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# Criminal and Quasi-Criminal Customs Enforcement Among the U.S., Canada and Mexico†

*by Bruce Zagaris* and David R. Stepp***

## I. INTRODUCTION

Regardless of the ultimate outcome of the North American Free Trade Agreement (NAFTA) negotiations, the three countries of the Americas are thrown together and are bound to experience greatly enhanced levels of movement of people, goods, and capital. The challenge to liberalize the flow and minimize dislocations and adverse consequences of the flow, especially from criminal elements, requires innovative thinking on mechanisms and structure of the criminal relations. Customs is a key substantive legal area because it cuts across the movement of goods and, to a lesser extent, of persons and capital. From a substantive legal perspective, the areas of international criminal law, customs law, administrative law, and international relations, especially international regime theory, will increasingly interact.[1] This article discusses competing national criminal and quasi-criminal laws of the United States, Canada and Mexico with respect to customs enforcement. Enforcement of customs law is of particular interest in the wake of negotiations for a North American Free Trade Agreement (NAFTA) among the three countries because of the amount of trade among the three countries.

Enforcement of customs law from an international criminal law perspective requires a consideration of the classification of customs

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1. For a discussion of the application of international regime theory to international criminal cooperation in the context of European integration, *see* Scott Carlson and Bruce Zagaris, *International Cooperation in Criminal Matters: Western Europe's International Approach to International Crime*, 15 NOVA L. REV. 551-79 (1991).

law between criminal law and administrative law. This paper discusses the status of customs law within international criminal law. In particular, it considers the classification of customs as "administrative penal law," which system is non-penal in a legal sense, but nonetheless retributive.

## II. JURISDICTIONAL BASES

### *A. The United States*

The United States asserts extraterritorial jurisdiction in criminal law on five traditional bases of jurisdiction: territorial, protective, nationality, universal and passive personality.[2] A sixth theory of jurisdiction, sometimes called the floating territorial principle, recognizes the "flagship" state as having jurisdiction over any offense committed on one of its crafts or vessels.[3]

The principal basis of jurisdiction over crime in the U.S. is the territorial principle, which permits a state in control of a territory to prescribe, adjudicate and enforce its laws in that territory.[4] A crime is deemed committed wholly within a state's territory when every essential constituent element is consummated within the territory.[5] A crime is committed partly within a state's territory when any essential constituent element is consummated there.[6] The U.S. also recognizes and utilizes subjective territoriality, when a constituent element of the crime occurs within the U.S.[7] Additionally, U.S. jurisprudence sanctions the assertion of jurisdiction over offenses when the conduct giving rise to the offense has occurred extraterritorially, provided the harmful effects or results have occurred within the U.S. territory.[8] The objective territorial principle has received an expansive interpretation in recent years in the U.S. Assertion of jurisdiction will be enforced as proper in either state and extradition will be approved pursuant to either

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2. *Jurisdiction with Respect to Crime*, 29 A.J.I.L. 435, 439-442 (Supp. 1935) [hereinafter HARVARD RESEARCH].

3. *See* Lauritzen v. Larsen, 345 U.S. 571 (1953); Note, *Jurisdiction*, 15 TEX. INT'L L.J. 379, 404, n. 3 (1980); Empson, *The Application of Criminal Law to Acts Committed Outside the Jurisdiction*, 6 AM. CRIM. L. 32 (1967); George, *Extraterritorial Application of Penal Legislation*, 64 MICH. L. REV. 609, 613 (1966).

4. Christopher L. Blakesley, *Extraterritorial Jurisdiction* II INTERNATIONAL CRIMINAL LAW PROCEDURE 8 (1986).

5. HARVARD RESEARCH, *supra* note 2, at 495.

6. *Id.*

7. *Id.*

8. Strassheim v. Daily, 221 U.S. 280 (1911).

state's theory of jurisdiction so long as the offense itself, its result or effects, or any of its constituent or material elements actually occur within the sovereign territory of the requesting party.[9] However, difficulties ensue when a claim of jurisdiction is asserted on some theory other than territoriality, or when the claimed "territorial basis" is strained beyond that believed proper by the other state.[10]

The protective theory of jurisdiction provides a basis for jurisdiction over an extraterritorial offense when that offense has an adverse effect on, or is a danger to, a state's security, integrity, sovereignty or governmental function. The focus of the jurisdictional principle is the nature of the interest that may be injured, rather than the place of the harm, the place of the conduct causing the harm, or the nationality of the perpetrator. This conduct has included lying to a consular officer.[11] Even though the conduct happens wholly abroad, it may be considered as constituting a danger to the sovereignty of the U.S. and as having a deleterious impact on valid governmental interests.[12]

Jurisdiction based on the nationality of the perpetrator is a generally accepted principle of international law.[13] Under international law, nationals of a state remain under the state's sovereignty and owe their allegiance to it, even though traveling or residing outside its territory. The state has the right based on this allegiance, to assert criminal jurisdiction over actions of one of its nationals deemed criminal by that state's laws.[14] In the U.S. the application of any law to extraterritorial offenses is an exception to the territorial principle and must be done on a case-by-case basis. U.S. case law has approved jurisdiction over nationals who commit crimes abroad even though the appropriate statute did not expressly provide that it applied extraterritorially.[15]

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9. *Id.* at 285.

10. Christopher L. Blakesley, *United States Jurisdiction Over Extraterritorial Crime*, 73 J. CRIM. L. AND CRIMINOLOGY 1109, 1132-1229 (1982).

11. *Id.* at 1132-1229.

12. *See, e.g.*, United States v. Pizzarusso, 388 F.2d 8 (2d Cir. 1968) (in which an alien was convicted of knowingly making false statements under oath in a visa application to a U.S. consular officer in Canada. The court noted that the violation of Title 18, sec. 1546 of the U.S. Code occurred entirely in Canada. The accused's entry into the U.S. was not an element of the offense). *See* Blakesley, *supra* note 10, at 1136 for additional discussion and authority.

13. HARVARD RESEARCH, *supra* n.2, at 1155-57.

14. *See* Blackmer v. United States, 284 U.S. 421 (1932).

15. *See, e.g.*, Steel v. Bulova Watch Co., 344 U.S. 280 (1952) (application of

The passive personality theory of jurisdiction generally is not favored in U.S. law. The Restatement (Third) of Foreign Relations Law of the U.S. provides that a state does not have jurisdiction to prescribe a rule of law attaching a legal consequence to conduct of an alien outside its territory merely on the basis that the conduct affects one of its nationals. The U.S. has protested the assertion of this jurisdiction by Mexico and other countries and major incidents have occurred as the result of cases in which U.S. nationals have been arrested and prosecuted on the basis of the passive personality theory.[16]

Under universal jurisdiction, international law allows any of the "community" of nationals to prosecute a perpetrator who allegedly commits a heinous offense universally condemned. Universal jurisdiction has been allowed for piracy, slave trade, war crimes, hijacking and sabotage in civil aircraft, and genocide. A trend exists to include terrorism and traffic in narcotic drugs.[17]

### *B. Canada*

In general, Canadian legislation follows the territorial theory of criminal jurisdiction by prescribing rules of law, criminalizing: (a) conduct within the territory of Canada and, (b) conduct outside the territory that causes effect within Canadian territory.[18] Jurisdiction is seldom based on the nationality of the offender (active nationality principle) and never on the nationality of the victim (passive nationality principle). The Canadian Parliament has authority to enact laws that have extraterritorial operation, restricted to matters within its com-

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U.S. antitrust laws extraterritorially to activities of U.S. nationals); Ramirez & Feraud Chile Co. v. Las Palmas Food Co., 146 F.Supp. 594 (S.D. Cal. 1958), *aff'd per curiam*, 245 F.2d 874 (9th Cir. 1957), *cert. denied*, 355 U.S. 927 (1958); *cf.* Vanity Fair Mills, Inc. v. T. Eaton Co., 234 F.2d 633 (2d Cir. 1956) (holding that the Lanham Act did not apply to a Canadian corporation although harm occurred in the U.S. as a result of offenses committed by that corporation).

16. Cutting Case, 187 For. Re. 751 (1888), *reported in* 2 J.B. Moore, INTERNATIONAL LAW DIGEST 232-40 (1906).

17. For a useful discussion of universal jurisdiction, *see* Christopher L. Blakesley, *Extraterritorial Jurisdiction*, in M.C. Bassiouni (ed.), INTERNATIONAL CRIMINAL LAW PROCEDURE 3, 31-33 (1986); RESTATEMENT (THIRD) FOREIGN RELATIONS LAW OF THE UNITED STATES, §404 (1986).

18. S. WILLIAMS, INTERNATIONAL CRIMINAL LAW 8 (1978); Statute of Westminster (Imperial) (1931), 22 Geo V., c. 4, s. 3; *see also* § 8, Interpretational Act, R.S.C., 1970, c. I-13; Extraterritorial Act of Canada R.S.C., 1952, c. 107, § 2.

petence. Some Canadian laws provide specifically for extraterritorial application.

### C. *Mexico*

In general, the Mexico Criminal Code provides for jurisdiction over international crimes on several bases. Mexican criminal law applies to crimes that are initiated, prepared or committed abroad, produced or having an effect within Mexico.[19] Jurisdiction is provided for crimes committed in Mexican consulates or against consulate officials when they have not been adjudicated in the country in which the crime was committed.[20] Continuing crimes committed abroad that have effect in Mexico, can be prosecuted in accordance with the laws of Mexico or the place of the defendant.[21] Crimes committed abroad by a Mexican against Mexicans or against foreigners, or by a foreigner against a Mexican will be punished in Mexico in accordance with federal laws if the following requirements exist: the accused is in Mexico; the defendant has not been definitively adjudicated in the country in which the crime was committed; and the infraction of which one is accused is considered a crime in the country in which it is committed and in Mexico.[22]

The latter provision known as the passive nationality principle (the nationality of the victim) caused a problem in *Cutting Case* in 1986.[23] Cutting, a U.S. citizen, was arrested and subsequently jailed in El Paso del Norte, Mexico, for an alleged libel against a Mexican citizen with whom he had been in controversy. The libel was published in a newspaper in El Paso, Texas. Mexico claimed it had a right to punish Cutting, because under its Penal Code, offenses committed by foreigners abroad against Mexican citizens were punishable in Mexico.[24] The U.S. requested Cutting's release and revision of the Mexican Penal Code in this respect in order to avoid similar incidents in the future. The U.S. was not able to persuade Mexico to grant either request. However, Cutting was later released when the plaintiff withdrew his action.[25] Another example of the problem involved Ri-

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19. Mexico Federal Penal Code of Jan. 2, 1931, art. 2(I).
20. *Id.* at art. 2(II).
21. *Id.* at art. 3.
22. *Id.* at art. 4.
23. Cutting Case, 187 For. Re. 751 (1888), *reported in* 2 J.B. Moore, INTERNATIONAL LAW DIGEST 232-40 (1906).
24. 6 WHITEMAN'S DIGEST OF INTERNATIONAL LAW 104-5.
25. MOORE, *supra* note 16, at 228.

chard Fielder, a U.S. citizen, who was detained by Mexico City police officials for a crime alleged to have been committed in New Jersey. The case never came to trial however because Mr. Fielder was released and departed from Mexico before the trial date.[26]

The Mexican Code provides that a crime would be considered as committed in the Mexican territory if: the crimes are committed by Mexicans or by foreigners on the high seas on board Mexican boats, or committed on board a Mexican warship in the port or territorial waters of the other country.[27] This extends to merchant boats if the delinquent has not been adjudicated in the country to which the port belongs. Mexico also asserts jurisdiction over acts which disturb the public tranquility. Such acts include those committed on board a foreign boat in a Mexican port or in territorial waters of Mexico, or those committed on board a Mexican or foreign airline, which is in Mexican territory or in its atmosphere, as well as crimes committed in Mexican embassies and legations.[28] In addition, when one commits a crime not provided for in the Code, where a special law or an international treaty of Mexico obligates it, Mexico will assert jurisdiction.[29]

## III. THE STATUS OF CUSTOMS LAW WITHIN INTERNATIONAL CRIMINAL LAW

Within the field of international criminal law, customs law in large part is classified as "administrative penal law," a term that indicates a system is non-penal in the legal sense, but whose philosophical foundation is nonetheless retributive. In order to properly deal with customs law in the context of international criminal law, its relationship with other systems of sanctioning must be considered. As a recent Congress of the International Penal Law Association has observed, the connections between administrative penal law and international penal law are a source of practical difficulties.[30]

Among the legal problems are the risk that penal sanctions will be ineffective and that a plurality of proceedings will be conducted

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26. 6 WHITEMAN'S DIGEST OF INTERNATIONAL LAW 104.

27. *Id.*

28. *Id.* at art. 5.

29. *Id.* at art. 6.

30. For an excellent overview of the novel legal problems and practical difficulties, on which this account relies heavily, *see* Mireille Delmas-Marty, *The Legal and Practical Problems Posed by the Difference Between Criminal Law and Administrative Penal Law*, 59 REV. INT'L DE DROIT PENAL 21 (1988).

and sanctions will be imposed for the same act. The movement towards individualization within penal law has resulted in a diversification of sanctions that makes it more difficult to demarcate each of the systems of sanctions, because the penal sanction can no longer be identified with deprivation of liberty. Similarly, the philosophical foundations of the penal sanction vis-à-vis those of the administrative sanction become equally difficult to identify. Because depenalization has resulted in recourse to penal "administrative law" as a possible alternative to penal law, the question becomes within which limits the general principles of penal law and of penal procedure need to be transplanted into the administrative field.[31]

Practical difficulties arise in part from the profoundly different traditions and on closed and largely uncoordinated institutional structures. Prosecutors fear that the penal system may be dispossessed of its jurisdiction by the administration. Simultaneously, they may fear an overburdening of the criminal justice system in cases in which the penal infraction is merely non-compliance with a ruling or a sanction imposed by the customs agency. The customs agency may fear being dispossessed of the monopoly over regulating customs, which in some cases may have predated the establishment of the criminal justice system. Customs agencies may believe that a court exercising criminal jurisdiction is not able to appreciate the appropriateness of an administrative decision. Sometimes the customs agencies may be criticized for not appreciating the legal subtleties of criminal law and procedure.[32]

In discussing the interaction of the customs laws of the U.S., Mexico, and Canada in the context of reform of international criminal law, especially in the wake of a NFTA, this article will follow the issues utilized by the International Penal Law Association Congress which considered the legal and practical problems posed by the difference between criminal law and administrative penal law.[33]

## IV. THE DIFFERENCE BETWEEN CRIMINAL LAW AND ADMINISTRATIVE PENAL LAW IN THE U.S., CANADA AND MEXICO

### *A. The U.S.*[34]

#### *1. Substantive Law Issues*

In the U.S., administrative agencies have law-making (quasi-legislative or rulemaking) and judicial (quasi-judicial or order-making)

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31. *Id.*; *cf.* The Oztürk Judgment, Reb. 21 Eur. Ct. H.R. (1984).
32. Delmas-Marty, *supra* note 30, at 22.
33. *Id.* at 23-25.
34. For more detail from which this account relies in part, *see* Emilio Viano,

powers that the legislative branch delegates at both the national and state levels to administrators. Administrative law is unique, in that more than 90% of it is derived from common law.[35] Hence, administrative law is based only marginally on statutory law. Another difference of administrative law in civil law systems is that the philosophical foundation of U.S. administrative law is not retributive; rather its purpose is to deliver government services to its citizens. Furthermore, the constitutional organization of the U.S. government involves the courts in an active role in almost every administrative system. Congress also maintains oversight and adjusts the legislative mandate whenever the circumstances appear to warrant action.

Both the Tariff Act of 1930[36] and criminal law contain numerous penalty and enforcement provisions for violations of the laws governing the importation of merchandise. With respect to infractions under the Tariff Act, the Secretary of the Treasury is empowered by statute to institute various punishments and to deal with their remission or mitigation. Part V of the Tariff Act of 1930, as amended, contains a long list of enforcement provisions, including fines, penalties, and forfeitures for violations of various provisions of the Tariff Act.[37] The Secretary also has the general statutory authority to create a regulatory and administrative framework in which to implement and dispose of its enforcement responsibilities.[38] The Customs guidelines for recordkeeping, inspection, search, and seizure are found in 19 C.F.R., section 162. Section 171 of 19 C.F.R. contains provisions relating to the filing of petitions for relief from fines, penalties, and forfeitures incurred, and petitions for the restoration of proceeds from the sale of seized and forfeited property.

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*The Legal and Practical Problems Posed by the Difference Between Criminal Law and Administrative Penal Law: Questions Relating to the Legal Structure of the Two Systems*, 59 REV. INT'L DE DROIT PENAL 95-108.

35. KEN DAVIS, DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY 140 (1969).

36. ACT OF JUNE 17, 1930, *as amended* (codified in 19 U.S.C.).

37. The main areas covered by Part V include the following: the boarding of vessels; search of persons and baggage; certification of manifest; falsity or lack of manifest; departure before report or entry; unlawful unlading or transshipment; examination of hovering vessels; transportation between American ports via foreign ports; penalties for fraud, gross negligence, and negligence; libel on vessels and vehicles; searches and seizures; forfeitures; interest of officers in vessels or cargo; seizures and their disposition; referral of prosecution to a U.S. district court; disposition of proceeds of forfeited property; compromise of government claims; and the remission or mitigation of penalties. 19 U.S.C. 1581 *et seq.* (1991).

38. *Id.* at §§ 66, 1624.

Section 1592 of the Tariff Act of 1930[39] is recognized as the primary statutory provision used for the enforcement of the tariff laws. The Customs Procedural Reform and Simplification Act of 1978[40] substantially changed this section to limit penalties thereunder, to codify the prepenalty procedures, to provide for judicial *de novo* review, and to change the statute of limitations.[41] Part II of the Tariff Act pertains to the reporting, entry, and unlading of vessels and vehicles. Penalties are assessed for the failure to report, make entry, and pay duties on the cost of repairs of vessels and equipment thereon engaged in foreign or coastwise trade.[42] Part III of the Tariff Act provides statutory authority for customs to ascertain, collect, and recover duties. Provisions are included for seizures and forfeiture for merchandise bearing U.S. trademarks[43] and of wild mammals and birds in violation of foreign law.[44]

Under the separate and distinct criminal customs law provisions, punishment by fine and/or imprisonment are provided for specific activities.[45] The government has regularly used other criminal statutes in combination with the enumerated customs criminal statutes.[46]

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39. 19 U.S.C. § 1592.

40. Pub. L. No. 95-419.

41. For an extensive overview of the changes made to Section 1592 by the Customs Procedural Reform and Simplification Act of 1978, *see* John M. Peterson, *Civil Customs Penalties Under Section 1592 of the Tariff Act: Current Practice and the Need for Further Reform*, 18 VAND. J. TRANSNAT'L L. 679 (1985) [hereinafter Peterson]. *See also*, United States v. Ven-Fuel, Inc., 758 F.2d 741 (1st Cir. 1985).

42. 19 U.S.C. § 1466 (1991).

43. *Id.* at § 1526.

44. *Id.* at § 1527.

45. The customs criminal statutes cover the following activities: entry of goods falsely classified, by means of false statements, or for less than legal duty 18 U.S.C. §§541-543 (1991); relading of goods (§544); smuggling goods into the U.S. or into foreign countries (§§545, 546); depositing goods in buildings on boundaries (§547); removing or repacking goods in warehouses (§548); removing goods from customs custody and breaking seals (§549); false claims for refund of duties (§550); concealing or destroying invoices or other papers (§551); officers aiding importation of obscene or treasonous books and articles (§552); and, importation or exportation of stolen motor vehicles, off-highway mobile equipment, vessels, or aircraft (§553).

46. The government often uses 18 U.S.C. § 1001 (1991) which prohibits knowing and willful false statements to a U.S. agency. For a discussion of the appropriate use of § 1001 with the other criminal customs statutes, *see* United States v. Rose, 570 F.2d 1358 (9th Cir. 1978). Other statutes which are often triggered are 18 U.S.C. § 371 (conspiracy) and §§ 1956, 1957 (prohibiting the use of the proceeds of certain criminal activity).

*Determination of Responsibility: Culpability and Imputability*

The U.S. does not distinguish between penal law and administrative law in the determination of responsibility. Many agencies have the authority to seek criminal sanctions by acting as the prosecuting authority in a traditional criminal trial. Unlike many civil law systems, there is no possibility in the U.S. to merge and try in the same trial criminal, administrative, and civil law issues. Additionally, the U.S. does not have a separate criminal and administrative court.

There are three levels of culpability under the main civil enforcement statute, Section 1592 of the Tariff Act of 1930: negligence, gross negligence, and fraud.[47] Negligence is a violation which results from an offender's failure to exercise reasonable care and competence to ensure that a statement that is made is correct. A negligent violation may result from acts of either commission or omission. Gross negligence is a violation which results from an act or acts (of commission or omission) done with actual knowledge of or wanton disregard for the relevant facts and with indifference or disregard for the offender's obligations under the statute, but without intent to defraud the revenue or violate the laws of the United States.

Fraud is a violation which results from an act or acts (of commission or omission) deliberately done with intent to defraud the revenue or to otherwise violate the laws of the United States, as established by clear and convincing evidence.

Most of the criminal statutes require an intent to either knowingly or willfully perform a particular act.[48] Under Section 1592, liability is imputed to individuals as well as corporate executives and managers. The Court of International Trade has held that the word "person" under Section 1592 is not limited to either natural persons or corporations and no such limitation can be implied.[49]

*Grounds for Exoneration*

The grounds for exoneration are clearly articulated in the penal law; however, in administrative law the quasi-judicial order-making

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47. These levels of culpability are defined in Appendix B, 19 C.F.R. Part 171, *as amended* by T.D. 89-83, 23 CUST. BULL. (1989).

48. *See, e.g.*, 18 U.S.C. § 545 (1991) ("Whoever knowingly and willfully, with intent to defraud the United States, smuggles . . . ."), § 550, ("Whoever knowingly and willfully files any false or fraudulent entry or claim . . . ."); § 548 ("Whoever fraudulently conceals, removes, or repacks merchandise in any bonded warehouse . . . .").

49. *See* United States v. Appendagez, Inc., 5 Ct. Int'l Trade 74, 80 (1983). The criminal statutes similarly use the term "any person" in their language of who can be held accountable thereunder; and thus corporate executives may be pursued personally under the criminal statutes.

level grounds for exoneration vary widely. For example, clerical errors or mistakes of fact are not violations of Section 1592 unless they are a part of a pattern of negligent conduct.[50]

Section 1618 of the Tariff Act of 1930[51] provides for remission and mitigation proceedings for any person who has had goods seized or fines instituted under the customs laws. The Secretary of the Treasury has delegated to Customs the authority to remit or mitigate duties.[52] For penalties under Section 1592, Customs has provided certain mitigating factors which should be considered when assessing a penalty amount in a case involving gross negligence or negligence. They are contributory customs error, cooperation, immediate remedial action, inexperience in importing, prior good record, and other extraordinary mitigating factors. An alleged violator bears the burden of demonstrating these mitigating factors with sufficient evidence.[53]

*Sanctions*

The terminology for most administrative sanctions is the same as for legal terminology. Sanctions as punishment are the province of the criminal court with the administrative agency acting as the prosecutor. Administrative agencies have the authority to arrest and imprison persons for relatively long periods of time without having to invoke court proceedings, so long as the incarceration is done with the intent to punish.[54] Congress has authorized administrators to arrest and temporarily imprison persons who have not been accused of or convicted of any criminal offenses to protect the larger interests of society.[55] Such administrative discretion opens the possibility for abuse of innocent persons. Administrative agencies have also arrested and detained persons without complying with the normal constitutional restrictions on making arrests and detentions.[56] With respect to sanctions against property,

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50. 19 U.S.C. § 1592(a)(2) (1991).

51. *Id.* at § 1618.

52. 8 CUST. BULL. 553, T.D. 74-287 (1974).

53. 19 C.F.R. § 171.23 (1991).

54. Wing v. United States, 163 U.S. 228 (1896).

55. *See, e.g.*, *Ex parte* Hardcastle, 208 S.W. 531 (Tex. 1919) (public health administrators, to protect public health, have the authority to apprehend and confine those who pose a dangerous health threat to the community without the benefit of a judicial proceeding).

56. *See, e.g.*, Abel v. United States, 362 U.S. 217 (1960) (an administrative agency working with the FBI circumvented 4th amendment protections); *see also* United States v. Alvarado, 321 F.2d 336 (2nd Cir. 1963) (upheld the constitutionality of an administrative arrest carried out by the U.S. Customs Service without first obtaining an administrative warrant).

forfeiture, revocation of licenses, such administrative sanctions are subject to the review of the courts. The extent of sanctions against property vary according to the agency, empowering statutes, and the area of enforcement. In general, the agencies usually have discretion over the actual amounts of the fine, so long as they stay within the upper and lower limits contemplated in the law.

The enforcement of the sanction normally has been provided to the agencies, so that they can revoke licenses and take other action when businesses refuse to comply with the agency's sanctions. Normally, agencies have broad discretion to use various enforcement measures depending on past performance, compliance record, and seriousness of the violation. Other intervening variables may be the size of the business, the perceived importance or essential nature of the services performed by the business for the nation's economy or security. A person may be deprived of his or her liberty if found in civil contempt by the court for not obeying an agency's order. However, it is used only in egregious situations. Managers or owners may also be charged and convicted of a crime and deprived of liberty after conviction.

Under the criminal law, all of the criminal customs statutes are imposed against the person and provide for both imprisonment and fines. Most of the sanctions impose a fine of not more than $5,000 or two years imprisonment, or both;[57] others impose longer imprisonment and/or larger fines.[58] Any officer who knowingly admits to the entry of goods for less than legal duty may be removed from office in addition to being subject to a fine and imprisonment.[59] The nature of the sanctions imposed under U.S. customs statutes are both *in personam* and *in rem* in nature. *In rem* procedures include the forfeiture of the merchandise at issue.[60]

Maximum civil penalties imposed under Section 1592 are delineated by the culpability of the wrongdoer. For a fraudulent violation, Customs

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57. 18 U.S.C. §§ 541-544, 546-551 (1991).

58. *Id.* at §§ 545, 552, 553. The sanctions for violating the money laundering statutes are significantly harsher. For a violation of 18 U.S.C. § 1956, one is subject to a fine of $500,000 or twice the value of the monetary instrument or funds, whichever is greater, or imprisonment for not more than twenty years, or both. For § 1957, which involves monetary transactions for criminally derived property, a violator is subject to a fine of up to twice the amount of the criminally derived property instead of, or in conjunction with, imprisonment of not more than ten years. 18 U.S.C. § 981 is the civil forfeiture provision which serves as a counterpart to §§ 1956 and 1957.

59. *Id.* at § 543.

60. *Id.* at §§ 544, 545, 548, 550.

may assess a civil penalty in an amount not to exceed the domestic value of the merchandise.[61] A grossly negligent violation is punishable by a civil penalty in an amount not to exceed the lesser of the domestic value of the merchandise or four times the lawful duties of which the U.S. is or may be deprived. If the violation did not affect the assessment of duties, the penalty will equal forty-percent of the merchandise's dutiable value.[62]

A negligent violation is punishable by a civil penalty in an amount not to exceed the lesser of the merchandise's domestic value, or two times the lawful duties of which the U.S. is or may be deprived. If the violation did not affect the assessment of duties, the penalty will equal twenty-percent of the merchandise's dutiable value.[63]

Customs may seize merchandise under Section 1592 if the Secretary has reasonable cause to believe that a person has violated the provisions of that section and that person is insolvent or beyond the jurisdiction of the U.S. or where seizure is otherwise essential to protect the revenue of the U.S. or to prevent the introduction of prohibited or restricted merchandise into the customs territory of the U.S.[64] The Customs Procedural Reform and Simplification Act of 1978 transformed Section 1592 from a primarily *in rem* forfeiture law to an *in personam* monetary penalty statute.[65]

Whereas Section 1592 is *in personam* in nature, Customs may still institute an *in rem* action under 19 U.S.C. § 1595(a), which directs that any merchandise that is introduced into the U.S. contrary to law may be seized and forfeited. Seizure and forfeiture is also authorized of all vehicles and other items used to aid such importation or transportation of articles contrary to law. Any person who assists in such activity is liable to a penalty equal to the value of the article or articles introduced or attempted to be introduced. Civil penalties may be assessed from an owner or master who willfully or knowingly neglects or fails to report, make entry, and pay duties on vessels, vehicles, and equipment thereon, which are employed in foreign or coastwise trade. Customs may also seize and forfeit the vessel or impose a penalty up to the value of the vessel.[66]

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61. 19 U.S.C. § 1592(c)(1) (1991).
62. *Id.* at § 1592(c)(2).
63. *Id.* at § 1592(c)(3).
64. *Id.* at § 1592(c)(5).
65. United States v. One Red Lamborghini, 10 Ct Int'l Trade 7 (1986).
66. 19 U.S.C. § 1466 (1991).

Civil penalties may be assessed *in personam* against any person who fails to declare an article at entry, prior to the examination of baggage, in the amount equal to the value of such article. Seizure of such articles is also authorized.[67] Customs is empowered to seize and forfeit any imported merchandise which bears a trademark registered with the Patent and Trademark Office by a U.S. entity and recorded with the U.S. Customs Service. Any person importing such merchandise may be required to export or destroy the merchandise or to remove or obliterate the offending trademark. In addition, the person will be liable for damages and profits for use of the trademark.[68] Similarly, Customs is authorized to seize and forfeit any wild mammal or bird which was imported into the U.S. in violation of the laws of the origin country.[69]

Criminal actions are brought by the U.S. Government in the federal district court system. Under the Customs Courts Act of 1980, proceedings for the recovery of civil penalties under Section 1592 must be brought in the Court of International Trade.[70] Section 1592 sets forth procedures which must be used when such an action is brought by the U.S..

