers in thirty-eight states were using braceros.[174] The same year, however, a group of consultants appointed by the Secretary of Labor released a report that criticized the effects of the bracero program on domestic farm workers.[175] The bracero program began to decline, and after 1964 the program expired.[176]

During the bracero program, the number of braceros rose from 4,203 in 1942, to 437,643 in 1959.[177] The program clearly demonstrated the United States need for low-wage agricultural workers. Moreover, the program indicated the overwhelming willingness of Mexican laborers to fill agricultural jobs in the United States. Although illegal immigration had been a problem between 1947 and 1951,[178] during the entire bracero program almost ninety percent of the Mexican nationals were documented.[179] Hence, despite the administrative difficulties associated with the bracero program, the program was modestly successful at curbing the number of undocumented workers.[180]

(ii) *The European experience with temporary workers*—The use of temporary foreign workers is not unique to the United

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169. *Id.*

170. Pub. L. No. 82-78, tit. 5, 65 Stat. 119 (1951) (amending Pub. L. No. 81-439, 63 Stat. 1051 (1949)) (title 5 repealed 1964).

171. *Id.*; *see* H.R. REP. No. 115, *supra* note 79, pt. 2, at 22.

172. *Id.*

173. *Id.* at 23.

174. *Id.*

175. *Id.*

176. *Id.* at 23-24.

177. *See* HISTORY OF THE INS, *supra* note 166, at 65 (Table 30).

178. *See supra* note 166 and accompanying text.

179. *The Knowing Employment of Illegal Immigrants*, *supra* note 17, at 110 (prepared statement of Robert T. Thompson, Southeastern Regional Vice Chairman of the Board of Directors, U.S. Chamber of Commerce).

180. *Id.* There were, however, other serious side effects of the bracero program. Employee's rights, working conditions, and wages often were substandard. *See id.*

States; it is also a common practice in Western Europe.[181] Furthermore, the short-run benefits of the European guestworker programs appear to outweigh the short-run costs.[182] By accepting lower wages foreign guestworkers help to stimulate economic growth and to retard inflation in the European host countries.[183] The short-run benefits, however, have not been achieved without long-run costs.

Although Germany halted its guestworker program in 1973,[184] in 1976 half of Germany's guestworkers had lived in Germany for six years.[185] Generally, the European experience has indicated that thirty to fifty percent of the "temporary" guestworkers become permanent residents.[186] In European host countries, the immigration prompted by the guestworker programs continues. The new immigrants, however, are the spouses and dependents of the "temporary" workers.[187] Throughout the 1960s, the unemployment rate among migrants was lower than among domestic workers, but now migrant unemployment is higher.[188] This may be attributed to the tendency of migrant children to adopt native attitudes and reject the type of work their parents once willingly accepted.[189]

The long-run effects of Europe's guestworker programs are not encouraging. First, large-scale guestworker programs merely become immigration avenues for up to half of the "temporary" guestworkers.[190] Second, mechanization of labor-intensive industries is postponed due to the availability of the guestworkers.[191] Third, the short-run benefit of cheap labor tends to prolong the

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181. Germany, France, Italy, Switzerland, and Luxembourg have (or had) guestworker programs. *See generally* GENERAL ACCOUNTING OFFICE, *supra* note 109 (describing the guestworker programs of various countries).

182. Greenwood, *supra* note 18, at 87.

183. *Id.* at 88.

184. P. MARTIN, *supra* note 28, at 10. France and Switzerland terminated their guestworker programs in 1974. *Id.*

185. *See id.* at 17. In Switzerland, 80% of the migrant workers had been present for more than seven years. *Id.*

186. Lansing & Alabart, *supra* note 71, at 24; *see also* P. MARTIN, *supra* note 28, at 15-16.

187. *See* P. MARTIN, *supra* note 28, at 15.

188. *Id.* at 16.

189. *Id.*

190. *Id.* at 41.

191. *Id.*

operations of marginal firms.[192] Last, the permanence of the migrant workers forced the host countries to increase their social expenditures.[193]

b. The H-2 visa program

The United States H-2 visa program takes a different approach to temporary worker programs. The H-2 program focuses upon specific local labor market needs rather than macro-level labor needs. Hence, the annual number of H-2 entrants has averaged approximately 30,000.[194] The temporary workers under the H-2 visa program are nonimmigrant laborers who are admitted to fill jobs that are also temporary.[195] Prior to an alien's admittance, a prospective employer must petition the Attorney General to import a foreign laborer. The employer must accompany his petition with a certification (a "labor certification") from the Secretary of Labor.[196] The Secretary must certify that qualified domestic workers are not available to perform the desired work and that the admission of the alien will not adversely affect United States workers.[197] The Secretary will notify a petitioning employer if certification cannot be granted.[198]

The major differences between the present H-2 system and the old bracero program are (1) the H-2 provisions are a permanent part of United States law and are not intended to fill a specific national manpower shortage;[199] (2) the number of foreign persons admitted is significantly smaller;[200] (3) H-2 visa holders are not limited to agricultural work;[201] and (4) the H-2 provisions are not

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192. *Id.*

193. *Id.* at 29.

194. *Hearings—Temporary Workers*, *supra* note 24, at 21 (testimony of Robert W. Searby, Deputy Under Secretary for Int'l Affairs, Dep't of Labor). Among the 30,000 annual H-2 visa workers admitted between the years 1973-1976 approximately 12,000 were agricultural workers. *See* Final Report, *supra* note 63, at 227. In 1981, the United States certified 36,000 aliens for H-2 visas; 18,153 were nonagricultural workers. H.R. REP. No. 115, *supra* note 74, pt. 2 at 25.

195. H.R. REP. No. 115, *supra* note 74, pt. 2, at 24.

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.* at 25.

200. *Id.*

201. *Id.* More than one-half of all nonagricultural H-2 visa holders are in entertainment, engineering, sports, and construction. *Id.*

reinforced by any international treaties.[202]

Under the present system, the employer must file a job order and application for labor certification eighty days prior to his date of need.[203] For the next sixty days, the employer must undertake recruiting efforts to find qualified domestic workers.[204] At the end of the sixty-day recruiting period, the Secretary of Labor determines the availability of domestic workers.[205] Although the Secretary of Labor must grant or deny labor certification, the Attorney General makes the final decision on the employment eligibility of an alien.[206]

The present program, however, has its shortcomings. By the time the employer has satisfied the procedural requirements, the temporary need often has evaporated.

c. Streamlining and modifying the labor certification process

Under the present cumbersome labor certification process, the employer must include with his application any documents that will help the Department of Labor determine whether qualified workers are available in the employer's area.[207] These documents include advertisements, posted notices, lists of professional associations consulted, and statements from the employer that detail his attempt to find workers.[208] The Department of Labor must then certify that domestic workers are not available and that the H-2 workers will not adversely affect the wages and working conditions of similarly employed domestic workers.[209]

The Simpson-Mazzoli Bill attempts to streamline the present labor certification process, but the House, Senate, and conference approaches differ. For agricultural workers, the House bill establishes a fifty-day recruitment period between the date of the employer's application and the date of hire,[210] thus, accelerating the application process. Furthermore, no later than twenty days

202. *Id.*
203. *Id.* at 26.
204. *Id.*
205. *Id.*
206. *Id.* at 24.
207. *See* NATIONAL LAWYERS GUILD, IMMIGRATION LAW AND DEFENSE § 3.7(c), at 3-25 (2d ed. 1983).
208. *Id.*
209. H.R. REP. No. 115, *supra* note 74, pt. 1, at 61.
210. H.R. 1510, *supra* note 13, sec. 211(b)(3), § 214(c)(3)(A)(i), 130 CONG. REC. at H6177; H.R. REP. No. 115, *supra* note 74, pt. 1, at 63.

before the date of hire, the Secretary of Labor must issue a decision on the employer's application.[211] By limiting the amount of time that the Secretary has to make his decision, the House bill decreases the chance that the application process will extend beyond the date when the workers are needed. The Senate bill, however, sets the recruitment period at eighty days.[212]

The conference bill employed many provisions similar to those contained in the House bill. Under the conferees' new H-2(a) program,[213] the Secretary of Labor can certify a grower's request for alien laborers upon a showing "that there are not sufficient workers who are able, willing and qualified and who will be available at the time and place needed to perform the labor services involved in the petition."[214] With respect to growers of perishable commodities, the conferees essentially adopted the House bill's proposal, providing a seventy-two hour limitation for review of any certification requests that the Secretary of Labor denies.[215]

Although the conferees essentially adopted the provisions of the earlier House bill, there are some differences. First, under the H-2(a) program, the Secretary of Agriculture would consult with the Secretary of Labor.[216] Second, the conference bill establishes procedures for emergency petitions from employers when the need for temporary alien laborers was unforseeable.[217] Last, employers participating in the H-2(a) program must pay the cost of

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211. H.R. 1510, *supra* note 13, sec. 211(B)(3), § 214(c)(3)(A)(iii), 130 CONG. REC. at H6177; H.R. REP. No. 115, *supra* note 74, pt. 1, at 63.

212. S. 529, *supra* note 13, sec. 211(b)(3), § 214(c)(3)(A)(i), at S6980.

213. The conference bill provides a new subsection (a) to the existing H-2 program. *Conference Committee Nears Completion on Simpson-Mazzoli Bill*, 61 INTERP. REL. 768, 772 (1984). The new H-2(a) program replaced the House bill's H-2(P) foreign guestworker program. *See infra* notes 239-52 and accompanying text. The H-2(a) program provides an expedited labor certification process for persons who "perform agricultural labor or services . . . of a temporary or seasonal nature." H.R. 1510, *supra* note 13, sec. 211(a)(1), § 101(a)(15)(H)(ii)(a), 130 CONG. REC. at H6176. Under the new H-2(a) program, the Secretary of Agriculture would have a consultative function in the operation of the agricultural H-2 program. *Conference Committee Nears Completion, supra*, 61 INTERP. REL. at 773.

214. H.R. 1510, *supra* note 13, sec. 211(b)(3), § 214(c)(2)(A)(i)(I), 130 CONG. REC. at H6167.

215. *See id.*, § 214(c)(2)(C)(ii), 130 CONG. REC. at H6177; *see also Conference Committee Nears Completion, supra* note 213, at 773.

216. *See supra* note 213.

217. *See Conference Committee Nears Completion, supra* note 213, at 773.

transporting their alien employees.[218]

For nonagricultural workers, the House bill essentially continues the present system.[219] The Senate bill, however, makes a substantial change. Currently, when deciding whether to issue certification, the Secretary considers the availability of workers at the particular place where the labor will be performed. Under the Senate bill, the Secretary would consider the availability of workers throughout the United States.[220] Thus, the Secretary could make a comprehensive review of the United States labor needs.

Finally, the House and conference bills modify the labor certification process by imposing new duties on the Secretary of Labor and the employer. First, the Secretary must ensure that the employer has provided housing or a housing allowance for the H-2 workers.[221] Second, employers must assure the Secretary of Labor that if the employee will not be covered by state worker's compensation, the employer will provide benefits equal to those provided under the state program.[222] Without these assurances, the Secretary cannot issue the labor certification.

d. The transitional nonimmigrant agricultural worker program

Unlike earlier proposals, both the House and Senate versions of the Simpson-Mazzoli Bill include a three-year transitional agricultural labor program (the "transitional labor program").[223] The conference committee adopted the provisions of the Senate bill.[224] The purpose of the program is "to assist agricultural employers in shifting from the employment of unauthorized aliens to the employment of eligible individuals."[225] The respective proposals,

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218. *See id.* at 772.

219. H.R. REP. No. 115, *supra* note 74, pt. 1, at 61.

220. S. REP. No. 62, *supra* note 61, at 44-45. Under § 201 of the 1982 House bill, the Secretary of Labor would have been able to use "labor market information with or without reference to the specific job opportunity." H.R. 6514, 97th Cong., 2d Sess., sec. 201(a), § 212(a)(14), *reprinted in* H.R. REP. No. 890, pt. 1, 97th Cong., 2d Sess. 16 (1982). The House version of the 1983 Bill deleted all of the old section 201.

221. H.R. 1510, *supra* note 13, sec. 211(b)(3), § 214(c)(3)(A)(iv), 130 CONG. REC. at H6177.

222. *Id.*, § 214(c)(2)(B)(iii), 130 CONG. REC. at H6177.

223. *See id.* sec. 211(b)(4), 130 CONG. REC. at H6177; S. 529, *supra* note 13, sec. 214, 129 CONG. REC. at S6981.

224. *House-Senate Conferees*, *supra* note 138, at 792a.

