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An Overview of Foreign Direct Investment in Mexico

*Brandon W. Freeman**

Mexico's economic policy throughout most of the twentieth century has been founded on the principle of self-sufficiency.¹ This perceived need for self-determination resulted in a tightly regulated, isolationist economy.² Mexico's aversion to foreign economic control and political influence can be traced back to the administration of Porfirio Diaz (1876-1911).³ By the end of President Diaz's administration, productive enterprise in Mexico was dominated by foreign capital, and over half the country's wealth was foreign owned.⁴ The large foreign presence in Mexico's economy generated strong anti-foreign sentiment and eventually resulted in the Mexican Revolution of 1910.⁵

The principles behind the Mexican Revolution of 1910 included sovereignty and independence from foreign, economic, and political control.⁶ These principles were embodied in the Mexican Constitution of 1917.⁷ The Mexican Constitution of 1917 is the foundation for the isolationist economic policy and many of the laws that have discouraged and, in some areas, prevented foreign direct investment in Mexico for more than seventy years.⁸ Specific policies that have discouraged foreign direct investment in Mexico include: (1) the prohibition of foreigners from owning land within a restricted zone;⁹ (2) restraints on the creation, modification, liquidation, and transfer of Mexican stock;¹⁰ (3) the prohibition of

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1. Michael W. Goldman et al., *An Introduction to Direct Foreign Investment in Mexico*, 5 IND. INT'L. & COMP. L. REV. 101, 101 (1994).

2. *Id.*

3. Gloria L. Sandrino, *The Nafta Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 279 (1994).

4. *Id.*

5. Sandrino, *supra* note 3, at 281.

6. *Id.* at 283.

7. See CONSTITUCIÓN POLITICA DE LOS ESTADOS UNIDOS MEXICANOS CONST. reprinted in CONSTITUTIONS OF THE COUNTRIES OF THE WORLD (Albert P. Blaustein & Gilbert H. Flanz eds., Gilbert H. Flanz & Louise Morenotrans., Oceana Publications, Inc. vol. XII 1988)(1971) [hereinafter CONSTITUTION]. The 1917 Constitution remains in effect with significant amendments.

8. WHITING, *supra* note 4, at 55-79.

9. See CONSTITUTION, *supra* note 7, art. 27.

10. ALEXANDER C. HOAGLAND, JR., COMPANY FORMATION IN MEXICO B-2 (1980).

majority ownership¹¹ and majority control¹² by foreigners in certain industries; and (4) discriminatory taxation, the awarding of government contracts on a discriminatory basis, and the selective use of permits and licenses.¹³ Other factors that have discouraged foreign investment include: (1) the expropriation of foreign owned companies;¹⁴ (2) political insurrection;¹⁵ and (3) currency inconvertibility.¹⁶

In the last few years, Mexico's economic policy has undergone a dramatic reformation from isolationism to a more open, free market economy.¹⁷ In 1993 the Mexican Congress adopted a new Foreign Investment Law (FIL) that encourages foreign participation in the Mexican economy.¹⁸ In 1994 Mexico entered into the North American Free Trade Agreement (NAFTA) with Canada and the United States.¹⁹ "Chapter 11 of NAFTA (Investment Chapter...) establishes a liberalized investment regime that expands the protection of foreign investors and investments...."²⁰ In conjunction with the NAFTA, Mexico signed the U.S./Mexico tax treaty which minimizes the burden of double taxation.²¹

11. See Michael W. Gordon, *The Joint Venture as an Institution for Mexican Development: A Legislative History*, A 1978 ARIZ. ST. L. J. 173, 183.
12. See Sandra F. Maviglia, *Mexico's Guidelines for Foreign Investment: The Selective Promotion of Necessary Industries*, 80 AM. J. INT'L L. 281, 285 (1986).
13. See ECONOMIC ISSUES AND POLITICAL CONFLICT: U.S.-LATIN AMERICAN RELATIONS 20-21 (Jorge I. Domínguez ed., 1982).
14. In 1938 Mexico expropriated all foreign owned oil companies. HARRY K. WRIGHT, *FOREIGN ENTERPRISE IN MEXICO* 70 (1971). This oil industry was one of the largest blocks of foreign capital in the country. *Id.*
15. "Losses from damage" to or the destruction or disappearance of tangible assets caused by politically motivated acts of war or civil disturbance in the host country. Daniel, *A New World for Political Risk Investment Insurance*, RISK MANAGEMENT Oct. 1994, at 30, 32.
16. "[I]nvestors inability to convert local currency returns (profits, principal, interest, royalties, capital and other remittances) into foreign exchange for transfer outside the host country." Wagner, *supra* note 15, at 32.
17. See Goldman, *supra* note 1, at 101.

This 'economic miracle' contrasts greatly with the debt stricken Mexico of the early 80's. Salinas initiated this economic restructuring to repair the damages caused by decades of overly protectionist practices that staggered the Mexican economy. This process of structural adjustment is constantly developing, and if this development continues, Mexico's economic future will be bright.

Guillermo Marrero, *What Foreigners Should Know About the Mexican Market*, in NAFTA: WHAT YOU NEED TO KNOW NOW 1994, at 117, 124 (PLI Com'l Law & Practice Market, Course Handbook Series No. A4-4466).

18. "Ley de inversión extranjera," L.I.E.D.O., 27 de diciembre de 1993, reprinted in *Mexico: Foreign Investment Act of 1993*, 33 I.L.M. 207 (Jorge A. Vargastrans., 1994) [hereinafter FIA].
19. North American Free Trade Agreement, drafted Aug. 12, 1992, revised Sept. 6, 1992, U.S.-Can.-Mex., 32 I.L.M. at 605 (entered into force Jan. 1, 1994) NAFTA.
20. Sandrino, *supra* note 3, at 262.
21. Convention Between the Government of the United States of America and The Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, 139 Cong. Rec. S16, 857-59 (dailied. Nov. 20, 1993).

Through the adoption of legislation and international treaties, Mexico established an economic policy that encourages and protects foreign direct investment.²² This comment has three principal parts. The first section gives a brief overview of the important implications of Mexico's FIL and the NAFTA regarding foreign direct investment. The second section gives an overview of the various business enterprises available to foreign investors and the pros and cons of operating under each. The third section discusses two NAFTA side agreements regarding the enforcement of Mexico's labor and environmental laws with respect to their impact on the foreign investor.

I. 1993 Foreign Investment Law.

On December 28, 1993 Mexico adopted a new federal statute entitled the 1993 Foreign Investment Law (FIL).²³ The purpose of the FIL "[i]s to formulate the rules to channel foreign investment into the Nation and to ensure that said investment contributes to the national development."²⁴ The FIL covers all foreign direct investment in Mexico.²⁵ A foreign investor is defined as anyone, corporate or individual, other than a Mexican.²⁶ The FIL opens new areas of investment to foreigners including certain sectors of the oil service industry and the automobile industry.²⁷ In addition, certain investors are allowed to own property outright, which allows foreign investors who have formed Mexican corporations the freedom to choose and to negotiate their own locations.²⁸ Furthermore, foreign investors are no longer required to have Mexican partners, but are allowed to control the business alone.²⁹ The FIL also establishes less ambiguous and less time consuming registration procedures for foreign investors.³⁰ In effect, the FIL brings Mexico's common law into symmetry with requirements established under the NAFTA.³¹

22. See John M. Vernon & Carole A. Azulay, *A Guide to Implementing Mexico's New Foreign Investment Law*, 13 FRANCHISE L.J. 105, 128 (1994). See also Eric Griego, *The Labor Dimension of the NAFTA: Reflections on the First Year*, 12 ARIZ. J. INT'L & COMP. L. 473, (1995) (noting significant investment barriers in the investment climate in Mexico prior to NAFTA, and the NAFTA's elimination of those barriers); Sandrino, *supra* note 3, at 327 (noting that Chapter 11 of the NAFTA represents a major departure from Mexico's previous position on foreign investment and international economic relations creating a hospitable environment for foreign investment amongst its signatories); Goldman, *supra* note 1, at 125 (noting that under Mexico's new policy regarding foreign investment, investors can assure themselves of an ever growing market of consumers). But see Mahmood A. Zaidi, *Employment, Trade and Foreign Investment Effects of NAFTA*, Minn. J. Global Trade 333 (1996) (using empirical data to illustrate how the NAFTA will have a relatively small impact on the U.S. economy).