2. *Procedural Questions*

*Conditions For Establishing An Infraction*

An agency often initiates an infraction, often through its inspections. The agency has the authority to charge and inform. U.S. Customs has broad authority to inspect all merchandise, persons, vehicles, vessels, instruments of international travel, documents and buildings which relate to merchandise brought into the U.S. contrary to law. Customs is also authorized to make searches and seizures of any structure which it believes may contain any merchandise upon which duties have not been paid, or which was brought in the U.S. contrary to law.[71] To obtain a search warrant under Section 1595, Customs must make application to the appropriate municipal, county, state, or federal judge.

Imported merchandise required by law or regulation to be inspected, examined or appraised may not be delivered from Customs, except under bond or other security, until it has been inspected, ex-

67. *Id.* at § 1497.

68. *Id.* at § 1526(c).

69. *Id.* at § 1527(b). Under 18 U.S.C. § 42, there is a general prohibition against the importation of injurious mammals, birds, fish, amphibia, and reptiles.

70. 28 U.S.C. § 1582 (1991).

71. 19 U.S.C. § 1595(a) (1991); 19 C.F.R. § 162, Subpt. B (1991).

amined and is reported by the appropriate Customs officer to have been truly and correctly invoiced and found to comply with the pertinent requirements.[72] Customs has the power to inspect, examine, search vessels arriving at U.S. ports as well as any person or merchandise thereon.[73] Customs may also examine any person's baggage arriving in the U.S., regardless of whether a declaration and entry has been made to determine whether it contains dutiable or prohibited articles.[74]

Customs has implemented regulations covering Customs examination, sampling, and testing of merchandise.[75] The district director has the power to examine such packages or quantities of merchandise as he deems necessary for the determination of duties and for compliance with the Customs laws and other laws enforced by the U.S. Customs Service.[76] U.S. Customs may board any vessel or vehicle within the U.S. or the customs waters to inspect the vessel or vehicle itself or any person, package, cargo, or manifest thereon.[77]

The administrative summons is available to Customs during the course of any inquiry or investigation initiated to determine duty liability, liability for any fines, penalties or forfeitures, or to insure compliance with all Customs laws and regulations. Customs may obtain through the use of the summons any relevant records, statements, declarations, or other documents. Customs may also examine witnesses under oath to obtain pertinent information.[78] Customs may seek judicial enforcement of a summons. Contempt of court sanctions may be imposed on an importer who fails to comply with a court's enforcement order. A party who fails to comply may be stripped of his importing privileges and have the delivery of imported merchandise withheld.[79]

When prosecution is pursued under the Customs criminal statutes, the role of charging and informing the accused is performed in the same manner and by the same party as that in any other criminal case. That is, the prosecutor performs this role, aided by the police and the courts.[80]

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72. 19 U.S.C. § 1499 (1991).
73. *Id.* at § 1467.
74. *Id.* at § 1496.
75. Part 151 of 19 C.F.R.
76. *Id.* at § 151.1.
77. 19 U.S.C. § 1581(a) (1991); *see* 19 C.F.R. §§ 162.3 - 162.7 (1991).
78. *Id.* at § 1509.
79. 19 U.S.C. § 1592(b) (1991).
80. Very often in prosecutions for violations of the customs laws, the government seeks an indictment or information to charge a violation of 18 U.S.C. § 1001 which prohibits the making of false statements or entries to government agencies.

Whenever Customs contemplates the issuance of a claim for monetary penalty under Section 1592, that provision requires that it send a pre-penalty notice to the person concerned. The pre-penalty notice is a written notice of Customs' intention which sets forth all details which give rise to the claim. Once the concerned party has had the opportunity to make representations in response to the pre-penalty notice, Customs may issue a penalty notice if it still determines that a violation occurred.[81]

*Agency with the Jurisdiction to Impose a Sanction*

Most administrative agencies have the authority to impose sanctions, except in criminal cases. Some agencies must refer criminal cases to the Justice Department although a few agencies can go to court themselves if the Attorney General does not.[82]

*Appeal or Other Recourse Available to the Defense*

Once administrative review is exhausted, recourse to judicial review by the courts allows the courts to declare legislative and administrative actions unconstitutional. U.S. courts typically give much closer scrutiny to an agency action that is penal in nature, especially if it appears disproportionate to the offense and represents an abuse of discretionary authority.[83]

Any person who has an interest in any vessel, vehicle, or merchandise seized under the Customs laws and who has incurred any monetary penalty thereunder, may file a petition for remission or mitigation of such fine, penalty, or forfeiture prior to the sale of such items.[84] After Customs has considered such a petition and issued its decision, an importer has the option of accepting the penalty assessed

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81. 19 U.S.C. § 1592(b) (1991). Customs Regulations provide that written notice of *any* fine, penalty, or liability for forfeiture must be given to each party that the facts of record indicate has an interest in the claim or seized property. The notice must supply to the party the provision of law alleged to have been violated, a description of the merchandise at issue, as well as all other pertinent information. 19 C.F.R. § 162.31 (1991).

82. *See, e.g.*, 15 U.S.C. § 56 (the Federal Trade Commission can go to court if the Attorney General does not).

83. *See* Beck v. Securities and Exchange Commission, 432 F.2d 832 (5th Cir. 1969) (the court held inadequate an order imposing a sanction under the Securities Exchange Act because justification of such sanction was not disclosed).

84. 19 U.S.C. § 1618; *see* 19 C.F.R. Part 171, Subpart B and Appendix B (1991).

by Customs or allowing suit to be brought against him in the Court of International Trade. In such a suit, the person may contest all issues which gave rise to the penalty and/or seizure, including the amount of the penalty.

*Character of the Procedure*

The U.S. criminal justice system has an accusatorial (adversarial), oral, and public procedure. Administrative procedures, although not as clearly defined, tend to be accusatorial although they are increasingly inquisitorial (especially in the investigative and discovery stages, the use of warrantless searches, the limited cross-examination, the more limited due process protection, and the erosion of constitutionally protected privacy guarantees), increasingly written, and public in most cases. Agency adjudications are normally closed to outside interested parties who are not specific litigants to the dispute.[85]

The character of the procedures under Section 1592 is accusatorial, also because Customs has the various powers to ascertain the facts of the case through the use of the search warrant or the administrative summons with opportunities for both written and oral representations. Under 19 U.S.C. § 1618, the Secretary of Treasury may issue a commission to any Customs officer to take testimony to ascertain the facts of a case. When Customs has issued a pre-penalty notice, the concerned person may make both written and oral representations as to why a claim for a monetary penalty should not be issued in the amount stated. If Customs finds that the issuance of a penalty notice is warranted, thereafter, the person concerned again has the opportunity to make both oral and written representations seeking remission or mitigation of the monetary penalty, in accordance with 19 U.S.C. § 1618.

The Customs Regulations give an importer the opportunity to submit supplemental petitions for relief.[86] Where a party is not satisfied with a decision rendered by Customs, a supplemental petition may be filed. A party may request review of the supplemental petition by the regional commissioner of Customs "if the amount of the liability is

85. 5 U.S.C. § 554(c) (1991) (only interested parties may participate in an administrative consent adjudication. The term "interested parties" has been limited to those with "a legally recognized private interest" and courts have refused to broaden the category of those entitled to demand a hearing). *See* Local 282, Int'l Brotherhood of Teamsters v. NLRB, 339 F.2d 795 (2d Cir. 1964).

86. Supplemental Petitions for Relief, 19 C.F.R. § 171.33 (1991).

$25,000 or less, or [by] the Commissioner of Customs if the amount of the liability is more than $25,000 but does not exceed $100,000."[87] One further supplemental petition is allowed to appeal a decision made with respect to the first supplemental.[88] In order to have the opportunity of this second supplemental petition process, a party must first pay all penalties withheld and excess duties owed.

*Rules of Evidence*

The common law rules of evidence do not apply even in formal hearings of administrative law since there is no jury and many of the common law rules of evidence are designed to keep potentially prejudicial evidence from the jury.[89] In addition, constitutional protection, namely the fourth and fifth amendments, can be invoked in administrative discovery.[90] During the administrative process for Customs

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87. *Id.* at § 171.33(b).

88. *Id.* at § 171.33(c)(1).

89. An example is the burden of proof in a customs forfeiture action involving a seized automobile instituted under 19 U.S.C. § 1595(a). First, the government must prove that "evidence establishes probable cause," then the owner of the seized vehicle must show by the "preponderance of the evidence that the violation was committed by a person who unlawfully obtained the vehicle." *See*, United States v. One 1975 Ford, 558 F.2d 755 (5th Cir. 1977). In criminal cases the government always has the burden of proving guilt beyond a reasonable doubt. In administrative law cases, the issue of which party bears the burden is not always clear.

Whereas constitutional due process protections apply in criminal cases, they only have limited applicability in disputes involving alleged administrative procedural violations. Although hearsay evidence is only allowed by exception in criminal trials, it can be more readily introduced in agency hearings. In both criminal and administrative cases, a finding cannot stand unless it is supported by evidence. Whereas criminal convictions must be based on evidence beyond a reasonable doubt, hearing decisions need only be supported by substantial evidence, that is, evidence that reasonably substantiates the decision. In both criminal trials and administrative hearings courts and hearing examiners can officially notice facts which are not obvious to the general public yet are readily accepted as common knowledge to the courts or examiners. This happens more readily in administrative proceedings.

A variety of different information gathering techniques is available in the administrative process. Compulsory process by means of subpoenas, prehearing conference as a discovery tool; depositions; interrogatories to parties; and searches. In general the rules of attorney-client privileges in administrative proceedings are no different from the privilege applied outside administrative law.

90. Neither of these constitutional protections has provided those subject to discovery with significant protection. A refusal to answer based on the fourth amendment's ban on unreasonable searches and seizures, without more, will not defeat enforcement. United States v. Carroll, 567 F.2d 955 (10th Cir. 1977). The fifth

violations, the concerned party has the burden of proving that the violation did not occur or that the circumstances otherwise warrant remission or mitigation of the penalty. Under the mitigation guidelines of Section 1592, a petitioner must establish any mitigating factors with "sufficient evidence."[91]

When a violation claimed under Section 1592 is referred to the U.S. Attorney, the following burdens of proof will apply: (1) if the monetary penalty is based on fraud, the U.S. shall have the burden of proof to establish the alleged violation by clear and convincing evidence; (2) if the monetary penalty is based on gross negligence, the U.S. shall have the burden of proof to establish all the elements of the alleged violation; and (3) if the monetary penalty is based on negligence, the U.S. shall have the burden of proof to establish the act or omission constituting the violation, and the alleged violator shall have the burden of proof that the act or omission did not occur as a result of negligence.[92]

During any Customs administrative investigation regarding a penalty or seizure, Customs must refrain from disclosing any information regarding the investigation until the Customs' action is concluded.[93] A party who is the subject of a Customs investigation has the opportunity to request records under the Freedom of Information Act (FOIA).[94] Customs, however, generally denies requests for disclosure of investigative materials under the exemption in 19 U.S.C. § 552(b)(7). Thus, importers seeking remission or mitigation of a penalty on the administrative level have no right to discover the evidence used against them or to cross examine government witnesses. Such materials would be discoverable by an importer defending an action by the government in the Court of International Trade to collect a Section 1592 penalty.

Customs has the power to issue an administrative summons to acquire evidence related to a Customs violation. If Customs issues a summons to a third party record keeper of documents related to an import transaction, such as an attorney, accountant, or customhouse broker, it must issue notice of the summons to the person who is

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amendment protection against self-incrimination also has only a limited effect on administrative discovery. *See* Fisher v. United States, 425 U.S. 391, 96 S. Ct. 1569, 48 L.Ed. 2d 39 (1976); Couch v. United States, 409 U.S. 322, 328, 93 S. Ct. 611, 615-16, 34 L.Ed. 2d 548 (1973).

91. 19 C.F.R. Part 171, Appendix B (1991).

92. 19 U.S.C. § 1592(e) (1991).

93. 19 C.F.R. § 103.16 (1991).

94. 5 U.S.C. § 552. The regulations covering the Customs guidelines in implementing the FOIA are found in 19 C.F.R. 103 (1991).

identified in the description of the records (i.e., importer of record).

Upon receipt of notice, an importer may request the summoned third party not to comply with the Customs request.[95] Whenever a person does not comply with a Customs summons, Customs may request the U.S. Attorney to seek an order requiring compliance from the U.S. district court for the district in which the person is found, resides, or is doing business. Another evidentiary tool which Customs has is the search warrant under Section 1595 of Title 19 of the United States Code. Customs, however, is restrained from conducting an unreasonable search and seizure under this statute by the Fourth Amendment.[96]

3. *Relationship between the Two Systems*

*Possible Transition from One Procedure to Another*

A clear distinction and significant differences exist between criminal and administrative procedures. Many agencies have the authority to seek criminal sanctions by becoming the prosecuting authority in a traditional criminal trial. Other agencies must refer the case to the Justice Department for prosecution. In the U.S., whenever Customs determines that the circumstance surrounding a seizure or a violation of the Customs laws "requires" prosecution by the U.S. Attorney, it shall report such case to the U.S. Attorney for prosecution.[97]

*Cumulative or alternative operation*

In the U.S., plurality of proceedings are possible and a time sequence exists in those proceedings. A number of principles limit recourse to federal courts until a person has utilized the administrative avenues of adjudication (i.e., the exhaustion rule, the concept of primary jurisdiction, the ripeness principle, and the comity and abstention doctrines).

For a party contesting a penalty imposed by Customs to gain jurisdiction in the Court of International Trade, that person must exhaust the remission and mitigation procedures of Section 1618 of Title 19 of the United States Code. The Court of International Trade

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95. 19 U.S.C. § 1509(c) (1991).

96. *See In Re* No. 32 East Sixty-Seventh Street, 96 F.2d 153, 155 (2nd Cir. 1938), *mandate amended* 96 F.2d 795 (1938).

97. 19 U.S.C. § 1603 (1991). Under § 1604, the Attorney General must review the information provided and investigate the facts of the alleged violation and begin the necessary proceeding to collect any fine, penalty, or forfeiture. 19 U.S.C. § 1604 (1991).

has exclusive jurisdiction over civil penalties issued.[98] Because civil and criminal penalties are distinct and independent from each other, plurality of sanctions can be imposed. Civil *in rem* forfeiture is pursued by the U.S. Government before, during, or after conviction. Administrative penalties may be imposed before criminal action is instituted. In practice, with the exception of civil *in rem* forfeiture, plurality of sanctions does not occur often. In the customs area, civil penalties may be imposed even if a criminal action has been pursued for the same violation of the Customs laws.[99] Customs may resort to the Court of International Trade to enforce a civil penalty imposed against a person arising out of a violation of certain provisions of the Customs laws. Again, Customs has the ability to refer a case to the U.S. Attorney to prosecute a wrongdoer regardless of whether a civil suit has been initiated.

*Criteria of Demarcation Between the Two Systems*

In the U.S., a substantial difference exists between criminal and administrative proceedings. As a result, several constitutional guarantees that protect the citizen in criminal proceedings are considerably diminished in the administrative process.[100] For example, U.S. Customs has sweeping powers of search and seizure at the borders which are not restricted by the constitution of the United States. Unreasonable searches conducted under Section 1595 of Title 19 of the United States Code, however, are prohibited by the Fourth Amendment.

U.S. Customs administrative penal law has been criticized for its failure to provide importers with due process in its administrative proceedings. Although the Customs Procedural Reform and Simplification Act of 1978 instituted the prepenalty notice, the same local Customs officials who previously investigated an importer's action review any prepenalty response as well as determine whether a penalty is issued. Thus, the same officials are involved throughout most of the administrative process as investigator, prosecutor, trial judge, and appellate judge (in the case of a motion for reconsideration) and often have the incentive to reaffirm their prior judgments. Customs Head-

98. 19 U.S.C. §§ 1592, 1641(b)(6), 1641(d)(2)(a), 1671(i)(2), or 1673c(i)(2) (1991).

99. *See* United States v. Murray, 5 CIT 102, Slip Op. 83-18 (1983).

100. *E.g.*, protections against unreasonable searches and seizures under the Fourth Amendment, the right against self-incrimination under the Fifth Amendment, the right to a trial by jury in the Seventh Amendment and procedural due process under the Fifth and Fourteenth Amendments.

quarters often will rely heavily on the local Customs factual determinations and findings in making its decision during the administrative appeal process.[101]

Another disadvantage for the importer during the administrative penal process is the lack of access to evidence during an investigation. Due to exemptions under the FOIA, the importer is unable to discover evidence or cross-examine government witnesses. Customs, on the other hand, has many tools to gather evidence against an importer, including the administrative summons. This lopsided access to evidence under the administrative process is not present under the criminal process since evidence regarding an investigation would be discoverable therein.[102]

## *B. Canada*[103]

### 1. *Substantive Law Issues*

In Canada, no clear distinction exists between the criminal law system, which is administered by criminal courts, and the administrative penal law system, which is administered by a variety of federal, provincial, municipal and specific organs. Administrative law in Canada is much less developed than criminal law. Appellate review by the courts concerns form rather than substance, and is concerned with legality rather than the merits of the case.

Canada's main statutory customs laws are set forth in the Customs Act and are both civil and criminal in nature. Various provisions of the Customs Act authorize the Governor in Council to make regulations for the implementation of those provisions. Under the Customs Act, the Governor in Council has the general mandate to make regulations to carry out the purposes of the Act.[104]

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101. *See* Peterson, *supra* note 41, at 710.

102. *Id.* at 711.

103. For a useful discussion of legal and practical problems posed by the difference between criminal and administrative law in Canada, *see* Grygier, *XIVth International Congress on Penal Law, Addendum to the Report Presented to Section I*, 59 REV. INT'L DE DROIT PENAL 136-39 (1988).

104. CUSTOMS ACT, § 164(j) (1989). Revenue Canada has issued its own set of administrative rulings, called D Memoranda, which provides the government's position on a wide variety of customs issues. The general areas of customs law in the Customs Act and the Customs Tariff relate to the following: licensing and regulation of customs brokers, all aspects of importing, including classification, valuation, entry requirements, movement and storage of goods, warehouses and duty free shops, origin of goods, which relate to marking and preferential tariff programs, abatements, refunds, draw-

Another source of statutory law is the Customs Tariff Act which sets forth the tariff schedules and certain basic rules for classification thereunder. It is under the Customs Tariff that one determines whether certain articles are prohibited or regulated at importation or exportation which, in turn, may determine whether violations of the Customs Act have occurred.

2. *Determination of Responsibility*

Canadian law on culpability and imputability is inconsistent. In theory there can be no crime without *actus reus* (criminal act) and *mens rea* (guilty mind or criminal intent). However, the 1985 Crime Code of Canada does not define *mens rea*. Rather it uses and implies a variety of definitions of intent, recklessness and negligence and uses presumptions of intent when intent is clearly absent.

Administrative penal law has no strict requirement of *mens rea*, but it does require reasonably conforming behavior. The lack of a strict requirement of *mens rea* make a finding of responsibility against the defendant easier. The distinction with the *mens rea* requirement in a criminal case facilitates prosecution of such cases and conversely exacerbates the defense. The only general rule of culpability is provided in section 153(c) which states that no person shall "wilfully" evade or attempt to evade compliance with any provision of the Customs Act. Managers of major enterprises, particularly corporations, were in the past rarely ever held responsible for what could be defined as corporate offenses. However, in recent years they have been fined.

Where a corporation commits an offense, any officer, director or agent of a corporation who "directed, authorized, assented to, acquiesced in, participated in" the commission of the offense is personally liable on conviction to punishment.[105]

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backs and remission of duties, exportation, enforcement, and, regulations.

The main areas of infractions, or offenses as they are called in the *Customs Act*, cover the following: making false or deceptive statements; evasion of duties; misdescription of goods in accounting records; keeping, acquiring, disposing of goods illegally imported; possession of certain blank customs documents; opening or unpacking unreleased imported goods; breaking or tampering with customs seals; certain illegal actions of corporate officials; smuggling; and a general offense relating to the contravention of certain enumerated provisions of the Customs Act. Finally, the Act contains an all inclusive offense which provides for the contravention of any provision of the Customs Act where punishment is not elsewhere provided.

105. *Id.* at § 158.

*Grounds for Exoneration*

No general rules exist in Canada to mitigate circumstances and grounds for exonerations. Instead, the courts proceed from case-to-case. Similarly, Revenue Canada has wide latitude in determining the amount of a monetary penalty or whether seized goods will be forfeited. For example, when Revenue Canada has determined that a violation under the Customs Act has in fact occurred under section 131, Revenue Canada *may* release seized goods upon the payment of a monetary amount. This payment may be any amount that the Minister determines, as long as it does not exceed a ceiling amount.[106] Publicity of court actions is viewed as a fundamental principle in the Canadian judicial process and is utilized unless special circumstances exist. Unless limited by statute, the use of publicity by an administrative tribunal is discretionary.[107] Revenue Canada makes its determination of the amount assessed on a case by case basis, with the opportunity for judicial review.

*Sanctions*

The courts and administrative agencies have available a wide range of sanctions, such as the right to seize smuggled goods and contraband, and to impose fines or prohibitions. A number of federal laws provide for the possibility of suspended sentences, intermittent incarceration, placement in a community-based home, restriction of professional activities, probation, parole, restitution, forfeiture of property, and a variety of prohibitions.

Administrative agencies have authority in many cases to impose the above-mentioned and other sanctions (i.e., seizure of contraband, suspension of licenses, and fines). In Canada administrative agencies can only indirectly enforce sanctions. The most immediate way Revenue Canada may impose a sanction where it believes a violation has occurred is to seize the goods which gave rise to the violation. The Customs Act provides for seizure of such goods as well as any conveyance used whether at or after the time of the contravention.[108]

Two major types of criminal punishments are set forth in the Customs Act. Summary conviction is the type of sanction which is used in the vast majority of criminal customs violations in Canada. A

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106. *Id.* at § 133.

107. *See Re* Millwood v. Public Service Commission (1974) 2 F.C. 530, 49 D.L.R. (3) 295.

108. CUSTOMS ACT at § 110.

person who is guilty of an offense punishable on summary conviction is liable to a fine of not more than $2000 and not less than $200 or to imprisonment for a term not exceeding 6 months or to both.[109] Courts in Canada frequently and effectively use publicity as a form of sanction.

Indictment is used in those cases where aggravating circumstances are present, such as where a violation is incurred by a repeat offender or the value of the prohibited goods is very large. A person who is guilty of an indictable offense is liable to a fine of not more than $25,000 and not less than $200 or to imprisonment for a term not exceeding five years or to both.[110]

*Jurisdiction to Impose Sanctions*

The enforcement of sanctions is divided among federal and provincial authorities and administrative agencies. The National Revenue for Customs and Excise enforces the provisions of the Customs Act and has been given broad authority to determine if violations have occurred thereunder. A Customs officer may search any person who has arrived in Canada, who is about to leave Canada, or who has had access to an area designated for use by such persons if he has reasonable grounds to suspect that the Act was contravened.[111] Similarly, a Customs officer may examine goods which have been imported into Canada or are about to be exported from Canada in order to enforce the Act and the regulations or any other act of parliament. He also may, upon reasonable grounds, open and examine any piece of mail that weighs over thirty grams.[112] Revenue Canada may place an officer on any conveyance arriving in Canada from outside Canada in order to do anything to facilitate the administration or enforcement of the Customs Act or any other act of parliament.[113]

Revenue Canada also may authorize any person to make an inquiry into a matter for any purpose related to the enforcement and administration of the Customs Act.[114] The use of search warrants is available which gives Revenue Canada the power to search any building, receptacle, or place connected with the violation of the Customs Act upon

109. *Id.* at § 160.
110. *Id.* at § 161.
111. *Id.* at § 98.
112. *Id.* at § 99.
113. *Id.* at § 100.
114. *Id.* at § 109.

reasonable grounds.[115] With the search warrant, Revenue Canada may seize any goods or conveyances involved in a contravention of the Customs Act, as well as anything which will afford evidence in an action under the Customs Act.[116]

Whenever Revenue Canada believes that a person has violated the Customs Act in respect to any goods or conveyance, it may demand payment of an amount of money if the goods are not found or seizure would be impractical. This amount may be equal to the aggregate of the value for duty of the goods and the amount of any duties due thereon, or any lesser amount as the Minister may direct.[117]

When a sanction such as seizure or demand for payment has been issued under section 124, the concerned person may request a decision of the Minister under section 129 by giving written notice to the officer who made the seizure or issued the notice for payment. Upon receipt of such notice, the Minister must provide the person requesting such decision a written notice describing the reasons for seizure or the request for payment. Thereafter, the person may furnish evidence on his behalf within 30 days.[118] Under section 131, the Minister must then consider and weigh the circumstances of the case and decide whether there was a contravention of the Act which warranted the seizure or the notice for payment.

The decision of the Minister under section 131 is not subject to review except by the federal courts, as provided in section 135. Within ninety days of being notified of the Minister's decision, the person may appeal the decision by way of action to the Federal Court-Trial Division in which that person is the plaintiff and the Minister is the defendant.

Where Revenue Canada determines that a contravention of the Customs Act has not occurred, it must release from custody any seized goods and refund any moneys paid, with interest.[119] In cases where a contravention has occurred, Revenue Canada may either: return the goods or conveyances seized upon the receipt of an amount of money;[120]

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115. *Id.* at § 111.

116. *Id.* Sections 117-121 of the Customs Act set forth a framework for the return of goods, conveyances, animals, and perishable goods seized. Customs may release goods seized upon receipt of an amount of money equal to the aggregate of the value for duty of the goods and the amount of any duties due thereon. *Id.*

117. *Id.* at § 124.

118. *Id.* at § 130.

119. *Id.* at § 132.

120. *Id.* at § 133(2). Goods may be returned upon the payment of an amount of money of a value equal to the aggregate of the value for duty of the goods and

remit any portion of any money or security charged; and where necessary, demand additional money as the circumstances warrant.[121]

A third party who claims an interest in seized goods as owner, mortgagee, lien-holder, or holder of like interest, may apply to a court for an order declaring that his interest is not affected by such seizure and declaring the nature and extent of his interest at the time of the contravention or use. The court which issues this order is not a federal court, but rather one of the provincial courts set forth in section 138(5).[122]

When a person owes the government an amount rising from a violation under the Customs Act and fails to satisfy that debt, several means are available for enforcing such an infraction. First, after the government has notified a person of any amount owed (except under sections 124 or 131(1)(c)) and that person has appealed the notice of arrears in accordance with section 144, a judgment may be obtained in federal court.[123] Liens also may be placed on goods for unpaid duties[124] and the government may garnish amounts owed by the government to a person who is indebted under the Customs Act.[125] Many courts have held that administrative discretions given statutorily are partly or wholly unreviewable.[126]

*Rules of evidence*

In Canada, the rules of evidence in criminal proceedings are based on the adversary system. The rules of evidence in administrative penal law proceedings, on the other hand, are flexible and variable, but influenced by the adversary system. In contrast to the civil law system,

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any amount of duties assessed thereon, or any lesser amount. For conveyances, the payment may equal the value of the item at the time of seizure, or any lesser amount. § 133(3).

121. *Id.* at § 133(4). This amount may not exceed an amount equal to the sum of the value for duty of the goods and the amount of duties assessed thereon. With respect to conveyances, the amount may not exceed an amount equal to value of the conveyance at the time of seizure or the service of notice under section 124. § 133(5).

122. *Id.* at §§ 138-141.

123. *Id.* at §§ 143-145.

124. *Id.* at § 146.

125. *Id.* at § 147.

126. *See* Robert F. Reid & Hillel David, ADMINISTRATIVE LAW & PRACTICE 312-313 (1978) (citing cases holding that actions by various administrative officials were shielded from judicial review). In the customs area, a court has refused to review the Minister of National Revenue's determination on the value of goods for customs duties. *See* R. v. Weddel Ltd., Ex. C.R. 97 (1945) 4 D.L.R. 385.

the judge takes no initiative in the conduct of the trial or other proceedings, and takes limited initiative during the trial. The counsel argue about procedure, take procedural steps, and seek and present evidence. The judge rules about the points of procedure and the admissibility of evidence. When the trial is conducted before the jury, the judge summarizes the evidence and explains and applies the law but the jury decides on the facts of the case.

The adversary system does not fit the administrative penal law. However, its influence strengthens the proclivity to hear as fully as possible the accused's point of view and evidence in its support. Very few administrative decisions are reviewed by the federal court in Canada. The burden of proof in a prosecution under the Customs Act with respect to the identity of origin of any goods, the circumstances surrounding the importation or exportation of any goods, the payment of duties, or the compliance with the Customs Act with respect to any goods lies on the accused, if the government establishes that the facts of the case are within the knowledge of the accused or are or were within the accused's means to know.[127]

Revenue Canada may release all types of evidence obtained for purposes of enforcing the Customs Act on the order or subpoena of a court of record. Also, Revenue Canada may provide documentary evidence obtained under the Customs Act to the person by or on behalf of whom the item was provided, or to that person's authorized agent.[128] As well, Revenue Canada may use the search warrant to gather evidence when it believes that there has been a contravention under the Customs Act.[129]

### 3. *Relationship Between the Two Systems*

Even after the establishment of the federal court, federal and provincial courts hearing appeals from penal administrative decisions often encroach on each other's jurisdiction. However, there has been more consistency in their procedure and decisions. Appeals of seizures and notices of payments under section 124 are pursued in the federal courts.[130] Appeals from other fees and amounts owed are also within the jurisdiction of the federal courts.[131] Third-party claims under section

127. *Id.* at § 152(4).
128. *Id.* at § 108.
129. *Id.* at § 115.
130. *Id.* at § 135.
131. *Id.* at § 144.

138 are appealed within the provincial court system. The criminal punishments of summary judgment and indictment are instituted, heard, tried, or determined in the place in which the offence was committed or in which the accused is apprehended or is located.[132]

*Cumulative or Alternative Operations*

When an administrative decision is deemed by an aggrieved person as unfair, illegal, or arbitrary, the person can appeal to the court. Noncompliance with an administrative sanction does not constitute a criminal offense in Canada, but the same act may be subject to administrative and/or criminal sanctions.