225. H.R. 1510, *supra* note 13, sec. 211(b)(4), § 214(e)(1), 130 CONG. REC. at

however, differ in several respects.

First, under the House bill an employer must enter the transitional labor program in its first year.[226] The Senate program, however, permits an employer to participate if a notice of intention to participate has been filed with the Attorney General within twelve months of the effective date of the program.[227]

Both the Senate and House bills require the Attorney General to specify the maximum number of transitional workers that an employer can include in his work force.[228] That number must "approximate the employer's maximum reasonable requirement for nondomestic seasonal workers."[229] Nevertheless, the two bills differ regarding the total number of participants. The House bill allows an employer in the second year of the program to hire sixty-seven percent of the number of employees he hired during the corresponding period for the first year.[230] For the third year, the corresponding proportion is thirty-three percent.[231] Under the Senate approach, however, the employer is not constrained by any previous year's hiring.[232] Because the House bill restricts em-

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H6177.

226. *Id.* § 214(e)(2)(A), *reprinted* at 21.

227. S. 529, *supra* note 13, sec. 214(f)(1), 129 CONG. REC. at S6982. The apparent effect of the language of the Senate version is that an employer may participate in any or all three years that the program is in effect—so long as he gives *notice* of his intention to participate within twelve months of the Bill's enactment.

228. *See, e.g.* H.R. 1510, *supra* note 13, sec. 211(b)(4), § 214(e)(2)(B), 130 CONG. REC. at H6177.

229. *Id.* The Senate bill guarantees an employer 100% of his entire seasonal agricultural worker needs for the first year of the program. S. 529, *supra* note 13, sec. 214(b), 129 CONG. REC. at S6981. Under the House version, the Attorney General determines the number of nonimmigrant workers an employer needs by looking at the employer's historic needs. *See id.* The Senate version of the Bill appears to allow an employer to use an entirely nonimmigrant work force during the first year of the program *regardless of his long-term employment history.* The employer must, however, "submit a numerical count of the number of seasonal agricultural workers employed during the immediately preceding twelve month period." *See* S. 529, *supra* note 13, sec. 214(f)(2), 129 CONG. REC. at S6982.

230. H.R. 1510, *supra* note 13, sec. 211(b)(4), § 214(e)(2)(D), 130 CONG. REC. at H6177.

231. *Id.*

232. The Senate version allows the employer to employ 33% and 67% of his entire seasonal worker need for the particular year, irrespective of his first-year labor force. S. 529, *supra* note 13, sec. 214(b), 129 CONG. REC. at S6981.

ployers to a hiring ceiling corresponding to his first year needs, the potential number of available transitional employees is smaller than the number available under the Senate bill.

Under both bills, transitional employees are entitled to the same benefits as H-2 workers,[233] but the two bills differ with respect to a laborer's eligibility for participation in the program. The Senate bill provides that an employee is eligible to participate in the transitional labor program only if he or she worked as a seasonal agricultural worker in the United States for at least ninety days since January 1, 1980.[234] In addition, only workers who participate in the first year of the program are eligible in the subsequent two years.[235] The House bill does not contain similar provisions. In his letter to the House Committee on the Judiciary, Attorney General Smith recommended that the House add an eligibililty requirement[236] because without one, the transition program would become "a magnet for additional illegal migration."[237] Attorney General Smith also expressed concern that "the legislation should make clear that transitional workers are not to replace available U.S. workers."[238]

6. *The Panetta Amendment: The New H-2(P) Program*

On June 14, 1984, the House amended its bill to create the H-2(P) program, a foreign guestworker program to aid growers during the harvest.[239] The conference committee, however, subsequently replaced the H-2(P) program with the H-2(a) program.[240] The H-2(P) program would expand the existing H-2 program to ameliorate some of the hardships that the employer sanctions provisions impose upon agricultural employers.[241] Each year the

233. *Id.* sec. 214(b), 129 CONG. REC. at S6982; H.R. 1510, *supra* note 13, sec. 211(b)(4), § 214(e)(4)(A), CONG. REC. at H6178.

234. S. 529, *supra* note 13, sec. 214(e)(1), 129 CONG. REC. at S6981.

235. *See id.* sec. 214(e)(2), 129 CONG. REC. at S6981.

236. *See* Smith Letter, *supra* note 77, at 7. Attorney General Smith recommended that the House amend its version of the bill "to restrict eligibility to aliens within the U.S. who have previously been employed in agriculture." *Id.*

237. *Id.*

238. *Id.*; *see also* S. 529, *supra* note 13, sec. 214(c), 129 CONG. REC. at S6981.

239. The House passed the Pannetta Amendment by a vote of 228 to 172. *See* Cohodas, *Immigration Reform Measure Nearing Final Vote in House*, 42 CONG. Q. WEEKLY REP. 1407 (1984).

240. Cohodas, *Conferees Near Agreement, supra* note 60, at 2298.

241. Cohodas, *House Passes Immigration Bill by Five Votes*, 42 CONG. Q.

H-2(P) program would permit approximately 500,000 agricultural workers to enter the United States on nonimmigrant visas.[242] At present, a grower must apply for laborers at least fifty days in advance of his date of need;[243] the H-2(P) program would reduce the minimum period of notice to seventy-two hours.[244] In the application to participate, a grower could include a statement of preference stating the nationality of the workers he intended to hire.[245] The grower must show a good faith effort to find domestic workers in the designated agricultural region prior to hiring any nonimmigrant laborers.[246] The grower also would have to provide the nonimmigrant employees wages and working conditions that would not affect adversely the prevailing wages and working conditions of similarly situated domestic workers.[247] If the nonimmigrant workers were ineligible to receive state worker's compensation benefits, an employer would have to obtain insurance sufficient to provide his employees with the equivalent degree of protection.[248]

Aliens who wished to obtain nonimmigrant visas under the H-2(P) program could not bring their families into the United States,[249] nor were they entitled to receive benefits under any federal financial assistance program.[250] The program would permit a nonimmigrant worker to work for an unlimited number of participating employers within a designated "agricultural region."[251] Each worker was allowed to stay in the United States for up to eleven consecutive months.[252]

WEEKLY REP. 1493 (1984).

242. *See id.*

243. Cohodas, *House Passes, supra* note 241, at 1410.

244. *Id.*

245. H.R. 1510, *supra* note 13, sec. 214(b)(1)(C), § 214(f)(2)(A), 130 CONG. REC. at H6180 (proposed addition after the end of section 214 of the 1952 Act, 8 U.S.C. 1184).

246. *Id.* § 214(f)(3)(B)(i), 130 CONG. REC. at H6180.

247. *Id.* § 214(f)(3)(B)(ii), 130 CONG. REC. at H6180.

248. *Id.* § 214(f)(3)(B)(iii), 130 CONG. REC. at H6180.

249. *Id.* § 214(f)(2)(C), 130 CONG. REC. at H6180.

250. *Id.* § 214(f)(4), 130 CONG. REC. at H6180-81.

251. Cohodas, *House Passes, supra* note 241, at 1410.

252. H.R. 1510, *supra* note 13, sec. 214(a), § 101(a)(15)(P), 130 CONG. REC. at H6179.

7. *Comments on the H-2(a), H-2(P), and Transitional Agricultural Labor Programs*

Although the temporary worker provisions of the conference bill help employers meet their labor needs, the provisions do not realistically address many other problems facing United States employers. Many feel that a de facto temporary worker program already exists between the United States and Mexico which allows between 500,000 and 1,000,000 illegal aliens to "participate" every year.[253] Unfortunately, the only control the United States can exercise over the present "program" is to deport some of the "participants."[254] Although the Select Commission on Immigration and Refugee Policy split on the guestworker question, the Reagan Task Force offered three options. Two of those options propose massive guestworker programs. The other option suggested a more liberal H-2 visa program.[255] Although the European experience suggests that guestworkers are not necessarily temporary, the United States does face a considerable labor shortfall in the next few decades.[256] Admittedly, the Bill's legislation and amnesty provisions[257] provide the United States with a large pool of laborers. Many Mexicans, however, do not wish to stay permanently within the United States. Their families usually remain in Mexico, and the dollars earned are worth much more at home.

Among the proposals submitted thus far, the H-2(P) program appears to be the most viable. The Administration's separate legislative proposal for a 50,000 worker "experimental program"[258] seems woefully inadequate. Furthermore, the conference bill's transitional labor and the new H-2(a) programs fall far short of meeting the United States needs for labor *and* fail to curb illegal immigration.

Employer sanctions tend to repel undocumented aliens, yet the desired approach should be to *channel* Mexican immigrants into classifications that permit the United States Government to ac-

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253. *Hearings—Temporary Workers, supra* note 24, at 6 (statement of Alan C. Nelson, Deputy Commissioner, INS).

254. *Id.*

255. *See supra* notes 68-73 and accompanying text.

256. *See supra* note 44 and accompanying text.

257. *See supra* notes 52-60 and accompanying text. *See generally* H.R. 1510, *supra* note 13, sec. 301(a), § 245A, 130 CONG. REC. at H6181 (establishing the legalization program).

258. *See supra* note 72 and accompanying text.

count for their numbers and to plan its policy accordingly. As the Reagan Task Force noted, the employer sanctions comprise an integral part of a package that includes a temporary worker program.[259] Admittedly, the Simpson-Mazzoli Bill makes a strong attempt to address the problem of illegal immigrants, and Congress should be commended for its effort. The Bill, however, has some serious shortcomings.

The House bill[260] leaves intact the present cumbersome labor certification provisions for nonagricultural workers. Because the trend among undocumented workers is away from agricultural work,[261] the House bill is extremely shortsighted. The Senate bill, which allows the Secretary of Labor to grant certifications based on a comprehensive evaluation of labor market needs, is a relatively simpler, expeditious system and allows a greater number of migrant workers to enter the United States. The conference bill's H-2(a) program, while providing for an expeditious review procedure, essentially employs the existing cumbersome procedures of an employer's initial applications to hire alien workers.[262]

The transitional labor program proposed in the House bill could attract additional Mexican workers, rather than encourage a shift to legal channels of labor migration.[263] By restricting access to Mexican laborers who already have been employed in the United States as seasonal agricultural workers, the Senate transitional program helps to avoid any "magnet" effect. The Senate's program, adopted by the conference committee, may undercut its own objective of discouraging displacement of domestic workers. Although the Senate bill forbids alien laborers from displacing domestic workers,[264] the Attorney General is not *required* to consider an employer's past use of seasonal agricultural workers prior to allowing the employer to participate in the first year of the transitional labor program. Hence, employers who once hired domestic workers in accord with the present law might be able to

259. *See supra* note 66 and accompanying text.

260. *See supra* notes 203-06 and accompanying text.

261. *Cf. supra* note 44 (stating that in the future the United States will suffer a shortage of nonfarm workers—the inevitable niche of illegal aliens).

262. Opponents to the H-2(a) program point out that certifications are granted in 98% of all reviews under the present H-2 program. *See Conference Committee Nears Completion, supra* note 213, at 772 (argument of Rep. George Miller, D-Cal.).

263. *See supra* text accompanying notes 236-37.

264. S. 529, *supra* note 13, sec. 214(c), 129 CONG. REC. at S6981.

hire foreign farmworkers exclusively during the first year of the program. The House bill, on the other hand, requires the Attorney General to consider an employer's past need for nonimmigrant, seasonal, agricultural workers prior to establishing the number of foreign workers the employer may hire.[265] The effect of the House bill's treatment of the transitional labor program is to reduce any displacement effects.

Although the H-2(P) program was introduced to remedy the anticipated deficiencies in the original legislation, both of the name sponsors of the Simpson-Mazzoli Bill correctly predicted that the program would not survive the conference committee sessions without substantial alteration.[266] Certainly the original form of the H-2(P) program could be improved. The provision that permits employers to request workers of a particular nationality conflicts with the Bill's general prohibition against discrimination on the basis of nationality or alienage.[267] Without effective enforcement measures the H-2(P) program might simply expedite the entry of illegal alien workers into the United States. If unsupervised, alien workers are likely (1) to overstay their visas as European guestworkers have done, (2) to work outside their predesignated agricultural region, or (3) to work in industries other than those producing perishable commodities. The more common criticism is that the program will simply resurrect the discarded bracero program and all its attendant ills.[268] Labor unions, in particular, are not convinced that an adverse effect upon the wages and working conditions of domestic workers can be avoided.[269] Nevertheless, opponents' fears are probably overstated. By requiring that the guestworkers receive wages and working conditions equivalent to those of domestic workers and that employers provide protection equivalent to state worker's

265. *See* H.R. 1510, *supra* note 13, sec. 201(b)(4), § 214(e)(2)(B), 130 CONG. REC. at H6177.