23. FIL, *supra* note 18.

24. *Id.*

25. *Id.*

26. *Id.*

27. Vernon & Azulay, *supra* note 22, at 105.

28. *Id.*

29. *Id.*

30. *Id.*

31. Goldman, *supra* note 1, at 114.

A. PARTICIPATION IN MEXICAN COMPANIES.

The most significant departure from Mexico's traditional treatment of foreign direct investment is rooted in article 4 of the FIL.³² Article 4 allows foreign investors to control 100 percent of capital stock in a Mexican enterprise, subject to specific limitations.³³ The specific limitations referred to in article 4 are separated into three categories.³⁴ The first category includes activities reserved exclusively to the Mexican Government.³⁵ These activities include: (1) petroleum; (2) basic petrochemicals; (3) electricity; (4) nuclear energy; (5) radioactive materials; (6) satellite communications; (7) telegraph services; (8) radiotelegraphy; (9) mail service; (10) railways; (11) issuance of paper money; (12) mintage of currency; (13) control of ports, airports, and heliports; and (14) any other activity specifically mentioned by applicable legal provisions.³⁶ The second category is activities reserved exclusively for the Mexican People or to Mexican companies with an "Exclusion of Foreigners Clause."³⁶ These activities include: (1) domestic land transportation of passengers, tourists and cargo, not including messenger and express package services; (2) retail sale of gasoline and the distribution of liquid petroleum gas; (3) radio and television broadcasting services, excluding cable television; (4) credit unions; (5) developmental banking institutions; and (6) rendering of professional and technical services.³⁸

Foreign investors cannot participate in the activities in these two categories either directly or through the use of trusts, agreements, social or statutory covenants, pyramid schemes, or any mechanism granting them control or participation.³⁹ The only exception is through neutral investment, which is discussed later in this comment.⁴⁰

The third category limits foreign participation in certain areas to set percentages. These percentages are divided into five brackets: (1) up to 10 percent; (2) up to 25 percent; (3) up to 30 percent; (4) up to 49 percent; and (5) over 49 percent.⁴¹ The up to 10 percent bracket includes cooperatives.⁴² The up to 25 percent bracket includes domestic air trans-

32. *Id.* at 116.

33. FIL, *supra* note 18, art. 4. This article allows foreign investors to participate in any proportion in the capital of Mexican corporations, the acquisition of fixed assets, the entering into any new areas of economic activity or in the manufacturing of new lines of products, the opening and management of commercial entities, or in the expansion or relocation of those already in existence, save what is provided by this act. *Id.*

34. *Id.* arts. 5, 6, 7, and 8.

35. *Id.* art. 5.

36. *Id.* Activities reserved exclusively to the Mexican Government under 1973 Foreign Investment Law include: petroleum and other hydrocarbons; basic petrochemicals; exploitation of radioactive minerals and the generation of nuclear energy; mining; electricity; railroads; telegraphic and wireless communications; and other activities established in specific laws. "Reglamento de la ley para promover la inversion mexicana y regular inversion extranjera," D.O., 16 de mayo de 1989 reprinted in *DOING BUSINESS IN MEXICO*, (Andrea Bonmo-Blanc & William E. Mooz, Jr. eds., Alexander Hoagland trans., vol. 2, pt. IV, app. 4 1989 (1980)).

37. FIL, *supra* note 18, art. 6.

38. *Id.*

39. *Id.*

40. Goldman, *supra* note 1, at 118.

41. FIL, *supra* note 18, art. 7.

42. *Id.*

portation, air taxi transport, and specialized air transportation.⁴³ The up to 30 percent bracket includes controlling companies of financial groups, multiple banking credit institutions, stockmarket houses, and stock market specialists.⁴⁴ The up to 49 percent bracket includes insurance institutions, bond institutions, money exchange houses, manufacturing and marketing of explosives, printing and publication of newspapers, cable television, telephone services, fishing, port services of pilotage to ships, and services related to the railroad sector.⁴⁵ The final bracket requires approval by the Foreign Investment Commission (FIC)⁴⁶ before a foreign investor may invest in over 49 percent in any of the following activities: private education, legal services, securities appraisal institutions, insurance, cellular telephones, construction of pipelines for transporting oil and gas, and drilling of oil and gas wells.⁴⁷

B. REAL PROPERTY.

The Mexican Constitution prohibits foreigners from owning land within 100 kilometers of Mexico's borders and within 50 kilometers of Mexico's coastline.⁴⁸ This area is known as the "restricted zone."⁴⁹ However, these restrictions have been eased by the FIL. Mexican corporations having foreign shareholders may now acquire and hold real estate in the restricted zone, provided that real estate is used for nonresidential purposes and the purchase is registered with the FIC.⁵⁰ In order for a Mexican corporation to own property in the restricted zone for residential purposes or for foreign natural persons or foreign legal entities to own property in the restricted zone, a real estate trust must be created.⁵¹ Creating a real estate trust requires approval from the FIC.⁵² Upon approval, the FIC will issue a permit to a Mexican credit institution authorizing the institution to acquire rights,

43. *Id.*

44. *Id.*

45. *Id.*

46. *See, supra* note 36. The 1973 Foreign Investment Law established the FIC in order to implement the law and to supervise foreign investment. *Id.*

47. *Id.* art. 8.

48. CONST. art. 27.

49. *Id.*

50. FIL, *supra* note 18, art. 10.

51. *Id.* art. 11.

52. *Id.*

as trustee, on property located in the restricted zone.⁵³ Once the trust has been created, the beneficiaries have full rights to the land, including any benefit from a profit-making operation and exploitation.⁵⁴ The FIL provides that real estate trusts are valid for fifty years, and renewal is automatic and may continue indefinitely subject to FIC approval.⁵⁵

C. NEUTRAL INVESTMENT.

The FIL also expands a foreign investor's opportunity to invest in "neutral investments."⁵⁶ Neutral investment consists of that which is realized in Mexican companies that is not taken into account in determining the percentage of foreign investment in the capital stock of Mexican companies.⁵⁷ Direct neutral investment may take the form of non-voting shares in which the shareholder has the rights to pecuniary interests in the corporation, but only limited corporate rights.⁵⁸ Neutral investment shares issued to foreign investors must be approved by the National Securities Commission.⁵⁹

D. SANCTIONS.

The FIL also provides several articles that permit sanctions for acts performed in contravention of the law.⁶⁰ The sanctions range from fines to revocation of authorization to conduct business in Mexico.⁶¹ The revocation of authority to do business results in the nullification of all business and statutory agreements, and may be imposed on a Mexican national, Mexican company, foreign national, or foreign legal entity.⁶²

II. North American Free Trade Agreement.

On January 1, 1994 Mexico entered into the NAFTA with the United States and Canada, thereby creating a free trade area in which tariff and other barriers to trade are greatly reduced.⁶³ Chapter 11 of the NAFTA (Investment Chapter) represents a significant shift in Mexico's economic policy regarding foreign investments, particularly with respect to treatment, protection against dispossession, and compensation for expropriation of foreign owned property.⁶⁴

The NAFTA defines an investor as a NAFTA "Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an

53. Goldman, *supra* note 1, at 120.

54. FIL, *supra* note 18, art. 12.

55. *Id.* art. 13.

56. Vernon & Azulaye, *supra* note 22, at 128.

57. FIL, *supra* note 18, art. 18.

58. *Id.* art. 19.

59. *Id.* art. 20.

60. *Id.* arts. 37-9.

61. *Id.* arts. 37, 38.

62. *Id.*

63. NAFTA, *supra* note 19.

64. Sandrino, *supra* note 3, at 307.

investment.”⁶⁵ The Investment Chapter is applicable not only to the NAFTA states, but also to investors with substantial business activities in the NAFTA states.⁶⁶

A. TREATMENT STANDARDS.

The NAFTA's Investment Chapter begins by providing general equality of treatment for foreign investors.⁶⁷ The provision ensures that foreigners and foreign investments in Mexico are treated equally as national investors in like circumstances with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or disposition of investments.⁶⁸ The provision also ensures that NAFTA investors and their investments are accorded at least as favorable treatment as any other investors or investments from other non-NAFTA parties.⁶⁹ Thus, a foreign investor in Mexico will not be subject to different or more onerous operating conditions simply by virtue of foreign ownership.⁷⁰ This Investment Chapter also provides that no party shall require that a minimum level of investment be held by nationals or require an investor, by reason of its nationality, to sell or otherwise dispose of investment in the territory of the party.⁷¹ Furthermore, no party may require an enterprise that is a foreign investment to reserve certain senior management positions to local nationals.⁷²

The NAFTA also requires that investments of a NAFTA party be treated “[i]n accordance with international law, including fair and equitable treatment and full protection and security.”⁷³ Thus, foreign investors will be accorded the same security as nationals, and will not be put at a competitive disadvantage in obtaining permits or authorizations necessary to conduct business operations.⁷⁴

B. PERFORMANCE REQUIREMENTS.

Another important provision of the NAFTA's Investment Chapter is the prohibition of performance requirements. Performance requirements have been a major barrier to investment in Mexico.⁷⁵ The Investment Chapter provides that no party shall enforce any commitment or undertaking in connection with the establishment, acquisition, expansion, management, conduct, or operation of an investment of an investor of a party or of a non-party if the commitment is:

65. NAFTA, *supra* note 19, art. 1139.

66. *Id.*

67. *Id.* art. 1102.