Under the Canadian Customs Act there can be a plurality of sanctions concerning the same act. The result of an act of smuggling, for example, can result in seizure of the goods in an *in rem* procedure, while a separate *in personam* action can be instituted to imprison the wrongdoer. Thus, the civil sanctions can be pursued simultaneously with the criminal sanctions. If a penalty or fine is not paid, the government can institute forfeiture proceedings and dispose of the seized merchandise to satisfy the outstanding debt. Liens and garnishments of payments due a citizen are both mechanisms that the government can utilize to enforce a civil penalty.

No criteria explicitly demarcates the two systems of application of penal sanctions. There is no consistency in the nature of the values protected, or harm or danger established. The gravity of the infraction is probably the best, albeit still uncertain, criteria. Different agencies have different sanctions at their disposal, some severe (detention, confiscation, extradition), some minor. The two systems appropriately coexist in Canada. Administrative sanctions are applied swiftly and effectively in some major and most minor cases by officials well acquainted with the operation of the agency they serve. The courts have more power to apply the law.

Under the Customs Act, no criteria explicitly demarcates the penal administrative law from the criminal law. Revenue Canada will move from the former to the latter on a case by case basis. Both qualitative and quantitative criteria are considered when determining whether to impose criminal sanctions in a particular case. For example, the undeclared entry of three bottles of spirits for personal use may result in seizure of the alcohol and the issuance of a small administrative fine to the wrongdoer. A person importing a larger amount of spirits with

132. *Id.* at § 162.

the intention of selling it could result in an indictable offense, especially if the wrongdoer has a prior bad record for the same violation.

### C. *Mexico*

Customs law in Mexico fits into the administrative penal law classification. There is a depenalization of some of the offenses, a heavy reliance on monetary fines, and confiscation; and sanctions are provided as retributive reactions to violations of the primary regulations. In addition, Mexico has followed the international trend toward removing some customs violations of minor social importance from the traditional criminal law.

Enforcement of customs law relies largely on imposition of penal responsibility on the basis of personal fault (intent or negligence). The severity of customs sanctions emphasizes proportionality to the gravity of the infraction. The defenses of justification and excuse are available in the Mexican adjudication of alleged criminal violations of customs laws.

#### 1. *Substantive Law Issues*

Customs law consists of customs laws supplemented by the Fiscal Code of the Mexican Federation. The substantive law of customs crimes is contained in Title VII of the law.[133] In contraband cases, the Fiscal Code is considered to be a special law which is applicable to federal cases (pursuant to art. 6 of the Penal Code of the Federal District) and thus regulates this type of illegal conduct. In criminal cases involving contraband or theft of merchandise in tax or criminal courts, the Secretary of the Treasury must declare that the federal treasury has suffered or could suffer the loss of goods, or in the cases of contraband, that taxes were not paid, or that trafficking of illegal substances was involved.

Under the Fiscal Code, the crime of contraband is committed when one introduces to the country or exports from it merchandise, while omitting the total or partial payment of the duties, charges, and taxes

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133. Customs Law of December 28, 1991, as amended by law of January 10, 1983, Law of January 10, 1984, Law of January 10, 1985, Law of January 10, 1986, Law of January 10, 1987, Law of January 10, 1988, Law of January 10, 1989, Law of January 10, 1990, and of January 10, 1991. For a discussion of customs law and customs crime, *see* MAXIMO CARVAJAL CONTRERAS, DERECHO ADUANERO (1986), on which this account relies heavily. *See also* MANUEL RIVERA SILVA, DERECHO PENAL FISCAL (1984).

that are due.[134] The crime of contraband is also committed when one imports or exports merchandise without the permission of the competent authorities when required.[135] It is also considered a crime when one imports or exports illegal substances, or if foreign merchandise is transported from the free zones to the rest of the country.[136] A person who has in his or her possession illicit substances, or substances whose trafficking is banned, is also guilty of the crime of contraband.

Similarly, the law regulates conduct which does not contain all the elements of the crime of contraband, but where the same legal property rights have been violated. A violation of customs law occurs when one acquires and/or has in her possession foreign merchandise that is not for personal use, or if one sells the merchandise without proper documentation to prove its legal status. It is illegal for merchandise to be misrepresented by documentation, or for it to be represented by authentic documentation but different from what is required by law.

Title VII criminalizes the failure to present required documents to the customs authorities, the failure to present the documents or information required by the customs authority within the specified time period, and the presentation of documents with inexact or false dates.[137] A person who, in his capacity as a functionary or public employee of the Federation of the States, of Federal District or Municipalities, authorizes the import of some vehicle, furnishes documents or plaques for its circulation, grants matriculation or abandonment, or intervenes for its inscription into the Federal Vehicle registration, or when the import of such vehicle has occurred without prior permission of competent federal authorities, has committed the crime of contraband.

It is also a crime to have in one's possession a vehicle from abroad imported without permission into Mexico, or in the case of autos or trucks, models from the last five years. It is illegal for a person who has acquired a vehicle imported for transit in the free zones or border areas, or that has been granted permission to circulate in a cited border area, to use that vehicle if the person does not use them or reside in the specified zones or areas.

The concealment of contraband suggests the idea of realization of criminal activity while benefiting the offender or a third person. The Fiscal Code states that the concealment of contraband provides that such actions constitute participation in the crime. A person is responsible

134. Fiscal Code of the Federation of Mexico, article 127, (I) (1983).
135. *Id.* at art. 27 (II).
136. *Id.* at art. 127.
137. *Id.* at art. 136.

for concealment even if there was no prior agreement or participation in the crime, as long as the actual crime took place. If one transfers or hides an object of crime with the idea of personal gain, or who understands the illegality of the proceeds, or helps another hide or transfer it for personal gain, then he/she is guilty of contraband. Anyone who assists an accused person in eluding an investigation from authorities, or hides the actions of the accused, or destroys, alters or conceals evidence of the crime, including any profits from the crime, is guilty of contraband. Such concealment will be punished by imprisonment of three months to six years.

The Mexican customs law criminalizes violations of the requirements to maintain control, security, and safekeeping of the merchandise of foreign commerce.[138] Violations may include failure to use proper labels, locks, stamps, and other means of security required by law or regulation.[139] A person commits a customs crime if the person does not properly place warnings on the package that merchandise is contained that is explosive, flammable, contaminating, radioactive or corrosive.[140] The captains or pilots of vessels and airplanes with international services and business to which they belong violate the law on customs control and security when they unjustifiably arrive or land in an unauthorized place.[141]

The Fiscal Code establishes a continuing crime when there is a plurality of conduct and acts, with a unity of criminal intent and identity of legal disposition. One who commits continuing customs crime, even of a small nature can receive a sentence that is increased by as much as one-half the normally applicable sentence. Persons will be held responsible for any intention of attempting to commit a crime, including execution of actions directed towards realizing the crime, even if execution was stopped by outside forces acting upon the agent. If

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138. *Id.* at art. 138.

139. *Id.* at art. 138, I.

140. *Id.* at art. 138, III.

141. *Id.* at art. 138, VII. Persons are held responsible for the crime of contraband who have helped or assisted generally or who have specifically orchestrated the execution of the act. The law defines such actions as constituting the crime of contraband in the following circumstances: when there is understanding of the illegality of the act; when there is comprehension of the action as it is described by the law; when one commits the crime with another; when one acts as an instrument for the completion of the crime; when one induces another under false pretenses to commit the crime; or if according to a prior agreement, a person helps someone after the execution of the crime has taken place. *Id.*

the actor stops the execution of a crime, or attempts to hinder its completion, sanctions are not imposed.

*Sanctions*

In contraband crimes, the Secretary of the Treasury formulates the damages and then confiscates property in the amount equivalent to the damages caused. This result applies only in criminal procedures which have not rebounded into administrative procedures. In these crimes the court does not impose pecuniary sanctions. By virtue of the administrative authority, the Treasury will order effective the omitted contributions, the charges and administrative corresponding sanctions. To determine the value of merchandise and the amount of duties omitted, authorities will take into account the amount of the items if they are produced before smuggling. The penalty for contraband is from three months to six years, if the amount of customs duty omitted does not exceed approximately $10,000. If the amount of customs duty which was not paid exceeds the before mentioned amount, the penalty increases from three to nine years. Imprisonment of three to nine years is proscribed for illegal trafficking of merchandise which has been prohibited by the Federal Executive under the second paragraph of Article 131 of the Constitution of Mexico and its regulatory law. In all other cases of illegal trafficking of merchandise, the sanctions range from three to nine years imprisonment. The penalty is slightly less for crimes where it is not possible to determine the amount of duties omitted when smuggling merchandise without permission from the competent authorities, generally 3 to 6 years. An attempted crime is punished with a sentence of two-thirds the duration of the punishment which would have been levied against the agent if the crime had been committed.

*Grounds for Exoneration*

Prosecution of customs crimes can be halted if the Secretary of the Treasury requests that they be stopped, and if the defendants pay the duties lost as a result of their actions. This petition must be realized before the Federal Public Ministry recommends prosecution.

In the case of an infraction pursuant to the Article 127.1 of the Fiscal Code involving nonpayment of duties, when the lack of payment was due solely to arithmetic errors, the customs authority will take corrective action.[142] An offender can receive exoneration when the

142. *Id.* at art. 103.

inexact classification of duties is due only to the genuine differences of a technical nature in the interpretation of the tariffs contained in the laws of the general import or export duties, provided that the nature and other characteristics of the merchandise have been correctly manifested to the authority.[143]

Exoneration will apply when an offender has not received permission from the competent customs authority, while the merchandise remains on deposit before the customs. In this case, the customs authority will withhold the merchandise until permission is received or the requirement withdrawn.[144]

The legal status in the country of foreign merchandise is proved by: customs documentation required by law; the bill of sale required by the Federal Fiscal Authority; the bill required by a person inscribed in the Federal Register to Contributors; and the document of carriage which contains the dates of the remittance, and, if applicable, the destination and the effects that are covered.[145]

## V. PROBLEMS AND SOLUTIONS

### *A. No States Prosecute*

One of the problems that results from the parallel existence of different jurisprudence and criminal laws in different countries and

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143. *Id.* at art. 133, II.

144. *Id.* at art. 133, III, IV. No sanctions will be imposed on merchandise cataloged as personal use. The following merchandise is considered to be for personal use: food and drink for consumption, clothes and other personal objects, except jewelry; cosmetics, sanitary and cleaning products, lotions, perfumes, medicine and medical apparatus that the owner personally utilizes; domestic articles for residences provided always that they are limited to no more than two of the same articles. *Id.*

145. *Id.* at art. 136, I and art. 128. A person is presumed to commit the infraction of contraband when: a person unloads surreptitiously foreign merchandise from the means of transport; a person deals with foreign merchandise without documents, or when a person unloads merchandise and puts it on boats which operate exclusively cabotage, except if the person can demonstrates that they were lost in an accident or disembarked in a place other than the national territory; an airplane with foreign merchandise lands in a place not authorized for international traffic, except by cause of a major force such as a storm; the foreign merchandise in domestic or international transit is not unloaded in the authorized place, so that it may clear customs; a person introduces or brings from the country hidden merchandise or with artificial attributes, so that its natural state can pass customs unknown, if its importation or exportation is prohibited or restricted or by itself should require payment of foreign commerce taxes, and a person introduces into the country merchandise or brings it by itself to an unauthorized place. These presumptions under Mexican law save the prosecution from its burden of proving the *mens rea*, thereby facilitating the work of the prosecution in contraband cases.

from the use of different bases of criminal jurisdiction is that there may be crimes that no state criminalizes. Consequently, the offender escapes or both the state where the crime was committed and the state where the suspect is a resident may claim jurisdiction when an offender crosses a border, so that a customs crime perpetrated by one or a group of persons may escalate into a conflict of international law.

It appears that, due to the gradual extension of extraterritorial jurisdiction in criminal cases, even by the common law countries of the U.S. and Canada, and because of the doctrines of objective and subjective territoriality, as well as the floating territorial principle of asserting jurisdiction over crimes committed on a national vessel, customs and quasi-customs offenses will go uncovered only infrequently by laws of one of the three countries concerned.

Nevertheless, to assure such potential lacunae are identified and remedied and due to the increased traffic of goods and persons, the enforcement offices of the customs authorities in the three countries should as a matter of course examine the enforcement of their respective customs law and discuss potential problems and prospective means of remedying them. This should occur regardless of the outcome of the discussions of a North American Free Trade Agreement. Indeed, pursuant to the bilateral mutual assistance in customs matters agreements between Mexico and the U.S., and between each of the three governments, a working group could be established. This has occurred, for instance, under the Mutual Legal Assistance in Criminal Matters Agreement (MLAT) between the U.S. and Italy. The working group has focused on specific problems, such as narcotics, organized crime, and terrorism.[146] A working group of customs officials could focus on cooperation in enforcement matters such as contraband, documents fraud, narcotics, currency violations, identification and recovery of stolen cultural property, trafficking in endangered species, trade in counterfeit goods and violation of intellectual property laws, and so forth. The groups may also want to discuss potential harmonization of documents. Any customs working group would have a brief that would not supercede, but rather complement other bilateral enforcement groups.

Alternatively or in addition, the three governments could establish a common working group(s) to which the customs authorities of each

146. For a discussion of the establishment and operation of the working group between the U.S. and Italy and less formal working groups on anti-terrorism between the U.S. and France, *see* Bruce Zagaris and David Simonetti, *Judicial Assistance Under U.S. Bilateral Treaties*, LEGAL RESPONSES TO INTERNATIONAL TERRORISM U.S. PROCEDURAL ASPECTS 219, 227-28 (M. Bassiouni ed. 1988).

of the three governments would belong. Such a working group could focus on simultaneous investigations, especially where third countries might be involved or where specialized industries are involved, and the governments may want to exchange information and utilize specialists. Such working groups are used to conduct simultaneous examinations in the international tax area.[147]

*B. International Legal Assistance*

To strengthen cooperation in customs matters, the three countries should review the operation of customs cooperation. In connection with the review, the legal mechanisms should be carefully considered. The operation of the Mutual Assistance in Criminal Matters Agreement (MLAT) between the U.S. and Canada would be considered. The governments might want to consider the operation of the mutual assistance in customs cooperation agreements. Article XVIII of the U.S.-Canada MLAT provides that the two government will consult "as appropriate to develop other specific agreements or arrangements, formal or informal, on mutual legal assistance."[148] The two governments can agree on such practical measures as may be necessary to facilitate the MLAT's implementation. The annex specifically applies to enforcement of environmental and wildlife crimes. The manner in which the annex is likely to be implemented is that periodically the law enforcement officials responsible for both international cooperation and environmental cooperation will meet to discuss specific legal areas in which environmental problems have been raised and design solutions. This has begun already between the U.S. and Mexico outside of the context of the MLAT as a result of the pressure by environmentalists for improved procedures to stop cross-border environmental problems. Among the areas of the environment that are likely to be discussed within the annex of the U.S.-Canada MLAT are: enforcement of the Convention on the International Trade in Endangered Species,[149] the

147. For a discussion of simultaneous tax examinations in the context of tax information exchange agreements, *see* Bruce Zagaris, *New Exchange of Information Agreements*, FOREIGN INVESTMENT IN THE UNITED STATES: A PRACTICAL APPROACH FOR THE 1990s 247, 261 (PLI 1990).

148. Treaty With Canada on Mutual Legal Assistance in Criminal Matters, Mar. 18, 1985, U.S.-Canada, art. XVIII(i), S. TREATY DOC. No. 14, 100th Cong., 2d Sess. (1988) [hereinafter U.S.-Canada MLAT].

149. For background on the need for better coordination between the U.S. and Canada in enforcing CITES, *see* Ronald I. Orenstein, *The Federal Government's Role in the Protection of Endangered Species*, SUSTAINABLE DEVELOPMENT IN CANADA: OPTIONS FOR LAW REFORM 235-37 (The Canadian Bar Assoc. Committee Report 1990).

World Heritage Convention,[150] and the Convention on Wetlands on International Importance Especially as Waterfowl Habitat;[151] enforcement of cross-border air and water pollution; waste-dumping;[152] management of transboundary fishery resources;[153] and perhaps joint training of officials, especially officials whose job is to enforce environmental crimes, but whose expertise is not environmental law (i.e., customs and border officials).

Another important issue will be to properly structure cooperation under the annex. In conjunction with the conclusion of other MLATs, such as the Italian-U.S. MLAT in 1983, the contracting states have provided for periodical meetings to cooperate on certain crime problems (i.e., drugs and organized crime in the case of the U.S. and Italy). The Italian-U.S. working group has broadened its agenda to include cooperating in combatting terrorism.[154]

The U.S. and Mexico may want to review measures to deal with the implementation of an MLAT since the lengthy impasse that precluded the Mexican government from exchanging its instrument of ratification has finally been resolved.[155] Customs authorities might find it useful to review the many agreements that exist and provide for assistance in criminal and enforcement matters that the customs authorities either implement or may find relevant and useful in the performance of their duties and interaction with other officials.

The recent bilateral agreement between Canada and Mexico regarding mutual assistance and cooperation between their customs

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150. 11 I.L.M. 1358; T.I.A.S. no. 8226 (1972).

151. 11 I.L.M. 963 (1971).

152. *See, e.g., U.S. Indictment of Defendants in Crossborder Waste Dumping Signals New Enforcement Cooperation with Mexico*, 5 INT'L ENFORCEMENT LAW REP. 211 (May 1990) (for a discussion of how the U.S. and Mexico have cooperated on crossborder waste cases).

153. For a discussion of the need for improved international and bilateral regulation and management of fisheries resources, *see* Richard Paisley, *International Regulation of Fisheries*, SUSTAINABLE DEVELOPMENT IN CANADA: OPTIONS FOR LAW REFORM 221, 228-29 (1990).

154. For a discussion of the formation of the working group, *see Meese Addresses Italy-USA-Switzerland Conference*, 1.2 INT'L ENFORCEMENT LAW RPTR. 29 (Oct. 1985); Bruce Zagaris and David Simonetti, *Judicial Assistance Under U.S. Bilateral Treaties*, M. Cherif Bassiouni, LEGAL RESPONSES TO INTERNATIONAL TERRORISM U.S. PROCEDURAL ASPECTS 219, 226-27 (1988).

155. For background on the impasse and controversy that caused the Mexican government not to exchange its instrument of ratification for more than one year, *see* Zagaris (ed.), DEVELOPMENTS IN MEXICAN-U.S. LAW ENFORCEMENT COOPERATION: WHAT THE PRACTITIONER NEEDS TO KNOW 22-24 (1990).

administrations[156] includes provisions not found in earlier customs agreements which will encourage a higher level of customs cooperation. For example, the Canadian and Mexican customs administrations are directed to communicate immediately on their own initiative, any information relating to the following: observations and findings resulting from the successful application of new enforcement aids and techniques; techniques and improved methods for processing travellers and cargo; and, new means or methods used to take action against customs offenses.[157] Although the 1984 U.S.-Canadian agreement[158] has two of these three provisions,[159] the 1976 U.S.-Mexican agreement[160] has not been revised to encompass this type of information sharing for enforcement purposes.

The requirement to exchange observations and findings of new enforcement aids and techniques, techniques and improved methods for processing travellers and cargo, and new means and methods to take action against customs offenses provide a framework in which customs officials disclose to each other new technology, laws, and processes. The exchange of information also occurs in the context of joint training and informal discussions and in the context of similar laws and shared traditions. Although the requirement in the agreements do not by themselves stimulate the information exchange, it facilitates such exchanges.

Similarly, the U.S.- Mexican agreement does not include a specific provision which directs the two customs services to cooperate in the research, development and testing of new systems and procedures, in the exchanging of customs personnel, and in coordinating the border facilities of the two countries.[161] Accordingly, the U.S. and Mexico may benefit by updating their mutual customs cooperation agreement to

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156. Agreement Between the Government of Canada and the Government of the United Mexican States Regarding Mutual Assistance and Co-operation Between Their Customs Administrations, signed at Mexico City, March 16, 1990, entered into force September 21, 1990.

157. *Id.* at art. VI(a)(iv)(vi).

158. Agreement Between the United States of America and Canada Regarding Mutual Assistance and Co-operation Between Their Customs Administrations, signed at Quebec, June 20, 1984, entered into force January 8, 1985.

159. *Id.* at art. XI.

160. Agreement Between the United States of America and the United Mexican States Regarding Mutual Assistance Between Their Customs Services, signed at Mexico City, September 30, 1976, entered into force January 26, 1979, T.I.A.S. 8642.

161. *See* Canadian-Mexican Agreement, *infra* note 156 art. II(1)(c); U.S.-Canadian Agreement, *supra* note 158, art. II(1)(c).

reflect the increased level of information sharing which has been negotiated in both of the Canadian agreements. In light of the increased trade among the three countries, the sharing and coordination of technology, manpower, and other resources will be vital for the enforcement efforts of each country's customs administrations.

Other bilateral enforcement cooperation agreements that impact on customs officials and which the customs authorities may find useful to review include: the agreement for return of stolen art;[162] the agreement for recovery of stolen vehicles and aircraft;[163] the bilateral narcotics treaty;[164] extradition treaty;[165] the tax information exchange agreement;[166] and mutual assistance in criminal matters agreement.[167] Since some of these agreements and enforcement efforts (e.g., simultaneous tax audits and exchange of routine bank records)

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162. Treaty of Cooperation Between the United States of America and the United Mexican States Providing for the Recovery and Return of Stolen Archaeological, Historical and Cultural Properties, entered into in Mexico City, July 17, 1970, entered into force March 24, 1971. For the texts and legislative history, *see* Franklin Feldman & Stephen Weil, ART WORKS: LAW, POLICY, PRACTICE 555-72 (1974). The U.S. Customs Services has issued regulations and import restrictions governing pre-Columbian art (part 12 of the Customs regulations to implement title II of Public Law 92-587).

163. Convention Between the United States of America and the United Mexican States for the Recovery and Return of Stolen or Embezzled Vehicles and Aircraft, signed on January 15, 1981, entered into force on June 28, 1983. For the text, a discussion of its operation by the U.S. Department of Justice and background to its operation, *see* Bruce Zagaris (ed.), DEVELOPMENTS IN MEXICAN-US LAW ENFORCEMENT COOPERATION, *supra* note 155, at 96-169.

164. Agreement on Cooperation in Combating Narcotics Trafficking and Drug Dependency, signed at Mexico Feb. 23, 1989, entered into force July 30, 1990, 29 I.L.M. 58 (1990).

165. Extradition Treaty Between the United States of America and the United Mexican States, signed at Mexico City May 44, 1978, 31 U.S.T. 5059.

166. Agreement Between the United States of America and the United Mexican States for the Exchange of Information with Respect to Taxes, signed in Washington on November 9, 1989, entered into force on January 18, 1990. For the text, *see* 5 Rufus van Rhoades and Marshall J. Langer, INCOME TAXATION OF FOREIGN RELATED TRANSACTIONS § 81.11; for a discussion of the agreement, *see* Michael J.A. Karlin & Paula E. Breger, *Exchange of Tax Information Between the United States and Mexico*, 6 INT'L ENFORCEMENT LAW REP. 69 (1990); Bruce Zagaris, *U.S. and Mexico Conclude Tax Information Exchange Agreement*, 5 INT'L ENFORCEMENT LAW REP. 413 (1990).

167. The Treaty on Cooperation Between the United States of America and the United Mexican States for Mutual Legal Assistance, signed at Mexico City on December 9, 1987. For the text see Senate Treaty Doc. 100-13 (100th Congr. 2d Sess., 1988); The Treaty Between the Government of the United States of America and the Government of Canada on Mutual Legal Assistance in Criminal Matters. For the text, *see* Senate Treaty Doc. 100-14 (100th Congr. 2d Sess., 1988).

only pertain to two of the three countries may want to discuss the feasibility and desirability of accession by the third government and/or negotiation of a similar agreement vis-à-vis the third government. In view of increased trade, commerce, and travel, the three countries may want in some cases to revise the relevant treaties, and perhaps apply all or part of them to the third government in appropriate cases.

An area that requires immediate improvement between customs authorities among the three governments is in the enforcement of the Convention on the International Trade in Endangered Species (CITES).[168] CITES operates by a system of permits, and proper enforcement requires that permits be examined and collected at border points by qualified personnel. This should be at designated ports of entry. Permits are examined by customs officers. In Canada, experts have criticized monitoring as woefully inadequate and as not correlated with the identical reports given by U.S. customs authorities.[169] In the enforcement of CITES and in the enforcement of other wildlife trade issues, experts have advocated that Canada strengthen its implementation of treaties, providing proper enforcement powers, coordination, and support.[170] In addition to CITES, the governments should consider their adherence to and enforcement of other conventions providing for environmental enforcement involving customs officials.[171] Enforcement of environmental and wildlife laws is also a matter of increased enforcement activity by the Mexican government[172] and of cooperation between the U.S. and Mexico.[173] The three governments should examine and try to harmonize legal sanctions against violators of international

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168. 12 I.L.M. 1085, T.I.A.S. no. 8249 (1973).

169. Ronald I. Orenstein, *The Federal Government's Role in the Protection of Endangered Species*, Sustainable Development in Canada, OPTIONS FOR LAW REFORM 231, 237 (1990).

170. *Id.*

171. The Conventions may include the World Heritage Convention, 11 I.L.M. 1358, T.I.A.S. no. 8226 (1972), and the Convention on the Conservation of Migratory Species of Wild Animals (the "Bonn Convention"), 11 I.L.M. 963 (1971).

172. *See* remarks by Mr. Sergio Reyes-Lujan, Undersecretary for Ecology Secretariat of Urban Development and Ecology (SEDUE), Government of Mexico, to a Congressional briefing on the North America Free Trade Agreement, March 21, at 6. He testified that Mexico has intensified its program of inspection and vigilance to control illegal traffic of all species. In 1990, it confiscated 700,000 specimens of wild flora and fauna.

173. For a discussion of the integrated environmental enforcement program, *see id.* and Bruce Zagaris, *Mexico-U.S. Initiate Border Environmental Cooperation*, 7 INT'L ENFORCEMENT LAW REP. 55 (1991).

treaties relating to wildlife. The lack of harmonization and unequal standards has led to disputes and cases in national and international fora concerning the catching and trade of shrimp and yellow fin tuna.[174] The formation of working groups within customs on environmental and wildlife issues would also meet the legitimate concerns of environmentalists who are demanding that environmental protection not be diminished for the sake of enhanced trade and have called for establishing working groups on the environment in the context of the FTA.[175] These working groups should be in part open for participation by citizens and nongovernmental organizations.[176]

An issue that overlaps international criminal and enforcement (e.g., quasi-criminal) cooperation and supranational criminal justice is the appropriate mechanisms and structure for the subsectoral cooperation. Environment is an example. The Canada-US MLAT has some provisions in the annex for such subsectoral cooperation while the Mexican-U.S. MLAT has no such provisions. However, in the context of the negotiation of (NAFTA), the U.S. Environmental Protection Agency (EPA) and the Secretaria de Desarrollo Urbano y Ecologia (SEDUE) released a working draft of the Integrated Environmental Plan. One chapter discussed the existing environmental institutional framework for the border area and the status of some of the environmental enforcement in place, and contemplated. Although there are a series of important bilateral and multilateral agreements, they do not provide clear and directly applicable enforcement mechanisms.[177]

The planning and coordination starts with regularly-scheduled meetings between the presidents of the two countries on a range of matters that include environment. Most importantly from a working

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174. For a discussion of the tuna controversy, *see* Sarah Barber, *U.S.-Mexico Tuna Fight Moves to GATT While U.S. Appellate Court Gives U.S. Environmentalists a Victory*, 7 INT'L ENFORCEMENT LAW REP. 58 (1991); and for the controversy on shrimp, *see* Lea F. Santamaria, *Shrimp Fishermen Fined in First Enforcement Proceeding While Turtles Complain About the Narrow Territorial Scope of the Endangered Species Act*, 7 INT'L ENFORCEMENT LAW REP. 268 (1990).

175. *See, e.g.*, Before the Subcommittee on International Economic Policy and Trade and the Subcommittee on Western Hemisphere Affairs of the House Committee on Foreign Affairs, 102nd Congress (1991) (testimony of Stewart J. Hudson on behalf of National Wildlife Federation.)

176. *See, e.g.*, The National Wildlife Federation's Position on Environmental Issues Related to the North American Free Trade Agreement (March 21, 1991).

177. For a discussion of the enforcement aspects of the plan, *see* Bruce Zagaris, *Mexico-U.S. Integrated Environmental Plan for Mexico-U.S. Border Area*, 7 INT'L ENFORCEMENT LAW REP. 318 (Aug. 1991).

level, the Mexican-U.S. planning activities occur within the framework of the Mexican-U.S. cabinet to cabinet Binational Commission, which brings together the highest levels of authority within the environmental agencies of both countries. At least annually, the Secretary of SEDUE and the Administrator of the EPA meet as part of the cabinet-level Binational Commission to further discussions involving cooperative environmental agreements between the two nations.

Another framework for cooperation is the 1983 Border Environmental Agreement which provides an annual meeting between the National Coordinators of the Agreement. The Mexican coordinator is the Under Secretary for Ecology of SEDUE and the U.S. Coordinator is the Assistant Administrator for International Activities of EPA. The foreign affairs ministries, the IBWC, and a host of representatives of other agencies of the two countries also participate.