266. Cohodas, *Immigration Reform Measure Now 'Hanging by a Thread,'* 42 CONG. Q. WEEKLY REP. 1839, 1840 (1984).

267. *See supra* note 136 and accompanying text.

268. *See* Cohodas, *Immigration Reform Measure Nearing Final Vote in House,* 42 CONG. Q. WEEKLY REP. 1407, 1410 (1984). One Texas representative stated that the new H-2(P) program amounted to "rent-a-slave." *Id.*

269. *Cf.* Cohodas, *Alien Guest Workers: A Lobbying Mismatch,* 42 CONG. Q. WEEKLY REP. 1497 (1984). Organized labor, an initial supporter of the Bill's employer sanctions provisions, opposes an expansion of the existing temporary worker program fearing that alien labor would replace domestic workers.

compensation laws, the designers of the H-2(P) program have specifically addressed the deficiencies of the bracero program that led to its demise. The effectiveness of these safeguards, however, depends upon adequate enforcement. Nevertheless, the overall approach of the H-2(P) program is a necessary element of a comprehensive immigration reform. To shift the inevitable inflow of aliens into documented channels requires the push-pull effect of employer sanctions *and* some type of large scale guestworker program. Moreover, "[f]rom a purely economic viewpoint . . . there are many advantages to a kind of 'guestworker' policy."[270] For example, guestworkers will help alleviate the expected shortfall of low-skill labor expected in the late 1980s.[271] The presence of a guestworker pool will also dampen inflationary pressures in the United States economy. The H-2(P) program is definitely worth retaining because it offers a realistic means to provide a substantial pool of agricultural workers.

Finally, the Senate bill fails to address the "push" factors that underlie the need for a temporary worker program. The House bill authorizes the President to establish an advisory commission to consult with the governments of Mexico and other countries.[272] The commission's duty would be to advise the Attorney General concerning the operation of the temporary worker programs. Thus, the provision would enable the Attorney General to stay abreast of developments in "sender" nations.

D. The Future of the Simpson-Mazzoli Bill

In each of the last three years, an ambitious immigration reform bill has died either in committee or on the floor of Congress.[273] The future of the Simpson-Mazzoli Bill will depend on a number of factors, but Senator Simpson has stated that he is ready to introduce a new immigration bill in early 1985.[274] Presidential support of a new bill, however, is indispensable to its successful enactment. Unfortunately, both political parties are divided over virtually every provision. Although the political obstacles are substantial, the largest obstacles are the improving

270. Wachter, *supra* note 24, at 167.

271. *See supra* note 44 and accompanying text.

272. H.R. 1510, *supra* note 52, sec. 211(b)(4), § 214(f), 130 CONG. REC. at H6178.

273. *See* Cohodas, *Immigration Reform Bill, supra* note 81, at 2623.

274. *See id.*

economies of the United States and Mexico. If the Mexican attempt to restructure its economy stalls due to the softening of the crude oil market, or if the United States economic recovery falters, and harder times return to either country, the Bill's prospects for enactment will improve. Historically, illegal aliens have been the scapegoats during United States economic straits. If, however, the economic outlook in each country continues to improve, the opponents of the Bill will have a much better chance to defeat it. It is ironic that an upswing in the United States economy, which increases the "pull" effect for illegal aliens, would jeopardize the enactment of a bill designed to solve the United States immigration problems.

V. Recent Developments in Transboundary Pollution Litigation—The United States and Mexico

A. Introduction

The specific problems of transboundary pollution along the United States-Mexican border run the gamut of possibilities: oil spills, air pollution, water pollution, and hazardous waste dumping. The Mexican economic crisis of 1982 indirectly has affected transboundary pollution litigation arising from these problems. A government cutting back on public spending to comply with International Monetary Fund loan requirements[1] obviously is neither interested in promulgating regulations that require expensive enforcement mechanisms nor able to subsidize needed sanitation systems.[2] A government facing social unrest from unemployment and high inflation rates[3] is not likely to burden industry with expensive regulations designed to improve air quality.[4] On

1. Riding, *OPEC Rift Unsettles Mexico*, N.Y. Times, Jan. 28, 1983, at D1, col. 3 (compliance with $3.9 billion IMF loan requires price increases and cutback in government spending).

2. *See generally* Note, *City Growth and Cooperation Along the United States/Mexican Border*, 10 GA. J. INT'L & COMP. L. 619, 628 (1980) (discussing problems faced by Mexican border cities even in noncrisis times).

3. Riding, *Mexico Has Dominoes of Its Own to Worry Over*, N.Y. Times, Mar. 20, 1983, § 4, at 4, col. 3.

4. Bath, *Alternative Cooperative Arrangements for Managing Transboundary Air Resources Along the Border*, 18 NAT. RESOURCES J. 181, 187-88 (1978). For a discussion of the economic impact of clean air legislation on industry, see Lutz, *Managing a Boundless Resource: U.S. Approaches to Transboundary Air Quality Control*, 11 ENVTL. L. 321, 341-43 (1981).

the other hand, officials of a country whose chief source of income is oil exports understandably might gloat at the discovery of a major new source of oil supply,[5] even when the new well spills its riches on the shores of another country.

The already difficult problem of transnational pollution clearly is exacerbated when the adjoining nations—the United States and Mexico—stand far apart on the scale of economic strength and overall industrialization. Predictably, the disparity will be a factor in the formulation and implementation of intergovernmental solutions. When government solutions do not work, however, private individuals are still hurt, but legal action often is not possible or advisable.

This section will survey recent private litigation aimed at the prevention of, or the recovery for, transboundary pollution damage. It will focus primarily on the 1982 Texas district court decision, *In re Sedco, Inc.*[6] The *Sedco* case consolidated litigation arising from a 1979 oil spill in the Bay of Campeche.[7] Sedco, a Texas corporation, had leased an oil drilling rig to Perforaciones Marinas Del Golfo (Permargo), a Mexican company drilling oil under a contract with Petroleos Mexicanos (Pemex), a government-owned monopoly that oversees oil production in Mexico.

5. Leonhard, *Ixtoc I: A Test for the Emerging Concept of the Patrimonial Sea*, 17 SAN DIEGO L. REV. 617, 627 (1980) (paraphrasing the Director General of Petroleos Mexicanos (Pemex), who commented at the height of the Ixtoc I oil spill that the 30,000 barrels of oil gushing out daily "was proof that his nation might have greater petroleum reserves than earlier estimated").

6. *In re* Sedco, Inc., 543 F. Supp. 561 (S.D. Tex. 1982). Numerous articles were written on the *Sedco* case prior to the court's decision. *See, e.g.*, Comment, *The Bay of Campeche Oil Spill: Obtaining Jurisdiction over Petroleos Mexicanos Under the Foreign Sovereign Immunities Act of 1976*, 9 ECOLOGY L.Q. 341 (1981); Comment, *The Ixtoc I Oil Spill Litigation: Jurisdictional Disputes at the Threshold of Transnational Pollution Responsibility*, 16 TEX. INT'L L.J. 475 (1981) [hereinafter cited as Comment, *Jurisdictional Disputes*]; Note, *Domestic and International Liability for the Bay of Campeche Oil Spill*, 6 INT'L TRADE L.J. 55 (1980-81) [hereinafter cited as Note, *Domestic Liability*]; Comment, *Troublesome Aspects of the Sedco 135 Disaster: Has the Plight of the Transnational Pollution Victim Really Improved in the Wake of Torrey Canyon?*, 2 HOUS. J. INT'L L. 387 (1980) [hereinafter cited as Comment, *Troublesome Aspects*]. For summaries of the decision, see *In re* Complaint of Sedco, Inc., [1982] 12 ENVTL. L. REP. (ENVTL. L. INST.) [Litigation] 20,635 (July 1982); Leigh, *Judicial Decisions*, 77 AM. J. INT'L L. 149 (1983).

7. *See In re* Sedco, Inc., ENVTL. L. REP. (ENVTL. L. INST.) [Pending Litigation] 65,657 (Jan. 1980) (listing the litigation that was consolidated).

The massive oil spill, the largest to date,[8] allegedly resulted from negligent drilling.[9] The oil spread to the Texas coast and subsequently cost the United States Government approximately $12.5 million to clean up.[10] This section focuses on two issues relevant to recovery: foreign sovereign immunity and the categorization of the oil drilling rig for the purposes of the Limitation of Liability Act.[11] The section also briefly surveys subsequent agreements and motions that grew out of the *Sedco* decision. It then scans a 1983 agreement between the United States and Mexico to cooperate on environmental problems, and recent private and governmental litigation addressing the issues of air pollution, hazardous waste transportation and storage, and water pollution along the United States-Mexican border.

B. *In Re* Sedco, Inc.

1. *Legal Background*

a. Foreign sovereign immunity

The doctrine of foreign sovereign immunity, codified in the Foreign Sovereign Immunities Act of 1976 (FSIA or Act),[12] presents a major obstacle to recovery in any transnational suit, particularly one against a government-owned or government-created entity. Under the FSIA, the jurisdictional immunity granted foreign states extends to the states' political subdivisions, agen-

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8. 10 ENV'T REP. (BNA) 900 (Aug. 3, 1979).

9. *Id.* at 1165 (Sept. 14, 1979). *See also In re* Sedco, Inc., ENVTL. L. REP. (ENVTL. L. INST.) [Pending Litigation] 65,657, 65,657 (Jan. 1980) (claims of the United States and Texas); *In re* Sedco, Inc., 543 F. Supp. at 569.

10. Sedco, Inc.-United States: Agreement Concerning Settlement of Claims Arising from the 1979 Oil Well Blowout and Oil Spill in the Gulf of Mexico, Mar. 1, 1983, 22 I.L.M. 580, 581 (1983) [hereinafter cited as United States Agreement].

11. A third issue, whether the Texas district court may assert in personam jurisdiction over Permargo, is not discussed in this section. The court denied Permargo's motion to dismiss for lack of personal jurisdiction, holding that Permargo was amenable to service of process because (1) it was "doing business" in Texas within the meaning of the Texas long-arm statute, and (2) Permargo's systematic activity in Texas, as well as its anticipation of damage to Texas shores as a result of its drilling activities and the substantiality of the blowout's alleged impact on Texas residents met due process requirements. *In re* Sedco, Inc., 543 F. Supp. at 567-70.

12. 28 U.S.C. §§ 1602-11 (1982).

cies, and instrumentalities.[13] Each can elude United States jurisdiction unless its activities fall within one of the exceptions listed in section 1605 of the Act. The list includes an exception for a state's commercial acts that give rise to the cause of action and have sufficient contact with the United States.[14] Another exception, for noncommercial acts, applies to actions for damages that are based on "personal injury or death, or damage to or loss of property, occurring in the United States," that are caused by the foreign state or its officials or employees acting within the scope of their employment, unless the action on which the claim is based was discretionary.[15]

The FSIA's commercial activities exception represents Congress' intent to give statutory form to the "restrictive" theory of sovereign immunity espoused by a growing number of countries and adopted as State Department policy in the famous "Tate

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13. "A 'foreign state,' except as used in section 1608 of this title, includes a political subdivision of a foreign state or an agency or instrumentality of a foreign state as defined in subsection (b)." *Id.* § 1603(a). A corporation "which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof" is an agency or instrumentality of a foreign state under the FSIA. *Id.* § 1603(b)(2).

14.

> A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case—
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> . . . .
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> (2) in which the action is based upon a commercial activity carried on in the United States by the foreign state; or upon an act performed in the United States in connection with a commercial activity of the foreign state elsewhere . . . .

Id. § 1605(a)(2).

15.

> A foreign state shall not be immune from the jurisdiction of courts of the United States or of the States in any case—
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> . . . .
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> (5) not otherwise encompassed in paragraph (2) above, in which money damages are sought against a foreign state for personal injury or death, or damage to or loss of property, occurring in the United States and caused by the tortious act or omission of that foreign state or of any official or employee of that foreign state while acting within the scope of his office or employment; except this paragraph shall not apply to—
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> (A) any claim based upon the exercise or performance or the failure to exercise or perform a discretionary function regardless of whether the discretion be abused . . . .

Id. § 1605(a)(5)(A).