68. *Id.*

69. *Id.* art. 1103.

70. Sandrino, *supra* note 3, at 310.

71. NAFTA, *supra* note 19, art. 1102.

72. *Id.* art. 1107.

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

74. Sandrino, *supra* note 3, at 311.

75. Hope H. Camp, Jr. et al. *Foreign Investment In Mexico From the Perspective of the Foreign Investor*, 24 ST. MARY'S L.J. 775, 794 (1993).

- (a) to export a given level or percentage of goods or services;
- (b) to achieve a given level or percentage of domestic content
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
- (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
- (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.⁷⁶

This article goes on to prohibit a party from conditioning receipt of advantages in connection with an investment of an investor of a party or of a nonparty on compliance with any of the following requirements:

- (a) to achieve a given level or percentage of domestic content;
- (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
- (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
- (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.⁷⁷

The prohibition on performance requirements is not absolute. A party may still condition the receipt of an advantage, in connection with an investment in its territory of a party or of a nonparty, on compliance with the requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development in its territory.

76. NAFTA, *supra* note 19, art. 1106.

77. *Id.* art. 1106.

78. *Id.*

C. TRANSFERS RELATING TO INVESTMENTS.

The risk of currency inconvertibility greatly reduces the amount of foreign direct investment in high risk nations.⁷⁹ Currency inconvertibility is defined as an "[i]nvestor's inability to convert local currency returns (profits, principal, interest, royalties, capital and other remittances) into foreign exchange for transfer outside the host country."⁸⁰ Industrialized nations emphasize the importance of a foreign investor's ability to make monetary transfers,⁸¹ while most Third World states have exchange control laws to regulate the conversion of currency abroad.⁸² The NAFTA's Investment Chapter provides the guarantees that industrialized states and their investors and firms seek in order to optimize their investment projects.⁸³

The NAFTA provides that certain transfers relating to an investment shall be made "freely and without delay."⁸⁴ These transfers include: (a) profits, dividends, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind, and other amounts derived from the investment; (b) proceeds from the sale of all or any part of the investment or from the partial or complete liquidation of an investment; and, (c) payments made under a contract entered into by the investor, or its investment, including payments made pursuant to a loan agreement. These transfers shall be made in a freely usable currency at the market rate of exchange.⁸⁵ Certain transfers may be prevented through the goodfaith application of laws relating to: (a) bankruptcy, insolvency, or the protection of creditors; (b) issuing, trading, or dealing in securities; (c) criminal or penal offenses; (d) reports of transfer of currency or other monetary instruments; and (e) ensuring the satisfaction of judgments in adjudicatory proceedings.

D. EXPROPRIATION AND COMPENSATION.

One of the major deterrents to foreign direct investment in developing nations is the possibility of expropriation.⁸⁶ This possibility is a particularly serious impediment to

79. "The inability to convert local currency creates detrimental consequences for investors. For example, inconvertibility reduces the ability of the investor to meet financial commitments such as the payment of dividends or the withdrawal of profits from the country where the investment is located." George Thomas Ellinidis, *Foreign Direct Investment in Developing and Newly Liberalized Nations*, 4 J. INT'L L. & PRAC. 299, 316 (1995).

80. Wagner, *supra* note 15, at 32.

81. Most BIT's prohibit any restrictions placed on the ability of a foreign investor to transfer currency generated in their business enterprise out of the host country. Edward A. Fallon, *Going International: Fundamentals of International Business Transactions*, American Law Institute, American Bar Association Continuing Legal Education, July 8, 1996.

82. Sandrino, *supra* note 3, at 315.

83. *Id.*

84. NAFTA, *supra* note 19, art. 1109.

85. *Id.*

86. See David A. Gantz, *The Marcona Settlement: New Forms of Negotiation and Compensation for Nationalized Property*, 71 AM. J. INT'L L. 474 (1977); See generally William D. Rogers, *Of Missionaries, Fanatics, and Lawyers: Some Thoughts on Investment Disputes in the Americas*, 72 AM. J. INT'L L. 1 (1978).

investment in Mexico.⁸⁷ Expropriation is defined as "[t]he taking of an investor's property without compensation or with inadequate compensation."⁸⁸ Public international law recognizes a nation's right to nationalize foreign owned property if: (a) there is no discrimination involved; (b) there is a public purpose; and (c) the foreigner or foreign organization is fairly compensated for the investment.⁸⁹ The common problem arising in these situations is determining what constitutes "fair compensation."⁹⁰ The NAFTA drafters recognized this problem and appropriately defined the law regarding nationalization in the NAFTA states.⁹¹

The NAFTA provides that no party may directly or indirectly nationalize or expropriate an investment of an investor in its territory or take a measure tantamount to nationalization or expropriation of such an investment, except when the nationalization is: (a) for a public purpose; (b) on a nondiscriminatory basis; (c) in accordance with due process of law and with treatment in accordance with international law, including fair and equitable treatment; and (d) is accompanied by payment of compensation equivalent to the fair market value, paid without delay and fully realizable with interest from the date of expropriation.⁹² This provision in the NAFTA's Investment Chapter marks a significant turn in Mexico's policy toward foreign investment and recognition of the international laws and customs that have been in place between developed nations for many years.⁹³

87. Mexico has traditionally viewed expropriation as a major vehicle for self-determination. See generally Sandrino, *supra* note 3. Accordingly, they have opposed the customary international law governing expropriation. *Id.* Since Mexico's 1938 oil expropriation, the United States has asserted that the Hull Doctrine is customary international law regarding expropriations. *Id.* The Hull Doctrine requires prompt compensation for expropriated property in convertible foreign exchange, equivalent to the full value thereof. *Id.* This has been codified in the Hickenlooper Amendments. 22 U.S.C.A. §2370(e)(1)(1990). Mexico has generally asserted that no international rule existed and that issues of compensation are to be determined by Mexico's laws. See Charter of Economic Rights and Duties of States, G.A. Res. 3281, U.N. GAOR, 29th Sess., Supp. No. 31, at 50, U.N. Doc. A/9631 (1975), reprinted in 14 I.L.M. 251 (1975).

88. A.A. FATOUROS, GOVERNMENT GUARANTEES TO FOREIGN INVESTORS 50 (1962).

89. INGRID DETTER DE LUPIS, FINANCE AND PROTECTION OF INVESTMENTS IN DEVELOPING COUNTRIES 68 (1987).

90. *Id.* at 81.

91. NAFTA, *supra* note 19, art. 1110.

92. *Id.*

93. In 1938 President Cardenas signed a decree nationalizing the assets of British owned Royal Dutch Shell and U.S. based Standard Oil of New Jersey. See Wright, *supra* note 14 at 70. The drastic measure by the Mexican Government was based on the oil companies' refusal to obey the Supreme Court of Mexico's order for increased wages in the oil industry. *Id.* The Mexican Government's bold move in nationalizing foreign owned oil companies resulted in increased flight in foreign capital. MIGUEL D. RAMIREZ, MEXICO'S ECONOMIC CRISIS: ITS ORIGIN AND CONSEQUENCES 81 (1989). The Mexican Constitution of 1917, which is still in effect today, provides that "expropriations can only be made by reason of utility and by means of indemnity." CONST., *supra* note 7, art. 27. Mexico took this one step further during the oil expropriations, excusing fair compensation when expropriations were "inspired by legitimate causes and the aspirations of social justice." Samuel K.B. Asante, *International Law and Foreign Investment: A Reappraisal*, 37 INT'L & COMP. L.Q. 588, 599 (citing Reply of Mexican Minister of Foreign Affairs dated Aug. 3, 1938, in Vernon & Azulay, *supra* note 30).

E. SETTLEMENT OF DISPUTES.

NAFTA's Investment Chapter establishes a mechanism for the settlement of investment disputes between a NAFTA state and an investor of another NAFTA state.⁹⁴ The chapter provides that investors may seek resolution of their claims through international arbitration in accordance with the International Center for Settlement of Investment Disputes Convention or the United Nations Commission on International Trade Law Arbitration Rules.⁹⁵

Under the investor-state arbitration mechanism, an investor, on its own behalf⁹⁶ or on behalf of the enterprise the investor owns or controls,⁹⁷ may submit to arbitration a claim for loss or damage resulting from the breach by the host state of a treaty provision. An investor's right to arbitration is subject to a three year statute of limitations⁹⁸ and notice to the host country at least ninety days prior to submitting a claim to arbitration.⁹⁹ In addition, claimants must waive their right to seek resolution through any other means, including the courts under the law of any NAFTA party.¹⁰⁰ However, because the tribunal can only award monetary relief, investors do not waive their right to seek injunctive, declaratory, or other extraordinary relief not involving the payment of damages.¹⁰¹ The issues in dispute are decided in accordance with the NAFTA treaty and the applicable rules of international law.¹⁰²

The NAFTA's extensive investment dispute mechanism represents a significant departure for Mexico with respect to its recognition of international law in international economic relations.¹⁰³ Mexico historically distrusted private-state arbitration mechanisms.¹⁰⁴ This distrust is attributed to the Calvo Clause¹⁰⁵ in the Mexican Constitution,¹⁰⁶ which specifically states that submission to international dispute resolution is in no manner an invocation of diplomatic protection by foreign governments.¹⁰⁷ The implementation of the NAFTA and the New Foreign Investment Law¹⁰⁸ clears "all

94. *NAFTA*, *supra* note 19, B.