Without question, effective transnational enforcement of environmental cooperation will be required just to keep pace with the new levels of trade and investment that will accompany the implementation of NAFTA. Institutionally, none of the many bilateral agreements provide substantial enforcement cooperation. For the most part, cooperation is limited to exchanging information and occasionally personnel. Because of the number of environmental issues and agreements that require serious enforcement cooperation (i.e., hazardous wastes, air, water, protection of flora and fauna, and endangered species), an urgent need for an enforcement cooperation or at least a Memorandum of Understanding (MOUs) on enforcement cooperation exists. Models exist in the areas of international securities and commodities futures trading enforcement, in which the U.S. has both agreements and MOUs.[178] An enforcement cooperation agreement is especially important since the Mutual Assistance in Criminal Matters Treaty between the two governments, which was signed on December 9, 1987, and was ratified by the Mexican government on January 8, 1988 has come into force in 1991 and has not been used much. The lack of enforcement mechanisms is exacerbated by the lack of understanding of each other's

178. For a background on these agreements, *see* Lisa L. Davis & Bruce Zagaris, *International Cooperation in a World Marketplace: Preventing & Prosecuting Commodity Futures Fraud and Abuses*, 15 NOVA L.R. 507-10 (1991); Michael Mann & Joseph Mari, *Current Issues in International Securities Law Enforcement*, WHITE COLLAR CRIME 1989 229 (ABA Nat'l Instit., March 1989); Bruce Zagaris, *U.S. Concludes First Agreements for Securities Enforcement Cooperation*, 5 INT'L ENFORCEMENT LAW REP. 466-67 (1989); Pamela Jimenez, *International Securities Enforcement Cooperation Act and Memorandum of Understanding*, 31 HARV. INT'L L.J. 295-311 (1990).

laws, the lack of experience in cooperation enforcement, and the air of uncertainty and some lack of trust that is inevitable in the context of the relations of the two countries. To overcome these difficulties requires at least an MOU on enforcement cooperation. Subsequently, a full-blown treaty would be required. Alternatively, enforcement cooperation provisions should be added to the bilateral agreements on the environment. However, this would be more time-consuming.

Another area in which cooperation enforcement should make provision is participation by non-governmental organizations. Such provisions would be unique since, normally, enforcement cooperation agreements are only between governments, and non-governmental parties are only objects and not subjects of such agreements. However, there is precedent in that the NAFTA environmental action plan provides for broadening public participation in the formulation and implementation of trade policy to ensure that efforts to liberalize trade are consistent with sound environmental practices.[179]

The three governments may want to consider the feasibility and desirability of more uniform approaches to policy and legislation. While the governments meet regularly in the form of a working group, they should also encourage the academic and business communities to continue to explore these areas. The facilitation of more uniform approaches to the enforcement of customs law and policy could also provide solutions for dealing with the comparative law problems when the customs laws of the three countries interact, particularly due to the nature of customs law as administrative penal law within the context of international criminal law.[180]

One of the goals of the establishment of working groups and supranational institutions as suggested above would be to identify and provide for rules to resolve conflicts between procedural and substantive laws and regulations. This should include discussion, mediation, and binding arbitration. Some thought should be given to allowing individuals to initiating the process for resolving investigations and cases in which such persons are caught.

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179. For background on the broadening of public participation in the formulation and implementation of trade policy to ensure that efforts to liberalize trade are consistent with sound environmental practices, *see* Bruce Zagaris, *NAFTA Environmental Action Plan Fortifies Fast-Track Success and Transborder Enforcement Efforts*, 7 INT'L ENFORCEMENT LAW REP. 203, 204 (May 1991).

180. *See, e.g.*, the draft resolutions in *The Legal and Practical Problems Posed by the Difference Between Criminal and Administrative Penal Law*, 59 REV. INT'L DE DROIT PENAL 523-25 (1988).

C. *Supranational Criminal Justice*

To close gaps in the operation of international legal assistance, some countries have moved to the third level where it is no longer a question of agreements between states, but of a shift in criminal law jurisdiction to institutions superior to individual states, so that rather than speaking of *international*, experts refer to *supranational* law and institutions. In the universal context, the international criminal law field has discussed the creation of an international criminal code and the establishment of an international criminal court. The parameters of cooperation in a supranational context, especially of the U.S., Canada, and Mexico, is limitless because of the magnitude and intensity of the issues that provide the need for cooperation. In the context of supranational criminal justice, customs can be part of the overall umbrella and/or it can be somewhat autonomous in terms of its own mechanisms and structures.

Regionally, in the context of integration, supranational institutions include the Council of Europe and the institutions of the European Community, which have been adopting directives and other instruments concerning matters as criminalizing money laundering, customs, and immigration violations.[181]

While the sensitivity to sovereignty, at least on the part of Mexico, and the absence of agreement on a free trade agreement may make closer cooperation in the form of supranational law and institutions premature, such supranational cooperation appears imminent. Already, Mexico and the U.S. cooperate in the form of common working groups in narcotics, border issues and environmental issues. Each of these groups has detailed programs and activities on enforcement, training, and joint operations. Similarly, the cooperation between Canada and the U.S. is extremely close on many issues.

One area in which exchange of personnel, information, and education would be useful is how the law enforcement officials of each country interact with their own counterparts. For instance, the existence of the Treasury Enforcement Compliance System (TECS), the "look out" maintained by customs and immigration at the border, the operation of the Financial Law Enforcement Intelligence Network (FINCEN) within Treasury, interagency task forces dealing with organized crime and narcotics, would be extremely useful for key officials of each

181. For a discussion of international criminal cooperation in Western Europe, *see* Scott Carlson and Bruce Zagaris, *International Cooperation in Criminal Matters: Western Europe's International Approach to International Crime*, 15 NOVA L.R. 551-79 (1991).

of the customs officials. Understanding the interaction of policies, objectives, and laws of related agencies would also be helpful. For instance, the detection, confiscation (or allowed entry in the case of setting up an organized crime operation) of pre-cursor chemicals, pilots, planes and vessels and the importance for major narcotics traffickers may be very important. Understanding the limits of the law, constitutional rights of individuals, politics surrounding the operation of customs laws and officials in the other countries would also serve the key officials from each of the three countries. The legal basis for such cooperation is provided between the U.S. and Canada already. The U.S.-Canadian MLAT states that the requested state may provide copies of any document, record, or information in the possession of a government department or agency, but not publicly available, to the same extent and under the same conditions as would be available to its own law enforcement and judicial authorities.[182]

In some cases such education already occurs in a multilateral sense. For instance, the Organization of American States (OAS) in cooperation with Canada, is providing training on customs relating to narcotics. A trilateral program on a range of customs cooperation matters would supplement this and other awareness-raising and training activities.[183]

One subject for discussion in a supranational institution is the policy of the three countries vis-à-vis all other countries. There are many common problems with which the three countries need to deal. For instance, many customs problems facing the U.S. and Canada, such as contraband (e.g., narcotics trafficking), false documents, and so forth, and which enter through its border with Mexico, actually may be stopped or reduced by a common policy of Mexico with Central America.[184] By actively identifying and suggesting solutions to some of these problems, the Executives and Legislatures, and eventually supranational authorities, may be able to deal and ameliorate the problems external to the territories of the three countries.

If the North American Free Trade Agreement becomes a reality, the three governments may want to consider establishing cooperation

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182. U.S.-Canada MLAT, art. XIII(2).

183. *See, e.g., Canadian Government and CICAD Host Workshop/Seminar for High-Level Drug Officials in Americas*, 6 INT'L ENFORCEMENT LAW REP. 221-22 (1990).

184. An example is in the area of narcotics policy. An effect of Mexican policy of interdiction and eradication is the use of Central American countries for the growing and transiting of drugs. Mexico has begun to play a leading role in shaping policies in Central America. *See* Bruce Zagaris, *Mexican Government Outlines New Drug Policy Initiatives*, 7 INT'L ENFORCEMENT LAW REP. 2-5 (1991).

emulating selected provisions of the Schengen Accord[185] and Convention,[186] whereby the European Convention on Mutual Assistance in Criminal Matters is supplemented, especially with respect to immigration and customs matters.[187] In this connection, an elaborate intelligence network is established[188] and mutual assistance is provided concerning infringements of their rules concerning excise duty, value added tax and customs duties.[189] Special measures and working groups are established concerning drugs,[190] firearms, and ammunition.[191] In particular, the infrastructure established to implement the Schengen Convention should be monitored closely by the three governments for possible emulation.

In the medium- and long-term, the three governments would be best to construct a framework in which to deal comprehensively with a wide range of criminal matters. The most efficient structure would probably be a regional organization, such as an Americas Committee on Crime Problems with the Assistant Ministers of Justice, with their assistants meeting on a regular basis to discuss and take action and cooperate against drugs, money laundering, customs, and a panoply of criminal justice problems.[192] Such an organization would be best established within an existing organization such as the OAS or perhaps the U.N. Committee for the Prevention of Crime and Treatment of Offenders in Latin America. The OAS is the organization that appears, for political, historical and infrastructure reasons, best suited.[193]

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185. Belgium-France-Federal Republic of Germany-Luxembourg-Netherlands: Schengen Agreement on the Gradual Abolition of Checks at Their Common Borders and the Convention Apply the Agreement, done at Schengen, June 14, 1985, 30 I.L.M. 68 (1991).

186. Convention Applying the Schengen Agreement of June 14, 1985, Between the Governments of the States of the Benelux Economic Union, the Federal Republic of Germany and the French Republic, on the Gradual Abolition of Checks at Their Common Borders, signed at Schengen, June 19, 1990, 30 I.L.M. 84.

187. For a discussion of the Convention and its potential application to other integration efforts, *see* Zagaris, *Schengen Convention Points Way to Enhanced EC Criminal Cooperation*, 7 INT'L ENFORCEMENT LAW REP. 26-33 (1991).

188. Convention, Title IV, arts. 92-133.

189. Convention, art. 50.

190. *See, e.g.*, Convention, arts. 70-71.

191. *See, e.g.*, Convention, arts. 77-78.

192. *See* Bruce Zagaris and Constantine Papavizas, *Using the Organization of American States to Control International Narcotics Trafficking and Money Laundering*, 57 REV. INT'L DE DROIT PENAL 118 (1986).

193. *Id.*

Another series of potential mechanisms to consider in the medium- and long-term to strengthen cooperation in customs enforcement among the three countries would be to adopt some of the provisions of criminal cooperation adopted on December 18 at Maastricht, Netherlands, in the Treaty on European Union. In particular, in Title VI are Provisions on Co-operation in the Spheres of Justice and Home Affairs. The provisions deepen the process already under way in areas such as narcotics and terrorism, which the Trevi Group covered, fraud which was already under EC control, and immigration and customs, which the Schengen Convention already covered. It is worthwhile looking at these provisions in some detail for purposes of seeing some possibilities for cooperation between Mexico, the U.S. and Canada in customs and other related enforcement areas.

The three governments, universities with Mexican-U.S. studies, U.S.-Canadian, and Mexican-Canadian studies, and with international criminal law programs, should stimulate research and discussion on those issues. Politicians should begin the consultative process as well, so that political proposals receive considerations of citizens in the three countries. Shaping the course of relations among the three countries will test the ability of law to contribute positively to the dynamic change that is inevitable in this hemisphere.

# Japan's Investment Trust: A Vehicle of Savings for Tomorrow

*Noboru Tanabe**

## I. INTRODUCTION

Japan's investment trusts have experienced phenomenal growth over the past decade. From 1979 to 1989, the total net assets of Japan's investment trusts grew from 6 trillion yen to 58.6 trillion yen, an almost tenfold increase.[1] During this same period, the total net assets of the United States' mutual funds industry also increased at a tenfold rate from 94.5 billion dollars to 982 billion dollars.[2] If Japan's investment

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1. INVESTMENT TRUSTS ASSOCIATION OF JAPAN, MONTHLY SURVEY OF SECURITIES INVESTMENT TRUSTS (Dec. 1990).

JAPANESE INVESTMENT TRUSTS:
(Total Net Assets in Billions of Yen with % in Parenthesis)

| | December 1979 | December 1984 | December 1989 |
|---|---|---|---|
| (1) Stocks | 1,840 (30.6) | 2,764 (15.1) | 22,533 (38.4) |
| (2) Warrants | — | — | 179 ( 0.3) |
| (3) Bonds | 3,096 (51.4) | 13,465 (73.6) | 17,845 (30.4) |
| (4) Call Loans | 1,047 (17.4) | 2,145 (11.7) | 18,314 (31.2) |
| (5) Others | 39 ( .06) | -76 (-0.4) | -222 (-0.3) |
| TOTAL | 6,022 | 18,298 | 58,649 |

Call loans include bills bought, commercial paper, and certificates of deposit.

2. U.S. INVESTMENT COMPANY INSTITUTE, MUTUAL FUND FACT BOOK 1990, 78 (1990).

trusts are to continue this vigorous expansion, there must be a deeper understanding of the uniqueness of Japan's investment trust, which is the result of many efforts to develop an investment product with a strong savings orientation. This Article will present an international comparison of investment trusts and analyze the savings orientation of Japanese investment trusts with some discussion of their historical background and policy motivations. Finally, the Article will conclude with some insights into the future of the investment trust both in Japan and in the world.

Due to their expansive growth, Japan's investment trusts at times have been called a new industry. This expansive growth is the result of the dedicated efforts and energy of many people within the securities industry. This growth has been sparked by the gradual relaxation of controls by regulatory authorities and by the unprecedented low interest rates that prevailed in Japan throughout the decade of great liquidity, especially in the 1980s. Japanese investment trusts have grown from constituting 1.7% of the financial assets held by individuals in Japan in 1975 to 4.9% of such assets in 1988.[3] In comparison, the proportion of all United States household financial assets held in mutual funds has grown from 1.8% in 1981 to 6.1% in 1989.[4]

Behind this expansive growth stands the unique history of Japan's investment trust. Japanese investment trusts were developed in response to the poor state of the Japanese economy after World War II and

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3. THE BANK OF JAPAN (1988).

FINANCIAL ASSETS HELD BY INDIVIDUALS IN JAPAN
(In hundred billions of yen with % in parentheses)

| | 1975 | 1985 | 1988 |
|---|---|---|---|
| 1. Cash | 100 ( 6.0) | 202 ( 3.5) | 275 ( 3.5) |
| 2. Demand deposits | 196 (11.8) | 358 ( 6.2) | 467 ( 5.9) |
| 3. Savings deposits | 850 (51.1) | 2,781 (48.0) | 3,389 (42.8) |
| 4. Trust Accounts | 103 ( 6.2) | 394 ( 6.8) | 503 ( 6.3) |
| 5. Insurances | 213 (11.9) | 886 (15.3) | 1,464 (18.5) |
| 6. Securities | 194 (11.7) | 1,093 (18.9) | 1,750 (22.1) |
| (a) Government bonds | 9 ( 0.5) | 164 ( 2.8) | 98 ( 1.2) |
| (b) Financial bonds | 66 ( 4.0) | 198 ( 3.4) | 199 ( 2.5) |
| (c) Stocks | 52 ( 3.1) | 485 ( 8.4) | 987 (12.5) |
| (d) Collective Investment Trusts | 29 ( 1.7) | 170 ( 2.9) | 387 ( 4.9) |
| (e) Other securities | 38 ( 2.3) | 76 ( 1.3) | 79 ( 1.0) |
| 7. Others | 7 ( 0.4) | 78 ( 1.3) | 70 ( 0.9) |
| TOTAL | 1,663 | 5,792 | 7,918 |

4. U.S. INVESTMENT COMPANY INSTITUTE, *supra* note 2, at 64.

developed as a reasonable response to Japan's changing socioeconomic conditions.

## II. INTERNATIONAL COMPARISON OF INVESTMENT TRUST: CONCEPT AND STRUCTURE

The concept and structure of an investment trust are complex. The investment trust is a scheme for collective investment in stocks and bonds by a large number of individuals with small fortunes, offering them the possibility of high returns and capital appreciation without involving large risks, a privilege so far only available to the very rich.[5] In the United States, the most common form of investment trust is the mutual fund which is defined as follows:

> A company that makes investments on behalf of individuals and institutions with similar financial goals. Pooling is the key to mutual fund investing. By pooling (which generates economies of scale) the financial resources of thousands of shareholders - each with a different amount to invest - investors gain access to the expertise of the country's top money managers, wide diversification of ownership in the securities markets, and a variety of services otherwise available only to institutions and wealthy families and individuals.[6]

In the European Community (EC), work has been underway in recent years in the direction of integrating collective investment schemes among its member countries. The adoption of the Minimum Standard for Investment Trust in 1989 by the EC stands as an important milestone in the EC's drive to 1992 and has led the investment trusts modeled on this minimum standard to be called UCITS-type funds. In the EC framework, the investment trust is defined as a form of "undertakings for collective investment in transferable securities of capital raised from the public, and which operates on the principle of risk-spreading, and the units of which are, at the request of their holders, repurchased or redeemed, directly or indirectly, out of those undertakings' assets."[7]

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5. H. BURTON AND D.C. CORNER, INVESTMENT AND UNIT TRUSTS IN BRITAIN AND AMERICA (1968).

6. U.S. INVESTMENT COMPANY INSTITUTE, *supra* note 2, at 14.

7. *UCITS-Undertakings for Collective Investment in Transferable Securities*, EUROPEAN COMMUNITY COUNCIL DIRECTIVE (1985).

This definition hinges on the notion of "open-endedness" so that shares of investors in an investment trust are redeemable or repurchasable at any time at the request of the investors and new fund shares can be offered at any time. United States mutual funds also incorporate this quality of open-endedness. In fact, open-endedness has led United States mutual funds and the EC's UCITS-type funds to be recognized as the international standard for the investment trust concept.

In Japan, the concept of the investment trust is similar to that of the United States and EC concepts with respect to such ideas as the pooling of resources, risk-spreading, and expert asset management. The structure of the Japanese investment trust involves four different parties: the investor (beneficiary), the investment trust management company (sponsor and trustor), the trust bank (trustee), and the securities company.

> A securities investment trust is a trust whose purpose is to invest trust funds in specified securities under the direction of a management corporation, with the beneficiary interest sold to the public. An investment trust is created when an investment trust contract is concluded between a management corporation, which makes investment decisions, and a trustee corporation which serves as custodian and performs the necessary bookkeeping functions. The beneficiary interest is divided into equal shares, and investors become beneficiaries by acquiring *pro rata* shares of the divided beneficiary interests from a securities company.[8]

Securities companies, which originally operate selling of funds' beneficiary certificates under agreements with management companies, play an additionally important role in the Japanese investment trust system by providing such services as the repurchasing of beneficiary certificates and the paying of dividends.[9]

In comparing the British unit trust with the Japanese concept of the investment trust, there are the following differences: (1) instead of defining the investor as a beneficiary as the Japanese law does, the

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8. ICHIRO KAWAMOTO, JAPANESE SECURITIES REGULATION 210 (1983).

9. Japan's investment trust is different from a British unit trust and a U.S. mutual fund in a variety of ways. Some of these differences have previously been pointed out by this author in a series of articles on the basic legal structure of Japanese investment trusts which this author has been contributing to *Shihon Shijyo*, the monthly journal (Japanese version) of the Capital Markets Research Institute of Japan. *See also*, Noboru Tanabe, *Japanese Investment Trust: The Legal Structure and Other Related Issues in International Perspective*, BUTTERWORTH'S JOURNAL OF INTERNATIONAL BANKING AND FINANCIAL LAW (Feb. - April 1992).

British law defines the investor as a participant in a collective investment scheme and grants him the status as a party to the trust agreement; (2) in a British unit trust, the experts who are responsible for the management of investments are not called trustor, but are called manager or operator to distinguish them from the investor who is the real trustor; (3) in Japan, the trustee (trust bank) is one of the parties to the trust deed while in Great Britain the trustee of a unit trust participates directly in the collective securities investment scheme; (4) in Japan, securities companies play an important role by providing such services to beneficiaries as the selling and repurchasing of beneficiary certificates and the payment of dividends, even though the securities companies' function is not precisely stipulated by the securities investment trust law; (5) in Great Britain, securities companies can act as underwriters, brokers, or as agents for the unit trust.

In general, investment trusts are comprised of characteristics of both individual and joint trusts, which creates difficulties in the formation of a legal theory and explanation of the structure of the investment trust.

The trust property of an investment trust is constituted of funds raised from investors at large (beneficiaries). The ownership of the trust property passes to the trustee company through the trust deed which is governed by the Securities Investment Trust Law. However, the trust property must be managed separately from that of the trustee bank and eventually reverted to the beneficiaries, and the all-important authority of giving instructions for the investment of trust property is reserved by the management company (trustor). Although the management company is duty-bound to manage the trust property in good faith in ways best suited to enhance the interest of beneficiaries, there is no provision holding it directly accountable to its beneficiaries. What is more, because the ownership (in the bearer form) is not registered with the trustee company and changes frequently from one hand to another, the fiduciary relationship which binds the trustee (including, in effect, the management company) with the beneficiaries is diluted with the passage of time, and this tends to encourage holders of certificates to become interested in annual dividends or any capital gains the investment trust might produce.

As the fiduciary relationship thus becomes diluted, the trust property tends to take on an existence of its own, independently from the trustor, trustee, and beneficiaries. This idea explains why some call trust property 'nobody's property'.[10]

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10. *See* NOBORU TANABE, SHIHON SHIJYO, CAPITAL MARKETS INSTITUTE OF JAPAN (Dec. 1989).

The beneficiary certificates of Japan's investment trusts, like those of United States mutual funds and EC UCITS-type funds, can in principle be redeemed at any time as was pointed out by the Investment Trusts Association of Japan. In practice, however, redemption is restricted in many investment trust funds through the inclusion of a closed period. The existence of such a closed period has led these funds to be called "semi-open."

The term "semi-open" can be easily understood through a descriptive analysis. The shares of a "semi-open" investment trust cannot be redeemed for an initial period of time, typically two or three years. However, its shares can be redeemed at any time after the expiration of this closed period, which is why this investment trust is described as "semi-open," rather than just open or closed. The "semi-open" quality of some Japanese investment trusts sets these funds apart from United States mutual funds and the EC UCITS-type funds.[11]

Japanese investment trusts are also classified either as unit-type or as supplementary-funding type, depending on whether or not additional capital can be raised for the investment trust fund after the time of initial subscription. Unit-type and supplementary-funding type investment trusts are themselves classified as either stock investment trusts or bond investment trusts depending on their portfolio structure. A bond investment trust is ordinarily comprised of bonds exclusively. A stock investment trust can contain both stocks and bonds.

At present, the majority of Japanese stock funds are offered as unit-type investment trusts with these funds being the mainstay of the Japanese investment trust industry. Since they do not replenish their capital through additional share offerings and since they restrict early redemption of beneficiary certificates, Japanese unit-type stock investment trust funds cannot be bought and sold with the same ease as can United States mutual funds and the EC's UCITS-type funds.

Investment trusts ordinarily take one of two legal forms: the contract-type or corporate-type. Other legal forms such as the partnership-

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11. Internationally, "open-end" refers to an investment trust which offers redeemable securities or which continuously redeems its securities/certificates and, as described in the body, is normally applied to mutual funds in the United States and the UCITS-type funds in the EC. This definition helps to explain why the term "semi-open" is used to describe those Japanese investment trusts with closed periods.

A small number of United States closed-end funds are now making periodical tender offers for their shares with this activity typically taking place on a quarterly basis. Functionally, these funds might be viewed as resembling a Japanese "semi-open" trust.

type also exist. Only contract-type investment trusts exist in Japan today while company or corporate-type investment trusts dominate the United States investment trust industry. In the EC, the investment trust integration program (UCITS) has provisions for both contract-type funds (FCP - *fonds commun de placement*) and corporate-type funds (SICAV - *societe d'investissement a capital variable*).[12] Therefore, some of the differences between Japanese investment trusts and United States mutual funds are due to the difference in legal form. Both types of trusts can serve similar financial purposes and functions. The segmentation of the trusts into contract-type and corporate-type reflects choices made at different times and in different countries under specific social and economic conditions.[13]

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12. CATEGORIES OF INVESTMENT TRUST

| | (a) Flexible type | (b) Fixed type |
|---|---|---|
| I. *Contract-Type* | | |
| (a) Flexible Type | | (1) Unit trust (open-end type) in the U.K. and European Community |
| | | (2) All unit type and open-end type in Japan's investment trust system |
| (b) Fixed Type | | (1) U.K. unit trust at a stage in its historical development |
| | | (2) U.S. unit trust at a stage in its historical development |
| | (a) Closed-end | (b) Open-end |
| II. *Corporate-Type* | | |
| (a) Closed-end | | (1) U.K. investment trust (mostly for institutional investors) |
| | | (2) Some investment companies in the U.S. |
| (b) Open-end | | (1) U.K. and EC investment companies |
| | | (2) U.S. mutual funds |

Fixed and flexible refers to the amount of discretion given to the trust's management to change the composition of securities held in the trust's portfolio. Managers of fixed type trusts cannot in their own discretion change the kinds of securities held in the fund's portfolio whereas in a flexible trust managers have complete discretion to make such changes.

13. The goal is to secure the best possible performance in the functioning of collective securities investment with the best possible protection for small investors. In Great Britain, where collective securities investment has a history of over 100 years, the contract-type trust was the norm in the early years. Corporate-type funds were later introduced in relation to the idea that investment trusts should be governed by the Company Act. In the United States, there was a period in the early 1900s when a variety of investment funds flourished. However, in 1929, when the Great Depression struck the stock market, speculative managements were exposed in some investment companies and many of these companies' clients experienced serious financial losses. Within a few years, these events led to the enactment of the Investment Company Act of 1940, which is the main piece of legislation governing the U.S. mutual funds

In Japan, debate over the introduction of corporate-type funds has not been exhausted, however. During times of major growth or downward kinds of investment trusts, study has often resumed in preparation for the introduction of corporate-type funds. Today a new focus on this subject is being called for with a view towards further improving the stability of fund management (for example, introduction of closed-end corporate-type funds) and harmonizing the Japanese system with its foreign counterparts in order to broaden the path towards cross-border marketing, distribution, and investment (e.g., introduction of open-end corporate-type funds).[14]

The following issues which are presently being discussed in the United States will, however, need to be examined as Japan considers introducing a corporate-type investment trust:

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industry to date.

In Japan, just before the outbreak of the Pacific War in 1941, a contract-type investment trust came to exist in the form of a specified money trust. This specified money trust provided Japan with experience in collective securities investment. After the war, collective securities investment was considered again and a draft of a Securities Investment Company Law was prepared. This draft provided for the creation of corporate-type funds in Japan. In 1948, the draft was abandoned as "premature" because of the still turbulent post-war economy, a weak securities market, and the inexperience of the public with direct securities market participation. In its place, the Securities Investment Trust Law was passed in 1951 as a form of special legislation which did not provide for corporate-type funds.

14. The REPORT OF THE STUDY GROUP ON INVESTMENT TRUSTS OF THE MINISTRY OF FINANCE states in its discussion of corporate-type investment trusts:

> [T]he corporate-type investment trust is a scheme of collective securities investment through a company established for that purpose, selling its shares to the investing public and distributing asset management income to them in the form of dividends. It features no limit on the management period and no reduction in fund assets, particularly in the case of closed-end funds. These factors enable long-term stable asset management. In this sense, the corporate-type investment trust differs in its basic concept from the current investment trust and, thus, requires solution of many problems including extensive amendment of the relevant laws, if it is to be introduced into the Japanese market. For this reason, opinions were expressed that its immediate introduction would not merit the heavy costs envisaged in the process. Nonetheless, the corporate-type is the most popular category of investment trusts. And from the viewpoint of promoting mutual cross-border marketing and sale of investment trusts, corporate-type funds should be worthy of examination for possible future introduction.

REPORT OF THE STUDY GROUP ON INVESTMENT TRUSTS OF THE MINISTRY OF FINANCE 8 (May 1988) [hereinafter MINISTRY OF FINANCE].

(i) With regards to open-end investment companies in the United States, it has long been argued that voting shareholders and directors are redundant and, therefore, will hinder the competitiveness of United States mutual funds in the world market. This argument has led to the possibility of the introduction of an alternative pooled vehicle called a Unitary Investment Fund (UIF). The UIF does not have either voting shareholders or a board of directors and can be described as a contract-type investment trust. The United States Securities and Exchange Commission (SEC) has described the UIF in detail in its "Request for Comments on the Reform of the Regulation of Investment Companies."[15]

(ii) United States closed-end investment companies have no limit on the length of the management period and allow no reduction in fund assets. Both factors enable them to seek long-term stable asset management. At present, some closed-end investment companies are making periodic public offers for their shares. There is discussion in the SEC's request mentioned above of allowing closed-end companies to provide a redemption-like mechanism.[16]

(iii) In recent years, taxation on income retained at the qualified fund level under Subchapter M of the United States Internal Revenue Code has been strictly reformed.

> Under Subchapter M of the Internal Revenue Code, [q]ualified funds pay no federal income tax on their earnings and capital gains which are distributed to shareholders. In order to qualify, a mutual fund has to distribute at least 90% of its investment company taxable income to its shareholders each year, among other requirements . . . [However] the Tax Reform Act of 1986 and subsequent legislation require that a fund distribute 97% of its income from dividends and interest, and 98% of its net realized capital gains with respect to the calendar year in which they are earned or realized. The 1986 act also required shareholders to be taxed on their share of a fund's gross income (income before fund expenses are subtracted), rather than on net distributions. This change would have imposed a tax on the 'phantom income' imputed to shareholders, that is, income that shareholders never received but for which they were held accountable on their tax returns.

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15. 55 Fed. Reg. 25322 (1990).
16. *Id.*

> However, this provision was amended in December 1989, before it was ever implemented, to permanently exempt almost all funds.[17]

Two other axes upon which investment trusts can be compared are the scope of eligible investments allowed and the scope of information disclosure required by regulatory provisions.[18] Great Britain, with its many decades of experience with unit trusts, recently enacted the Financial Services Act of 1986. This new law broadens the scope of eligible instruments for collective securities investment schemes, permitting the purchase of risky commodity products, real estate, futures, and options in addition to conventional securities market instruments.

> Unit trusts are at present over-regulated in some respects. The reforms set out below are intended to enhance the range of schemes available without doing away with essential safeguards. This will also enable arrangements of a more speculative character to be offered legally to those investors who have appropriate financial resources and experience . . . With a wider variety of investment opportunities on offer it will be particularly important for the potential investor to appreciate the nature of the investment which he is being offered and the degree of risk involved. The Government proposes that public offers of unit trusts should be made on the basis of a prospectus, as are public offers of shares in a company.[19]

The Investment Company Act of 1940 provides the regulatory framework in which United States investment companies must operate. The Act allows investment companies to offer investment vehicles with varying degrees of risk, ranging from the very low risk money market funds to such high risk ventures as junk bond funds. Investment companies are required to provide fairly detailed information to the Securities and Exchange Commission. Various provisions of the Investment Company Act are designed to ensure the proper exercise of companies' fiduciary duties and to detect any conflicts of interest and self-dealing on the part of companies. The "Investment Company Act is the most complex of the entire SEC series"[20] of regulation.