Letter."[16] The purpose of the exception is to protect persons doing business with foreign governments acting in their commercial capacity, especially when the United States Government would be subject to jurisdiction abroad when performing similar activities.[17] The legislative history of the Act states that Congress intended the term "commercial activities" to cover a broad spectrum of behavior.[18] An activity is presumed to be commercial in nature if it is one that either customarily is carried on for profit,[19] or arises from a contract that could have been made as easily by a private party.[20] Congress expressly directed courts to look to the nature of the activity, rather than its purpose, to determine whether it is commercial or public, an approach that allows the courts "a great deal of latitude in determining what is a 'commercial activity' for the purposes of this [Act]."[21] According to Congress, a court's determination of whether the activity has a direct effect on the United States should be consistent with section 18 of the *Restatement (Second) of Foreign Relations Law*.[22]

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16. *See* Texas Trading & Milling Corp. v. Federal Republic of Nig., 647 F.2d 300, 309-10 (2d Cir. 1981) (citing *Hearings on H.R. 3493 Before Subcomm. on Claims and Govenmental Relations of the House Comm. on the Judiciary*, 93d Cong., 1st Sess. 16 (1973) (testimony of Charles N. Brower, Legal Advisor, Dep't of State, on an earlier version of the FSIA)), *cert. denied*, 454 U.S. 1148 (1982); *see also* H.R. REP. No. 1487, 94th Cong., 2d Sess., *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 6604, 6605; Letter from Jack B. Tate, Acting Legal Advisor, Dep't of State, to Phillip B. Perlman, Acting Attorney General, May 19, 1952, 26 DEP'T ST. BULL. 984 (1952) [hereinafter cited as Tate Letter]. The restrictive theory of sovereign immunity, as opposed to the absolute theory of sovereign immunity, restricts immunity to those acts performed by a foreign state in its public, governmental capacity. *Id.* at 984.

17. Tate Letter, *supra* note 16, at 985 (noting the increasing commercial activity by governments). Tate also argued that an increasing number of countries were adopting the restrictive theory. *Id.* at 984-85.

18. H.R. REP. No. 1487, *supra* note 16, at 16, *reprinted* at 6614 (explaining the FSIA's definition of commercial activity). Among examples given of operations constituting a "regular course of commercial conduct," 28 U.S.C. § 1603(a), were "a mineral extraction company, an airline or a state trading corporation." H.R. REP. No. 1487, *supra* note 16, at 16, *reprinted* at 6614-15.

19. H.R. REP. No. 1487, *supra* note 16, at 16, *reprinted* at 6615.

20. *See infra* notes 23-24 and accompanying text.

21. H.R. REP. No. 1487, *supra* note 16, at 16, *reprinted* at 6615.

22. H.R. REP. No. 1487, *supra* note 16, at 19, *reprinted* at 6618. The text of section 18 reads:

> A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either

Courts have experienced some difficulty in distinguishing a foreign state's private or commercial acts from its public acts. In some instances the commercial nature of the activity is clear, particularly if it involves a contract for goods or services[23] or an activity normally engaged in by private parties.[24] The following cases demonstrate, however, that many activities are less amenable to categorization.

In *Yessenin Volpin v. Novosti Press Agency*,[25] the plaintiff charged two government-owned press agencies with libel for statements that had appeared in intragovernmental publications. The District Court for the Southern District of New York recognized that an agency can engage simultaneously in both commercial and noncommercial activities, and found the defendants immune under the FSIA. The court reasoned that subjecting a government-owned news agency to liability for acts of intragovernmental cooperation would contravene the spirit and letter of the Act.[26] In other words, the activity was considered more gov-

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(a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or

(b) (i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems.

RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 18 (1965).

The court in *Sedco* did not discuss the "direct effects" requirement of the third clause of section 1605(a)(2), and this section of the Special Project does not address that issue.

23. *See, e.g.*, Gemini Shipping, Inc. v. Foreign Trade Org. for Chems. and Foodstuffs, 647 F.2d 317, 319 (2d Cir. 1981) (trade organization wholly-owned by Syrian Government "beyond doubt" engaged in commercial activities when it purchased rice and soybeans); Ohntrup v. Firearms Center Inc., 516 F. Supp. 1281, 1286 (E.D. Pa. 1981) (agreement by a government-owned Turkish corporation to sell allegedly defective guns within the United States was commercial activity); Behring Int'l, Inc. v. Imperial Iranian Air Force, 475 F. Supp. 383 (D.N.J. 1979) (the contracted use of Iranian Air force planes to ship and deliver goods purchased in the United States was commercial), *aff'd*, 699 F.2d 657 (3d Cir.), *reh'g denied* (1982).

24. *See* China Nat'l Chem. Import & Export Corp. v. M/V Lago Hualaihue, 504 F. Supp. 684 (D. Md. 1981) (Chilean-owned ship carrying bulk nitrates for delivery in the United States was engaging in commercial activities).

25. 443 F. Supp. 849 (S.D.N.Y. 1978).

26. *Id.* at 856. The court held that the activity was not in connection with a

ernmental or public, than private in nature. A similar question arose in the same district in *United Euram Corp. v. U.S.S.R.*.[27] There the court held that the Soviet State was not immune from United States jurisdiction in a breach of contract suit. The contracts had been drafted pursuant to a cultural exchange for which the plaintiff had paid a fee, and covered the sale of plaintiff's services as an impressario. The court ruled that the public purpose of the exchange was irrelevant[28] and that the contracts were commercial in nature because they were similar to those drafted by private agents.[29]

In *International Association of Machinists and Aerospace Workers (IAM) v. Organization of Petroleum Exporting Countries (OPEC)*,[30] a California district court chose not to exercise its statutory discretion to interpret "commercial activity" broadly and instead emphasized the overall purpose of the FSIA, to keep courts away from sensitive political issues that could affect foreign relations. Differentiating between the OPEC countries' commercial actions as proprietors or oil producers and their actions as governments, the court found the OPEC members' price-fixing activity to be immune from suit.[31] The court ruled that by establishing "terms and conditions for the removal" from the territory of a resource that is crucial to the country's welfare, the OPEC countries' control over their oil resources was governmental activity.[32] In essence, foreign states acting in a regulatory capacity, as distinguished from a proprietary capacity, are immune from suit under the FSIA.

In 1981, two years after the *IAM* decision, the Southern District Court of New York in *Rios v. Marshall*[33] followed the California court's reasoning and held that the British West Indies

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contract or any other nongovernmental commercial activity. *Id.*

27. 461 F. Supp. 609 (S.D.N.Y. 1978).

28. *Id.* at 611.

29. *Id.*

30. 477 F. Supp. 553 (C.D. Cal. 1979), *aff'd on other grounds*, 649 F.2d 1354 (9th Cir. 1981) (antitrust action challenging OPEC's price fixing activities), *cert. denied*, 454 U.S. 1163 (1982).

31. *Id.* at 569. The court compared the OPEC nations' price setting activity with the United States regulation of the oil industry. *Id.* at 568.

32. *Id.*

33. 530 F. Supp. 351 (S.D.N.Y. 1981) (conspiracy action charging that BWICLO and New York apple growers plotted to replace immigrant farm workers with Jamaicans).

Central Labour Organization (BWICLO) was immune from suit under the FSIA when establishing the terms and conditions for Jamaican labor in the United States. According to the court, BWICLO was acting as a foreign state when regulating the removal of manpower, a Jamaican natural resource, from the country.[34] To support its ruling that the organization's acts were public in nature, the court noted that BWICLO, unlike a private sector organization, received no fees for its services, and was reimbursed only for expenses.[35]

One year earlier, in *Arango v. Guzman Travel Advisor's Corp.*,[36] the Fifth Circuit had also found the lack of remuneration to be significant in distinguishing between commercial and noncommercial actions of an airline wholly owned by the Dominican Republic. The *Arango* court ruled that the airline's involuntary rerouting of a plane back to the United States, without compensation and at the insistence of the government, was a noncommercial governmental act.[37] In contrast, the court ruled that the airline's negligence in screening the passengers and its failure to provide warnings and alternate vacation plans for the unfortunate passengers were commercial in nature, and therefore not protected by immunity.[38]

In *Najarro de Sanchez v. Banco Central de Nicaragua*,[39] a Louisiana district court held that the government-owned Banco Central de Nicaragua, acting without a fee and in a regulatory capacity, was immune under the FSIA for its action in refusing to redeem plaintiff's certificate of deposit. The court found the "nature" of the specific activity giving rise to the cause of action to be governmental, even though the bank's activities were predominantly commercial.[40] The same year, in *Texas Trading & Milling Corp. v. Republic of Nigeria*,[41] the Second Circuit attempted to define the elusive "commercial activity" exception by indicating three sources that could be consulted: legislative history, pre-FSIA case law decided in light of the Tate Letter, and current

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34. *Id.* at 371-72.
35. *Id.* at 372.
36. 621 F.2d 1371 (5th Cir. 1980).
37. *Id.* at 1379.
38. *Id.* at 1379-80.
39. 515 F. Supp. 900 (E.D. La. 1981).
40. *Id.* at 907.
41. 647 F.2d 300 (2d Cir. 1981), *cert. denied*, 454 U.S. 1148 (1982).

standards in international law.[42] After consulting these sources, the court concluded that Nigeria's cement contracts and letters of credit at issue in the case were commercial.[43]

Following *Texas Trading*, the Southern District Court of New York held in *Gibbons v. Udaras na Gaeltachta*[44] that the actions of two organizations serving as agents of the Republic of Ireland to promote investments within that country constituted commercial activity.[45] After applying what it referred to as the "nature-of-the-act" test, the court asserted that the joint venture agreement entered into by the public parties could easily have been entered into by private parties.[46] In *Bankers Trust Co. v. World-wide Transportation Services, Inc.*,[47] a similar contract to oversee the transportation of goods to Mexico, entered into by an agent for the Mexican equivalent of the Department of Agriculture, brought that agent within the commercial activities exception. An Arkansas district court felt the purpose of the contract, the stabilization of Mexican price supports and purchases, was irrelevant.[48] This approach is similar to that used by the court in *Gibbons* to discount the public purpose of the joint venture agreement.[49] In *Sedco*,[50] the District Court for the Eastern District of Texas asked whether Pemex, a company created by the Mexican Government in 1938 to operate the newly nationalized oil industry, had acted in a commercial or governmental capacity when drilling for oil. Pemex's oil drilling had prompted multiple causes of action when the oil rig suffered a blowout, spilling millions of gallons of oil into the Gulf of Mexico, much of which reached Texas shores.[51]

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42. *Id.* at 309-10.

43. *Id.* at 310.

44. 549 F. Supp. 1094 (S.D.N.Y. 1982).

45. *Cf.* Gibbons v. Republic of Ir., 532 F. Supp. 668 (D.D.C. 1982) (under the same facts, the court found the Republic of Ireland not subject to suit for the wrongdoing of its two agents).

46. 549 F. Supp. at 1110.

47. 537 F. Supp. 1101 (E.D. Ark. 1982) (action resulting from Worldwide's refusal to return $299,700, which plaintiffs allegedly transferred by mistake from the account of a department of the Mexican Government to that of Worldwide, its agent).

48. *Id.* at 1107.

49. *See supra* notes 44-46 and accompanying text.

50. 543 F. Supp. 561.

51. *See infra* notes 109-14 and accompanying text.