95. *Id.* art. 1120.

96. *Id.* art. 1116.

97. *Id.* art. 1117.

98. *Id.* art. 1116, 1117.

99. *Id.* art. 1119.

100. *Id.* art. 1121.

101. *Id.* art. 1122.

102. *Id.* art. 1131.

103. Sandrino, *supra* note 3, at 322.

104. *Id.*

105. The Calvo doctrine was developed by an Argentinean jurist named Carlos Calvo. *Id.* at 327. Mexico interpreted the doctrine as prohibiting an investor's state from intervening on his or her behalf against the host state, and excluding diplomatic protection in any circumstances. *Id.* at 268. Discussion of the Calvo Doctrine can be found in the following books: EDWIN M. BORCHARD, *THE DIPLOMATIC PROTECTION OF CITIZENS ABROAD* 795-809 (1915); JAMES L. BRIERLY, *THE LAW OF NATIONS* 181-183 (2d ed. 1938); CLYDE EAGLETON, *THE RESPONSIBILITY OF STATES IN INTERNATIONAL LAW* 168-76 (1928).

106. *CONST.*, *supra* note 7, art. 27.

107. *Id.* at 322.

108. *FIL*, *supra* note 18.

doubts about the scope of the 'Calvo Clause' in the Constitution...,¹⁰⁹ and marks a new era in Mexico's international relations.¹¹⁰

III. Business Enterprises.

An important part of an overview on direct foreign investment in Mexico involves exploring the various means of doing business in Mexico. Many different organizational forms are recognized by Mexican Law. These forms are regulated by Mexico's federal law, General Law of Mercantile Organizations¹¹¹ (Ley General de Sociedades Mercantiles [LGSM]), and the Civil Code (Codigo Civil), "both of which trace their origins to commercial and civil laws of Spain."¹¹² The LGSM applies throughout Mexico, and the various state civil codes are almost identical as to the formation of civil entities.¹¹³

IV. Corporate Law.

The most common method for domestic and foreign investors to operate in Mexico is through a corporation.¹¹⁴ Two corporate forms exist under Mexico's corporate law - Sociedad anonima¹¹⁵ (S.A.) and the Sociedad anonima de capital variable¹¹⁶ (S.A.C.V.).

109. Antonio Garza Canovas, Introductory Note, 31 I.L.M. 390, 391 (1992).

110. Justine Daly, *Has Mexico Crossed the Border On State Responsibility For Economic Injury To Aliens? Foreign Investment and the Calvo Clause in Mexico After the NAFTA*, 25 ST. MARY'S L.J. 1147, 1181 (1994). Daly addresses the contradiction between the Calvo Clause in the Mexican Constitution and the dispute resolution mechanisms in the NAFTA. *Id.* Daly argues that Mexico's joining of the NAFTA is not indicative of Mexico's abandonment of the Calvo Doctrine. *Id.* However, she concedes that in regards to foreign investors the point is moot because the NAFTA provides adequate dispute resolution provisions reducing the probability of the United States asserting diplomatic protection. *Id.*

111. Ley General de Sociedades Mercantiles, Diario Oficial, Aug. 4, 1934, as amended June 11, 1992, reprinted and translated in COMMERCIAL LAWS OF THE WORLD: MEXICO 290-342 (Foreign Tax Law Publishers 1996) [hereinafter "LGSM"].

112. Marrero, *supra* note 17, at 129; Phanor J. Eder, *Company Law in Latin America*, 27 NOTRE DAME L. REV. 5 (1951) (commenting about the development of companies under Spanish Law), has observed, in contrast to the rule laid down by Coke and Blackstone and which is still followed in our [common] law, they did not derive their corporate personality from the sovereign, but only their special monopolistic privileges. *Id.* The corporate or legal personality came from men associating themselves, under the Mexican law, into a "company." *Id.* All "companies," whether formed as a general partnership or as a limited partnership (compania en comandita), had a legal personality adhered automatically to this new form of company, the stock company or anonima, as it was soon to be called. *Id.* at 15.

113. Eder, *supra* note 112, at 129.

114. Humbert Gayou & Robert G. Gilbert, *Legal Building Blocks For Structuring Sales in the Mexican Market*, 25 ST. MARY'S L.J. 1115, 1126 (1994).

115. LGSM, *supra* note 111, art. 87.

116. *Id.* art. 87.

The S.A. closely resembles the U.S. corporation and is the most formal business organization in Mexico.¹¹⁷ The S.A.C.V. differs from the S.A. in that it can decrease its capital within the limits set in the bylaws, by a mere stockholder's resolution without the need to fulfill certain formalities applicable to the S.A.¹¹⁸ Shareholders of either an S.A. or an S.A.C.V. are only liable for the amount of capital subscribed.¹¹⁹

A. INCORPORATION.

Companies incorporating in Mexico must follow the corporate name with the initials S.A.¹²⁰ The investors must seek authorization from the Ministry of Foreign Affairs prior to establishment.¹²¹ Authorization by the Foreign Ministry is reproduced in a notarized deed, which represents the combined articles of incorporation and the bylaws.¹²² An S.A. must consist of at least two shareholders, with no limit on the maximum number, and a minimum capital contribution of 50,000 NP (new pesos), of which at least 20 percent must be paid in immediately.¹²³

B. MANAGEMENT.

Shareholders of a Mexican corporation "are the supreme authority of the corporation."¹²⁴ Shareholders elect either a sole administrator or a board of directors (mandatarios) to manage the affairs of the corporation. Directors are usually elected for one year or until replaced.¹²⁵ If one or more of the directors resides outside of Mexico, it is usually customary to appoint alternate directors in order to facilitate a quorum.¹²⁶ However, no geographical restrictions exist on where a board of directors may choose to convene.¹²⁷

The articles of incorporation normally authorize the board to name a general manager to operate the business of the corporation and should specify any powers that the board may not delegate.¹²⁸ Shareholders have the power to remove directors from the board at

117. Marrero, *supra* note 17, at 130.

118. Thomas M. Shoesmith, *Investing and Manufacturing: Part I: Basic Business Structuring and The Maquiladora Option*, 1 No.1 MEX. TRADE & L. REP. 13 (1991). Changing the amount of capital in an S.A. requires amending the articles of incorporation and approval of the Ministry of Foreign Affairs and, in some cases, the Foreign Investment Commission. *Id.* Capital reductions also require publication three times in the Official Gazette to provide protection for creditors. PRICE WATERHOUSE, *DOING BUSINESS IN MEXICO "INFORMATION GUIDE"* (1995).

119. Ignacio Gomez-Palacio, *Some Observations on the United States and Mexican Corporate Law*, 3 U.S.-MEX. L.J. 25, 27 (1995).

120. LGSM, *supra* note 111, art. 88.

121. PRICE WATERHOUSE, *supra* note 118, at 84.

122. *Id.*

123. WILLIAM E. MOOZ JR., *AN INTRODUCTION TO DOING BUSINESS IN MEXICO* 57 (1995). If contributions are paid in kind, the initial capital must be paid in full. *Id.* If contributions are paid in cash, a minimum of 20 percent must be paid up front. *Id.*

124. Marrero, *supra* note 17, at 131.

125. PRICE WATERHOUSE, *supra* note 118, at 87.

126. *Id.*

128. *Id.*

any time.¹²⁹ However, directors elected by minority shareholders may only be removed if the entire board is removed.¹³⁰

In addition to electing directors, shareholders of a Mexican corporation typically appoint auditors (comisarios) who are responsible for supervising the board of directors.¹³¹ Auditors are generally lawyers and accountants and serve the function of corporate council and financial auditor.¹³²

C. SHAREHOLDER PROTECTION.

Mexican law protects minority shareholder interests by providing that a shareholder owning at least 10 percent of the corporate capital of an exchange listed corporation is entitled to elect at least one director to the board.¹³³ If the corporation chooses to elect three or more directors to the board, a minority shareholder owning at least 25 percent of the corporate capital is entitled to elect at least one director.¹³⁴ Similarly, if the corporation chooses to appoint three or more auditors, a minority shareholder owning at least 25 percent of the corporate capital is entitled to elect at least one.¹³⁵

General shareholder agreements in connection with the management of the corporation are not recognized under Mexican corporate law.¹³⁶ In addition, when important management issues are decided, extraordinary meetings must be held.¹³⁷ Quorum and super-majority voting requirements are often used in extraordinary shareholder meetings to protect minority shareholders.¹³⁸

Shareholders are also entitled to enjoin the implementation of a shareholders' resolution that is contrary to law or the bylaws of the corporation.¹³⁹ Shareholders may also seek damages for injury to the corporation through a derivative action against the directors who violate their duties to the corporation.¹⁴⁰ Shareholders filing suit for injunction or a derivative claim for damages must represent at least one-third of the corporate capital.¹⁴¹

129. LGSM, *supra* note 111, art. 144.

130. *Id.*

131. *Id.* art. 167.