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17. U.S. INVESTMENT COMPANY INSTITUTE, *supra* note 2 at 41-42.

18. One other considerable axis upon which investment trusts can be compared is the method of taxation of investment trusts. This subject will be discussed in a later section of this article.

19. U.K. Department of Trade and Industry, *Financial Services in the United Kingdom — A New Framework for Investor Protection*, 25 (Jan. 1985).

20. LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 263-264 (1989).

In the EC, the new UCITS Directive adopts a philosophy that appears fairly progressive and innovative to many. The EC's Directive provides for controls on the legal structure, administration, investment policy, disclosure, and marketing of investment trusts, so as to protect the trusts' participants from excessively risky investments and imprudent management. These provisions seem to reflect the experience of the EC's member countries with the investment trust and other securities related businesses.

The Japanese Securities Investment Trust Law does not contain as many eligible investments in comparison with the British scheme and does not contain the same detailed disclosure requirements as the United States scheme. However, the Securities Investment Trust Law does contain many regulatory provisions designed to protect the investing public in a manner similar to the EC's scheme.

In terms of investment scope, Japanese investment trusts are limited to certain kinds of securities. Investment in short-term financial products such as commercial paper, certificates of deposit, and call loans is allowed only as a temporary haven for their cash position. In fact, the mainstay investment trust is designed as a financial product with low risk and strong savings orientation. In terms of disclosure requirements, the Securities and Exchange Law states in general that no public offering of any security may be made unless the issuer of the security files a registration statement with the Ministry of Finance which fully discloses important information about the security being issued. No sales of the security are, in fact, allowed until the registration statement becomes effective.

The provisions of the Securities and Exchange Law do not, at present, apply to investment trusts.[21] Instead, the Securities Investment Trust Law stipulates that the management companies must prepare an explanatory statement to be given out by securities companies to prospective certificate subscribers. The companies must also prepare a financial report on the trust fund to be given to each certificate holder at the end of each fiscal year. In addition, the Securities Investment Trust Law provides for the self-regulation of trust structures and management companies' activities by the Investment Trusts Association. The Ministry of Finance plays an important role in protecting the interest of certificate holders by requiring advance approval of each trust deed which covers all matters related to management, sales load,

21. ICHIRO KAWAMOTO, *supra* note 8, at 221.

redemption periods, and other qualities of newly-established investment trusts. The description should indicate that the Japanese scheme with regard to disclosure policies and investment restrictions is uniquely Japanese in many respects.[22]

The comparison of the scope of eligible investments and the scope of information disclosure in various countries' investment trust systems provides some insight into the ways in which financial order is maintained and viewed in countries such as the United States and Japan. In the United States, judging and anticipating degrees of risk and volatility contained within any collective investment scheme are the investors' business and no one else's as long as the regulatory requirements prescribed for mutual funds are fully met. Almost every aspect of participation in a mutual fund is left to the judgment and choice of investors who may have quite different backgrounds. Investors are solely responsible for such decisions and must accept their results as a matter of course. As a logical consequence, this system requires accurate and adequate disclosure of the contents of the products which are offered for selection to the investors. Any mistake or fraud in the disclosure process is to be prosecuted and punished severely. Financial order of United States markets is usually described as being controlled by market forces. These market forces can have a destabilizing effect on financial order even though investors are well aware of the risks involved in their investments.

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22. In *Shihon Shijyo*, this author describes the legal structure of Japanese investment trusts and compares their governing law to those of other countries. The Financial Services Act of Great Britain and the UCITS minimum standards of the EC first grasp the whole operation of collective securities investment as a plan or an undertaking and then proceed to systematically establish legal relations among the instruments of investment, the management company, the trustee, and the investors. Within this basic framework, they offer a number of different schemes such as trust contract-type and company-type to accommodate investors' diverse needs. They also clearly establish rights and obligations between the management company and investors as the key components of this type of investment relationship.

It is often pointed out, by contrast, that the Japanese legal system for collective securities investment covers a narrower range of issues, does not provide for the investors' legal position in an explicit manner (vis-a-vis management companies in particular), and needs expansion in its systemic approach to legal relations within this type of joint trust which often transcends the bounds of the legal concepts and theories behind the unitary trust. *See* JAPANESE SECURITIES REGULATION (1983); SHOJIHOMU KENKYUKAI, AMERIKA TO NIHON NO SHOKEN TORIHIKIHO, Vols. 1-2 (1975) (for a comparison of securities exchange laws and investment trust legislation between the U.S. and Japan).

Japan has created an economic system that places great emphasis on the control over financial order. The structure and rules of the Japanese financial and capital markets and the relative credit system are carefully designed with an eye towards preventing company failures and extreme volatility as one of their top priorities. The investment trust constitutes one of the links in the chain of this financial system. It is guarded by preventive and reparative safety-net devices which include licensing, capital adequacy standards, line of business control, execution of audits by the Ministry of Finance, and the unprecedented lender of the last resort facility provided by the Bank of Japan during the securities market collapse of 1965.

A difference in the approaches of Japan and the United States in maintaining financial order can also be observed through the number of investment trust sponsors operating in each country. In the United States, roughly 300 investment trust sponsors were in operation as of September, 1988, with this number not restricted by any regulatory provision. This latter fact is consistent with the United States philosophy of letting market forces, to a great extent, determine the financial order of its markets. In Japan, the number of investment trust sponsors, who are screened and licensed by the Ministry of Finance using a regulatory scheme similar to one applied to banks and life insurance companies, was twenty as of February 1992.[23] This small number reflects the high standards which the Ministry of Finance requires a company to meet before it can obtain a license to offer investment trust services. Such examination of differences in approaches towards maintaining financial order should enable the United States and Japan to develop a deeper understanding of their investment trust systems so as to improve the cross-border marketing opportunities between the two countries.

## III. THE JAPANESE INVESTMENT TRUST AND ITS SAVINGS ORIENTATION

The unit-type stock fund is the mainstay in the product lines of the Japanese investment trust industry.[24] This unit-type stock fund

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23. Second International Conference of Investment Fund Associations, Toronto (September, 1988) (for world statistics of the number of management companies involved with collective investment schemes including investment trusts). Great Britain has approximately 180 investment trust sponsors.

24. TYPES AND SIZES OF JAPANESE INVESTMENT TRUSTS

(Figures are of January 31, 1990 and refer to net asset value of the trusts in billions

features a design which makes it "easy to buy and sell" and which provides for stable management. Structurally, this fund contains a closed prematurity redemption period which enhances its saving orientation through the stabilization of its capital base and thereby its management. The fund's savings-oriented design is provided for through the uniform provisions of securities investment trust deeds rather than in any provision of the Securities Investment Trust Law.[25]

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of yen.)

| | |
|---|---|
| Investment Trust (Contract-type) | 58,140.5 |
| I. Unit-type | 40,970.5 |
| a. Stock investment trust | 36,150.6 |
| (1) Regular interval/pattern offering type | 9,778.1 |
| (2) Spot-type | 26,372.5 |
| b. Bond investment trust | 4,819.9 |
| (1) Long-term government bond fund | 1,594.2 |
| (2) Japanese/foreign bond fund | 3,225.7 |
| II. Supplementary-funding type | 17,170.0 |
| a. Stock investment trust | 9,235.7 |
| b. Bond investment fund | 7,934.3 |

Of these categories, the mainstay unit-type stock funds, most of the supplementary-funding type bond funds, and some others (unit-type bond funds) have structures emphasizing a savings orientation. Their combined net asset value is a little less than 80% of the net asset value of investment trusts in Japan. INVESTMENT TRUSTS ASSOCIATION OF JAPAN (1990).

25. After World War II, the Japanese government and other public bodies assumed ownership of company stocks in vast quantities, following the dissolution of the Zaibatsu (family-controlled business groups) and the required payment of capital levies by the very wealthy. The Supreme Commander Allied Powers was urged to distribute these securities to the public in order to help begin the reconstruction of the shattered post-war economy and to promote the democratization of securities. However, the resources needed to absorb the released stocks were not in place. Many large potential investors lost much of their wealth through the reallocation of farmland, heavy capital levies, and the spiralling of inflation. Other individual investors suffered greatly from the drastic redistribution of income which occurred through the reforms of the post-war years. As a consequence, stocks were in excess supply, prices tumbled, and the securities market fell into a prolonged depression. The problem was further exacerbated by a huge pool of new stocks which resulted from the quasi-mandatory capital increases by corporations demanded by the Law concerning Corporate Reconstruction and Rehabilitation.

In order to overcome these problems and to foster investment in securities, securities companies and government authorities agreed in 1951 to adopt the investment trust as a means of coping with this crisis and as a way of promoting "people's capitalism" to support Japan's young democracy. The investment trust was chosen for several reasons. First, the capital market after the war was immature and small. The general public lacked sizable wealth, sufficient knowledge, and the requisite

To accommodate this preference, the investment trust was designed to:

> [S]tart with fixed amounts of capital to enable yield recognition within a certain range like bank deposits, diluting as much as possible price and yield volatility characteristic of any financial product featuring actual return payment. As a result, the new product started as a unit-type stock fund with its characteristics uniformly adopted throughout the industry. They consisted of (i) no ceiling for the ratio of stocks in the portfolio and (ii) fixed round-number par values (starting with 5,000 yen which was later increased to 10,000 yen) in (iii) bearer certificates offered for subscription almost every month for (iv) a relatively short two-year maturity (four to five years at present) with (v) a prematurity redemption privilege on the part of investors. But (vi) each fund, once established, was not to accept any additional capital.
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> In short, the newly launched investment trust was a unique modification fit for easy subscription by investors and for concerted mass sale by investment trust companies. Lying in the path of success of this distinctive system was the tradition of par value stock issues in Japan. Prototypical open-end funds offering initial and additional beneficiary certificates at market value with capital gains potential as their chief inducement could not win acceptance among investors long accustomed to par value stocks which virtually promised dividends at fixed rates and new stock allocations at par value.[26]

Unit-type stock funds were originally offered as packaged uniform financial products close in nature to bank deposits. In fact, these trusts were sold based upon the idea that they were almost like bank deposits with the exception that investors could choose, with the expert assistance of investment trust management companies, those funds whose investment objectives were in line with current investment theme and of great interest to the investors personally.

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experience needed for capital market investments. Therefore, the Japanese people favored indirect financial assets, such as bank deposits offering fixed interest rates and guaranteed repayment of principal. To accommodate this preference, the investment trusts were designed to be bank deposit-like, as mentioned in the main body.

26. JAPAN SECURITIES RESEARCH INSTITUTE, NIHON NO TOSHISHINTAKU (INVESTMENT TRUSTS IN JAPAN) (1966). This describes in complete detail the problems which occurred in the evolution of investment trusts after the securities market crisis of 1965.

These unit-type stock funds grew from their initial level of 14 billion yen in 1951 to over 718 billion yen in 1961.[27] However, when the securities market suffered a deep downturn in 1965, these and other investment trusts suffered a vicious cycle of stock price declines, net asset value drops, slow fund sales, higher redemptions, and ultimately, the cashing of portfolio stocks. Inevitable results of this cycle were further declines in stock prices, drastic attrition of the net asset value of trusts, and the forced extension of trust maturities. These maladies caused the securities industry to experience a depression of unprecedented severity. In fact, the Bank of Japan, acting as lender of the last resort, stepped in and provided special direct loans to two large securities companies during this depression. This action by the Bank was an unprecedented one and was undertaken because of the Bank's concern that these companies' failures would create great trouble in Japan's credit system as a whole.[28]

Alarmed by this bitter experience, all unit-type stock funds established after this mini-crisis had a built-in mechanism to further their savings orientation by trust deeds. This mechanism encourages stable asset management as much as possible by: (1) restricting the ratio or stock holdings (typically 70%); (ii) prescribing closed periods that typically restrict redemption for the first two to three years of the trust's maturity period (recently, the closed periods have been shortened or changed by introduction of new prematurity redemption charges to discourage redemption before maturity); and, (iii) requiring stock price fluctuation reserves to be set aside from 60% of the excess of net asset value of the fund over the fund's initial offering price, with this amount being similar in nature to retained earnings and with this amount to be invested in instruments other than stocks. These deeds also (iv) stipulated a maximum percentage up to which stocks of any one company can be bought and (v) set a management company's performance based fees at levels somewhat higher than those for other savings product offering fixed returns. (Recently, this incentive fee system has been changed to one based upon total net asset value of management companies).

The closed periods significantly reduce the liquidity of unit-type stock funds which, once established, accept no additional capital from investors. As mentioned earlier, the most apt categorization of these

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27. INVESTMENT TRUSTS ASSOCIATION OF JAPAN, INVESTMENT TRUSTS IN JAPAN-1990 4 (1990).

28. 6 THE BANK OF JAPAN, NIHON GINKKO HYAKUNEN-SHI, DAI 6-KAN (100 YEARS OF THE BANK OF JAPAN) (1986).

Japanese stock funds is "semi-open." This "semi-open" quality greatly enhances the stability of fund management by helping to maintain the fund's capital base.[29]

Characteristic (v), incentive fees constituted a major component of the savings orientation of Japanese investment trusts until the modification. These fees led investors and some observers to assume that Japanese investment trust management companies manage their funds in unique ways, including anticipating returns within a certain range and using techniques similar to portfolio insurance.[30] Such perceptions are in contrast with the basic concepts underlying collective securities investment schemes such as the unit trust in Great Britain and the mutual fund in the United States. These investment schemes are defined as a tool for individuals to seek volatile capital gains and annual trust income at their own risk, assuming that the appropriate disclosures required by regulatory authorities have been made.

The Japanese are sensitive about the preservation of principal and they favor savings vehicles which offer fixed interest income. To accommodate this investor preference, unit-type stock investment trusts were designed so as to anticipate (or target) returns within a certain range, despite their inherently volatile nature and to achieve as much stability as possible in asset management by establishing closed periods of two to three years. By adopting this philosophy, unit-type stock funds tried to build a "floor" below which their performance would not fall, so as to secure income stability even in the worst market conditions. To this end, they maintained meticulously calculated portfolios in which bonds, because of their stable income gains potential, formed the core. They were then mixed at various ratios with stocks that offered the possibility of variable capital gains.

The savings orientation of unit-type stock funds is even further enhanced by the taxation system. Although Japan's tax treatment may be unique and different from those accorded investment trusts in other countries, it has fairly well matched and served the actual stages of development in Japan's social economy. In general, Japanese investment

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29. For example, on Black Monday of 1987, a substantial portion of the balance of Japan's stock investment trust funds were in their closed periods. Therefore, instead of cashing their stockholdings due to early investor redemption, the trust funds could buy stocks at good bargain prices. In fact, the current consensus is that such behavior was a factor in keeping the Tokyo stock market in relative calm while other markets experienced greater downturns.

30. One such observer was Professor John Matatko of Exeter University of Great Britain.

trusts funds are not regarded as independent taxable entities; instead, investors are taxed when they receive the payments of distributions (income distributions and capital gains from trades or redemptions) from investment trusts. And those distributions are treated as separate, single dividend income (in the case of stock funds) or interest income (in the case of bond funds) without regard to the sources of original incomes (interest, dividend or capital gains) and without being combined with other incomes. At times, this separate taxation prompts foreign tax experts to ask if Japan's individual income taxation adopts a "scheduler" rather than a global income approach.

In the United States, distributions of incomes derived at investment companies are taxed on investors according to the income source, such as interest, dividend and capital gains, a practice based on the so-called "Conduit Theory." In fact, a mutual fund acts as a piece of conduit linking its shareholders and the securities in its portfolio. "Mutual fund shareholders are generally treated as if they directly held the securities in the fund's portfolio" so that "an extra layer of taxation is avoided."[31]

As described, Japanese investment trusts are taxed at the investor level rather than the fund level to alleviate any problem of double taxation.[32] The basic formula for taxation at the investor level is called

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31. U.S. INVESTMENT COMPANY INSTITUTE, *supra* note 2, at 41. In order for U.S. mutual funds to be treated as conduits or, more technically, regulated investment companies under Subchapter M of the U.S. Internal Revenue Code, the portfolio of an investment company must be diversified, it must meet certain composition-of-income tests, and not more than 30% of its gross income can be derived from the sale of securities held for less than three months. In addition, the fund must distribute at least 90% of its investment company taxable income to its shareholders each year. Failure to adhere to such regulations can result in the fund being treated as a U.S. corporation, thus having to pay federal tax at a rate of 34%. Additionally, the Tax Reform Act of 1986 placed further restraints on funds seeking to be regulated investment companies. In order to avoid imposition of a 4% federal excise tax, funds must declare to shareholders of record by December 31 of each year 98% of ordinary income and capital gains. Funds have until the following January 31st to actually pay the dividend. The purpose of this regulation was to accelerate the timing of income recognition by shareholders of such funds to the year in which dividends are declared. Tax compliance is one of the most difficult areas with which fund management and shareholders have to deal.

32. In Japan, there has been no taxation in principle at the fund level for the following reasons, even though any specific provision concerned is not clearly stipulated in tax laws:

(1) Since investment trust funds are not regarded as independent taxable entities, interest and dividend incomes of these funds are exempted from withholding taxation

the single income taxation formula. This term seems deceiving since income distributions from stock funds are classified as dividend income while income distributions from bond funds are classified as interest income. Moreover, when the shareholder is an individual instead of a corporation, a single flat withholding tax of 20% is imposed on trust income distributions whether these distributions emanate from stock or bond funds.[33]

Both approaches, Japanese and American, match the reality of collective securities investment offered in the form of financial products. The American flow-through system reflects the risk assumption of mutual fund investors. The Japanese formula accommodates the actual feelings of investors who are the recipients of dividends while simultaneously meeting the administrative needs of a simplified system of taxation.

As mentioned, under the current tax laws, income distributed from stock investment trusts is classified as dividend income and receives the same tax treatment as interest income. The Special Taxation Measures Law excepts it from ordinary stock dividend income and accords

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through prescribed procedures Individual Income Tax Law, Art. 176. (1965).

(2) Since no exemption is accorded to interest and dividends paid on foreign securities, these incomes are recognized for the trust properties in amounts after withholding taxes. The amounts equivalent to income taxes levied in accordance with foreign tax laws are kept on record but off the books of the investment trusts and are deducted from the amounts of withholding taxation under certain conditions at the time of income distribution or redemption of the investment trusts. Individual Income Tax Law. Art. 176, item 2. (1965).

(3) The Law for The Encouragement of Employees' Assets Formation which took effect in October, 1975, established the "System of Employers' Contributions to Employees' Asset Formation" in addition to the "Employees' Assets Formation System," and, under this law, the funds established exclusively for the management of these contributions are taxed as the only exception. The rate is one percent for the Special Corporation Tax and local taxes. This exceptional taxation is explained as an interest charge on arrears. Because these funds are not redeemable and do not distribute any income for seven years, paying income inclusive of investment income to the beneficiaries (employees) only once every seven years, the retention of such unpaid incomes causes long deferrals in taxation.

33. Japan, like the United States and other countries, once adopted the formula of taxation by income source. This formula did not fit well with reality, however. Investors often invest in a variety of fund beneficiary certificates and repeat buy and sell transactions many times during a taxable year. It makes income source identification an extremely complicated process, and the situation can be no less troublesome for the management companies and trustee banks. For this reason, the formula was soon replaced by other methods which have evolved into the current single income taxation formula.

it a reduced tax rate (15% income tax and 5% local tax at present) and separate taxation from other income. While no tax credits are given for dividend income from stock funds in the case of individual taxpayers, corporations enjoy the exclusion of dividend income from gross revenue within a prescribed range.

One reason given for the quasi-interest income treatment of stock fund distributions is that stock funds are today a widely accepted vehicle for small investments. Another reason is to put stock funds on an equal footing with the similarly structured jointly-managed money trust accounts whose income distributions are taxed as interest income. At any rate, the treatment of income distributions (dividend income) from stock funds as if this income was interest on deposits offering fixed rates on fixed amounts of principal is a major characteristic of stock investment trusts in Japan.

The extension in 1977 of the Maruyu privilege, the basic tax exemption for small-lot savings accounts, to stock investment trust funds is said to have marked an epoch in the history of Japan's investment trust system. However, to qualify for this exemption, (i) the fund's objective had to be to secure stable income distributions; (ii) stocks' ratio in the portfolio had to be less than 70%; and (iii) the weight of any one company's shares could not be more than 5%. Stock funds which met these requirements have been the major force in the growth of stock investment trusts and are the mainstay of this category of investment trusts in Japan today. However, the Maruyu tax incentive system was abolished in 1988. A similar tax exemption survives only for certain taxpayers, handicapped persons and senior citizens, under the "Tax Exemption for Senior Citizens' Small Amount Savings" plan.[34]

It may be asked why stock investment trusts have been granted the same favorable treatment regarding taxation as safe and sure savings deposits despite the inherent risk of share price volatility in these stock trusts due to the presence of stocks in their portfolios. In addition to the explanations for taxation of stock fund income distributions as interest income, the following two reasons were offered for the granting of the Maruyu privilege:

> (1) From the outset, the stock investment trust has been a scheme for stock investment by experts on behalf of and for the interest of many inexperienced investors who are the

34. Individual Income Tax Law, Art. 10 (1965); Income Tax Law Enforcement Order, Art. 33 (1965); Income Tax Law Enforcement Regulations, Art. 5 (1965).

beneficiaries in the trust. This characteristic has been accentuated by the increase in the number of small investors who flocked to this type of fund as a result of the introduction of the monthly payment cumulative investment plan. Furthermore, technical sophistication in fund management has advanced in the direction of stability through the introduction of family funds.[35]

(2) Although risk always exists due to stock price volatility, very stable bonds, principal-guaranteed call loans, and certificates of deposits have gradually come to constitute larger and larger shares of the stock funds' portfolios.[36]

Although the Maruyu tax incentive system has been abolished with regard to investment trusts, the savings orientation of unit-type stock funds still exists because of the inclusion of closed periods and the existence of stock price fluctuation reserves. The savings orientation of unit-type stock funds also is maintained through such factors as the licensing of investment trust management companies by the Ministry of Finance and many regulatory provisions.

The savings orientation of Japan's investment trust is not, however, the monopoly of unit-type stock funds. In fact, many bond investment trust funds are comprised of features which function to encourage

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35. Family funds were introduced in 1967 by an amendment to the Securities Investment Trust Law for the improvement of efficiency and consistency in asset management. Family funds are expected to accomplish these goals by allowing the unification of assets management for unit-type funds launched each month. Family funds are composed of a few parent (mother) funds and many subsidiary (baby) funds. Within this framework, mother funds are responsible for concentrated investment, and each baby fund invests in principle only in the beneficiary certificates of the mother fund. This scheme was designed to rectify the weakness of unit-type funds, namely, the fund capital attrition created by the early redemption without replenishment by additional beneficiary certificate sales and the resulting erosion in consistency in fund management. Family funds experienced rapid growth beginning in 1970, but have lost some of their momentum in recent years. This latter fact is due to the reversion by certain funds to independent investment management of each fund which has been stimulated by the phenomenal advances in computer-based asset management control capabilities.

36. INVESTMENT TRUSTS ASSOCIATION OF JAPAN (1990).

PORTFOLIO COMPOSITION OF STOCK INVESTMENT TRUSTS (%)

| | 1951 | 1961 | 1971 | 1981 | 1986 | 1989 |
|---|---|---|---|---|---|---|
| Call Loans, CDs, etc. | 9.4 | 10.6 | 28.2 | 23.6 | 20.8 | 31.7 |
| Bonds | 0.6 | 16.2 | 16.2 | 35.8 | 46.2 | 18.8 |
| Stocks | 90.0 | 73.2 | 55.6 | 40.6 | 33.0 | 49.5 |

savings by the Japanese citizenry. Long-term bond investment trust funds were introduced in 1961, ten years later than stock funds, and were the first bond investment trusts in Japan. These bond funds are of the supplementary-funding type, not unit-type. Long-term bond investment trusts operate in a uniquely Japanese way and are different from the typical international open-end bond fund that offers unrestricted purchase and sale opportunities. These long-term bond investment trusts are designed more elaborately than the unit-type stock funds mentioned above and exhibit attributes closer in nature to principal-guaranteed savings and deposit accounts. To achieve this latter quality, these funds utilize the characteristic of bonds that assures par value redemption if the bonds are held to maturity and mitigate bond price volatility through a special design which includes the anticipation of returns, the use of a theoretical valuation method, and the adoption of cumulative investment plans.

In practice, these funds are offered for subscription with an anticipated return set for the first year and an assurance of the maintenance of par value through the theoretical valuation of bonds held in their portfolios. In the case of unlisted bonds purchased in large quantities, valuation is on the basis of costs of these unlisted bonds which are normally lower than the par value of the bonds at purchase with unlisted bonds being subsequently valued in a virtually straight upward slanting line to reach par value at redemption.

Shortly after 1961, long-term bond investment trusts suffered a setback due to a rush of purchases by corporate hot money. At that time, the secondary market for bonds still remained undeveloped making recovery a slow process. However, since recovering from this setback, these funds have been sold exclusively to individuals for cumulative investment purposes. Because of their characteristics regarding management and sales, they have been accorded the same tax incentives as those accorded bank deposits even before these incentives were applied to stock investment trusts. Other tax privileges designed to encourage savings have been made available to these bond funds and others without requiring specific qualifications, setting bond funds apart from stock funds. Bond investment in Japan is generally thought to be difficult and unattractive to the individual investor. This may sound strange, given such characteristics of bond investment as long maturities, payment of a fixed amount of interest, and guaranteed return of capital at redemption. However, these plus factors are offset by such minus factors as large units of transactions, the possibility of capital losses if the bonds are cashed before maturity, meticulous attention required in the selection of issues and in regard to notices of redemption, and relatively burdensome administrative chores including the reception and

redemption of coupon payments. These factors have hampered the use of buying bonds as a means of savings by the general public.

Long-term bond investment trusts have been able to overcome these drawbacks even though their introduction was delayed by ten years mainly because of the immaturity of the bond market. In fact, long-term bond investment trusts opened the way for individuals with small means to invest in public and private bonds. These new instruments of savings have greatly contributed to the formation of diversified asset portfolios held by the general public and have permeated a broad spectrum of the saving populace, this development being aided by the expansion of cumulative investment accounts.[37]

In 1980, medium-term government bond funds were introduced as a new group of supplementary-funding type bond funds. These funds are primarily invested in medium-term government bonds and have a structure featuring a strong savings orientation. These funds also offer various arrangements, such as automatic dividend re-investment and relatively high returns to attract medium-to short-term stable funds.

Sharing many of the features of money market funds (MMF) which triggered a financial revolution in the United States, these funds were welcomed into the Japanese financial market as an epoch-making short-term financial product. Their characteristics are so close to bank

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37. In 1975, government bonds began to be issued in massive quantities. To cope with this situation, the Securities Exchange Council of the Ministry of Finance issued "A Recommendation for the Development of the Bond Market" in October, 1977. In this recommendation, the Council emphasized the need for the removal of controls over the bond market and advocated an open market for bonds and the market's expansion both in breadth and depth through effective competition. From this viewpoint, the recommendation called for improvement in the practice of anticipated returns premised on regulated interest rates as well as in artificial aspects such as the structure of the bond based on theoretical valuation. The Council then expressed the hope that new products would be developed on the basis of more flexible pricing reflective of demand and supply forces in the market and more in line with the trend of liberalization based on secondary market values.

Preceding this recommendation, the Investment Trusts Association noted in an opinion paper issued by the Committee for Research on Bond Investment Trusts and entitled "On Bond Investment Trusts, March, 1977" that "bond investment trusts meet investor needs through stable income distributions based on anticipated investment returns" and "the scheme will be sustainable through an emphasis on cumulative investments in fund sales and on the maintenance of liquidity in asset management." The paper concluded that for these reasons the current bond investment trust system should remain unchanged for the time being.

Today, these two positions, one calling for reform and the other calling for stability in the bond investment trust system, remain side by side with old-type long-term bond investment trusts structured on the basis of anticipated returns and theoretical values while new types are based on variable actual returns and market values.

deposits that they have almost transcended descriptions such as savings orientation and quasi-savings. Offering great liquidity and attractive returns, these funds have a strong competitive edge over rival products of financial institutions whose yields are typically subject to interest rate controls.

The recent introduction of the integrated fund investment account bolsters the competitive edge of medium-term government bond funds. This new account shares many features in common with cash management accounts (CMA) in the United States. It accepts funds through savings accounts opened with many Shinkin Banks for small business (swing service), an arrangement that provides a clearing function for medium-term government bond funds similar to that for savings and deposit accounts. This arrangement enhances the stability and convenience of these funds for the investor. The same effect is also achieved through cooperative ventures between medium-term government bond funds and credit card companies. Therefore, development of the integrated fund investment account represents the advent of a financial service which offers both a clearing function and an investment function in the same package.

Medium-term government bond funds are the largest type of bond investment trusts with approximately five-and-a-half trillion yen in net assets as of January, 1990.[38] Efforts are required to further increase the attractiveness of this type of investment trust in step with the expanding liberalization of short-term interest rates and the development of the short-term open market which lacks core instruments such as short-term treasury bills, as noted by the joint Special Study Group of the Ministry of Finance and the Bank of Japan.