Congress drafted the FSIA's noncommercial tort exception[52] in general terms to encompass all tort actions for money damages.[53] The legislative history of the Act explains that the tort may be based on strict liability or negligence and must occur "within the jurisdiction of the United States."[54] Because Congrèss has compared this exception to the Federal Tort Claims Act (FTCA),[55] courts have looked to the FTCA to determine whether an act is discretionary and thus exempted from the exception, rendering the actor immune from suit. In *Dalehite v. United States*,[56] the Supreme Court defined as discretionary for the purposes of the FTCA any act based upon policy judgments or decisions.[57] Acts of subordinates in carrying out such policy decisions were also held to fall within discretionary immunity.[58] Thus, the employees at a fertilizer plant could not be sued for the negligence that resulted in an explosion because they were carrying out decisions made at a "planning rather than an operational level."[59] The test applied by the Court appears to have been whether the particular action being carried out was one that had been specifically decided at the administrative or executive level.[60]

Subsequent decisions have narrowed the immunity for employees carrying out policy decisions, reasoning that once a discretionary decision has been made, a governmental employee should not be given a license to implement it negligently.[61] The distinction between the planning (discretionary) and operational (nondiscretionary) levels has been articulated more fully in recent decisions. In *Payton v. United States*[62] the Fifth Circuit reversed itself en banc, ruling that state mental hospital employees did not act in a discretionary capacity when they failed both to supply records to the parole board and to examine inmates and report their findings. While the decision to release the prisoner was discretionary,

52. 28 U.S.C. § 1605(a)(5) (1982); *see supra* note 15.
53. H.R. REP. No. 1487, *supra* note 16, at 20-21, *reprinted* at 6619.
54. H.R. REP. No. 1487, *supra* note 16, at 21, *reprinted* at 6619-20.
55. H.R. REP. No. 1487, *supra* note 16, at 21, *reprinted* at 6620.
56. 346 U.S. 15 (1953).
57. *Id.* at 36.
58. *Id.*
59. *Id.* at 42.
60. *See id.* at 39-41 (Court's application of principle).
61. Payton v. United States, 679 F.2d 475, 479-80 (5th Cir. 1982) (en banc) (reversing 636 F.2d 132 (5th Cir. 1981)).
62. *Id.*

it did not render discretionary the actions in connection with the decision.[63] "Discretionary decision-making, then, is accompanied by nondiscretionary acts of execution, whether termed operational, ministerial, or clerical."[64]

Fewer cases have focused on the statutory requirement that the tort occur in the United States. In *Letelier v. Republic of Chile*,[65] the assassination of a prominent Chilean dissident that formed the basis for the cause of action occurred in Washington, D.C. In *Perez v. The Bahamas*,[66] the Court of Appeals for the District of Columbia refused to extend the language, "occurring in the United States," to cover territory included in the statutory 200-mile Fishery Conservation Zone, particularly when the injury occurred less than one-half mile from an island of the Bahamas.[67] In *Asociacion de Reclamantes v. United Mexican States*,[68] the District Court for the District of Columbia held that because defendant's alleged tortious conversion of the plaintiff's claims took place in Mexico and did not affect property in the United States, the defendant was immune. In *Sedco*, the plaintiffs argued that the noncommercial tort exception provided an alternative basis for the federal court to exercise jurisdiction. If Pemex were to be found immune under the FSIA's commercial activities exception, the plaintiffs claimed that the negligence of Pemex employees aboard the Sedco oil rig caused property damage in Texas, and thus fit within the noncommercial tort exception, even though it occurred 500 miles off the coast.[69]

b. Limitation of Liability Act

Another obstacle to recovery for injury from polluting oil spills is the Limitation of Liability Act (LLA or Act).[70] Congress passed the Act in 1851 to place United States merchant ships on equal footing with those of England.[71] It promoted shipbuilding and

63. *Id.* at 480.
64. *Id.*
65. 488 F. Supp. 665 (D.D.C. 1980).
66. 652 F.2d 186 (D.C. Cir.), *cert. denied*, 454 U.S. 865 (1981).
67. *Id.* at 188-89.
68. 561 F. Supp. 1190 (D.D.C. 1983), *aff'd*, 735 F.2d 1517 (D.C. Cir. 1984).
69. *See infra* notes 115-18 and accompanying text.
70. 46 U.S.C. §§ 181-96 (1982).
71. University of Tex. Medical Branch at Galveston v. United States, 557 F.2d 438, 454 (5th Cir. 1977), *cert. denied*, 439 U.S. 820 (1978); *In re* United States Air Force Tex. Tower No. 4, 203 F. Supp. 215, 218 (S.D.N.Y. 1962).

commercial navigation by limiting a shipowner's liability to the value of the owner's interest in the ship and its cargo if the act giving rise to the liability occurred without the owner's "privity or knowledge."[72] Litigation has centered on the privity or knowledge requirement and the categorization of particular craft as "vessels" for the purposes of the Act.[73] Since the advent of insurance and the rise of the corporation, commentators repeatedly have noted that the Act has outlived its purpose, but nonetheless it remains on the books.[74] Some courts have responded to the anachronistic nature of the Act by refusing to apply the liberal construction principle historically considered appropriate.[75]

Recent maritime accidents that caused disastrous oil spills have highlighted the Act's inadequacy: the 1967 *Torrey Canyon* oil spill that cost England and France $16 million to clean up;[76] the 1978 *Amoco Cadiz* oil spill that reportedly cost France $300 million in cleanup expenses;[77] and the Ixtoc I blowout that cost the United States more than $12 million to clean up and resulted in millions of dollars in lost revenues claimed by private litigants.[78]

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72. 46 U.S.C. § 183(a).

73. *See* 46 U.S.C.A. § 188 (West 1958 & Supp. 1984) (annotations concerning the definition of "vessels"); *see also infra* notes 81-104 and accompanying text. The "privity or knowledge" requirement is not discussed in *Sedco*, and therefore is not discussed in this section.

74. *E.g.*, G. GILMORE & C. BLACK, THE LAW OF ADMIRALTY § 10-4, 10-4(a) (1975); *see Galveston*, 557 F.2d at 441.

75. *See, e.g.*, Admiral Towing Co. v. Woolen, 290 F.2d 641, 645 (9th Cir. 1961).

76. *See In re* Barracuda Tanker Corp., 281 F. Supp. 228 (court refused to decide ownership before trial), *modified*, 409 F.2d 1013 (2d Cir. 1969). The owners of the tanker eventually settled out of court, dividing $3 million between the Governments of France and England. G. GILMORE & C. BLACK, *supra* note 74, § 10-4(a)-(b) ("One more large-scale maritime disaster, following which the shipowners petition to limit their liability to a fund of $50, should suffice to bring the whole structure tumbling down."). *See generally* Nanda, *The Torrey Canyon Disaster: Some Legal Aspects*, 44 DEN. L.J. 400 (1967).

77. *In re* Oil Spill by the *Amoco Cadiz*, 471 F. Supp. 473, 475 (J.P.M.D.L. 1979) (per curiam) (ordering consolidation of the litigation); *see also* Comment, *Troublesome Aspects*, *supra* note 6, at 388.

78. *See supra* note 10 and accompanying text; N.Y. Times, Mar. 3, 1983, at A16, col. 6 ($2 million United States-Sedco agreement to cover $12.5 million in cleanup costs). Business losses along the Texas coast allegedly amounted to $155 million. *Voyage Into Uncertainty: Assigning Liability for the Bay of Campeche Oil Spill*, 9 ENVTL. L. REP. (ENVTL. L. INST.) 10,218, 10,218 (Dec. 1979) [hereinafter cited as *Voyage Into Uncertainty*]. Private class action litigants settled for

Under the LLA, the court limited the liability of the owners of the *Torrey Canyon* to $50, the salvage value of a recovered lifeboat.[79] In the *Sedco* disaster, however, nothing was salvaged of the Sedco oil rig.[80]

Craft determined to be "vessels" for purposes of the Act include a mud-carrying scow,[81] a barge with a pile driver,[82] a drillboat that required towing and was used to pump out barges,[83] and a derrick boat.[84] Those craft determined not to be vessels include a dry dock,[85] a wharfboat secured to shore,[86] an artificial island drilling rig,[87] and radar towers permanently installed on the North Atlantic continental shelf.[88] In *In re P. Sanford Ross*,[89] the district court held that the permanent attachment of a pile driver to a scow did not change the scow's character as a vessel and refused to allow permanent, as opposed to removable, cargo to change the character of the craft.[90] The court made clear, how-

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$2.14 million. Agreement of Settlement with Class Action Claimants and Assignment of Rights, Mar. 22, 1983, *In re* Sedco, Inc. [hereinafter cited as Class Action Agreement] [copy on file at offices of VAND. J. TRANSNAT'L L.]. For more on the settlement, see *infra* notes 167-70 and accompanying text.

79. *In re* Barracuda Tanker Corp., 281 F. Supp. at 230, 232.

80. *Voyage Into Uncertainty*, *supra* note 78, at 10,219.

81. *In re* Eastern Dredging Co., 138 F. 942 (D. Mass. 1905) (no requirement that merchandise or passengers be on board).

82. *In re* P. Sanford Ross, 196 F. 921 (E.D.N.Y. 1912), *rev'd on other grounds*, 204 F. 248 (2d Cir. 1913).

83. Eastern S.S. Corp. v. Great Lakes Dredge & Dock Co., 256 F. 497 (1st Cir. 1919).

84. Patton-Tully Transp. Co. v. Turner, 269 F. 334 (6th Cir. 1925) (vehicle classed as a "quasi vessel" by court).

85. Berton v. Tietjen & Lang Dry Dock Co., 219 F. 763 (D.N.J. 1915) (vessel that was capable of floating and used by workmen who were repairing and painting alongside the ship was not a vessel for LLA purposes).

86. Evansville & Bowling Green Packet Co. v. Chero Cola Bottling Co., 271 U.S. 19 (1926) (vessel not able to be used in transportation, but used as a wharf and office and therefore not subject to the "perils of navigation" was not a vessel for LLA purposes).

87. Rodrigue v. Aetna Casualty & Surety Co., 395 U.S. 352 (1969) (admiralty jurisdiction and law governing vessel ownership did not apply to rigs on the continental shelf off the Louisiana coast).

88. *Galveston*, 203 F. Supp. 215.

89. 196 F. 921 (E.D.N.Y. 1912), *rev'd on other grounds*, 204 F. 248 (2d Cir. 1913).

90. *Id.* at 925. In reversing on the issue of "privity or knowledge," the Second Circuit did not pass judgment on the lower court's characterization of the scow as a vessel. 204 F. at 250. *But see Berton*, 219 F. at 773 (drawing the impli-

ever, that permanent, as opposed to temporary, anchoring would cause the scow to lose its character as a vessel because it no longer would be a navigational vehicle engaged in commerce.[91] A drillboat found to be a vessel in *Eastern Steamship Corp. v. Great Lakes Dredge & Dock Co.*[92] also required towing in order to navigate. The drillboat moved its permanent cargo, a boiler engine required for pumping out barges, from place to place in order to remove sludge and, therefore, to aid commerce.[93] On the other hand, the court in *Berton v. Tietjen & Lang Dry Dock Co.*[94] held that a drydock was not a vessel because it was not designed as a means of transportation. The court reasoned that admiralty jurisdiction is based on the movable character of vessels used in navigation, trade, and commerce; and the drydock's ability to float was not enough to qualify it as a vessel.[95]

As the court in *Sanford Ross* indicated, the fixed nature of a formerly navigable craft can alter its categorization as a vessel.[96] In *Evansville & Bowling Green Packet Co. v. Chero Cola Bottling Co.*,[97] the Supreme Court ruled that a wharfboat was not a vessel because it was secured to the shore, connected with city utilities, and unable to be used for transportation. Because it did not encounter the "perils of navigation to which craft used for transportation are exposed," the Court found no reason to limit the owner's liability. According to the Court, the Act should be applied with regard to its purpose, the promotion of shipbuilding and navigation.[98]

In *In re United States Air Force Texas Tower No. 4*,[99] the district court expanded the *Chero Cola* requirements and held that radar towers installed on the continental shelf were not vessels under the LLA. The court observed that to qualify as a vessel the vehicle must be capable of being used as a means of maritime

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cation that the lower court's characterization in *Sanford Ross* was open to question).

91. 196 F. at 925-26.
92. 256 F. 497 (1st Cir. 1919).
93. *Id.* at 499-501.
94. 219 F. 763 (D.N.J. 1915).
95. *Id.* at 771-74. The drydock also was not capable of salvage service. *Id.* at 774.
96. *See supra* note 91 and accompanying text.
97. 271 U.S. 19 (1926).
98. *Id.* at 21-22.
99. 203 F. Supp. 215 (S.D.N.Y 1962).

transportation and currently must be used for transportation purposes.[100] On the basis of its observation, the court defined a vehicle to be a vessel if, at the time of the incident giving rise to the potential liability, the vehicle would be: (1) carrying freight; (2) operating as a means of transportation; (3) located in a nonpermanent position; and (4) exposed to the perils of navigation.[101] The court found that the towers were designed to be permanent and not to be subject to the perils of the sea in a navigational sense.[102] Although the *Texas Tower* court left the issue of the radar towers' qualification as vessels unresolved, the Supreme Court in *Rodrigue v. Aetna Casualty & Surety Co.*[103] held that artificial island drilling rigs off Louisiana's outer continental shelf were inappropriate for admiralty jurisdiction because the rigs stood on legs that reached to the sea floor, and were not aids to navigation.[104] In *Sedco*, the court also considered whether an oil rig engaged in exploratory drilling and anchored to the bottom of the Bay of Campeche is a vessel for the purposes of the LLA.[105]

2. *The Instant Opinion*

In *In re Sedco, Inc.*,[106] the court responded to Sedco's attempt to limit its liability in admiralty and to Petroleos Mexicanos' (Pemex) challenge to the court's jurisdiction. Pemex claimed immunity as a foreign state under the FSIA.[107] The court agreed that Pemex was a foreign state as contemplated by the Act, and was immune because it engaged in activities uniquely sovereign.[108] Plaintiffs had asserted that Pemex's exploratory oil drill-

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100. *Id.* at 219.

101. *Id.* (citing the factors considered by the court in *Chero Cola*).

102. *Id.*

103. 395 U.S. 352 (1969).