132. Edward A. Fallone, *Going International: Fundamentals of International Business: Latin American Laws Regulating Foreign Investment*, SB04 A.L.I.-A.B.A. 323, 345 (1996).

133. LGSM, *supra* note 111, art. 144.

134. *Id.*

135. *Id.* art. 171.

136. Fallone, *supra* note 132, at 345, *See* Gomez-Palacio, *supra* note 119, at 27.

137. PRICE WATERHOUSE, *supra* note 118, at 87. Extraordinary shareholder meetings must be held to approve any modification of the articles and bylaws, mergers, or issue of debentures. *Id.*

138. Fallone, *supra* note 132, at 345, *See Panel Discussion: A Hypothetical Problem on Securities Law*, 3 U.S.-MEX. L.J. 93, 102-104 (1995). The articles of corporations with substantial minority shareholders often provide resolution in key specified areas, such as amendments to the charter, incurring substantial indebtedness, appointment of higher level employees and their salaries, and may be approved only by, for example, 60% of the total shares outstanding. PRICE WATERHOUSE, *supra* note 118, at 87.

139. LGSM, *supra* note 111, arts. 201, 202.

140. *Id.* art. 163.

141. *Id.* arts. 163, 201, 202.

C. TRANSFER OF SHARES.

Typically, a corporate shareholder may transfer his shares without obtaining the approval of the remaining shareholders. However, the articles of incorporation may condition the transfer of shares upon board approval.¹⁴² The board may deny the transfer of shares to a specific person and in turn designate a different buyer at the market price.¹⁴³ Mexican law allows a corporation to purchase their own shares only in limited circumstances.¹⁴⁴

D. INCREASES AND DECREASES IN CAPITAL.

Before a corporation may reduce the minimum authorized capital stock, the shareholders are required to amend the articles of incorporation at an extraordinary shareholder meeting.¹⁴⁵ In addition, the corporation is required to obtain approval from the Ministry of Foreign Affairs and, in some cases, the Foreign Investment Commission.¹⁴⁶ Corporations are also required to publish capital reductions three times in the Official Gazette in order to provide notice to the corporations' creditors.¹⁴⁷

If the corporation reduces the amount of capital, shareholders have the right to redeem some of their shares in proportion to the amount of shares held by each.¹⁴⁸ Likewise, if the corporation decides to issue new shares of stock, shareholders have the right to purchase the new shares in order to maintain their interest in the corporation.¹⁴⁹

E. SOCIEDAD ANONIMA DE CAPITAL VARIABLE.

Foreign investors may also incorporate as an S.A.C.V. This form is identical to the S.A. except the corporation is not required to fulfill the formalities applicable to the S.A. when the corporation increases or decreases its capital.¹⁵⁰ Requiring minimum formalities for the issue of additional variable capital is important because Mexican corporations are prohibited from owning treasury shares.¹⁵¹ The procedures for capital increases and decreases of the variable portion of the capital stock should be provided in the company's articles of incorporation.¹⁵² Typically, the articles provide that increases or decreases in capital may be accomplished by a resolution of the board of directors of an ordinary shareholders' meeting.¹⁵³

142. *Id.* art. 130.

143. *Id.*

144. Fallone, *supra* note 132, at 345; See Ignacio Gomez-Palacio, *supra* note 119, at 27. In the United States, corporations are granted statutory power to purchase and to sell shares of its own stock. DEL. CODE ANN. tit. 8, § 160 (1994). However, the repurchase of outstanding stock with corporate funds may be grounds for a derivative claim by a shareholder if the purchase was improperly centered upon perpetuation of control. *Cheff v. Mathes*, 199 A.2d 548 (1964).

145. PRICE WATERHOUSE, *supra* note 118, at 86.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. Marrero, *supra* note 17, at 131.

151. PRICE WATERHOUSE, *supra* note 118, at 89.

152. *Id.* at 89.

153. *Id.* at 89.

V. Limited Liability Companies.

The Sociedad de Responsabilidad Limitada (S.R.L.) is similar to the limited liability company used in many states within the United States.¹⁵⁴ The Mexican limited liability company has characteristics of a corporation and some characteristics of a partnership.¹⁵⁵ The form provides limited liability, like a corporation, but the bylaws of the company can be drafted in such a way as to give it most of the characteristics of a partnership.¹⁵⁶

Organization of a Mexican limited liability company requires the same prior authorization and registration as the Mexican corporation.¹⁵⁷ An S.R.L. is limited to fifty members and is subject to a minimum capital contribution of 3000 NP.¹⁵⁸ These contributions are manifested by "partes sociales," which are negotiable instruments subject to special provisions.¹⁵⁹

The S.R.L. is rarely used as a vehicle for foreign investment.¹⁶⁰ The membership restrictions render the S.R.L. unsuitable for large businesses.¹⁶¹

VI. Partnerships.

Foreign investors may also form a general partnership (Sociedad en Nombre Colectivo) or a limited partnership (Sociedad en Comandita).¹⁶² In a general partnership, all partners are jointly liable to creditors of the company.¹⁶³ In the limited partnership, the "socios comanditarios" have joint and unlimited liability, and are responsible for all decision making pertaining to the enterprise.¹⁶⁴ The "financiers," on the other hand, are only liable for the amount of their capital contribution and may not participate in the management of the business.¹⁶⁵ The general partnership and the limited partnership are rarely used by foreign investors because of the unlimited liability.¹⁶⁶

VII. Joint Venture Contract.

The joint venture contract (asociacion en participacion) is another method of conducting business in Mexico.¹⁶⁷ In a joint venture contract, a person grants a working

154. Marrero, *supra* note 17, at 130.

155. *Id.* at 129-130.

156. PRICE WATERHOUSE, *supra* note 118, at 90.

157. *Id.*

158. Marrero, *supra* note 110, at 130.

159. *Id.* at 130.

160. Shoesmith, *supra* note 118.

161. Marrero, *supra* note 17, at 130.

162. *Id.* at 129.

163. *Id.* at 129.

164. *Id.* at 129.

165. *Id.* at 129.

166. PRICE WATERHOUSE, *supra* note 118, at 91.

167. *Id.* at 91.

interest in his or her business to others, who provide property or services.¹⁶⁸ The joint venture contract does not create a separate legal entity like the formation of a Mexican corporation or partnership.¹⁶⁹ The business is operated by an active managing joint venturer (*asociante*), who is the only one with any liability to third parties.¹⁷⁰ There are no registration requirements for entering a joint venture contract and there are no requirements as to minimum capital.¹⁷¹

The joint venture contract provides some particular advantages to foreign investors. The form allows the investor to satisfy ownership requirements present in the host country's laws and allows for better access to, and interactions with, local labor unions, financial institutions, and the government.¹⁷² Further, the use of a domestic partner yields distribution channels, marketing practices, and cultural and language niceties.¹⁷³ However, the joint venture may limit the partners' ability to modify their commitments to the venture and result in a loss of general flexibility.¹⁷⁴

VIII. Branch Office.

Foreign investors may also choose to conduct business in Mexico by establishing a branch office (*scursal de sociedad extranjera*) after complying with certain formalities and obtaining approval of the Mexican government, including authorization by the Foreign Investment Commission.¹⁷⁵ A branch office is not treated as a separate legal entity.¹⁷⁵ Thus, the parent's capital resources may be exposed to any liabilities that accrue in the foreign branch.¹⁷⁷ For this reason, branches are not a popular vehicle for establishing operations in Mexico.¹⁷⁸

168. In a joint venture each party may contribute a predetermined amount of capital or the parties may contribute labor, expertise, knowledge, land, and resources, or some permutation of these. JOHN P. KARALIS, *INTERNATIONAL JOINT VENTURES* 7 (1992). Nonmonetary contributions are often assigned a monetary value in order to determine the amount of each parties' contributions. *Id.*

169. PRICE WATERHOUSE, *supra* note 118, at 91.

170. *Id.* at 91.

171. *Id.* at 91.

172. Ellinidis, *supra* note 79, at 305.

173. *Id.* at 305.

174. E.J. KOLDE, *THE MULTINATIONAL COMPANY*, 127 (1974).

175. PRICE WATERHOUSE, *supra* note 118, at 92.

176. *Id.* at 126.