The savings orientation of bond investment trusts can be examined not only in the supplementary-funding types of funds described above but also in unit-type bond investment trusts. The unit- and spot-type bond fund was introduced in 1974. This fund touts a portfolio comprised of high-yielding bonds purchased in the secondary market and complete

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38. TYPES AND SIZES OF BOND INVESTMENT TRUSTS
(Figures are of January 31, 1990 and refer to net asset value of the trusts in billions of yen)

| | |
|---|---|
| (1) Long-Term Bond Investment Trusts | 2,163 |
| (2) Medium-Term Government Bond Funds | 5,534 |
| (3) Free Financial Funds | 196 |
| (4) Others | 4,861 |
| Total Bond Investment Trusts | 12,754 |

INVESTMENT TRUSTS ASSOCIATION OF JAPAN (1991).

closure through the entire trust term, qualities designed to draw even more upon the above-mentioned characteristic of bonds that assures par value redemption if held to maturity.[39] This bond fund relies more upon its product development capability than the asset management expertise of its investment trust management company in terms of its attraction to investors.[40]

The response of Japanese investment trust management companies to this situation has been to offer a wide range of investment products from medium-term government bond funds on the reduced risk side to open-end stock funds which involve elements of price volatility exposure and greater risk exposure. Between these two poles comes the group of unit-type stock funds which today enjoy the greatest popularity and constitute the mainstay of the Japanese investment trust industry.

On the periphery of the mainstay group are funds like the open-end convertible bond fund and many supplementary-funding type investment trusts which offer investors dual discretion: the choice of funds

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39. When this type of fund was introduced in 1974, high-yielding public and corporate debt instruments were floated in quick succession, reflecting the financial tightening then underway. In the secondary market, bonds were traded in very large units since an overwhelming majority of bonds placed in circulation were held by financial institutions and were traded mainly among institutional investors. As a result, individuals with small amounts of money to invest had reduced access to high-yielding bonds. Under these circumstances, the development of the unit- and spot-type bond fund ideally fit the needs of small investors. Complete closure through the entire trust term restricts turnover in its portfolio while encouraging the maintenance of a strong savings orientation with attractive yields.

40. INVESTMENT TRUSTS ASSOCIATION OF JAPAN, SHOKEN TOSHI-SHINTAKU SANJYU-GO-NEN SHI (THE THIRTY-FIVE YEAR HISTORY OF INVESTMENT TRUSTS) (1987).

The development of Japanese investment trusts reflects responses to a great variety of specific socioeconomic events at varying stages in the reconstruction and growth of post-war Japan. Among the many factors which have affected the development of the investment trust industry, one of the more prominent is investment risk preference of the individual Japanese investor. Individual investors in Japan are made up of many different types. Some emphasize capital risk avoidance, stable asset management, and uninterrupted income distribution. Others are drawn to active management for capital gains purposes, while opt for a combination of the two.

In the United States, some individual investors also emphasize preservation of investment capital. This emphasis on preservation of capital has become more pronounced in the U.S. after the stock market collapse of Black Monday of 1987. For example, some long-term variable mutual funds are now trying to accommodate client's growing emphasis on stability by making their performance more predictable and stable even at the cost of somewhat larger expenses and lower returns. These funds are doing this by taking out special insurance policies and getting bank guarantees on bond yields and on the performance of options held in fund portfolios.

exhibiting or promising superior performances and the choice of timing to buy or sell. However, savings-oriented funds still constitute a high percentage of the total amount of funds. This fact raises the question of whether the present composition of investment trusts is the result of uniform trust characteristics, investors' motivation, marketing and subscription activities of securities companies, or a combination of these three factors and others. The answer to this question is not an easy one, but as this Article suggests, all these factors have greatly affected the development of investment trusts in Japan in one way or another.

## IV. INVESTMENT TRUST: CURRENT OUTLOOK AND FUTURE PROSPECTS

Today in Japan, investors should be completely free as a matter of principle in a market economy to choose their financial products or the services of intermediaries. Their choices should ultimately depend not only on their objectives for savings and investment but also on the quantity as well as quality of information they have about financial markets and financial products. This statement in support of investor selection freedom would have been unthinkable both during the years immediately before and after the introduction of the investment trust which took place after the end of World War II and during the years immediately following the securities market depression of 1965.

Today, however, the financial landscape has changed with the Japanese domestic markets growing and maturing each year while at the same time Japanese investors continue to mature. Behind these domestic changes stands the process of the internationalization of securities markets and all the effects which this process creates. Together, the domestic and international changes reflect the need for reexamining in detail the current Japanese investment trust system.

Other countries have responded to these changes in a manner similar to the one called for in this Article. For example, the United States' SEC has recently announced that it is considering revising the Investment Company Act of 1940 so that the Act will better reflect the changed market environment, which includes the internationalization of securities markets. The SEC "seeks comments on how to best facilitate competition between United States investment companies and advisers and foreign investment companies and advisers, both domestically and abroad."[41] Great Britain, through its Financial Services

41. *Supra* note 15. This request is part of a program in which a study group established by the SEC will undertake a comprehensive review of the American mutual

Act of 1986, introduced new forms of investor protection and an open-end style investment company which had been studied for many years before its introduction. In the EC, a move is afoot to liberalize cross-border marketing of investment trusts through the EC's UCITS Directive.

Such developments within other countries and Japan should provide Japanese investment trusts with a stimulus to pursue reforms and changes that will enable them to become more viable and competitive in this rapidly changing world. In other words, these changes raise questions about how each country's investment trust system must develop in order to achieve an appropriate level of international acceptability. Today, this process of adjustment has already begun and will continue for many years to come. In fact, foreign-owned investment trust management companies were recently allowed into the Japanese market.[42] Their entrance and operation will mark the opening of a new era for the investment trust in Japan. Such foreign investment trust management companies which have been onlookers from the outside may once inside be even more puzzled by the uniqueness of Japan's investment trust system.

Japan's investment trusts are broadly divided into the savings-oriented mainstay products of the unit-type stock funds versus all other funds. The unit-type stock funds clearly exhibit insularity in the restriction they place on liquidity through their prohibiting or discouraging trust deeds of prematurity redemption, the semi-open quality of these funds. Does this imply that, as far as Japan is concerned, internationalization or cross-border marketing of investment trusts are to be limited to the narrow area of non-mainstay products? Similarly, since Japanese citizens prefer those investment trusts which feature a savings orientation based on stable returns, any attempt by a non-Japanese investment trust management company to offer investment trusts in Japan without these characteristics may prove futile.[43]

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fund system. This review will focus on how to expedite cross-border marketing and sales of investment trusts and will examine the possibility of the introduction of contract-type investment trusts into the U.S. SEC CHAIRMAN RICHARD BREEDEN'S ADDRESS TO THE GENERAL MEETING OF THE U.S. INVESTMENT COMPANY INSTITUTE (May 10, 1990).

42. REPORT BY THE STUDY GROUP ON INVESTMENT TRUSTS, SECURITIES BUREAU OF THE MINISTRY OF FINANCE (1988). As of January, 1992, four foreign-affiliated financial companies have been approved to get a license to establish investment trust management companies.

43. Nihon Keizai Shinbun, THE JAPAN ECONOMIC JOURNAL (May 5, 1990) (Merrill Lynch reportedly sounding out the Ministry of Finance on the possibility of marketing in Japan a dollar-denominated MMF, a popular saving vehicle in the U.S.).

The non-mainstay products of the Japanese investment trust system are of the open-end type which is widely accepted internationally and which allows the purchase and sale of beneficiary certificates at any time. Thus, the greatest opportunity for international capital flows through or the largest growth potential for Japanese investment trusts might be found in the narrow world of non-mainstay instruments. Does this imply that a large unexplored territory remains before any future cross-border advances can be made by Japanese investment trusts?

Japan's unit-type stock funds are a mass market savings product incorporating many useful ideas and mechanisms. Even though these funds do not provide any legal protection to investors with regard to the preservation of fund capital, they do manifest great efforts for stable investment and initiative through the actions of their management companies as financial intermediaries. On the other hand, stock funds of the supplementary-funding type which are premised on the investors' own responsibility for risk emphasize disclosure commensurate with their inherently risky nature. From an international perspective, both of these types of funds have ample room for refinement. Refinement concerns the basic posture of Japan's investment trusts as to investor protection (particularly, disclosure requirements), the fiduciary duty owed by management companies to investors, and an adequate safety net surrounding investment trusts. The question remains as to how in the future should Japanese investment trusts refine these various elements.

Investment trusts supply funds to the real sector of the domestic economy as well as the international economy through the purchases of primary securities. This function should be continued and expanded in our rapidly changing world where drastic changes have been called for in Japan's domestic economy (i.e., increased public spending and increase in number of imports) and where major recycling of Japanese capital has been called for vis-a-vis the rest of the world. In fact, concerns are being voiced about a shortage of savings on a global scale, and, in this context, Japan is expected to make contributions to the supply of funds available to the poorest and most heavily indebted countries, newly developing countries, and the reforming economies of Eastern Europe.[44]

There is a question as to which direction the mainstay unit-type stock funds and the non-mainstay stock funds of the supplementary-funding type and all types of bond funds should be developed. The question may be answered by looking to the Foreign & Colonial Gov-

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44. INTERNATIONAL MONETARY FUND, WORLD ECONOMIC OUTLOOK (May 1990).

ernment Trust which was launched more than a century ago in Great Britain. This trust offered a fixed long-term yield, and was viewed as the pioneer of investment trusts. Country funds, which generally take shape as closed-end investment companies with their shares listed on stock exchanges, such as New York (for example, the Korean Fund which enjoyed a strong boom for some years in the United States), or as contract-type investment trusts (for example, the Spain Fund which was developed in Japan) provide other possible forms which investment trusts could take in order to address these important issues.

Some might say that we have come to a stage in history where developing and implementing effective programs for the recycling of capital accumulated in Japan to foreign countries requires investment trusts to simultaneously play new roles: specifically, to develop stronger savings orientations and to fine-tune their impact on the capital flows both inside and outside the securities markets of the recipient nations.

The questions raised above provide a brief look into the future of the Japanese investment trust system. These questions are not simple and will have to be examined with close scrutiny for some period of time. One study has been undertaken by the Study Group on Investment Trusts, Securities Bureau of the Ministry of Finance. This group recently released a report which stated:

> Reform efforts should not be limited to the international harmonization of investment trusts but should rather embrace a more down-to-earth reflection of the current system from a broader perspective focusing on how to accommodate mass investors' diverse needs and build an environment which will enable selections on their own initiative.[45]

In specific terms, the Report provides guidelines applicable on such subjects as: (i) diversification of product characteristics and maintenance of stable management (e.g., introduction of prematurity redemption charges to discourage massive redemptions often seen immediately following the end of a closed period); (ii) increase in the number of eligible investment products and relaxation of control over the investment of the trust's cash position; (iii) more thorough overall disclosure and comparison of performance; (iv) stronger independence of (or fulfillment of fiduciary duty by) management companies; (v) improvement in the rules for the marketing of foreign investment trusts in Japan; (vi)

45. REPORT OF THE STUDY GROUP ON INVESTMENT TRUSTS, 5 (1988).

reform of the current Securities Investment Trust Law;[46] and (vii) issues concerning new entries into the investment trust market.[47]

The utility of any guidelines or answers to the questions asked will depend to a large extent upon the views of those who are concerned with the future of the Japanese investment trust industry. Such views may provide the best insight into how the investment trust system must develop and change.[48]

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46. The Report's guidelines for the reform of the Securities Investment Trust Law require specific improvements in disclosure such as securities companies' obligations to provide explanatory statements to prospective certificate subscribers and investment trust management companies' responsibility for damage compensations for misrepresentations and their obligations to file explanatory statements with the Minister of Finance for review (including the Minister's power to order corrections). The Report demands that disclosure be made on levels similar as to those provided for in the Securities Exchange Law.

47. On March 9, 1990, the Investment Trusts Association released an opinion paper entitled "On the Improvements of the Investment Trust System." This paper represented an action program in pursuance of the recommendations proposed in a paper entitled "On the Future Course of Investment Trusts" which was issued in May, 1989, by the Study Group on Investment Trusts, Securities Bureau of the Ministry of Finance. The main part of the Investment Trusts Association's paper concerned the mainstay unit-type stock investment trust funds and proposed: (1) diversification of product orientations; (2) diversification of subscription fees and trust fees; (3) measures for the stabilization of asset management, including revival of withdrawal charges and leveraged asset management: and (4) expansion of disclosure regarding fund structures and performances.

48. Japan's investment trusts have come to a stage where the traditional Japanese paradigm should be transcended for further growth and development. They are very unique by international standards and so need basic reform in many respects to be accepted as internationally viable financial products. The present system is the product of many years of development. As such, it suits the purposes fairly well with no particular complaints lodged from investors. In this sense, reform may not be an urgent necessity. Nevertheless, since no financial products without universal compatibility can be expected to attain a meaningful position in the days ahead, these basic problems must be addressed seriously from every conceivable angle.

TOSHIYASU ASAO, FORMER CHAIRMAN OF THE INVESTMENT TRUSTS ASSOCIATION OF JAPAN (Interview for a special column on the announcement by the Ministry of Finance on the problem of new entry into the investment trust market), THE REPORT OF THE STUDY GROUP ON INVESTMENT TRUSTS, *Kinyu Zaisei Jijo* (June 19, 1989).

# Recent Chinese Tax Legislation Affecting Foreign Investment in China

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In April 1991, the National People's Congress of China passed the "Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment[1] and Foreign Enterprises"[2] (Foreign Investment Tax Law). At the same time, the National People's Congress repealed the "Income Tax Law of the People's Republic of China Concerning Joint Ventures with Chinese and Foreign Investment" (Joint Venture Income Tax Law)[3] and the "Income Tax Law of the People's Republic of China Concerning Foreign Enterprises" (Foreign Enterprise Income Tax Law).[4] The new tax law became effective on July 1, 1991, and marked a major step in China's effort to further simplify the tax system affecting foreign investment and to improve the foreign investment climate as a whole. This Article briefly reviews

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1. "Enterprises with foreign investment" refers to Chinese-Foreign Joint Ventures, both equity and contractual, and to Wholly-Foreign Owned Enterprises incorporated in China. INCOME TAX LAW OF THE PEOPLES REPUBLIC OF CHINA FOR ENTERPRISES WITH FOREIGN INVESTMENT AND FOREIGN ENTERPRISES, art. 2 (1991) (*see* appendix) [hereinafter FOREIGN INVESTMENT TAX LAW].

2. "Foreign enterprises" are defined as foreign companies, enterprises and other economic organizations which engage in production or business through their establishments in China, and those which do not have establishments in China but derive income from sources within China. *Id.*

3. THE INCOME TAX LAW OF THE PEOPLES REPUBLIC OF CHINA CONCERNING JOINT VENTURES WITH CHINESE AND FOREIGN INVESTMENT (1980) (repealed 1991), *reprinted in* PRICE WATERHOUSE, DOING BUSINESS IN THE PEOPLES REPUBLIC OF CHINA 175-77 (1988) [hereinafter JOINT VENTURE INCOME TAX LAW]; DETAILED RULES AND REGULATIONS FOR THE IMPLEMENTATION OF THE INCOME TAX LAW OF THE PEOPLES REPUBLIC OF CHINA CONCERNING JOINT VENTURES WITH CHINESE AND FOREIGN INVESTMENT (1980) (repealed 1991), *reprinted in* PRICE WATERHOUSE, *supra*, at 178-86 [hereinafter JOINT VENTURE INCOME TAX REGULATIONS].

4. THE INCOME TAX LAW OF THE PEOPLES REPUBLIC OF CHINA CONCERNING FOREIGN ENTERPRISES (1981) (repealed 1991), *reprinted in* PRICE WATERHOUSE, *supra* note 3, at 187-90 [hereinafter FOREIGN ENTERPRISE INCOME TAX LAW]; UNOFFICIAL TRANSLATION OF THE DETAILED REGULATIONS FOR THE IMPLEMENTATION OF THE FOREIGN ENTERPRISE INCOME TAX LAW (1982) (repealed 1991), *reprinted in* PRICE WATERHOUSE, *supra* note 3, at 191-201 [hereinafter FOREIGN ENTERPRISE INCOME TAX REGULATIONS].

the historical background of the Chinese income tax system, distinguishes the old and new law, outlines the major changes brought about by the new legislation, analyzes the policy considerations behind the new legislation, and finally considers some practical implications for a hypothetical investor.

## I. HISTORICAL BACKGROUND

China did not impose income taxes on business enterprises until 1978 when China began a series of economic reforms. The first income tax laws affected only collectively-owned enterprises and state-owned enterprises. Then in the early 1980's, China promulgated the Joint Venture Income Tax Law and the Foreign Enterprise Income Tax Law, both of which affected foreign investment in China. As a result of these laws, a dual tax system emerged in China that continues to exist today. Under this dual tax system, Chinese enterprises whose investments are limited to the domestic market are subject to one set of tax rules, while foreign corporations and "Enterprises with Foreign Investment" are governed by another set of tax rules.

Prior to July 1, 1991, there were also two corporate income tax laws affecting foreign investment in China. The Joint Venture Income Tax Law governed taxation of Chinese-Foreign Equity Joint Ventures (Equity Joint Ventures); whereas, the Foreign Enterprise Income Tax Law applied to Chinese-Foreign Contractual Joint Ventures (Contractual Joint Ventures) and to foreign companies doing business in China, whether or not through establishments there. Although these two income tax laws had many common provisions, they differed in scope of tax jurisdiction, rate structure, and tax incentive schemes.

## II. PRIOR LAW

### A. *Joint Venture Income Tax Law*

The Joint Venture Income Tax Law applied only to Equity Joint Ventures. Tax was assessed on the worldwide income of the Equity Joint Venture at a basic tax rate of 30% of taxable income. In addition, a local (provincial) surtax of 10% of the basic tax rate, or 3% of taxable income, was sometimes assessed.[5] The local surtax, when cou-

5. Local governments had authority to waive the local surtax, and, in competing for foreign investment, frequently did. *See* JOINT VENTURE INCOME TAX REGULATIONS, *supra* note 3, at art. 3.

pled with the basic rate, thus raised the overall effective tax rate to 33%. Furthermore, a 10% withholding tax was imposed if a foreign investor repatriated his profits from the Equity Joint Venture. However, if the foreign investor reinvested his earnings in China for at least five years, he was entitled to a tax refund of 40% of the income tax paid on his share of income.[6]

An Equity Joint Venture, which expected to operate in China for ten years or more, could apply to the tax authorities for exemption from national income tax in the first two profit-making years[7] and for a 50% reduction in national income tax in the subsequent three years.[8] In addition, such a joint venture could, upon approval by the Ministry of Finance, be allowed a further discretionary tax credit of 15 to 30%.[9]

### B. *Foreign Enterprise Income Tax Law*

The Foreign Enterprise Income Tax Law applied to Wholly-Foreign Owned Enterprises, to Contractual Joint Ventures, and to foreign companies doing business in China whether or not through establishments situated in China. The term "establishments" in the regulations referred to organizations, places, or business agents of the foreign company operating in China in one of the following forms: (a) management office; (b) branch; (c) representative office; (d) factory; (e) location where natural resources are being exploited; (f) location where contractual projects for construction, installation, assembly and exploration are based.[10]

Under the Foreign Enterprise Income Tax Law, foreign companies with an establishment in China were taxed differently from those without an establishment in China. An example of a foreign company lacking an establishment in China would be a U.S. corporation that had no Chinese office, but transfered technology to China. Foreign companies without an establishment, but with income such as interest, dividends, and/or royalties, were subject to a flat 20% withholding tax. The tax

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6. *Id.* at art. 6.

7. The "first profit making year" was defined in the regulations as the year in which a joint venture recognized profits after the accumulated operating losses from prior years had been used up. *Id.* at art. 5.

8. JOINT VENTURE INCOME TAX LAW, *supra* note 3, at art. 5.

9. *Id.* (discretionary tax credits were available for up to 10 years to joint ventures which engaged in such low-profit operations as farming and forestry, or which were located in remote, economically underdeveloped areas of China).

10. FOREIGN ENTERPRISE INCOME TAX REGULATIONS, *supra* note 4, at art. 2.

base was the gross amount received by such corporations from a source within China.

Foreign companies with an establishment in China were taxed as nonresident companies. They were thus subject to Chinese income tax only on their income from production, business operations, and other sources within China. The tax rate for these companies was progressive, ranging from 20 to 40%. The tax rate was as follows:[11]

| Amount of Annual Taxable Income in RMB[12] | Tax Rate |
|---|---|
| 250,000 or less | 20% |
| 250,000 to 500,000 | 25% |
| 500,000 to 750,000 | 30% |
| 750,000 to 1,000,000 | 35% |
| Over 1,000,000 | 40% |

In addition to this tax, a local surtax of 10% of taxable income was sometimes assessed.[13] The local surtax could be reduced or waived altogether at the discretion of the local government if the foreign company was engaged in a small or low-profit operation in China. However, if the local surtax was not reduced or waived, the effective tax rate would be 10% higher than the basic income tax rate. For instance, if the applicable income tax rate was 20%, the effective rate would be 30%.

A foreign company scheduled to operate in agriculture, forestry, animal husbandry, or other low-profit industries for ten years or more could apply to the tax authorities for exemption from national income tax in the first profit-making year[14] and for a 50% national income tax reduction in the second and third profit-making years.[15] After the period referred to above, the Ministry of Finance could authorize such a low-profit industry an additional tax credit of 15 to 30% for a period of ten years.[16]

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11. FOREIGN ENTERPRISE INCOME TAX LAW, *supra* note 4, at art. 3.

12. Renminbi (RMB) is the Chinese currency, sometimes called Yuan. One U.S. dollar equals approximately 5.29 RMB as of December 31, 1991.

13. FOREIGN ENTERPRISE INCOME TAX LAW, *supra* note 4, at art. 4; *see also supra* note 5 and accompanying text.

14. The "first profit-making year" is the year in which a foreign enterprise recognized profits after the accumulated operating losses from prior years had been absorbed.

15. FOREIGN ENTERPRISE INCOME TAX LAW, *supra* note 4, at art. 5.

16. *Id.*

## III. MAJOR CHANGES UNDER THE FOREIGN INVESTMENT TAX LAW

The new tax law[17] effectively combines the Joint Venture Income Tax Law with the Foreign Enterprise Income Tax Law and brings about several important changes. First, the new law imposes a flat tax rate of 33% for all "Enterprises with Foreign Investment" and for foreign companies doing business in China through their establishments there.[18] Under the new law, Contractual Joint Ventures, Wholly Foreign-Owned Enterprises and foreign companies doing business in China through their establishments are no longer subject to a progressive rate of 30 to 50%.[19] Instead, they are subject to income tax at a rate of 33%, regardless of the amount of their annual taxable income.[20] Consequently, the effective tax burden for enterprises other than Equity Joint Ventures will be either higher or lower than before. Most "Enterprises with Foreign Investment" can expect a decrease of tax burden of up to 17%. However, the tax burden of those with an annual taxable income of 250,000 RMB or less will be increased by at least 3%.

Second, the new law restructures tax incentive schemes under the prior law and codifies tax incentives found in previous administrative regulations. In doing so, the new law provides the same tax incentives for all "Enterprises with Foreign Investment." The law now limits tax incentives to manufacturing concerns, enterprises in Special Economic Zones and other enterprises in designated foreign investment areas.[21] For instance, the new law provides that all "Enterprises with Foreign Investment," which engage in any manufacturing and agree to operate for at least ten years, shall be exempt from income tax altogether for the first two profit-making years and will then be allowed a 50%

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17. *See supra* note 1 and accompanying text.

18. FOREIGN INVESTMENT TAX LAW, *supra* note 1, at art. 5. (This includes the 3% local surtax which goes to the local government. As under prior law, the local surtax can be waived by the local government).

19. FOREIGN ENTERPRISE INCOME TAX LAW, *supra* note 4, at art. 3-4. (This includes the 10% local surtax which could be imposed by local [provincial] governments under the prior tax law.).

20. "Enterprises with Foreign Investment" established in Special Economic Zones and other designated foreign investment zones may be subject to national income tax at a reduced rate of 15 or 24%. *See generally* FOREIGN INVESTMENT TAX LAW, *supra* note 1, at art. 7.

21. Special Economic Zones are geographic regions targeted by the Chinese government for foreign investment. The Chinese government provides special investment incentives to enterprises in Special Economic Zones and in other designated foreign investment zones. *See generally* PRICE WATERHOUSE, *supra* note 3, at 54-55.

reduction in the national income tax for the next three years.[22]

Third, the new law sets forth a new standard for determining whether a company is a resident or nonresident for tax purposes. Under the prior law, only Equity Joint Ventures were tax residents and subject to taxation on worldwide income. The new law, however, provides that any enterprise with a head office in China is a resident of China for tax purposes and hence subject to Chinese income tax on its worldwide income.[23]

Fourth, the new law repeals the 10% withholding tax imposed under prior law on outgoing dividends of Equity Joint Ventures.[24] Lastly, the new law introduces anti-tax evasion provisions. It authorizes the tax authorities to make reasonable adjustments if a transaction between affiliated companies is not made at arms length.[25] Further it imposes, in cases of tax evasion, fines of up to 500% of the amount due and/or criminal penalties.[26]

## IV. POLICY CONSIDERATIONS BEHIND THE NEW TAX LEGISLATION

In spite of its adherence to the socialist system, China is eager to absorb foreign investment. Over the past ten years, China has put in place considerable legislation affecting foreign investment. However, the legislation was piecemeal and resulted in some inconsistencies and a lack of coordination among various laws. In part, this prompted the new tax legislation.

The prior tax law was promulgated at a time when the Chinese-Foreign Joint Venture Law was the only corporate law governing foreign investment in China. Under that law, only Equity Joint Ventures were considered to be legal entities incorporated in China, and thus only

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22. This changes prior tax law under which only Equity Joint Ventures were eligible for a two-year tax exemption and an additional three-year 50% tax reduction. Under the new law, all "Enterprises with Foreign Investment" are eligible for the above-mentioned tax exemption and reduction. However, the new law limits eligibility to manufacturing concerns. *See* FOREIGN INVESTMENT TAX LAW, *supra* note 1, at art. 8.

23. Prior tax law did not contemplate taxation of the worldwide income of Wholly-Foreign Owned Enterprises or Contractual Joint Ventures which had head offices in China. The new law streamlines the tax jurisdiction and puts Chinese domestic law in line with the new corporate law system and the provisions of tax treaties that China has with foreign countries. *See generally* FOREIGN ENTERPRISE INCOME TAX LAW, *supra* note 4, at art. 1; FOREIGN INVESTMENT TAX LAW, *supra* note 1, at art. 3.

24. *See* FOREIGN INVESTMENT TAX LAW, *supra* note 1, at art. 19.

25. *Id.* at art. 13.

26. *Id.* at art. 25.

they were taxed on worldwide income. However, after the promulgation of the Wholly-Foreign Owned Enterprise Law[27] and the Chinese-Foreign Contractual Joint Venture Law, the prior tax law could no longer cope with the new corporation law system.

Under the Wholly-Foreign Owned Enterprise Law and the Contractual Joint Venture Law, "Wholly-Foreign Owned Enterprises" (Foreign Enterprises) and Contractual Joint Ventures, which are incorporated in China, are considered Chinese legal entities having their head office in China. Thus, they should be treated as resident companies and taxed on worldwide income. Accordingly, the new tax law provides that Foreign Enterprises and Contractual Joint Ventures shall be taxed on worldwide income.

The other major moving force behind the new tax legislation was the elimination of the disparate tax treatment of different forms of foreign investment. This disparity was created by the distinct rate structure and tax incentive schemes contained in prior tax laws. Under prior law, Equity Joint Ventures were subject to income tax at a maximum rate of 33%, while Foreign Enterprises and Contractual Joint Ventures were subject to income tax at progressive rates of up to 50%. Moreover, Equity Joint Ventures enjoyed greater tax benefits than the other business forms regardless of the nature of business conducted in China. These disparities in effect created artificial constraints on an investor's choice of business form in China, constraints which were not particularly beneficial to the investor or the Chinese government.

It is reasonable to assume that the Chinese government believed its tax rates, when compared to those of its Asian Rim neighbors, were too high to compete effectively for foreign investment. Chinese officials also came to the realization that tax incentive systems must be both industry-oriented and region-oriented. This overhaul of how China will tax foreign investment is seen in China as a key component of China's emerging foreign investment policy.

## V. PRACTICAL IMPLICATIONS

The recent Chinese tax legislation has a significant impact on contemplated foreign investment in China. With its single tax rate and streamlined tax incentive schemes, it allows foreign investors greater flexibility in choosing their form of business. Investors no longer need

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27. THE LAW OF THE PEOPLES REPUBLIC OF CHINA ON ENTERPRISES OPERATING EXCLUSIVELY WITH FOREIGN CAPITAL (1986), *reprinted in* PRICE WATERHOUSE, *supra* note 3, at 203-06.

to take into account different tax rates applicable to different business entities, unless they expect to derive an annual taxable income of 250,000 RMB or less.[28] The focus is now where to invest and in what projects to invest in order to get the best tax incentives.

One example will illustrate how China's new tax law might influence a typical investor's decisions. Company A, a U.S. meter equipment manufacturer, desires to set up a plant in China to manufacture meter equipment and export more than 70% of its products to Asian Rim countries and back to the United States. Company A agrees to maintain its investment in China for ten years. All other things being equal, Company A should choose to incorporate a subsidiary in China and locate its subsidiary in one of the Special Economic Zones. In doing so, Company A maximizes its tax benefits. By being in a Special Economic Zone, Company A's subsidiary will be subject to only 15% national income tax[29] and 3% local surtax. If it exports more than 70% in a tax year, the subsidiary is subject to only 10% national income tax.[30] Furthermore, assuming the local government agrees to waive the local surtax, the subsidiary will be entirely exempt from income tax in its first two profit-making years by virtue of agreeing to maintain a manufacturing concern for ten years.[31]

## VI. CONCLUSION

The recent Chinese legislation affecting foreign investment is of far-reaching significance. It will direct foreign investment to locations and projects China desires. At the same time, it will enable foreign investors to choose forms of business without concern for disparate tax treatment.

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28. *See supra* tax table and local surtax explanation at p. 4. (Under the prior Foreign Enterprise Income Tax Law, "Enterprises with Foreign Investment," other than Equity Joint Ventures, were subject to income tax at progressive rates of up to 50%.).