104. *Id.* at 363 n.9. The Fifth Circuit reached a similar conclusion in Sohyde Drilling & Marine Co. v. Coastal States Gas Producing Co., 644 F.2d 1132 (5th Cir. 1981) (admiralty jurisdiction inappropriate when high pressure gas well aboard a submersible drilling barge resting on the bottom of a dredged canal had no substantial relationship to maritime activities).

105. *See infra* notes 119-24 and accompanying text.

106. 543 F. Supp. 561 (S.D. Tex. 1982).

107. *Id.* at 564. The court declared that Pemex was immune from jurisdiction under the Tate Letter policy of restrictive sovereign immunity. *Id.* at 564-67; *see supra* notes 16-17 and accompanying text.

108. 543 F. Supp. at 565-66. The language of the Act is as follows:

(b) An "agency or instrumentality of a foreign state" means any entity—

(1) which is a separate legal person, corporate or otherwise, and

ing brought it within the Act's commercial activities exception.[109] Emphasizing that it should examine the specific acts giving rise to the claim, the court reviewed recent decisions distinguishing commercial from noncommercial acts.[110] After finding that existence of a contractual relationship is a significant if not essential indication of a commercial enterprise, the court noted the absence in this case of any contract to sell the oil and gas produced or any contract with a United States company to drill the well.[111] Instead, the court described Pemex's drilling activity as part of the Mexican Government's long range plan to develop and utilize its natural resources.[112] Relying on *IAM*,[113] the court defined the control of mineral resources as uniquely governmental in nature, and held that Pemex had acted in its capacity as a foreign state in the exploratory drilling operation that gave rise to the cause of action.[114]

The plaintiffs had urged, in the alternative, that the court assert jurisdiction under the noncommercial tort exception.[115] The court ruled, first, that under this exception the tort must occur in the United States, and the alleged act or omission on which the instant claims were based occurred in the Bay of Campeche;[116] and second, because the exception does not apply to discretionary acts, which include executing a national policy or plan, Pemex's actions in furtherance of the government plan to explore natural resources were discretionary and immune from suit.[117] According to the court, the instant facts closely resembled those in *Dalehite*,

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(2) which is an organ of a foreign state or political subdivision thereof, or a majority of whose shares or other ownership interest is owned by a foreign state or political subdivision thereof, and

(3) which is neither a citizen of a State of the United States as defined in section 1332(c) and (d) of this title, nor created under the laws of any third country.

28 U.S.C. § 1603(b) (1982).

109. 543 F. Supp. at 564.

110. *Id.* at 565-66; *see supra* notes 16-51 and accompanying text.

111. 543 F. Supp. at 566.

112. *Id.*

113. 477 F. Supp. 553 (C.D. Cal. 1979), *aff'd on other grounds*, 649 F.2d. 1354 (9th Cir. 1981), *cert. denied*, 454 U.S. 1163 (1982).

114. 543 F. Supp. at 566.

115. *Id.*

116. *Id.* at 567 (quoting H.R. REP. No. 1487, *supra* note 16, at 21, *reprinted* at 6619); *see supra* text accompanying note 54.

117. 543 F. Supp. at 567.

the leading case on the scope of the discretionary act exception.[118]

In order to limit their liability under the LLA, plaintiffs had argued that Sedco's drilling rig was a vessel for the purposes of the Act.[119] Recognizing that advances in technology had played havoc with the LLA and that commentators often had criticized the Act as anachronistic, the court nevertheless proceeded to apply the liberal interpretation historically given to the definition of "vessel."[120] After reviewing the case law on applicable structures,[121] the court applied three criteria: (1) whether the craft was intended to be used as a means of transportation; (2) whether it was permanently attached to the shore or seabed; and (3) whether it was subject to the perils of the sea.[122] The court concluded that the Sedco 135 rig was a vessel because it was built to be anchored at various drill sites, it was held in place only by anchors and a "drill string," and it was subject to the perils of the sea while being towed to its various drilling sites.[123] The court deferred to Congress the question of the Act's viability in modern circumstances.[124]

3. *Analysis*

In applying the FSIA's commercial activities exception, the instant court ignored the fundamental distinction between the nature and purpose of an activity as set out by Congress in the statute's legislative history[125] and followed in numerous cases. For example, the cultural exchange in *United Euram*,[126] Ireland's economic development in *Gibbons*,[127] and Mexico's price stabilization in *Bankers Trust*,[128] were labeled as public purposes, irrelevant in determining whether the specific activities in question were commercial in nature.[129] When the instant court decided

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118. *Id.; see supra* notes 55-60 and accompanying text.
119. 543 F. Supp. at 570.
120. *Id.* at 570-72.
121. *Id.* at 570-71.
122. *Id.* at 571-72.
123. *Id.* at 572.
124. *Id.* The court also held that it validly could assert personal jurisdiction over Permargo, but this section does not discuss that issue. *See supra* note 11.
125. *See supra* note 21 and accompanying text.
126. 461 F. Supp. 609; *see supra* notes 27-29 and accompanying text.
127. 549 F. Supp. 1094; *see supra* notes 44-46 and accompanying text.
128. 537 F. Supp. 1101; *see supra* notes 47-48 and accompanying text.
129. Only the latter two cases were decided after *Sedco.*

that Pemex's oil drilling was governmental because it was part of the Mexican Government's plan to control and utilize the country's natural resources,[130] it incorrectly focused on the purpose, rather than the the nature, of the activity. If the court in *United Euram* had applied this reasoning, it probably would have found the impressario's contract to be governmental because it was part of the U.S.S.R.'s policy to encourage cultural exchanges between countries.

In trying to determine whether the drilling that gave rise to the cause of action was commercial or governmental in nature, the instant court never asked whether it was an activity customarily carried on for profit or whether it derived from a contract that easily might have been made by a private party—the criteria established by Congress[131] and regularly applied by the courts.[132] Instead, the court believed significant the absence of a commercial contract to sell the oil and gas produced, implying, in spite of words to the contrary, that such a contract is virtually essential to a finding that the activity falls within the exception. The court failed to mention that Pemex had, in fact, contracted with Permargo to do the actual drilling in the same manner that a private company might subcontract its drilling operation.[133]

Other than the absence of a contract to sell goods or services, the instant court found neither of the other frequently mentioned touchstones of "governmental" activity: the compulsory, unreimbursed nature of the actions addressed in *Arango*;[134] and the intragovernmental, politically sensitive character of the alleged libel in *Yessenin*.[135] By relying on *IAM*,[136] the *Sedco* court focused instead on the *type* of activity, one involving natural resources. Although the California court in *IAM* held that the OPEC nations had acted in a governmental capacity when they established the "terms and conditions for removal" from their countries of a resource essential to their economies,[137] the instant court ex-

130. 543 F. Supp. at 566.
131. *See supra* notes 19-20 and accompanying text.
132. *See, e.g., supra* notes 25-29 and accompanying text.
133. For a discussion of the specific contracts, see Comment, *Jurisdictional Disputes*, *supra* note 6, at 479-82; *see also infra* notes 180-91 and accompanying text.
134. 621 F.2d 1371; *see supra* text accompanying notes 36-37.
135. 443 F. Supp. 849; *see supra* text accompanying notes 25-26.
136. *See supra* notes 113-14 and accompanying text.
137. *See supra* notes 31-32 and accompanying text.

panded the *IAM* holding to grant immunity to all actions of a government affecting the country's mineral resources, with the possible exception of a contract to sell the minerals.[138] The *IAM* holding, followed by that in *Rios v. Marshall*,[139] stressed the regulatory nature of the activity.[140] Pemex's drilling activity, however, was not regulatory and did not establish the terms and conditions for removal from the country of a resource essential to its economy. Instead, it was part of a process to gather data on available oil reserves, similar to that which a private oil company would undertake. In other words, the activity on which the plaintiffs' suit was based was more proprietary than governmental.

In expanding sovereign immunity to cover an essentially proprietary activity, the instant court did not act consistently with the purpose of the commercial activities exception,[141] with international law,[142] or with cases distinguishing a foreign state's proprietary acts from its sovereign acts.[143] The purposes of the exception, to protect private parties doing business with governments acting in a commercial capacity and to bring the United States in line with the jurisdictional practices of other countries, are not served by broadening immunity to cover almost all conduct related to natural resources.

The court's language linking the drilling operations to governmental policy is more reminiscent of the rationale used to determine whether an activity is discretionary under the noncommercial activities Federal Tort Claims Act standard.[144] The court appears to believe that the drilling is governmental in nature because it is the result of policy decisions made at the "higher levels of government."[145] This is the standard used in *Dalehite* for dis-

138. "Pemex had not entered into a contract with anyone for the oil and gas produced from the Ixtoc I well." 543 F. Supp. at 566.

139. 530 F. Supp. 351; *see supra* notes 33-35 and accompanying text.

140. *See* text accompanying *supra* notes 30-31.

141. *See supra* note 17 and accompanying text.

142. *See supra* note 17; *see also* N.V. Cabolent v. National Iranian Oil Co. (Hague Ct. App. Nov. 28, 1968), *reprinted in* 9 I.L.M. 152 (1970) (NIOC was not acting in sovereign capacity when concluding agreement concerning exploration and production of petroleum); Note, *Foreign Sovereign Immunity and Commercial Activity: A Conflicts Approach*, 83 COLUM. L. REV. 1440, 1492 (1983).

143. *See generally supra* notes 25-51 and accompanying text.

144. *See supra* notes 52-60 and accompanying text.

145. *See* 543 F. Supp. at 565-66.

cretionary activities,[146] not the nature-of-the-act test used by courts applying the commercial activities exception.

The instant court's finding of immunity under the noncommercial tort exception[147] is equally vulnerable to criticism. The conclusion that "the tort, in whole, must occur in the United States"[148] is neither supported by the wording of the statute or by the available, though scant, case law[149] nor directed by the legislative history, as the court seems to infer. The statute expressly states that the injury or damage, not the tortious act, must occur within the United States.[150] In quoting legislative history that the tortious act or omission must occur "within the jurisdiction of the United States,"[151] the court appears to misread Congress' jurisdictional requirement as a territorial one. If the court had applied a jurisdictional standard[152] it might have found that the oil spill's effects on the Texas coast brought Pemex within the requirements of the exception. Among the cases discussing this issue, *Asociacion*,[153] a post-*Sedco* case, sets forth a two-part analysis that looks to where the tort occurred and the effects of the tort in the United States.

In finding Pemex's noncommercial activity immune, the instant court applied a broad reading of "discretionary" derived from the Supreme Court's holding in *Dalehite*.[154] Even under *Dalehite*, however, an inquiry into whether this particular drilling decision had been made at the policy-making level might have resulted in a finding of no immunity.[155] Alternatively, decisions since *Dalehite* have been reluctant to grant immunity to negligent actions by government employees, even when those actions implement government policy.[156] *Payton*,[157] which was cited by the

146. 346 U.S. at 40-42. *See supra* notes 56-60 and accompanying text.

147. 543 F. Supp. at 567; *see supra* note 15.

148. 543 F. Supp. at 567.

149. *See supra* notes 65-68 and accompanying text.

150. 28 U.S.C. § 1605(a)(5) (1982); *see supra* note 15.

151. 543 F. Supp. at 567.

152. For example, the court could have applied the requirements set forth in the RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 18 (1965). *See supra* note 22 and accompanying text.

153. 561 F. Supp. 1190; *see supra* note 68 and accompanying text.

154. 346 U.S. 15 (1953).

155. *See supra* notes 56-64 and accompanying text.

156. *See supra* notes 61-64 and accompanying text.

157. 636 F.2d 132 (5th Cir. 1981).

court,[158] subsequently was reversed in a decision that further narrowed immunity for discretionary actions by government employees.[159] Following the later *Payton* decision, Pemex's oil drilling arguably could be considered as activity merely "in connection with" the Mexican Government's discretionary policy decision to explore oil deposits in the Bay of Campeche, and not as discretionary acts themselves.[160] Granting immunity for negligent employee conduct in carrying out administrative policy decisions based on adequate information makes less sense than refusing to find liability for damage or injury resulting, not from employee negligence, but from some carelessness or inadequacy at the policy-making level. The latter better protects the government from the plethora of suits that could grind its activity to a halt.