177. *Id.*

178. *Id.*

IX. The Maquiladora Program.

The Maquiladora Program was introduced in 1965 as part of the Mexican Border Industrialization Program.¹⁷⁹ The Maquiladora Program allows foreign investors to establish 100 percent foreign-owned and managed companies in Mexico.¹⁸⁰ The foreign-owned company (maquiladora)¹⁸¹ may import, in-bond and duty free, all the machinery, equipment, and tools to assemble or manufacture any product or component.¹⁸² The final products of the maquiladora industry are generally exported for sale outside of Mexico.¹⁸³

The maquiladora industry plays a substantial role in the Mexican economy. Maquiladora plants comprise 18 percent of Mexico's manufacturing jobs.¹⁸⁴ The total number of workers employed in maquiladoras was over 742,000 by the end of 1995.¹⁸⁵ Maquiladoras are the second largest generator of revenue in Mexico's current account, and represent 34 percent of the total value of Mexican exports.¹⁸⁶ From these figures, it is apparent that a substantial portion of foreign direct investment in Mexico is represented in the maquiladora industry.¹⁸⁷ At year end 1995, U.S. \$1.1 billion of total foreign direct investment in Mexico was attributed to maquiladoras.¹⁸⁸

179. M. Angeles Villarreal, *Maquiladoras: Mexico's Maquiladora Industry*, 2 No. 4 MEX. TRADE & L. REP. 17, 18 (1992). Maquiladoras actually originated in the early 1960's when U.S. companies and Mexican landowners entered into private contracts for the construction of industrial parks. *Id.* Fearing high unemployment, the Mexican Government encouraged agreements. *Id.* When the Maquiladora Program was formally established, plant sites were restricted to border zones. Shoesmith, *supra* note 118, at 14. These restrictions were later modified, allowing the establishment of foreign-owned maquiladoras throughout the interior of Mexico, except in zones of high industrial concentration. *Id.*

180. "Decreto que modifica al diverso para el Fomento y Operacion de la Industria Maquiladora de Exportacion," art. 19, D.O., 24 de diciembre de 1993.

181. The term maquiladora is derived from the Spanish word maquilar. Shoesmith, *supra* note 118, at 14. A maquilar is an arrangement when a miller retains a portion of the flour he makes in return for providing milling services. *Id.* Similarly, all facilities involved in the Maquiladora Program involve the processing of foreign inputs. *Id.* In Mexico, the word "maquilar" has come to mean performing the task for another. *Id.*

182. Marrero, *supra* note 17, at 133.

183. William C. Gruben, *Mexican Maquiladora Growth: Does It Cost U.S. Jobs?* ECON. REV. Jan. 1990 at 15, 16.

184. *Maquila Industry Growth*, MEX. BUS. MONTHLY, See Q. Feb. 1, 1996 available in 1996 WL 8154789.

185. *Id.*

186. *Id.*

187. The prosperity of the maquiladora industry can be partially attributed to Mexico's low wage rate. Marrero, *supra* note 17, at 134. When it is possible to separate the labor intensive phase of production from the capital and knowledge intensive phases, "it is beneficial -- in terms of profitability and competitiveness -- to process, assemble, test and package goods in countries with abundant lower cost labor." *Id.* Wages in Mexico escalated from the all-time low of 54 cents per hour in 1985 to an average of \$2 per hour in 1995. *Peso Devaluation Attracts Foreign Plants*, MEX. BUS. MONTHLY, May 1, 1995 available in 1995 WL 8119198. However, the 1995 devaluation of the peso reduced the hourly wage to below \$1 per hour. *Id.*

188. *New Foreign Investment Levels*, MEX. BUS. MONTHLY, April 1, 1996 available in 1996 WL 8155004.

A. FAVORABLE TARIFF TREATMENT AND RESTRICTIONS ON DOMESTIC SALES.

Traditionally, foreign-owned companies operating as a maquiladora were permitted to import, duty-free, all the machinery, equipment, tools needed for manufacturing, and any raw materials or components, as long as those items were eventually exported out of Mexico for resale.¹⁸⁹ However, the Mexican Government has liberalized the regulations of the maquiladora industry in several stages.¹⁹⁰ The limit on the maquiladora's domestic sales is now governed by the NAFTA.¹⁹¹ Under the NAFTA, the authorized domestic share of total sales is being raised by 5 percent each year until 2001, when sales are subject to no limitation.¹⁹²

In addition to favorable tariff treatment in Mexico, final products exported to the United States are given favorable treatment under items 9802.00 and 9802.00.80 of the Harmonized Tariff Schedule of the United States (HTSUS).¹⁹³ The HTSUS provides that tariffs are levied only upon materials not of U.S. origin and the value added to the original U.S. component by processing in Mexico.¹⁹⁴ Traditionally, U.S. owned maquiladoras have imported 95 percent of materials used in production from the United States.¹⁹⁵

B. TRANSFORMATION BY NAFTA.

Under the NAFTA, the concept of duty-free importation of raw materials into Mexican maquiladoras will eventually cease. Maquiladoras will then have to pay duties for the foreign raw materials and components instead of holding them on consignment.¹⁹⁶ However, for U.S. companies using maquiladoras as cost centers, the transformation will be one of form and not substance. Goods from the NAFTA partners will be free of duty if they meet the rules of preference,¹⁹⁷ as will the NAFTA goods for all other importers.¹⁹⁸ The NAFTA phases out the duty-free imports for maquiladoras and applies the same duties as imports destined for all other establishments in order to prevent circumvention of the NAFTA parties' external duties.¹⁹⁹

Asian-owned maquiladoras producing electronic and electrical products will be the principal companies affected by this transformation, because they import most of their raw materials from Asia.²⁰⁰ U.S. owned maquiladoras however, should continue to pros-

189. Gayou & Gilbert, *supra* note 114, at 1115, 1127.

190. The 1983 Maquiladora Decree permitted firms with maquiladora operations to sell up to 20% of their production in the domestic market. Villarreal, *supra* note 179, at 18. This was increased to 50% by the 1989 Foreign Investment Law. *Id.*

191. NAFTA, *supra* note 19, at 727. *See Q.*

192. *Maquiladoras: Maquiladoras Will Be Transformed By NAFTA*, 4 No. 9 MEX. TRADE & L. REP. 9 (1994). *See Q.*

193. Marrero, *supra* note 17, at 134.

194. *Id.*

195. *Id.*

196. Gayou and Gilbert, *supra* note 114, at 1127.

197. The NAFTA preferential rules of origin determine which goods will be duty-free. NAFTA, *supra* note 19, chp. 4. A product classified as originating in North America will not be subject to tariffs when imported into Mexico. *Id.* *See Q.*

198. NAFTA, *supra* note 19, at 727. *See Q.*

199. *Id.* at 727.

200. *Maquiladoras: Maquiladoras will be transformed by NAFTA*, *supra* note 192, at 9.

per.²⁰¹ The maquiladora was established primarily with the United States in mind, both as the supplier and as the export market.²⁰² In fact, three-quarters of the raw material imported by the maquiladora industry is from the United States.²⁰³

The primary attraction of using maquiladoras as cost centers is Mexico's abundant supply of cheap labor and its proximity to the United States.²⁰⁴ The differential between U.S. and Mexican wages is expected to persist in the foreseeable future.²⁰⁵ U.S. companies operating maquiladoras will only benefit from the effects of the NAFTA, as restrictions on domestic sales products will be eliminated.²⁰⁶ Furthermore, new opportunities will arise for U.S. producers to step in and replace some of the maquiladors' Far Eastern and other third-country suppliers who might lose their competitive advantage because of the new duties.²⁰⁷ Finally, there will be an incentive for existing maquiladora operations to shift from third-country sourcing to North American sourcing in order to benefit from the NAFTA preferences.²⁰⁸

C. ORGANIZATIONAL ASPECTS OF A MAQUILADORA.

Three alternative forms of operations may be considered when establishing a maquiladora: subcontracting, shelter operations, and subsidiaries.

1. *The Subcontracting Alternative.*

The subcontracting alternative is the least capital intensive method of utilizing the benefits of the maquiladora industry.²⁰⁹ Under the subcontracting method, a foreign manufacturer must arrange for raw materials or components to be shipped to the maquiladora for assembly or processing.²¹⁰ The maquiladora manufactures the materials for the foreign manufacturer on a per unit basis.²¹¹

The subcontracting alternative is the easiest method of operation because of its quick start-up time and ease of termination.²¹² However, the efficiency of this method may be lost if the maquiladora subcontractor lacks experience in manufacturing the particular product.²¹³ In this case, the shelter operation or subsidiary method are perhaps more attractive alternatives.