29. FOREIGN INVESTMENT TAX LAW, *supra* note 1, at art. 7.

30. DETAILED REGULATIONS FOR THE IMPLEMENTATION OF THE INCOME TAX LAW OF THE PEOPLES REPUBLIC OF CHINA FOR ENTERPRISES WITH FOREIGN INVESTMENT AND FOREIGN ENTERPRISES, art. 75, ¶ 7 (1991) (Chinese text on file with author). English translation will be reprinted in PRICE WATERHOUSE, DOING BUSINESS IN THE PEOPLE'S REPUBLIC OF CHINA (forthcoming 1992).

31. FOREIGN INVESTMENT TAX LAW, *supra* note 1, at art. 8.

# Appendix

## INCOME TAX LAW OF THE PEOPLE'S REPUBLIC OF CHINA FOR ENTERPRISES WITH FOREIGN INVESTMENT AND FOREIGN ENTERPRISES

(Author's Unofficial Translation)

*Article 1:* Income tax shall be paid in accordance with the provisions of this Law by enterprises with foreign investment within the territory of the People's Republic of China on their income derived from production, business operations and other sources.

Income tax shall be paid in accordance with the provisions of this Law by foreign enterprises on their income derived from production, business operations and other sources within the territory of the People's Republic of China.

*Article 2:* "Enterprises with foreign investment" referred to in this Law means Chinese-foreign equity joint ventures, Chinese-foreign contractual joint ventures and foreign-capital enterprises that are established in China.

"Foreign enterprises" referred to in this Law means foreign companies, enterprises and other economic organizations which have establishments or places in China and engage in production or business operations, and which, though without establishments or places in China, have income from sources within China.

*Article 3:* Any enterprise with foreign investment which establishes its head office in China shall pay its income tax on its income derived from sources inside and outside China. Any foreign enterprise shall pay its income tax on its income derived from sources within China.

*Article 4:* The taxable income of an enterprise with foreign investment and an establishment or a place set up in China to engage in production or business operations by a foreign enterprise, shall be the amount remaining from its gross income in a tax year after the cost, expenses and losses have been deducted.

*Article 5:* The income tax on enterprises with foreign investment and the income tax which shall be paid by foreign enterprises on the income of their establishments or places set up in China to engage in production or business operations shall be computed on the taxable income at the rate of thirty percent, and a local income tax shall be

computed on the taxable income at the rate of three percent.

*Article 6:* The state shall, in accordance with the industrial policies, guide the orientation of foreign investment and encourage the establishment of enterprises with foreign investment which adopt advanced technology and equipment and export all or greater part of their products.

*Article 7:* The income tax on enterprises with foreign investment established in Special Economic Zones, foreign enterprises which have establishments or places in Special Economic Zones engaged in production or business operations, and enterprises with foreign investment of a production nature in Economic and Technological Development Zones, shall be levied at the reduced rate of fifteen percent.

The income tax on enterprises with foreign investment of a production nature established in coastal economic open zones or in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located, shall be levied at the reduced rate of twenty-four percent.

The income tax on enterprises with foreign investment in coastal economic open zones, in the old urban districts of cities where the Special Economic Zones or the Economic and Technological Development Zones are located or in other regions defined by the State Council, within the scope of energy, communications, harbour, wharf or other projects encouraged by the state, may be levied at the reduced rate of fifteen percent. The specific rules shall be regulated by the State Council.

*Article 8:* Any enterprise with foreign investment of a production nature scheduled to operate for a period of not less than ten years shall, from the year beginning to make profit, be exempted from income tax in the first and second years and allowed a fifty percent reduction in the third to fifth years. However, the income tax exemption or reduction for enterprises with foreign investment engaged in the exploitation of resources such as petroleum, natural gas, rare metals, and precious metals shall be regulated separately by the State Council. Enterprises with foreign investment which actually operate for a period less than ten years, shall repay the amount of income tax exempted or reduced.

The relevant regulations, promulgated by the State Council before the entry into force of this Law, which provide preferential treatment of exemption from or reduction of income tax on enterprises engaged in energy, communications, harbour, wharf and other major projects

of a production nature for a period longer than that specified in the preceding paragraph, or which provide preferential treatment of exemption from or reduction of income tax on enterprises engaged in major projects of a non-production nature, shall remain applicable after this Law enters into force.

Any enterprise with foreign investment which is engaged in agriculture, forestry or animal husbandry and any other enterprise with foreign investment which is established in remote underdeveloped areas may, upon approval by the competent department for tax affairs under the State Council of an application filed by the enterprise, be allowed a fifteen to thirty percent reduction of the amount of income tax payable for a period of another ten years following the expiration of the period for tax exemption and reduction as provided for in the preceding two paragraphs.

After this Law enters into force, any modification to the provisions of the preceding three paragraphs of this Article on the exemption or reduction of income tax on enterprises shall be submitted by the State Council to the Standing Committee of the National People's Congress for decision.

*Article 9:* The exemption or reduction of local income tax on any enterprise with foreign investment which operates in an industry or undertakes a project encouraged by the state shall, in accordance with the actual situation, be at the discretion of the people's government of the province, autonomous region or municipality directly under the Central Government.

*Article 10:* Any foreign investor of an enterprise with foreign investment which reinvests its share of profit obtained from the enterprise directly into that enterprise by increasing its capital, or uses the profit as capital investment to establish other enterprises with foreign investment to operate for a period of not less than five years shall, upon approval by the tax authorities of an application filed by the investor, be refunded forty percent of the income tax already paid on the reinvested amount. Where other preferential provisions are provided by the State Council, such provisions shall apply. If the investor withdraws its reinvestment before the expiration of a period of five years, it shall repay the refunded tax.

*Article 11:* Losses incurred in a tax year by any enterprise with foreign investment and by an establishment or a place set up in China by a foreign enterprise to engage in production or business operations may be made up by the income of the following tax year. Should the

income of the following tax year be insufficient to make up for the said losses, the balance may be made up by its income of the further subsequent year, and so on, over a period not exceeding five years.

*Article 12:* Any enterprise with foreign investment shall be allowed, when filing a consolidated income tax return, to deduct from the amount of tax payable the foreign income tax already paid abroad in respect of the income derived from sources outside China. The deductible amount shall, however, not exceed the amount of income tax otherwise payable under this Law in respect of the income derived from sources outside China.

*Article 13:* The payment or receipt of charges or fees in business transactions between an enterprise with foreign investment, or an establishment or a place set up in China by a foreign enterprise to engage in production or business operations, and its associated enterprises, shall be made in the same manner as the payment or receipt of charges or fees in business transactions between independent enterprises. Where the payment or receipt of charges or fees is not made in the same manner as in business transactions between independent enterprises and results in a reduction of the taxable income, the tax authorities shall have the right to make reasonable adjustments.

*Article 14:* Where an enterprise with foreign investment or an establishment or a place set up in China by a foreign enterprise to engage in production or business operations is established, moves to a new site, merges with another enterprise, breaks up, winds up or makes a change in any of the main entries of registration, it shall present the relevant documents to and go through tax registration with, the local tax authorities after the relevant event is registered with or a change or cancellation in registration is made by the administrative agency for industry and commerce.

*Article 15:* Income tax on enterprises and local income tax shall be computed on an annual basis and paid in advance in quarterly installments. Such payments shall be made within fifteen days from the end of each quarter and the final settlement shall be made within five months from the end of each tax year. Any excess payment shall be refunded and any deficiency shall be repaid.

*Article 16:* Any enterprise with foreign investment and any establishment or place set up in China by a foreign enterprise to engage in production or business operations shall file its quarterly provisional

income tax return in respect of advance payments with the local tax authorities within the period of advance payments of tax, and it shall file an annual income tax return together with the final accounting statements within four months from the end of the tax year.

*Article 17:* Any enterprise with the foreign investment and any establishment or place set up in China by a foreign enterprise to engage in production or business operations shall submit its financial and accounting systems to the local tax authorities for reference. All accounting records must be complete and accurate, with legitimate vouchers as the basis for entries.

If the financial and accounting bases adopted by an enterprise with foreign investment and an establishment or a place set up in China by a foreign enterprise to engage in production or business operations contradict the relevant tax provisions of the State Council, tax payment shall be computed in accordance with the relevant tax provisions of the State Council.

*Article 18:* When any enterprise with foreign investment goes into liquidation, and if the balance of its net assets or the balance of its remaining property after deduction of the enterprise's undistributed profit, various funds and liquidation expenses exceeds the enterprise's paid-in capital, the excess portion shall be liquidation income on which income tax shall be paid in accordance with the provisions of this Law.

*Article 19:* Any foreign enterprise which has no establishment or place in China but derives profit, interest, rental, royalty and other income from sources in China, or though it has an establishment or place in China, the said income is not effectively connected with such establishment or place shall pay an income tax of twenty percent on such income.

For the payment of income tax in accordance with the provisions of the preceding paragraph, the income beneficiary shall be the taxpayer and the payor shall be the withholding agent. The tax shall be withheld from the amount of each payment by the payor. The withholding agent shall, within five days, turn the amount of taxes withheld on each payment over to the State Treasury and submit a withholding income tax return to the local tax authorities.

Income tax shall be reduced or exempted on the following income:

(1) The profit derived by a foreign investor from an enterprise with foreign investment shall be exempted from income tax;

(2) Income from interest on loans made to the Chinese government or Chinese state banks by international financial organizations shall be exempted from income tax;
(3) Income from interest on loans made at a preferential interest rate to Chinese state banks by foreign banks shall be exempted from income tax; and
(4) Income tax of the royalty received from the supply of technical know-how in scientific research, exploitation of energy resources, development of the communications industries, agricultural, forestry and animal husbandry production, and the development of important technologies may, upon approval by the competent department for tax affairs under the State Council, be levied at the reduced rate of ten percent. Where the technology supplied is advanced or the terms are preferential, exemption from income tax may be allowed.

Where the preferential treatment of reduction and exemption of income tax on profit, interest, rental, royalty and other income other than those provided for in this Article is required, it shall be regulated by the State Council.

*Article 20:* The tax authorities shall have the right to inspect the financial, accounting and tax affairs of enterprises with foreign investment and establishments or places set up in China by foreign enterprises to engage in production or business operations, and have the right to inspect tax withholding of the withholding agent and its payment of the withheld tax into the State Treasury. The entities inspected must report the facts and provide relevant information. They may not refuse to report or conceal any facts.

When making an inspection, the tax officials shall produce their identity documents and be responsible for confidentiality.

*Article 21:* Income tax payable according to this Law shall be computed in terms of Renminbi (RMB). Income in foreign currency shall be converted into Renminbi according to the exchange rate quoted by the state exchange control authorities for purposes of tax payment.

*Article 22:* If any taxpayer fails to pay tax within the prescribed time limit, or if the withholding agent fails to turn over the tax withheld within the prescribed time limit, the tax authorities shall, in addition to setting a new time limit for tax payment, impose a surcharge for overdue payment, equal to 0.2 percent of the overdue tax for each day in arrears, starting from the first day the payment becomes overdue.

*Article 23:* The tax authorities shall set a new time limit for registration or submission of documents and may impose a fine of five thousand yuan or less on any taxpayer or withholding agent which fails to go through tax registration or make a change or cancellation in registration with the tax authorities within the prescribed time limit, fails to submit income tax return, final accounting statements or withholding income tax return to the tax authorities within the prescribed time limit, or fails to submit its financial and accounting systems to the tax authorities for reference.

Where the tax authorities have set a new time limit for registration or submission of documents, they shall impose a fine of ten thousand yuan or less on the taxpayer or withholding agent which again fails to meet the time limit for going through registration or making a change in registration with the tax authorities, or for submitting income tax return, final accounting statements or withholding income tax return to the tax authorities. Where the circumstances are serious, the legal representative and the person directly responsible shall be prosecuted for their criminal liability, by applying mutatis mutandis the provisions of Article 121 of the Criminal Law.

*Article 24:* Where the withholding agent fails to fulfil its obligation to withhold tax as provided in this Law, and does not withhold or withholds an amount less than that should have been withheld, the tax authorities shall set a time limit for the payment of the amount of tax that should have been withheld, and may impose a fine up to but not exceeding 100 percent of the amount of tax that should have been withheld.

Where the withholding agent fails to turn the tax withheld over to the State Treasury within the prescribed time limit, the tax authorities shall set a time limit for turning over the taxes and may impose a fine of five thousand yuan or less on the withholding agent; if the withholding agent fails to meet the time limit again, the tax authorities shall pursue the taxes according to law and may impose a fine of ten thousand yuan or less on the withholding agent. If the circumstances are serious, the legal representative and the person directly responsible shall be prosecuted for their criminal liability by applying mutatis mutandis the provisions of Article 121 of the Criminal Law.

*Article 25:* Where any person evades tax by deception or concealment or fails to pay tax within the time limit prescribed by this Law and, after the tax authorities pursued the payment of tax, fails again to pay it within the prescribed time limit, the tax authorities shall, in

addition to recovering the tax which should have been paid, impose a fine up to but not exceeding five hundred percent of the amount of tax which should have been paid. Where the circumstances are serious, the legal representative and the person directly responsible shall be prosecuted for their criminal liability by applying the provisions of Article 121 of the Criminal Law.

*Article 26:* Any enterprise with foreign investment, foreign enterprise or withholding agent, in case of a dispute with the tax authorities on payment of tax, must pay tax according to the relevant regulations first. Thereafter, the taxpayer or withholding agent may, within sixty days from the date of receipt of the tax payment certificate issued by the tax authorities, apply to the tax authorities at the next higher level for reconsideration. The higher tax authorities shall make a decision within sixty days after receipt of the application for reconsideration. If the taxpayer or withholding agent is not satisfied with the decision, it may institute legal proceedings in the people's court within fifteen days from the date of receipt of the notification on decision made after reconsideration.

If the party concerned is not satisfied with the decision on punishment by the tax authorities, it may, within fifteen days from the date of receipt of the notification on punishment, apply for reconsideration to the tax authorities at the next higher level than that which made the decision on punishment. Where the party is not satisfied with the decision made after reconsideration, it may institute legal proceedings in the people's court within fifteen days from the date of receipt of the decision made after reconsideration. The party concerned may, however, directly institute legal proceedings in the people's court within fifteen days from the date of receipt of the notification on punishment. If the party concerned does not apply for reconsideration to the higher tax authorities or institute legal proceedings in the people's court within the time limit, and if the decision on punishment is not fulfilled, the tax authorities which made the decision on punishment may apply to the people's court for compulsory execution.

*Article 27:* Where any enterprise with foreign investment which was established before the promulgation of this Law would, in accordance with the provisions of this Law, otherwise be subject to higher tax rates or enjoy less preferential treatment of tax exemption or reduction than before the entry into force of this Law, in respect to such enterprise, within its approved period of operation, the Law and relevant regulations of the State Council in effect before the entry into force of this

Law shall apply. If any such enterprise has no approved period of operation, the laws and relevant regulations of the State Council in effect before the entry into force of this Law shall apply within the period prescribed by the State Council. Specific rules shall be regulated by the State Council.

*Article 28:* Where the provisions of the tax agreements concluded between the government of the People's Republic of China and foreign governments are different from the provisions of this Law, the provisions of the agreements shall apply.

*Article 29:* Rules for implementation shall be formulated by the State Council in accordance with this Law.

*Article 30:* This Law shall enter into force on July 1, 1991. This Income Tax Law of the People's Republic of China for Chinese-Foreign Equity Joint Ventures and the Income Tax Law of the People's Republic of China for Foreign Enterprises shall be annulled on the same date.

# Does the United States Need an Official Language?: The Examples of Belgium and Canada

## I. Introduction

Language is the essential medium of expression upon which all cultures depend. Most peoples and cultures do not willingly accept intrusion upon their rights to use their native language. At the same time, most nations in the world are composed of more than one language group,[1] and many, including the United States, have experienced conflict between groups. The current conflict in the United States is between those wishing to ensure the continued dominance of English and those linguistic minorities who desire to retain basic legal rights in their native tongues.

This Note will first examine current language policy in the United States in the areas of civil rights, education, voting rights, and employment. Following a review of the controversy surrounding the prospective designation of an official language in the United States, this Note will compare language policy in the United States with the policies developed in the two nations best known for the resolution of their significant language conflicts, Belgium and Canada.

## II. Current Linguistic Problems in the United States

While the United States has long envisioned itself as a melting pot of immigrants from varying ethnic and cultural backgrounds,[2] this vision of unity has been widely reexamined in recent years. Recent immigrants are perceived as less willing to abandon their native lan-

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1. J.A. Laponce, Languages and Their Territories 95 (1987).

2. For a discussion of the history of linguistic groups and assimilation in the United States, *see* Edward Sagarin & Robert J. Kelly, *Polylingualism in the United States of America: A Multitude of Tongues Amid a Monolingual Majority*, *in* Language Policy and National Unity 20, 36-37 (William R. Beer & James E. Jacob eds., 1985) [hereinafter Language Policy]; *see generally* Bill Piatt, Only English?: Law and Language Policy in the United States 26 (1990); Harvey A. Daniels, *The Roots of Language Protectionism*, *in* Not Only English: Affirming America's Multilingual Heritage 3-4 (Harvey A. Daniels ed., 1990) [hereinafter Not Only English]; Dennis Baron, The English-Only Question 8 (1990).

guages in order to assimilate into mainstream American culture.[3] The reaction has been a widespread call for restricting the use of languages other than English.[4]

Critics of language initiatives contend that laws restricting the use of languages other than English in public notices or in the extension of public services will impair access to these services by members of minority language groups with limited English skills.[5] Language restriction legislation has also been criticized as discriminatory because it can create barriers to the exercise of such rights as voting and education.[6] The issue of an official language for the United States evokes great passion from both sides. Both sides fear disenfranchisement, alienation, and discrimination on the basis of the language they speak. Both sides are concerned with language maintenance, but differ as to what sacrifices this maintenance should incur. Proponents of English as the official language wish to preserve English in what they perceive as its traditional role: a medium of communication that helped guarantee unity and equality among a predominantly immigrant population. Opponents of an official language designation, however, often feel that the designation of an official language will accord that language the powerful status of an exclusive force: the official language to the exclusion of all others.

### A. *Current Legislation in the States*

It is undisputed that English is the dominant language of government and commerce in the United States. Nevertheless, English is not

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3. BARON, *supra* note 2, at 8, noting that:

> [e]stablished ethnic groups perceive each new wave of immigrants as qualitatively different in its willingness to join the melting pot. In the nineteenth century, Germans and Scandinavians were often regarded by the Anglo-Saxon population as dangerous foreigners who were both racially distinct and bent on keeping their distance from American culture. In the early part of the twentieth century, newcomers from southern and eastern Europe were judged less adaptive to the American language and way of life than the northern and western Europeans who, after several generations in the New World, were finally shedding the linguistic trappings of their ethnicity. Today the same charges of unwillingness to assimilate are leveled at Hispanic and to a lesser extent at Asian Americans, despite linguistic evidence which shows that the children of these immigrants still learn English at an impressive rate.

4. The current demands for language restrictions are not unique to United States history. Various attempts at language restriction, such as bans on the use of German during World War I, have been made in the past. BARON, *supra* note 2, at 9.

5. *See* Laura A. Cordero, *Constitutional Limitations on Official English Declarations*, 20 N.M. L. REV. 17, 18 (1990).

6. *See generally* PIATT, *supra* note 2, at 167-78.

and has never been designated as the nation's official language. However, the number of statutes regarding the official use of English among the states[7] has greatly increased since 1981.[8] Some state legislation has been described as merely symbolic because the statutes have been drafted to resemble other symbolic acts such as the declaration of a state flower or bird.[9] In other states, such as Alabama and California, legislation has been drafted which restricts the legislature's power to make laws that "diminish or ignore the role of English as the common language of the state."[10] These states also created citizens' rights to enforce official English declarations in the courts.[11]

### B. *Federal Language Policy*

The federal government, by contrast, has not yet enacted legislation to make English the nation's official language. Federal policy on language does exist, however, in such areas as civil and voting rights, employment, and education. Federal language policy is not a product of direct regulation to grant official status to minority languages. Instead, federal policy has generally protected language minorities where failure to recognize linguistic diversity would have resulted in discrimination or the denial of basic rights.

#### 1. *Civil Rights*

The Civil Rights Act of 1964 has been credited with advancing the opportunities for bilingual education for children of linguistic minorities.[12] Title VI of the Act is the key by which courts could open

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7. Kathryn J. Zoglin, *Recognizing a Human Right to Language in the United States*, 9 B.C. THIRD WORLD L.J. 15, 16 (1989).

8. ALA. CONST. amend. 509; ARIZ. CONST. art. XXVIII, § 1; ARK. CODE ANN. § 1-4-117 (Michie Cum. Supp. 1991); CAL. CONST. art. III, § 6; COLO. CONST. art. II, § 30a; FLA. CONST. art. II, § 9; 1986 Ga. Laws 70; ILL. REV. STAT. ch. 1, para. 3005 (1989); IND. CODE § 1-2-10-1 (1988); KY. REV. STAT. ANN. § 2.013 (Michie/Bobbs-Merrill 1985); MISS. CODE ANN. § 3-3-31 (1991); NEB. CONST. art. I, § 27; N.C. GEN. STAT. § 145-12 (1990); N.D. CENT. CODE § 54-02-13 (1989); S.C. CODE ANN. §§ 1-1-696 to 1-1-698 (Law. Co-op. Cum. Supp. 1991); TENN. CODE ANN. § 4-1-404 (1991); VA. CODE ANN. § 22.1-212.1 (Michie 1985).

9. BARON, *supra* note 2, at 24 (noting that the symbolic statutes of Arkansas and Illinois have "not restricted minority-language rights or interfered with the assimilation process").

10. *See* Zoglin, *supra* note 7 and accompanying text.

11. *Id.*

12. Marguerite Malakoff & Kenji Hakuta, *History of Language Minority Education in the United States*, *in* BILINGUAL EDUCATION: ISSUES AND STRATEGIES 27, 31 (Amado M. Padilla, Halford H. Fairchild, and Concepción M. Valadez eds., 1990).

the doors of bilingual education by prohibiting discrimination because of "race, color, or national origin."[13] While no case has "expressly held that language-based classifications discriminate on the basis of national origin discrimination, the equation of language with national origin has been consistently recognized."[14]

2. *Bilingual Education*

The Bilingual Education Act (BEA) was enacted in 1968 to meet the needs of children of linguistic minorities.[15] It "provided grants to promote research and experimentation for meeting the needs of children who demonstrated little or no proficiency in the English language."[16] Significantly, the BEA "defined bilingual education programs as falling within federal educational policy."[17] In doing so, the BEA "marked a change of policy toward language minorities and undermined the English-only laws that were still on the books in many states."[18]

In addition, the Department of Health, Education, and Welfare (HEW) implemented regulations and guidelines under Title VI of the Civil Rights Act which stated that "school systems are responsible for assuring that students of a particular race, color, or national origin are not denied the opportunity to obtain education generally obtained by the students in the system."[19] A 1970 memorandum published in the *Federal Register* interpreted Title VI and its applicability to language minority students. School districts were specifically required to take "affirmative steps to rectify the language deficiency in order to open [their] instructional program[s] to these students."[20] The guidelines did not indicate what those steps should be.[21]

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13. *Id.* at 31.

14. Cordero, *supra* note 5, at 26-27 (citing cases on linguistic exclusion: Meyer v. Nebraska, 262 U.S. 390, 398-99 (1922) (discussing a Nebraska statute which mandated English as the only language of instruction and effectively singled out only children of foreign origin), Yu Cong Eng v. Trinidad, 271 U.S. 500, 524-25 (1926) (holding that a Philippine act prohibiting anyone from keeping accounting books in any language other than English, Spanish, or a local dialect was discriminatory against Chinese merchants), and Katzenbach v. Morgan, 384 U.S. 641, 654 (1966) (discussing a New York literacy requirement motivated by racial animosity to Puerto Ricans)).

15. 20 U.S.C. § 3281 (1988).

16. PIATT, *supra* note 2, at 43.

17. Malakoff & Hakuta, *supra* note 12, at 32.

18. *Id.*

19. *Id.* at 33 (quoting 33 Fed. Reg. 4956, (1968)).

20. *Id.*

21. *Id.* (citing 35 Fed. Reg. 11595) (1970)).

Then in 1974, the Supreme Court affirmed the effect of the HEW guidelines in *Lau v. Nichols*.[22] In a concurring opinion, Justice Stewart stated that the HEW guidelines correctly "require affirmative remedial efforts to give special attention to linguistically deprived children."[23] The Court also stated that "there is no equality of treatment merely by providing students with the same facilities . . . for students who do not understand English are effectively foreclosed from any meaningful education."[24] The Court, however, did not specifically require bilingual education as the remedy for solving educational deficiencies.

3. *Equal Educational Opportunity Act*

Congress extended the *Lau* decision to the states when it enacted the Equal Educational Opportunity Act of 1974 (EEOA).[25] Section 1703(f) states that "[n]o state shall deny equal educational opportunities to an individual on account of his or her race, color, sex, or national origin, by . . . the failure by an educational agency to take appropriate action to overcome language barriers that impede equal participation by its students in its instructional programs."[26] In *Castaneda v. Pickard*,[27] the United States Court of Appeals for the Fifth Circuit interpreted Section 1703(f) as giving federal courts jurisdiction to determine what constituted "appropriate action" under the EEOA.[28] The court held that "appropriate action" should ensure that "the language barrier is being overcome," it did not specifically endorse bilingual education.[29]

States which have enacted bilingual education statutes[30] have generally followed the *Lau* decision. In other words, they either require

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22. 414 U.S. 563 (1974).
23. *Id.* at 571.
24. *Id.* at 566.
25. 20 U.S.C. § 1701 (1988).
26. 20 U.S.C. § 1703(f) (1988).
27. 781 F.2d 456 (5th Cir. 1986).
28. Malakoff & Hakuta, *supra* note 12, at 35.
29. *Castaneda*, 781 F.2d 456, 470.
30. ALASKA STAT. § 14.30.400 (1975); ARIZ. REV. STAT. ANN. § 15-752 (1984); CAL. EDUC. CODE § 52160 (West 1981); COLO. REV. STAT. § 22-24-101 (1988); CONN. GEN. STAT. ANN. § 10-17a (West 1986); DEL. CODE ANN. Tit. 14, § 122(c) (1981); ILL. REV. STAT. ch. 122, para. 14C-1 (1973); IND. CODE § 20-10.1-5.5-1 (1976); KAN. STAT. ANN. § 72-9501 (1985); LA. REV. STAT. ANN. §§ 17:272, 17:273 (West 1982); ME. REV. STAT. ANN. tit. 20A, § 4701 (1984); MASS. GEN. LAWS ANN. ch. 71A (West 1982); MICH. COMP. LAWS ANN. § 380.1152 (West 1988); MINN. STAT. ANN. § 126.262 (West Cum. Supp. 1992); N.H. REV. STAT. ANN. § 189:19 (1989); N.J. REV. STAT. ANN. § 18A:35-15 (1989); N.M. STAT. ANN. § 22-23-1 (Michie 1978); N.Y. EDUC.

or specifically authorize bilingual programs which aid minority language students in acquiring English where the number of such students so warrants.[31]

4. *Voting Rights*

The Voting Rights Act of 1965 was enacted to protect the rights of all to vote under the Fourteenth and Fifteenth amendments. It currently prohibits states from providing "voting notices, forms, instructions, assistance, or other materials and ballots in English language only."[32] The Act was also intended to prevent language minorities from being denied access to the polls and the right to vote through the use of literacy tests as a condition to voting.[33]

5. *Employment*

Discrimination in employment generally is covered under Title VII of the Civil Rights Act of 1964 and under 42 U.S.C. § 1981, which was originally enacted in 1870.[34] Title VII, which is known as the Equal Employment Opportunity Act, prohibits employment discrimination primarily on the basis of race, color, religion, sex, or national origin. Both statutes have been used in determining the scope of language rights in employment. Under Title VII, the employee need generally only show "disparate impact upon a protected group"; however, "courts have found that a discrimination claim under 42 U.S.C. § 1981 requires proof of discriminatory intent."[35]

While courts have recognized that employment discrimination on the basis of language or accent is prohibited as national origin discrimination,[36] English-only rules in the workplace may be tolerated for

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LAW § 3204 (McKinney 1981); PA. STAT. ANN. tit. 24, § 15-1511 (Purdon Cum. Supp. 1991); R.I. GEN. LAWS § 16-54 (1988); TEX. EDUC. CODE ANN. § 21.451 (West 1987); WASH. REV. CODE ANN. § 28A.180.010 (1991); WIS. STAT. ANN. § 115.95 (West 1991).

31. Malakoff & Hakuta, *supra* note 12, at 38.

32. 42 U.S.C. § 1973aa-1a(b) (1988).

33. Cordero, *supra* note 5, at 36-37; For a discussion on literacy tests as prerequisites to voting, *see* BARON, *supra* note 2, at 58-61 and 123-25.

34. 42 U.S.C. § 2000e-2 (1988).