In defining an oil drilling rig as a "vessel" under the LLA, the instant court doggedly clung to the traditional liberal construction of the term in the face of historical and jurisprudential reasons to do otherwise. The court correctly emphasized the degree of permanence in the craft's attachment to the land or shore as crucial in determining its categorization as a vessel under the Act.[161] While the cases cited as analogous to the instant case have considered various temporarily anchored vehicles carrying permanent cargo to be vessels, a closer scrutiny of those cases reveals that the determinations were not based on the length of time the craft in question stayed in one place or the manner of anchoring, but on whether the craft was still in use as an aid to commerce and thus had retained its navigational character. In other words, if the craft were still a navigational vehicle engaged in commerce as in *Sanford Ross*,[162] or were still being used as an aid to commerce as in *Eastern S.S. Corp.*,[163] categorization as a vessel served the purposes of the Act. In *Sedco*, the court appeared to emphasize the nonpermanent method of anchoring, and never asked whether the vehicle's use as a drilling rig changed its navigational character because it was no longer being used in commerce. Furthermore, the court failed to follow *Texas Tower*'s di-

158. 543 F. Supp. at 567.

159. 679 F.2d 475 (5th Cir. 1982) (en banc); *see supra* notes 62-64 and accompanying text.

160. *See supra* text accompanying note 63.

161. 543 F. Supp. at 571.

162. 196 F. 921; *see supra* notes 89-91 and accompanying text.

163. 256 F. 497; *see supra* notes 92-93 and accompanying text.

rective to consider whether at the time of the incident giving rise to the potential liability the vehicle was being used as a means of transportation and was exposed to the perils of the sea "in a navigational sense."[164] The instant court, in contrast, relied on the oil rig's activities while it was being towed in the open ocean and *before* it was anchored and had commenced the same activities at sea that it would perform on land if the oil deposit happened to be located inland.

In sum, the oil rig must be used commercially for navigation in order to serve the purposes of the LLA, and it is inappropriate to construe the Act broadly in order to negate potential liability. While the instant court saw its only alternative as "legislating" the Act's demise, it instead could have chosen to follow other courts' recent inclination toward construing "vessel" more strictly, with an eye to the Act's original purposes.

4. *Subsequent Developments*

Eight months after the court's decision, Sedco filed a motion for rehearing, asking the court to reconsider its ruling on the FSIA commercial activities exception.[165] Before the court ruled on the motion, Sedco reached two settlements, one with the United States[166] and one with the class action claimants.[167] The settlements simplified the litigation by allowing Sedco to pursue not only its claims against Pemex and Permargo, but also those of the United States and the class action claimants.

The United States, apparently anticipating significant difficulty in establishing liability against Sedco and Permargo, agreed to accept $2 million as full and final settlement for an alleged $12.5 million in cleanup costs.[168] In return, Sedco received subrogation rights to the settlement amount against Pemex and Permargo.[169] The United States agreed not to sue Pemex or to pursue its

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164. 203 F. Supp. at 219; *see supra* notes 99-102 and accompanying text.

165. Memorandum in Support of Motions for Rehearing and Reconsideration of the Issue of Sovereign Immunity of Petroleos Mexicanos, *In re* Sedco, Inc., 543 F. Supp. 561 (S.D. Tex. 1982) [hereinafter cited as Motion for Rehearing] [copy on file at office of VAND. J. TRANSNAT'L L.].

166. United States Agreement, *supra* note 10.

167. Class Action Agreement, *supra* note 78.

168. United States Agreement, *supra* note 10, at 584.

169. *Id.* at 584-85, 587-88 (Exhibit B, Subrogation Document). The subrogation rights are those of a "third party" under the Clean Water Act (33 U.S.C. § 1321(g) (1978)). *Id.* at 587.

claims against Permargo.[170] Claims by private parties and the State of Texas against Sedco, Pemex, and Permargo were declared irrelevant to the agreement, which expressly stated that it was not an admission of fault, negligence, or liability by Sedco.[171]

In order to avoid protracted and expensive litigation, four groups of class action claimants, two engaged in the fishing industry and two directly or indirectly engaged in tourism, agreed to accept $2.14 million in exchange for a release of all tort claims against Sedco.[172] In addition, the claimants assigned to Sedco their rights in the class action suits against Pemex and Permargo.[173] The agreement also expressly stated that it did not constitute an admission of liability by any party.[174] Sedco retained the right to withdraw from the settlement if individuals electing to opt out asserted claims totalling ten per cent or more of the settlement fund.[175]

The agreements heighten the significance of Sedco's bid for jurisdiction under FSIA. If Sedco fails to obtain United States jurisdiction and the giant Pemex succeeds in shielding itself with governmental immunity, the burden of the litigation will fall on the much slighter shoulders of Permargo.[176] In its first memorandum in support of its motions for rehearing and reconsideration, Sedco argued that when the court considered whether the act of drilling fell within the FSIA commercial activities exception, it failed to observe the distinction between nature and purpose clearly delineated in the Act's legislative history and firmly estab-

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170. *Id.* at 585, 588-90 (Exhibit C, Covenant Not to Pursue Claims Against Permargo, and Exhibit D, Covenant Not to Sue Pemex). The United States did, however, reserve its rights against Pemex and Permargo, *id.* at 584, 587 (Exhibit A, Release), and agreed not to make further claims against Sedco or help others pursue their claims against Sedco, unless required by law to do so, *id.* at 584.

171. *Id.* at 582, 586.

172. Class Action Agreement, *supra* note 78, at 5-7. The agreement also establishes a Settlement Fund and provides for payment. *Id.* at 6-10.

173. *Id.* at 12-13.

174. *Id.* at 14.

175. *Id.* at 14-15.

176. Permargo's allegedly limited financial resources were such that Sedco had required indemnification by Pemex before leasing the oil rig to Permargo. Supplemental Memorandum of Sedco, Inc. in Support of Motions for Rehearing and Reconsideration of the Issue of Sovereign Immunity of Petroleos Mexicanos at 8, *In re* Sedco, Inc., 543 F. Supp. 561 (S.D. Tex. 1982) [hereinafter cited as Supplemental Memorandum] [copy on file at offices of VAND. J. TRANSNAT'L L.].

lished in the case law.[177] Sedco argued in its memorandum that the district court in *IAM*[178] had held the price setting activity of the OPEC nations immune because "it involved the control over the export of the total oil output of several entire nations" and therefore was "beyond anything which a private entity could accomplish."[179] Sedco distinguished the events in *IAM* from those of the instant case, in which the act of drilling an oil well occurred in the course of the performance of a contract between Pemex and Permargo and was an action that just as easily could have been performed by a private individual.[180] By emphasizing Pemex's intended use of the information gathered, the court mistakenly focused on the governmental purpose, rather than the commercial nature of Pemex's activities.[181] If the court insisted on emphasizing the purpose of the drilling, however, the memorandum argued alternatively that Pemex's drilling program clearly showed that Pemex's goal was commercial exploitation, not data gathering for long range government planning.[182]

In a supplemental memorandum, Sedco faulted the court for placing "near talismanic importance in the 'commercial activity' analysis to the existence of a contractual relationship between the foreign state and a United States company," while overlooking entirely Sedco's contract claims as a possible basis for jurisdiction.[183] In its third party complaint against Pemex, Sedco had alleged that it was a third party beneficiary of Pemex's contractual indemnification obligation to Permargo[184] and that an implied contract existed between Sedco and Pemex as a result of Sedco's active participation in both the negotiation and the actual writing of the Pemex-Permargo drilling contract.[185] Because of Permargo's limited assets and insurance, the memorandum explained, Sedco relied on Pemex's implied contractual obligation for protection and indemnification in leasing the oil drilling rig to Permargo.[186] Pemex's refusal to provide protection and indemnifi-

177. Motion for Rehearing, *supra* note 165, at 6-9.
178. 477 F. Supp. 553; *see supra* notes 30-32 and accompanying text.
179. Motion for Rehearing, *supra* note 165, at 8.
180. *Id.* at 11.
181. *Id.* at 10-11.
182. *Id.* at 11-14 & ex. A (Drilling Program for Ixtoc No. 1 Well).
183. Supplemental Memorandum, *supra* note 176, at 5-6.
184. *Id.* at 6-7.
185. *Id.* at 7-8.
186. *Id.* at 8.

cation, therefore, was a breach of either its third party beneficiary contract or its implied contract with Sedco.[187] The memorandum further argued: (1) Sedco's factual allegations should be construed liberally for the purposes of Pemex's motion to dismiss;[188] (2) the specific acts giving rise to Sedco's contract claims are commercial activity for the purposes of the FSIA[189] because case law clearly supports contractual activity as a basis for jurisdiction under the FSIA's commercial activities exception, even when the contract is not written,[190] and because the specific contractual activity in question comprised acts in which any private person could engage.[191]

C. Transnational Pollution

Although the *Sedco* litigation contains issues unique to maritime pollution, it also adequately illustrates several problems common to most transnational pollution incidents: the questionable effectiveness of intergovernmental agreements,[192] the inadequate protection for private litigants,[193] and the practical as well as legal barriers to recovery facing both individuals and governments.[194] In response to the problems encountered in the Ixtoc I oil spill, the United States and Mexico entered an agreement on liability for marine oil pollution incidents that contained many of the strengths and weaknesses characteristic of such agreements.[195]

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187. *Id.* at 8-9.

188. *Id.* at 9.

189. *Id.* at 12.

190. *Id.* at 12-16.

191. *Id.* at 15. Sedco also argued that through its contract claims the court could exercise jurisdiction based on either the first or third clauses of the FSIA's commercial activities exception, 28 U.S.C. § 1605(a)(2) (1982).

192. Reinhold, *Cross-Border Pollution Vexes U.S. and Mexico*, N.Y. Times, Sept. 14, 1983, at 10, col. 1. *See generally* Handl, *The Environment: International Rights and Responsibilities*, AMER. SOC'Y INT'L L., PROCEEDINGS 1980 223 (1980).

193. Handl, *supra* note 192, at 230; *see also* Comment, *Jurisdictional Disputes*, *supra* note 6, at 486 & nn.68-69 (United States Government's attempts at private relief after the Ixtoc I oil spill); Note, *Domestic Liability*, *supra* note 6, at 56-57, 76; Comment, *Troublesome Aspects*, *supra* note 6, at 397-401, 422.

194. Cost is an overriding problem. The various legal barriers are discussed at length in the sources cited *supra* in note 183 and, of course, are obvious in the *Sedco* litigation itself.

195. Agreement of Cooperation Regarding Pollution of the Marine Environment, July 24, 1980, Mexico-United States, *reprinted in* 20 I.L.M. 696 (1980)

The agreement does not address the problem of compensation for private litigants; instead, it leaves them to face the nearly insurmountable problems of jurisdiction, controlling law, and litigation costs.

Pollution incidents along the United States-Mexican border are further complicated by the economic disparity between the two countries—a complication that affects both private and governmental parties.[196] Mexico, a nation less industrialized than the United States, has also promulgated fewer regulations over industry. If implemented, regulations could help achieve the goals of governmental agreements; if broken, a regulation could form the basis for a private plaintiff's cause of action. [197] Furthermore, a country in Mexico's current economic situation is unlikely to place high priority on creating or enforcing any regulation that would place an additional strain on businesses laboring to survive.[198]

These difficulties play themselves out in several theaters along the United States-Mexican border where water, air, and hazardous waste pollution problems exist.[199] Well-recognized sanitation problems exist at Tijuana-San Diego, where untreated sewage pollutes the beaches; at Mexicali-Calexico, where partially treated and untreated sewage pollutes the New River; at Nuevo Laredo-Laredo, where the Rio Grande is similarly affected; and at Nogales-Nogales, where untreated sewage from the larger Mexican city creates a health hazard for the residents of its smaller Arizona sister city.[200] Government documents indicate that a 1980

[hereinafter cited as Marine Pollution Agreement]. For an analysis of that agreement, see Recent Development, *Transnational Pollution: Agreement Regarding Marine Pollution Incidents*, 23 HARV. INT'L L.J. 177 (1982).

196. *See generally*, Leonhard, *supra* note 5, at 626-27 (outlining obstacles to Latin American participation in the creation of laws to deal with oil spills).

197. Mexico, for example, has yet to formulate regulations for the prevention, control, and treatment of hazardous waste. Regulations are to be developed under the Jan. 1982 New Federal Law on Environmental Protection (*Nueva Ley Federal de Proteccion al Ambiente*). Airgram from United States Embassy, Mexico City, to Dep't of State (Jan. 26, 1983) (update on toxic wastes in Mexico).

198. *See supra* notes 1-4 and accompanying text.

199. *See generally* Handl, *supra* note 192.