201. *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.*

208. *Id.*

209. Marrero, *supra* note 17, at 135.

210. *Id.*

211. *Id.*

212. *Id.*

213. *Id.* If the maquiladora lacks experience in manufacturing the particular product, the manufacturer may utilize inadequate technology. *Id.* Furthermore, the foreign manufacturer may face problems such as decreased quality and delivery of the final product. *Id.* If these risks are realized, the subcontracting alternative may result in a higher cost per unit produced in comparison to the shelter operation and the subsidiary alternative. *Id.*

2. Shelter Operations.

The shelter operation combines the advantage of ease of start-up and termination associated with the subcontracting alternative with the additional advantage of working with an experienced operator located in Mexico.²¹⁴ The shelter arrangement consists of three parties: a foreign-based manufacturer needing the shelter services, a U.S. or Mexican company providing the shelter services, and a Mexican subsidiary of the U.S. company that serves as a vehicle for the assembly or manufacturing operations.²¹⁵

The foreign-based manufacturer needing the shelter services is responsible for supplying the raw materials, certain capital equipment, manufacturing expertise, and management.²¹⁶ The company providing the shelter services handles labor, services, customs, and accounting.²¹⁷ The Mexican subsidiary is responsible for acquiring the space needed for production, complying with all the applicable Mexican laws and regulations and is the assembler and manufacturer.²¹⁸

Although the shelter operation has the advantage of minimum exposure to Mexican law and provides the ability to work with an experienced operator, the shelter operation may result in less control over technology and product quality and is often more expensive than the subsidiary alternative.²¹⁹

3. The Subsidiary Alternative.

The subsidiary alternative is the third method in which a foreign investor may operate in the maquiladora industry.²²⁰ The foreign company owns 100 percent of the maquiladora and is fully responsible for control of the production process and administration.²²¹ As a consequence, the foreign manufacturer is responsible for providing extensive managerial support and for complying with all applicable incorporation, real estate, labor, tax, and insurance laws of Mexico.²²²

The subsidiary form is often preferred,²²³ especially by large foreign companies, because it allows for total control of every aspect of production.²²⁴ Though this method is naturally more capital intensive, in the long run the per unit cost of production is lower for several reasons.²²⁵ The most obvious reason is that under the subcontracting or shelter alternatives the company in charge of assembly or processing will naturally have an incentive to maximize their profit margin, whereas a subsidiary of the foreign company will operate exclusively as a cost center.²²⁶ In addition, the subsidiary may employ the particu-

214. Marrero, *supra* note 17, at 136.

215. *Id.* at 135.

216. *Id.* at 136.

217. *Id.*

218. *Id.*

219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.*

223. "Virtually all maquiladora companies therefore are organized as wholly-owned subsidiaries...." Shoesmith, *supra* note 118, at 14-15.

224. Marrero, *supra* note 17, at 136.

225. *Id.*

226. Gayou & Gilbert, *supra* note 114, at 1128.

lar technology and expertise needed to maximize efficiency in the assembly or processing of their particular products.²²⁷

Although the subsidiary alternative is the most cost-effective alternative in the long-run, many small foreign investors are precluded from using this form because of the high start-up costs and long-term commitment involved.²²⁸

X. Mexican Labor Law.

Mexican labor law should be discussed early in counseling all businesses interested in investing or expanding operations into Mexico.²²⁹ This discussion is especially appropriate as arguments are often made that U.S. investors do not establish facilities in Mexico to take advantage of growing consumer markets, but strictly in pursuit of larger profits at the expense of workers' rights.²³⁰ Many U.S. investors perceive Mexico as offering a large, cheap labor force protected by few enforceable labor standards.²³¹ The question facing today's investors is whether labor costs will remain low and whether labor laws will continue to be sacrificed in order to attract jobs for low-skilled workers.

Mexico has one of the most comprehensive and progressive collections of statutes, regulations, and policies protecting the collective bargaining and other employment rights of Mexican workers.²³² Nevertheless, "[t]he enduring alliance between the government and Mexico's powerful unions has resulted in scant enforcement of Mexican labor law, particularly within facilities owned by foreign investors."²³³ However, as a result of the NAFTA side-agreement on labor entitled the North American Agreement on Labor

227. Marrero, *supra* note 17, at 136.

228. *Id.* at 135-36.

229. David E. Dubberly, *What South Carolina Lawyers Need to Know About Mexican Labor Law*, S.L. LAW., Nov.-Dec. 1995, at 45.

230. Charles B. Craver, *The Vitality of the American Labor Movement in the Twenty-first Century*, 1983 U. Ill. L. Rev. 633.

231. Bradford T. Hammock, Note, *The Extraterritorial Application of the National Labor Relations Act: A Union Perspective*, 22 SYRACUSE J. INT'L L. & COM. 127 (1996).

232. Ann M. Bartow, *The Rights of Workers in Mexico*, 11 COMP. LAB. L.J. 182, 182 (1990). Mexico was the first country to incorporate basic labor protection in its constitution. Harry K. Wright, *FOREIGN ENTERPRISE IN MEXICO* 285 (THE UNIV. OF NORTH CAROLINA PRESS, 1971). In fact, Mexico has some of the strongest labor laws in the world, including principles relating to work hours, rest days, vacations, minimum wages and other benefits, occupational safety, discharge of workers, collective bargaining, strikes, and dispute settlement. *Id.* Most importantly, Mexican labor law clearly favors employees in all dealings with employers, placing many burdensome restrictions on employers. Dubberly, *supra* note 28, at 42.

233. Lousie D. Williams, *Trade, Labor, Law and Development: Opportunities and Challenges for Mexican Labor Arising From the North American Free Trade Agreement*, 22 BROOK. J. INT'L L. 361, 372 (1996). The Confederacion de Trabajadores de Mexico, Mexico's largest labor organization, has historically been closely tethered to Mexico's powerful El Partido Revolucionario Institucional (PRI). *Id.* at 375. In light of the historical affiliation between the Mexican Government and Mexico's labor unions, Mexican labor law has provided a setting for continuous dealmaking and mutual gain for the PRI and for labor leaders. *Id.* at 374.

Cooperation (NAALC),²³⁴ which was demanded by President Bill Clinton as a condition of supporting the NAFTA, this lack of enforcement may not persist indefinitely.²³⁵ Some argue that the NAALC will result in much more vigorous enforcement of the Mexican labor laws.²³⁶ However, in light of recent decisions pursuant to the NAALC, it appears the NAALC does not provide an opportunity to address the concerns of Mexico's failure to enforce its labor law, particularly with respect to the rights of employees to organize and to form unions as was anticipated.²³⁷

Whether the NAALC is an effective tool in addressing concerns about lack of enforcement of Mexico's labor laws remains to be seen.²³⁸ The NAALC was not drafted with the intent of changing Mexico's weak enforcement of labor laws, but as a tool to provide

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234. The NAALC was signed by the leaders of the three nations in September 1993, North American Agreement on Labor Cooperation, Sept. 14, 1993, U.S.-Can.-Mex., 32 I.L.M. 1499, (1499) [hereinafter NAALC], and became effective on January 1, 1994. *Id.* at 1514. "The NAALC establishes a tri-national dispute resolution scheme seeking specifically to respond to differences in labor regulation throughout North America." Michael J. McGuinness, *Recent Development, The Protection of Labor Rights in North America: A Commentary on the North American Agreement on Labor Cooperation*, 30 STAN. J. INT'L L. 579, 582 (1994). The NAALC sets forth several principles protecting the rights of labor, including: (1) the right to organize; (2) the right to bargain collectively; (3) the right to strike; and (4) minimum employment standards. NAALC, *supra*, note 733 at 1515. Article 27(1) of the NAALC established the Commission for Labor Cooperation to oversee enforcement proceedings against any nation which demonstrates a persistent pattern of failure to enforce its labor laws. *Id.* at 1509. In articles 15 and 16, the NAALC established the National Administrative Offices (NAO), which are responsible for receiving and investigating public communications or complaints related to labor law issues in the territorial domain of another party. *Id.* at 1507. Article 29(1) of the NAALC gives the NAO the power to initiate a formal review of any complaints and to impose monetary fines (article 39) and suspension of treaty benefits (article 41). *Id.* at 1509, 1511-1513.
235. Dubberly, *supra* note 228, at 42. Prior to the passage of the NAFTA, a process of intense discussion and analysis culminated as a result of the fear that closer economic integration with Mexico would result in a shift of U.S. investment to that country, and downward pressure on U.S. wages and benefits. Jorge F. Perez Lopez & Eric Griego, *The Labor Dimension of the NAFTA: Reflections on the First Year*, 12 ARIZ. J. INT'L & COM. L. 473, 473-74 (1995).
236. Dubberly, *supra* note 228, at 42. It is also argued that Mexico's currency crisis has created considerable pressure to increase government revenue through greater enforcement of regulations, including labor regulations. *Id.* at 41.
237. Daniel Friedenzohn, Note, *The "Reality" Faced by Mexican Employees Who Lose Their Jobs: A Review of The North American Agreement on Labor Cooperation and Two U.S. National Administrative Office Decisions*, 22 SYRACUSE J. INT'L L. & COM. 103 (1996). In two complaints, pursuant to the NAALC, the issue was whether the Government of Mexico properly complied with and effectively enforced its labor laws guaranteeing the workers' right to associate and to freely organize in the workplace. *Id.* at 111-14. In both submissions, the dismissed employees decided to accept severances offered by the companies. *Id.* Thus, the NAO decided it was not in a position to determine whether Mexico enforced its relevant labor laws. *Id.* at 114.
238. *Id.* at 123. "Whether this exchange of information and the ability for interested parties to file complaints with their respective NAOs leads to better enforcement and fairer trade between the two countries remains to be seen." *Id.* at 126. The NAALC is the first time the United States negotiated an agreement addressing labor issues to supplement an international trade agreement. *Id.* at 103.
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insight into how the labor laws of a country operate.²³⁹ Nevertheless, active use of the NAALC may only generate better labor protection for workers in all NAFTA countries through the enforcement of labor laws.²⁴⁰ Thus, foreign investors should be apprised of Mexican labor laws and take such laws into consideration when determining the costs of investing in Mexico.²⁴¹