200. *See id.; see also* Telegram from Secretary of State, Washington, D.C., to United States Embassy, Mexico City (Sept. 1983) (United States-Mexican Environmental Agreement—Draft Annex on Border Sanitation Problems). *See generally Symposium on U.S.-Mexican Transboundary Resources (Part II)*, 18

agreement between the United States and Mexico on the Mexicali-Calexico situation has been ineffective in alleviating the problems of transnational pollution because of Mexico's failure to comply fully with the terms of the agreement.[201] Similarly, intergovernmental discussions have failed to spur Mexico to make needed improvements in the Tijuana waste disposal system while San Diego's system, adapted on an emergency basis in 1966 to handle waste disposal for both cities, becomes increasingly unsatisfactory.[202]

In August 1983 the United States and Mexico entered into an agreement to cooperate in implementing solutions to environmental problems in the border area.[203] The agreement provides for future subagreements and annexes to work out specific problems.[204] It establishes a national coordinator for each country and requires the parties to hold at least one high level meeting annually to review progress in implementation.[205] In December 1983 the Mexican Government "ratified" the agreement;[206] by early 1984 the United States had proposed subagreements and annexes covering both border sanitation problems and inland oil spills.[207] To date, however, no joint governmental action has been

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NAT. RESOURCES J. 1, 1-235 (1978) [hereinafter cited as *Symposium*].

201. Border Ecology Problems, United States Dep't of State Briefing Paper 1 (May 11, 1983).

202. *Id.*

203. Agreement Between the United States of America and the United Mexican States on Cooperation for the Protection and Improvement of the Environment in the Border Area, Aug. 14, 1983, *reprinted in* 22 I.L.M. 1025 (1983). [hereinafter cited as Environmental Agreement].

204. Environmental Agreement, *supra* note 203, art. 3, *reprinted* at 1027.

205. Environmental Agreement, *supra* note 203, arts. 8-10, *reprinted* at 1028-29.

206. The Mexican Government treated the Agreement as a treaty and required it to go through the ratification process, which it completed on Dec. 28, 1983. Telephone conversation with Walter J. Hunt, Coordinator of Border Environmental Programs, Environmental Protection Agency (EPA) (Feb. 2, 1984).

207. Implementation of the U.S./Mexico Border Environment Agreement, Sept. 24, 1983 (authorized draft of "first cut at a plan to resolve the priority sanitation problems") [copy on file at offices of VAND. J. TRANSNAT'L L.]; Agreement of Cooperation Between the United States of America and the United Mexican States Regarding Pollution of Environment Along the Inland International Boundary by Discharges of Hydrocarbons and other Hazardous Substances, presented to Secretariat of Foreign Relations by United States Embassy in Mexico City on Aug. 18, 1983 (Joint Contingency Plan Annexes I - VI attached) [copy on file at offices of VAND. J. TRANSNAT'L L.].

taken.[208]

While the two governments search for long-term solutions to the sewage pollution problems, individuals in the San Diego area seeking more immediate relief from an inadequate waste disposal system filed suit against the city, state, and federal governments in both federal and state courts.[209] The federal court dismissed plaintiffs' motion seeking injunctive relief to abate a public nuisance, holding that: (1) the United States was protected from suit by statutory immunity; (2) the state also was immune under the eleventh amendment; and (3) the city was protected by plaintiffs' failure to exhaust administrative remedies as required by state law.[210] The court also denied plaintiffs' subsequent motion to alter or amend the judgment.[211] The state suit based on an inverse condemnation claim, however, was more successful. After the California Superior Court found the city and state jointly and severally liable for any damages legally caused by the Tijuana River Valley Flood Control Project, the jury awarded monetary relief on claims resulting from sewage contamination.[212]

The Environmental Agreement also reaches air pollution problems.[213] Among those problems are excess vehicle exhaust emissions from some Mexican sister cities and lead emissions from the American Smelting & Refining Co. (ASARCO) smelting plant in El Paso.[214] ASARCO emissions have been the target of long-standing litigation between the City of El Paso, the State of Texas, and ASARCO. The resulting court-ordered action has been amended and modified several times; and state health de-

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208. Telephone conversation with Walter Hunt, EPA (Feb. 2, 1984).

209. California Leasing Corp. v. San Diego, No. 80-0419-E (S.D. Cal.); General Telephone v. San Diego, No. 463619 (Cal. Super. Ct., San Diego).

210. *California Leasing*, No. 80-0419-E, slip op. at 3 (S.D. Cal. Sept. 25, 1980) (summarizing and affirming Aug. 15, 1980, judgment of dismissal).

211. *Id.* at 2. The motion was denied because: (1) plaintiffs failed to amend their original complaint to withdraw the claim for damages; (2) the court's decision on the merits of the damages issue was correct; (3) plaintiffs failed to argue the inadequacy of legal remedies, as required in a suit for injunctive relief; and (4) permitting a "unilateral withdrawal after judgment" would be unfair to defendants. *Id.* at 2-3.

212. Telephone conversation with Jeff Trauberman, Environmental Law Institute.

213. Environmental Agreement, *supra* note 203, art. 5, *reprinted* at 1027.

214. Border Ecology Problems, United States Dep't of State Briefing Paper 2 (May 11, 1983) ("Air Pollution"); *see also* Reinhold, *supra* note 192. *See generally Symposium, supra* note 200, at 91, 181.

partments, as well as the Environmental Protection Agency (EPA), the Department of Health and Human Services, and their Mexican counterparts have been active in assessing the problem.[215] In 1979 Mexican private citizens initiated a suit against ASARCO for damages allegedly suffered as a result of the factory's emissions.[216] Plaintiffs in that action, however, eventually settled for a minimal amount[217] after the federal district court denied them class action certification [218] and applied Mexican law to govern damages,[219] and after defendants agreed to a partial summary judgment on the negligence per se claim.[220]

The transportation and disposal of hazardous waste also fall under the umbrella of the Environmental Agreement and will be addressed by future subagreements and annexes.[221] Under the Resource Conservation and Recovery Act of 1976 (RCRA),[222] the EPA requires exporters of hazardous waste to notify, via the EPA, the receiving country.[223] In spite of both this requirement and the installation of a hot line in 1980 to facilitate intergovernmental communication on hazardous waste exports,[224] the system has rarely been used.[225] Yet, United States Government memos clearly indicate that this single notification by no means reflects the amount of hazardous waste exported from the United States to Mexico.[226] Most hazardous waste, therefore, apparently is

215. *See* El Paso v. American Smelting & Refining Co. (ASARCO), No. 70-1701 (Tex. Dist. Ct., 41st Jud. Dist.) (order filed May 11, 1972; amended May 14, 1975; revised June 26, 1976).

216. The suit eventually included over 130 individuals and an alleged class. Ontiveros v. ASARCO, Inc., No. EP-79-CA-117 (W.D. Tex., filed June 22, 1979).

217. *Id.* (final judgment on Jan. 24, 1983, granted 57 plaintiffs $100 each and a *guardian ad litem* $5,000).

218. *Id.* (class action certification denied Sept. 24, 1981).

219. *Id.* (Order on Applicable Law July 26, 1982).

220. *Id.* (partial summary judgment granted Oct. 12, 1982).

221. Environmental Agreement, *supra* note 203, art. 5, *reprinted* at 1027; United States and Mexico Agree to Cooperate in the Solution of Environmental Problems in the Border Area, United States Dep't of State Press Release No. 313 (Aug. 19, 1983).

222. 42 U.S.C. §§ 6901-6987 (1982).

223. Briefing Paper Prepared for the U.S.-Mexico Environmental Meetings 1 (Aug. 1983) (Hazardous Waste).

224. *Id.; see also* Border Ecology Problems, United States Dep't of State Briefing Paper 2-3 (May 11, 1983).

225. Briefing Paper for Environmental Meetings, *supra* note 212, at 2 (no notices received by Mexico since Oct. 1981).

226. *See, e.g.,* Memorandum of Conversation from Wendy Grieder, EPA

transported without notice.

A little-discussed provision of the Solid Waste Disposal Act's[227] funding reauthorization now under consideration by Congress requires both consent of and notification to the receiving country, and prescribes stiff fines for noncompliance.[228] In addition, the EPA reportedly is increasing its efforts to bring criminal charges against those who illegally transport or dump hazardous waste.[229] The first prosecution under the felony provisions of RCRA was directly related to the illegal transportation of hazardous wastes into Mexico. Two defendants were indicted for improper transportation and storage of hazardous wastes in a Hidalgo, Texas warehouse.[230] The waste allegedly was bound for a storage and disposal facility owned by Clarence Nugent in Nuevo Mercurio, Mexico.[231] One year earlier, on March 7, 1981, Nugent had been arrested by Mexican authorities and charged with the illegal importation of hazardous substances; among the items imported were forty-two drums of a substance containing polychlorinated biphenyls (PCBs).[232] Once emptied, the drums were sold to Mexicans who used them to store drinking water. Consequently, Nugent was also charged with a violation of Mexican health laws.[233] Nugent served approximately two years in a Mexican jail. The Texas district court dismissed the case against the two United States defendants for lack of sufficient evidence.[234] In San Diego,

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(Dec. 6, 1982) (stating that Charles Frice of San Diego's District Attorney's office contacted EPA with information about a potential illegal export of toxic wastes to Mexico).

227. Pub. L. 95-609, § 7, 92 Stat. 3081-84 (1978) (codified as amended at 42 U.S.C. §§ 6901-6987).

228. S. 757, 98th Cong., 1st Sess. § 13(a)(amendment to Subtitle C of Solid Waste Disposal Act requiring: (1) notification, (2) consent by the receiving country, (3) a copy of the consent attached to the shipment, and (4) shipment conformity with the terms of consent).

229. *U.S. Is Bringing Stronger Action in Waste Cases*, N.Y. Times, Apr. 4, 1983, § 1, at 1, col. 2 [hereinafter cited as *Stronger Action*].

230. United States v. Matula, No. H-82-206 (S.D. Tex., indicted Sept. 13, 1982); *see also Stronger Action, supra* note 229.

231. Airgram, *supra* note 197, at 3 ("The Nugent Case").

232. Blumenthal, *Mexico Jails American on Charge He Imported U.S. Chemical Wastes*, N.Y. Times, Mar. 20, 1981, at A12, col. 3. *See also* Airgram, *supra* note 197, at 3.

233. Blumenthal, *supra* note 232, at A12, col. 3.

234. United States v. Matula, No. H-82-206 (S.D. Tex., indicted Sept. 13, 1982).

another scheme allegedly related to the illegal shipping of hazardous waste into Mexico[235] is the subject of an ongoing state suit against two individuals charged with maintaining a public nuisance and improperly disposing of hazardous wastes.[236]

In summary, although intergovernmental agreements historically have failed to solve transboundary water pollution problems, the continuing efforts of the United States and Mexican Governments to find workable solutions have been bolstered by the 1983 Agreement between the two countries. One private suit by San Diego residents against the city and the state has produced some results. A suit by the City of El Paso against a United States corporation has rendered some relief from air pollution problems in El Paso; a private suit against the same company had produced little. Although addressed in several United States statutes, the problem of hazardous waste disposal into Mexico remains unsolved. Federal criminal prosecution has been unsuccessful in reaching this problem, although a civil action in California is attempting to reach it indirectly. In order to avoid drawing too many conclusions from too little data, it should be noted that all of the failures to alleviate the problems have not resulted from defects in the system of intergovernmental regulation; some simply reflect weak individual cases. The ineffectiveness of both governmental actions and private suits, however, presents a disheartening picture overall.

D. Conclusion

Sovereign immunity obviously is a major obstacle to recovery in transnational suits against government-owned enterprises. The *Sedco* court's broad definition of that immunity increases the likelihood that plaintiffs doing business with foreign governments and plaintiffs harmed as a result of a foreign government's arguably commercial activities will be left out in the cold. The court's liberal construction of "vessel" for the purposes of the Limited Liability Act builds another barrier to recovery for private plaintiffs. Intergovernmental agreements, when effective, can provide long-term solutions to specific environmental problems. Unfortunately, to date agreements between the United States and Mexico

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235. Memorandum of Conversation, *supra* note 226; Note to File by Wendy Grieder, EPA (May 25, 1983).

236. California v. Ingalls, No. 488199 (Cal. Super. Ct., San Diego, filed June 24, 1982).

in this area have proven to be less than successful. Meanwhile, private litigation for damages caused by air and water pollution remains difficult, costly, and uncertain. On the northern side of the border, government suits may prove helpful in preventing hazardous waste export to Mexico; an additional advantage to such suits is that both parties are United States citizens.

A major factor underlying the slow progress on intergovernmental agreements is Mexico's economic situation. Mexican private plaintiffs suffering damages from United States corporations have recourse to United States courts, statutes, and case law on which to base a cause of action. United States plaintiffs suffering damage from Mexican industry often have no recourse but to sue a United States party indirectly to force more aggressive intergovernmental activity aimed at the prevention of future damage. Until the Mexican economy improves and Mexico begins to catch up with the United States level of industrialization, the prognosis for successful transboundary pollution litigation and more effective intergovernmental agreements is not likely to improve.

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