XI. Mexican Environmental Laws.

Foreign investors considering doing business in Mexico should also be aware of the North American Agreement on Environmental Cooperation, known as the supplemental agreement.²⁴² This agreement is a result of the fear that economic growth would come at the expense of necessary environmental protections.²⁴³

The NAFTA ensures that each party to the agreement has the right to promulgate and to enforce its own domestic environmental laws.²⁴⁴ The supplemental agreement provides that: (a) each party must effectively enforce its environmental laws and regulations;²⁴⁵ and (b) each party shall ensure that its laws and regulations provide for high levels of environmental protection and shall strive to continue to improve those laws and regulations.²⁴⁶ In addition, the supplemental agreement created the Commission for Environmental Cooperation,²⁴⁷ which has jurisdiction to handle parties' claims when there has been a

239. *Id.* at 126.

240. *Id.*

241. Dubberly, *supra* note 228, at 42.

242. North American Agreement on Environmental Cooperation, Sept. 14, 1993, U.S.-Can.-Mex., 32 I.L.M. 1480. This agreement is often referred to as the Environmental Side Agreement or Environmental Supplemental Agreement [hereinafter supplemental agreement]. Almost a year after the original NAFTA, on August 13, 1993, the Parties agreed on the supplemental agreement. See Steve Charnovitz, *The NAFTA Environmental Side Agreement: Implications for Environmental Cooperation, Trade Policy, and American Treaty Making*, 8 TEMP. INT'L & COMP. L.J. 257, 259 (1994) (citing Keith Bradsher, *The Free Trade Accord: 3 Nations Resolve Issues Holding Up Trade Pact Vote*, N.Y. TIMES, Aug. 14, 1993, at A1). The supplemental agreement was signed and made available to the public on September 14, 1993. *Id.*

243. See Michael D. Madnick, *Comment: NAFTA: A Catalyst for Environmental Change in Mexico*, 11 PACE ENVTL L. REV. 365, 367 (1993) ("economic growth absent consideration of environmental consequences cannot only harm our environment, but slow down the very economic progress sought").

244. NAFTA, *supra* note 19, art. 904 provides that "[e]ach party may in accordance with their agreement, adopt, maintain or apply any standards-related measure, including any such measure relating to safety, the protection of human, animal or plant life or health, the environment or consumers, and any measure to ensure its enforcement or implementation." *Id.*

245. Supplemental agreement, *supra* note 241, at 1483-84.

246. Supplemental agreement, *supra* note 241, at 1484.

247. Supplemental agreement, *supra* note 241, at 1485.

"persistent pattern of failure by the Party complained against to effectively enforce its environmental law." 248

The relevance of the supplemental agreement to foreign investors should be apparent. Mexico's enforcement of its environmental laws has been notably lethargic, and thus has enticed U.S. companies to relocate there to avoid the more restrictive environmental laws in the United States.²⁴⁹ If Mexico's labor laws²⁵⁰ are more strictly enforced, foreign investors will have to consider the cost of such enforcement when determining whether to relocate to or to start a new company in Mexico. However, whether the supplemental agreement will result in increased environmental regulations is yet to be seen. It is argued that the supplemental agreement will be ineffective in causing Mexico to enforce its envi-

248. Supplemental agreement, *supra* note 241, at 1490. "[T]he CEC is the powerhouse of the Supplemental Agreement." Alicia A. Samios, *NAFTA's Supplemental Agreement: In Need of Reform*, 9 N.Y. INT'L L. REV. 49, 65 (1996). "The functions of the CEC are twofold: (1) it provides a forum for request of environmental records; and (2) it resolves disputes concerning non-enforcement of domestic environmental laws." *Id.*

249. See Jane J. Duffer, *Dump at the Border*, PROGRESSIVE, Oct. 1988, at 24, 28. American companies are lured into Mexico because of their ability to bypass environmental regulations. *Id.* "It's all too easy for the U.S. companies to turn a blind eye to such incompetence [of waste handling and disposal] when they know how much money they're saving by disposing of the wastes in Mexico." *Id.* Although required by law to return all hazardous materials to the country of origin, American companies have been known to engage in illegal dumping by surreptitiously transporting their waste trucks to Mexico. See Michael L. Connor, *comment, Maquiladoras and the Border Environment: Prospects for Moving from Agreements to Solutions*, 3 COLO. J. INT'L ENVTL. L. & POL'Y 683 (1992). Richard Wolkowicz, *Hot on the trail of toxic dumpers and other eco-outlaws*, *Texas-style*, SMITHSONIAN 26, 27 May (1994) (reporting on recent incident in which the FBI caught an American company attempting to dump 171 drums of PCB wastes in El Paso); Gene M. Grossman & Alan B. Krueger, *Environmental Impacts of Nafta In the Mexico-U.S. Trade Agreement* 13, 15 (Peter M. Garber ed. 1994). Elizabeth A. Ellis, Note, *Bordering on Disaster: A New Attempt To Control The Transboundary Effects of Maquiladora Pollution*, 30 VAL. U. L. REV. 621, 621 (1996) (attributing "forty-two cases of anencephalic babies" in Matamoros to the maquiladora industry).

250. Mexico's principal environmental law is the General Law of Ecological Equilibrium and Environmental Protection (Ecology Law). *La Ley General Del Equilibrio Ecologico Y La Proteccion Al Ambiente*, D.O., published Jan 28, 1988, effective Mar. 1, 1988, reprinted in *Environmental Regulations of Mexico* (General Law Division of Language Services, United States Dep't of State 1995) [hereinafter Ecology Law]. The Ecology Law covers environmental concerns including air pollution, water pollution, soil pollution, toxic wastes, pesticides, conservation, and hazardous wastes. See Lawrence J. Rowe, Note, *NAFTA, The Border Area Environmental Program, and Mexico's Border Area: Prescription for Sustainable Development*, 18 SUFFOLK TRANSNAT'L L. J. REV. 197, 200 (1995).

ronmental laws.²⁵¹ Nevertheless, foreign investors should be aware of the increasing awareness of environmental concerns, which includes anticipating more stringent enforcement of environmental regulations.

XII. Conclusion.

Mexico's adoption of the Foreign Investment Law and the North American Free Trade Agreement opened the doors to foreign direct investment.²⁵² Business opportunities for the foreign investor in Mexico are better than they have been for fifty years.²⁵³ Investors will make better decisions by considering the cultural differences and the history of foreign-investment regulation in Mexico.²⁵⁴

Although this comment provides an overview of several factors to be taken into account prior to planning a strategy for entering the Mexican market, investors should consider Mexico's laws with particular regard to the enterprise sought to be formed. Additionally, obtaining legal counsel who has both experience doing business in Mexico and established contacts with the Mexican legal community is crucial for the foreign investor to navigate through the many complex and unfamiliar laws and customs of Mexico.²⁵⁵

251. See Samios, *supra* note 246, at 76. "Unfortunately the Supplemental Agreement, as it is currently structured, does not serve as an adequate protector of the environment." *Id.* "Major shortcomings of the supplementary agreement include its: 1) failure to provide non-citizens access to private remedies; 2) lack of representation of non-governmental interests; 3) limitation on the scope of matters that the panel can address; 4) its vulnerability to political manipulation; and 5) its deviation from traditional arbitration." *Id.* See Ellis, *supra* note 247, at 661-76 (noting that the supplemental agreement as it is currently drafted will be ineffective in its attempts to protect the border from the transboundary effects of maquiladora pollution). Ellis points out that the primary failure is the inability for the environmental standard to be enforced on an individual level by targeting the profit margin of facilities which do not comply with environmental regulations. *Id.* at 627.

252. See Goldman, *supra* note 1., See also Sandrino, *supra* note 3.

253. Hope H. Camp, Jr. et.al., *Foreign Investment in Mexico From the Perspective of the Foreign Investor*, 24 ST. MARY'S L.J. 775, 800 (1993).

254. *Id.*

255. *Id.* at 801; Marrero, *supra* note 17, at 140.