35. PIATT, *supra* note 2, at 63-64.

36. Bill Piatt, *Toward Domestic Recognition of a Human Right to Language*, 23 HOUS. L. REV. 885, 891 (1986)(citing Saucedo v. Brothers Well Serv. Inc., 464 F. Supp. 919, 920 (S.D. Tex. 1979); Carino v. University of Okla. Bd. of Regents, 750 F.2d 815, 819 (10th Cir. 1984)).

valid business reasons.[37] The 1988 decision in *Gutierrez v. Municipal Court*[38] recognized the *rigorous business necessity standard* promulgated in Equal Employment Opportunity Commission guidelines and followed the standard of review established in *Robinson v. Lorillard Corp.*[39] The business necessity standard requires that the needs of an employer in imposing a rule "that has a disparate impact on groups protected by the national origin provisions of Title VII" be sufficiently justified under the 1964 Civil Rights Act.[40]

## III. LANGUAGE OF GOVERNMENT ACT OF 1991

In January and February of 1991, identical bills were introduced in both houses of Congress to amend the United States Code and establish English as the official language of the United States government.[41] The stated purpose of the proposed Language of Government Act is to "maintain the benefits of a single official language of the Government . . . ."[42] Although the proposed Act states that there is no intent to "discriminate against or restrict the rights of any individual," it does provide that,

> [e]xcept where an existing law of the United States directly contravenes this Act (or the amendments made by this Act)(such as requiring the use of a language other than English for an official act of Government of the United States), no implied repeal of existing laws of the United States is intended.[43]

Proposed Chapter 6, section 163 of the Act states that "[n]o entity to which this chapter applies shall make or enforce an official act that

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37. *Id.* at 892, which discusses Garcia v. Gloor, 618 F.2d 264 (5th Cir. 1980), *cert. denied*, 449 U.S. 1113 (1981) (where Garcia was hired as a bilingual salesman, but was forbidden to speak Spanish except to customers. Garcia was fired for speaking with a co-worker in Spanish, and subsequently challenged the employer's rule under 42 U.S.C. § 2000e-2(a). The district court denied Garcia's claim because it found that the rule was valid for business reasons. The Fifth Circuit affirmed without examining specifically the business reasons offered).

38. 838 F.2d 1031 (9th Cir. 1988).

39. *Id.* at 1044; The test established in *Robinson* is whether "there exists an overriding legitimate business purpose such that the practice is necessary to the safe and efficient operation of the business." *Robinson*, 444 F.2d 791, 798 (4th Cir.), *cert. dismissed* 404 U.S. 1006 (1971).

40. *Gutierrez*, 838 F.2d at 1040.

41. H.R. 123, 102d Cong., 1st Sess. (1991); S. 434, 102d Cong., 1st Sess. (1991). As of February, 1992, neither Bill had been enacted.

42. *Id.*

43. *Id.*

requires the use of a language other than English."[44] However, "actions, documents, or policies that are purely informational, educational," or that protect "the public health or safety" or "the rights of victims of crimes or criminal defendants" would be exempted under the Bills' definition of *official* governmental actions.[45]

## IV. THE ENGLISH-ONLY MOVEMENT

The Language of Government Act is not the only prospective federal official language legislation to surface in recent years. Several versions of an English Language Amendment to the U.S. Constitution have been proposed as recently as 1988.[46] These congressional initiatives indicate the growth of the English-only movement since the early 1980's. Numerous constitutional amendments and state statutes enacted since then indicate that the movement has been gaining momentum.[47]

The primary motive of English-only proponents is the maintenance of national unity through a common language.[48] Many cite the traditional assimilation of immigrants into the English- speaking majority, and fear that the recognition of rights in languages other than English will not promote assimilation but will instead lead to separatism.[49] The English-only movement also supports legislation limiting governmental powers to use languages other than English in extending services to minority groups,[50] reasoning that this practice only encourages refusal to adapt to an English-speaking society.[51]

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44. *Id.*

45. *Id.*

46. H.R. J. Res. 96, 99th Cong., 1st Sess., 131 CONG. REC. H167 (daily ed. Jan. 24, 1985); S.J. Res. 20, 99th Cong., 1st Sess., 131 CONG. REC. S468 (daily ed. Jan. 22, 1985). On the history of the ELA in general, *see* Cordero, *supra* note 5, at 23; *see also* PIATT, *supra* note 2, at 21 for a discussion of the English Language Amendment of 1988.

47. *See generally*, note 8 for a list of state constitutional amendments and statutes.

48. Cordero, *supra* note 5, at 23; Barnaby W. Zall & Sharon McCloe Stein, *Legal Background and History of the English Language Movement*, *in* PERSPECTIVES ON OFFICIAL ENGLISH 261 (Karen L. Adams & Daniel T. Brink eds., 1990) [hereinafter PERSPECTIVES].

49. *See, e.g.*, PERSPECTIVES, *supra* note 48, at 263, where Zall and Stein liken immigration to entering into a social contract, whereby the immigrant who assimilated by learning English achieved the right to be treated as an equal and participate in the political process; *see also*, Cordero, *supra* note 5, at 24 n. 49, for a description of the various organizations and fears of Hispanic separatism.

50. Cordero, *supra* note 5, at 24.

51. *Id.* at 23.

Supporters of official English also cite countries with more than one official language, such as Belgium and Canada, as examples of what they are afraid will happen to the United States if there is not one exclusive official language.[52] They point to the political and social conflicts historically associated with the language diversity present in those countries.[53] As this Note will examine, the conflicts in Belgium and Canada have different social and political bases. In the final analysis, it will become clear that certain elements of their language policies would serve the United States well.

## V. RESPONSE TO ENGLISH-ONLY

Critics of the English-only movement feel that the push for official language legislation is a reaction from the English-speaking majority who fear that they will lose power and influence if the use of minority languages were sanctioned.[54] They fear that the rights already acquired by language minorities in voting, education, and social services will be in jeopardy if the United States adopts English as the official language. For example, the gains made in voter registration by Hispanics could be annulled if Hispanics no longer had access to voter registration, ballots, and the polls in Spanish.[55] Critics say this would effectively disenfranchise these people from exercising their constitutional right to vote.[56]

The educational needs of language minority children to receive instruction in their native language while learning English would be hindered by instructional restrictions. History has shown that instruction only in English, without support from students' native language, only serves to force many out of the educational process.[57] Ironically, many

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52. BARON, *supra* note 2, at 181.

53. *Id.*

54. Roseann Dueñas Gonzalez, *In the Aftermath of the ELA: Stripping Language Minorities of Their Rights*, *in* NOT ONLY ENGLISH, *supra* note 2, at 49, 50. Gonzalez cites three general conditions in United States' history from which have issued support for restrictive language legislation: war or national crisis, massive immigration, and economic recession.

55. *Id.* at 55.

56. *Id.*

57. Dennis Baron, *The Legal Status of English in Illinois: Case Study of a Multilingual State*, *in* NOT ONLY ENGLISH, *supra* note 2, at 13, 24 (noting that "today's bilingual education programs exist because English-only school laws often served as excuses for the schools to permit non-English-speaking students to sink rather than swim").

non-English-speaking adults who desire to learn English are denied that opportunity due to a lack of funding for classes and instructors.[58]

While proponents of official English feel that an English-only policy would increase national unity, opponents argue that language restrictions would only serve to further isolate minority groups and create a subclass of citizens.

## VI. BELGIUM

Belgium is commonly held out as an example of the instability which results when a nation is divided between various linguistic groups. Political instability in Belgium usually arises out of the conflict between Dutch-speaking Flemings and French-speaking Walloons.[59] The nation also contains a German-speaking minority whose cultural rights are recognized along with those of the Dutch and French majority.[60]

Belgium is divided into separate language territories, with the capital, Brussels, officially bilingual. One problem has been that the geographic linguistic boundary does not always correspond to demographic reality. Within each language territory, language rights are generally guaranteed only as to the use of the language corresponding to one's own territory. The result has been a nation divided internally by language.

The territorial language division of Belgium arose out of an unstable political and cultural situation in which French had been the dominant language both economically and politically, even though the majority of the population was of Flemish origin.[61] The dominance of French was guaranteed only so long as the Flemish population was inferior economically.[62]

As Dutch-speaking citizens achieved greater influence, they demanded rights equal to their French-speaking compatriots. The Flemings pressed for the greater linguistic rights which corresponded more eq-

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58. On the demand for programs to teach English to Hispanics, *see* Jon Amastae, *Official English and the Learning of English*, *in* PERSPECTIVES, *supra* note 48, at 199, 206.

59. For a general history of Belgium in the context of bicultural division, *see* Reginald de Schryver, *The Belgian Revolution and the Emergence of Belgium's Biculturalism*, *in* CONFLICT AND COEXISTENCE IN BELGIUM 13 (Arend Lijphart ed., 1981).

60. *Id.* at 31.

61. JEAN-WILLIAM LAPIERRE, LE POUVOIR POLITIQUE ET LES LANGUES 146 (1988).

62. David F. Marshall & Roseann D. Gonzalez, *Una Lingua, Una Patria?: Is Monolingualism Beneficial or Harmful to a Nation's Unity?*, *in* PERSPECTIVES, *supra* note 48, at 30, 37.

uitably to their population. Following a period of bilingualism, the country was split after 1932 into language regions established according to census data of the time.[63] With the exception of bilingual Brussels, the language of administration and education would be that of the majority of the locality.[64]

Following the Second World War, the language situation in Belgium once again reached a critical point as the number of French speakers around Brussels surpassed that of Dutch speakers traditionally located there.[65] Brussels itself had long contained a French majority, even though it was officially bilingual.[66] Fearing a further loss of territory, the Flemish *Volksunie* (People's Union), which contested the results of the census of 1947, demanded that the linguistic boundary be fixed.[67] In 1962, it was fixed after difficult negotiations surrounding the linguistic future of several contested municipalities.[68]

The linguistic conflict in Belgium was not completely solved with the resolution of the language boundary disputes. The internal political division which resulted still left behind a certain amount of domestic instability. It would, however, be unfair to state that all of Belgium's problems are based on language. Economic and political factors also play a role. It should be pointed out that despite language issues, Belgium has remained a relatively peaceful and prosperous country.

Belgium is often incorrectly cited by proponents of official English as an example of the detriments which could result if the United States is not united linguistically. However, the situation in the United States is not analogous.

First, the United States is not as drastically divided between competing language groups. On the contrary, the language of the majority is the undisputed *de facto* official language. Second, linguistic minorities in the United States are not struggling to establish their language as dominant, they merely seek expanded language rights in areas where justice and social reality so demand. While this is partly the case in Belgium, language minorities in the United States are not motivated by the nationalistic or separatist tendencies present in Belgium.

Third, except for native Americans, and Spanish and French speak-

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63. LAPIERRE, *supra* note 61, at 151.
64. *Id.*
65. *Id.* at 152.
66. *Id.*
67. *Id.* at 154.
68. *Id.*

ers annexed into the United States during its territorial expansion, most linguistic minorities in the United States are immigrants or their descendants. As such, they do not have a common national identity within the United States other than that of any American. The Flemings and Walloons, by contrast, form what amounts to separate nations within their common nation-state.

Still, Belgium's example should shed light on the need for recognition of minority language rights in the United States. Belgium would not be one nation today had the rights sought by excluded language groups not been recognized, and had compromises not been made.

## VII. CANADA AND QUEBEC

French and English are the official languages of Canada. The majority of Canadians are English-speaking, but Francophones constitute a majority in the province of Quebec. Some provinces, such as New Brunswick, contain significant Francophone minorities.

Language rights in Canada were established by the *British North America Act*.[69] The constitution which followed in 1867 granted the French-speaking population control over provincial matters in Quebec, among which was the question of language.[70] Under the constitution, the federal government is required to use both French and English in "crucial aspects of . . . operation."[71] What emerged in Canada "[a]s . . . provinces joined the federation," was that "the tradition of protecting the language and denominational rights of linguistic and religious minorities by special constitutional collective rights was continued where, prior to confederation, these groups had enjoyed such autonomy."[72]

The *Official Languages Act* of 1969 affirmed that both French and English are the "official languages of Canada for all purposes of the Parliament and government of Canada and possess and enjoy equality of status and equal rights and privileges as to their use in all the institutions of Parliament and the government of Canada."[73] As a

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69. Leslie Green, *Are Language Rights Fundamental?*, 25 OSGOODE HALL L.J. 639, 639 (1987).

70. Joseph E. Magnet, *Canadian Perspectives on Official English*, *in* PERSPECTIVES, *supra* note 48, at 53, 53.

71. *Id.*, referring to the *Constitution Act, 1867* (U.K.), 30 & 31 Vict., c.3, s.133. Magnet also states "[w]here the provincial minorities are significant in size, constitutional protection extend equally to provincial government operations, and also to religious schools.

72. *Id.*

73. Milton J. Esman, *The Politics of Official Bilingualism in Canada*, *in* LANGUAGE POLICY, *supra* note 2, at 45, 47.

consequence, all persons have the right to communicate with and receive communications from the federal government in either French or English. Moreover, Francophones employed in the civil service have the right to work in French.[74]

But as demographic changes led to a decline in the number of Francophones in Quebec, fears that Quebec would lose its French culture and heritage increased.[75] Quebec's economy was dominated by Anglophone business, and Francophones were excluded from senior management.[76] Support for the separatist Parti-Québecois grew as a response to the perceived lack of concern shown by the rest of Canada for the interests of French-speaking Quebeckers.

A referendum on independence for the province held in the early 1980's failed to yield the necessary support for separation from Canada, but the results did have an effect on future federal compromises with Quebec on language and cultural issues. Quebec passed legislation which confirmed and strengthened French as the official language of the province, both in government and commerce.[77]

The Canadian constitution was revised in 1982.[78] Among the revisions was a Charter of Rights and Freedoms, which confirmed constitutional language rights.[79] Paragraph 23, for example, guarantees the right of Canadian citizens to have their children educated in the official language of their choice where warranted by substantial demand.[80] The rights of all to communicate with the federal government and to receive services therefrom in either official language was confirmed in the new constitution[81] and made enforceable in the courts.[82]

While debate on the future of Canadian unity and cultural recognition continues, the situation has improved considerably since the 1980's. Canada has been described as bilingual in the center and

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74. Magnet, *supra* note 70, at 55. *See also* Esman, *supra* note 73, at 50.

75. Magnet, *supra* note 70, at 55. Cited by the author are higher mortality and lower birth rates, and the tendency of immigrants to assimilate into the English-speaking community.

76. *Id.*; *see also* Esman, *supra* note 73, at 55.

77. *E.g., La Loi 22* (Langue officielle), L.Q. 1974, c. 6, as rep. *Charte de la Langue Française*, L.R.Q. 1977, c. C-11. *See also* Esman, *supra* note 73, at 58.

78. *Constitution Act, 1982,* being Schedule B of the *Canada Act 1982* (U.K.), 1982, c. 11.

79. *Canadian Charter of Rights and Freedoms,* Part I of the *Constitution Act, 1982,* being Schedule B of the *Canada Act 1982* (U.K.), 1982, c. 11 [hereinafter *Charter*].

80. *Id.*; *see also* Esman, *supra* note 73, at 63.

81. *Charter, supra* note 79.

82. *Id.*

unilingual in the provinces, where limited and pragmatic concessions are made to official language minorities.[83]

Complete harmony, of course, does not exist. The current situation does not satisfy either the Anglophone minority in Quebec, who find that their rights to use English are greater on a federal level than on a local one, or the Anglophone majority in the rest of the country, who resent bearing the costs of providing bilingual federal government for a French-speaking minority.

What must be recognized is that the Francophone minority reacted, and will continue to react, to the disadvantaged position in which they found themselves. Namely, Francophones were discriminated against on a wide scale, even in the province in which they were still a majority. The compromises which have been made have kept the peace and have preserved for the greatest portion of the population the linguistic and cultural rights which will promote harmony in the future.

Canada provides the United States with the best available example of how language policy can help alleviate the pressures created by language diversity. The experiences of Canada should serve as a warning to language policymakers in the United States.

First, the United States needs to recognize the important role which language plays in all segments of society. Both proponents of English-only and minority language groups are concerned with a possible loss of their language rights. Rather than implement an official language policy which would strengthen the role of English to the detriment of other languages, the United States should follow the Canadian example and provide greater guarantees of language rights. The roles of both sides of the English-only movement would thereby be strengthened.

Second, the example of Quebec demonstrates that language groups would rather decide for themselves how to use their language. Although there has been no indication yet of separatist desires among language minorities in the United States, the Canadian example shows that restrictive language policies provide no assurances for the continued dominance of a language not preferred by the population. The recognition of French in Quebec has significantly calmed the clamor for Quebec independence which arose as a consequence of anti-French policies.

Third, minority language children in the United States are often severely disadvantaged when subjected to English-only education. Be-

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83. Esman, *supra* note 73, at 63.

cause of the federal courts' refusal to recognize a definite right to bilingual education, not all states have enacted statutes guaranteeing at least a basic right to bilingual education. In Canada, extensive education rights are granted to language minorities.

Certain aspects of Canadian language policy, however, are not applicable or necessary to the United States' situation. A bilingual federal government or civil service, for example, would be impracticable and is not needed to protect the rights of language minorities in the United States. What is needed instead are legislation and policies which ensure language minorities greater access to the government and services which are their right. Minority language services where warranted would provide this access without overburdening the government as a whole.

The United States similarly should not recognize minority languages as official. Except for English, no single language group is numerous enough to warrant such a costly designation. Moreover, such designations could create situations similar to that of the Anglophone minority in Quebec, where English is official on a federal level but not recognized on a provincial one.

## VIII. CONCLUSION

Some scholars have noted that language rights are recognized in important human rights documents.[84] These provisions serve to underscore the importance that language rights should be accorded in the United States. That one language is dominant is to the country's credit because unity of language can promote unity of nation. However, this is true only when the groups which use that language are confident that they are not being forced to abandon their own language and culture.

The examples of Belgium and Canada show that discrimination on the basis of language leads to discord. They also show that this discord can in large part be avoided by the intelligent use of language policy.

First, the United States should avoid language policies which are discriminatory or which effectively remove the participation of language minorities from society. Second, national unity is best promoted when cultural and linguistic diversity are not discouraged. The repression of linguistic minorities will only lead to a divisive backlash.

The United States is not threatened with the disappearance of its English-language tradition. The reality is that the United States is a

84. *For example*, Magnet, *supra* note 70, at 56; Zoglin, *supra* note 7; PIATT, *supra* note 2, at 162.

multilingual society. Minorities will continue to learn and use English as long as success within American society demands it. The greatest threat to this voluntary assimilation are policies which repress those who have not yet achieved it, because the unity of a nation stems from the will of its people and their need to act in concert, not from an official language.

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# Taiwan Keeps Antitrust Torch Burning By Enacting Fair Trade Law

*In view of the fact that most doctrines in trade law have been observed to originate in the United States, an issue of particular practical and theoretical significance in this regard is the degree to which . . . Taiwan may be following or departing from the American model as . . . [Taiwan's] own import control regime evolve[s] to respond to the new environment resulting from . . . [its] rapid economic development.*[1]

## I. INTRODUCTION

The 1990s started the second century of federal antitrust legislation in the United States.[2] First enacted in 1890,[3] with significant additions in both 1914[4] and 1950,[5] the initial goal of U.S. antitrust legislation was to protect market competitors and consumers from the evils of market concentration.[6] The U.S. now wants to export its antitrust provisions to help create a more level playing field for U.S. companies competing abroad, thereby helping to decrease the U.S. trade deficit.[7] The Republic of China (Taiwan), which ranks ninth in U.S. export markets and makes up more than ten percent of the U.S. trade deficit,[8] enacted its first comprehensive antitrust law in January, 1991. This

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1. Clyde D. Stoltenberg, *Overview: U.S.-Korea and U.S.-Taiwan Trade Law Issues in Comparative Perspective*, 11 MICH. J. INT'L L. 273, 276 (1990) (footnote omitted).

2. This Note will be concerned only with federal antitrust legislation in the United States, not state antitrust laws. *See generally* David Millon, *The First Antitrust Statute*, 29 WASHBURN L.J. 141, 141 (1990) (discussing state antitrust legislation).

3. Sherman Act, ch. 647, 26 Stat. 209 (1890) (current version at 15 U.S.C. § 1-7 (1990)).

4. Clayton Act, ch. 323, 38 Stat. 730 (1914) (current version at 15 U.S.C. § 12-27 (1990)).

5. Kefauver-Cellar Act, ch. 1184, 64 Stat. 1125 (1950) (current version at 15 U.S.C. § 18, 21 (1984)).

6. *See* Frederick M. Rowe, *The Decline of Antitrust and the Delusions of Models: The Faustian Pact of Law and Economics*, 72 GEO. L.J. 1511, 1514-1517 (1984).

7. *See* David L. Kleykamp, The U.S.-Taiwan Trade Problem — An American Perspective 1-2 (1991) (unpublished paper presented at the 3rd Illinois-Tamkang International Conference discussing U.S. responses to its trade deficit with Taiwan) (available from the political science department at Illinois University - Champaign).

8. *Id.* at 2.

law became effective for private companies on February 4, 1992.[9] The Legislative Yuan, the Taiwanese counterpart of the U.S. Congress,[10] passed the Fair Trade Law (FTL) to appease U.S. threats of protectionism[11] and to maintain competition in its increasingly liberalized economy.[12]

This Note compares the FTL's antitrust provisions with similar U.S. provisions, and discusses the effects of FTL enforcement on Taiwanese businesses and Taiwan's trade relationships.

## II. HISTORY OF TAIWAN'S ECONOMIC SUCCESS

As the United States Congress was passing the Sherman Act, the Ch'ing dynasty was about to lose its war with Japan resulting in Japanese control of the Taiwan province.[13] A few benefits of Japan's

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9. Lawrence S. Liu, *Fair Trade Law And New Policy On Competition*, E. Asian Executive Rep., March 15, 1991, *available in* LEXIS, Intlaw library, Easian file [hereinafter *New Policy on Competition*].

10. *See generally* David G. Pierce, *The Legal And Administrative Framework For Foreign Investment In Taiwan*, 7 UCLA PAC. BASIN L.J. 1, 2 (1990) (describing Taiwan's governmental structure).

> The [Taiwan] Constitution of 1947 provides for a system of government based to some extent on the theories of Sun Yat-sen, a founder of the republican government and of the ruling party, the Kuomintang. Its structure consists of an elected National Assembly as the supreme government organ, a President elected by the National Assembly, who is head of state, and five branches of national government, each of which is called a 'Yuan.' The President is vested with considerable power while the practical tasks of the National Assembly are few and, in the realm of law-making, restricted to amendment of the Constitution. *Ordinary legislation is left to an elected Legislative Yuan, one of the five branches of the national government.* The remaining four branches are the Executive Yuan, the Examination Yuan, the Control Yuan, and the Judicial Yuan.

*Id.* (emphasis added) (footnote omitted).

11. Kleykamp, *supra* note 7, at 12-13.

12. *New Policy on Competition*, *supra* note 9.

13. *See* Thomas A. Metzger & Ramon H. Myers, *Understanding the Taiwan Experience: An Historical Perspective*, 2 PAC. REV. (1989), *reprinted in* Thomas A. Metzger & Ramon H. Myers, UNDERSTANDING THE TAIWAN EXPERIENCE: AN HISTORICAL PERSPECTIVE 2 (Kwang Hwa Publishing Co. 1990) (providing a brief history of Taiwan). The country was not discovered by the West or used extensively by the Chinese until around 1600. *Id.* Many left the Chinese mainland to seek refuge against overpopulation. In 1895, Japan received Taiwan from China as a concession for a victory in Korea. "The Japanese rapidly carried out a programme of modernization: they eliminated most of the serious tropical diseases; established an elementary school system; and launched fiscal, agricultural, and commercial reforms." *Id.* Because of these changes

occupation were the rapid modernization of Taiwan in education, agriculture and commercial reforms and the remnants of an industrial infrastructure left by the Japanese after World War II.[14]

In 1949, Taiwan found itself the refuge for a defeated Chiang K'ai-shek and his followers.[15] After receiving initial protection from invasion by the Chinese Communists from the Truman administration, Chiang K'ai-shek, leader of the Nationalists, "embarked on a policy of . . . economic modernization . . . ."[16] In the past 20 years, that revitalization has paid off, as Taiwan has experienced high rates of growth in its material standard of living.[17] The basis of that growth has been the Taiwanese export markets, especially the U.S. market. In 1990, exports accounted for 41.6% of Taiwan's GNP[18] with 32% of those exports going to the United States.[19] Taiwan's foreign exchange reserves for 1990 were $75 billion which were accumulated mostly through trade surpluses.[20] The United States accounted for over 80% of Taiwan's merchandise trade surplus.[21]

### *A. The Taiwanese Government and its Role in the Economy*

In comparing the FTL with U.S. antitrust laws, the role Taiwan's government has played in its economy must be considered. Because Taiwan was faced with both domestic and foreign instability, Chiang K'ai-shek decided to combine in the government both "dictatorial and

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Gross Domestic Product in Taiwan had at least doubled by the late 1930s. Japanese success in raising Taiwan's standard of living persuaded many native Taiwanese to accept a Japanese viewpoint of the world. This has resulted in many of Taiwan's business activities as well as the Fair Trade Law having a substantial resemblance to their Japanese counterparts. *Id.*

14. *Id.* at 2-4.

15. *Id.*

16. *Id.*

17. TAIWAN GOVERNMENT INFORMATION OFFICE, THE ROC SIX-YEAR NATIONAL DEVELOPMENTAL PLAN IN BRIEF 1 (3d ed. 1991) [hereinafter ROC DEVELOPMENTAL PLAN].

18. *See* CHINA EXTERNAL TRADE DEVELOPMENTAL COUNCIL, DOING BUSINESS WITH TAIWAN R.O.C. 6-7 (14th ed. 1991) [hereinafter DOING BUSINESS].

19. Chee-Man Wong & Jyh-Hirng Lin, The U.S.-Taiwan Trade Problems: The Taiwan Perspectives 1, 2 (1991) (unpublished paper presented at the 3d Illinois-Tamkang International Conference) (available from the political science department at Illinois - Champaign).

20. Kleykamp, *supra* note 7, at 24.

21. STAFF OF JOINT ECONOMIC COMM., 100TH CONG., 1ST SESS., RESTORING INTERNATIONAL BALANCE: THE TAIWAN ECONOMY AND INTERNATIONAL TRADE 12 (Comm. Print 1987) [hereinafter RESTORING INTERNATIONAL BALANCE].

democratic tendencies."[22] Chiang justified his power through the 1946 Constitution of the ROC which emphasized democracy combined with concern for "Confucian virtues, patriotism and anti-communism."[23] Most importantly, however, Chiang's nationalist party held a monopoly on political power because opposition parties were suppressed.[24] As a result, the government has played a large role in the Taiwanese economy. It runs a number of the major businesses, creates planning projections and helps Taiwanese businesses stay healthy, especially against foreign competition, with the use of tariffs and import duties.[25]

The stability of Taiwan's one party government and its "commitment to . . . steady, financially conservative, pragmatic, and growth-oriented polic[ies]"[26] accounts for the country's tremendous post World War II growth. In the 1990s, Taiwan is moving away from protecting domestic industry and promoting exports and instead is encouraging foreign investment, especially in the high technology markets.[27] To attract foreign technology into the country, Taiwan must meet international standards in intellectual property protection and antitrust enforcement. After four decades of government intervention, current Taiwanese policies point toward economic liberalization.[28]

### *B. Legislative History of FTL*

While the FTL merely supplements current Taiwanese law on business concentration,[29] the passage of the FTL was Taiwan's first attempt at comprehensive antitrust legislation.[30] In addition, the FTL

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22. *See* Metzger & Myers, *supra* note 13, at 7.

23. *Id.*

24. *See id.* at 7-9.

25. J.W. Wheeler, *Comparative Development Strategies of South Korea and Taiwan as Reflected in Their Respective International Trade Policies*, 11 MICH. J. INT'L L. 472, 473-475 (1990).

26. *Id.* at 474.

27. *See id.* at 474-75.

28. *New Policy on Competition*, *supra* note 9.

29. FAIR TRADE LAW [F.T.L.] art. 1-49 (Lee & Li trans., Preparatory Office of the Fair Trade Commission 1991) (Taiwan).

30. Lawrence S. Liu, *Draft Fair Trade Law*, E. Asian Executive Rep., July 15, 1986, *available in* LEXIS, Intlaw library, Easian file [hereinafter *Draft*] (discussing the Law Governing Agricultural, Mining, Commercial and Industrial Enterprises (LAMCI), which provides for treble fines and imprisonment for monopolization, manipulation and speculative practices). The government, however, limited LAMCI's reach to certain industries. In addition, a foodstuffs law imposes severe criminal liabilities for the stockpiling of foodstuffs, but the government rarely enforces the law. *Id.*

closely follows Taiwan's attempt to protect intellectual property rights.[31]

The Legislative Yuan modeled the FTL after similar antitrust laws in the United States, Japan, Germany[32] and Korea.[33] The first draft of the FTL was completed in 1983[34] but the bill stalled due to controversy over the draft's antitrust and merger provisions.[35] Opposition came from corporate lobbyists[36] and government officials owning some of the businesses that could be affected by the FTL.[37] For an example of the conflict of interest that can exist when the Taiwanese government tries to regulate its economy, C.F. Koo, chairman of the Taiwanese government's National Association of Commerce and Industry, also heads one of Taiwan's largest companies, the Taiwan Cement Corporation.[38]

## III. DOMESTIC AND INTERNATIONAL REASONS FOR PASSAGE OF FTL

The FTL states that it "is enacted to maintain order in transactions, to protect the interest of consumers, to ensure fair competition, and to promote the stability and prosperity of the national economy."[39] Specifically, the FTL was passed to help protect Taiwan's small and medium-sized enterprises, to serve as an economic counterpart to Taiwanese political democratization and to appease threats of protectionism from its trading partners.

### *A. Maintaining Taiwan's Small and Medium-sized Enterprises*

The backbone of Taiwan's past economic success has been its small and medium-sized enterprises (SME).[40] A major reason for the large

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31. *See* BOARD OF FOREIGN TRADE, MINISTRY OF ECONOMIC AFFAIRS, THE REPUBLIC OF CHINA ON TAIWAN IN THE 1990s - AN INCREASINGLY IMPORTANT TRADING PARTNER IN THE PACIFIC REGION 2-5 (1991) (discussing how Taiwan's new Trademark and Patent Law meets world standards, and how the FTL itself also protects against the domestic pirating of well-known foreign trademarks that are not registered in Taiwan.)

32. *Rules of Competition - General*, Investing Licensing & Trading, June 1, 1990 *available in* LEXIS, Europe library, Inlitr file [hereinafter *Rules of Competition*].

33. *Draft*, *supra* note 30.

34. *Id.*

35. Glenn P. Rickards, *New Fair Trade Law Will Strengthen I.P. Protection*, Int'l Bus. Daily (BNA), April 3, 1991 *available in* LEXIS, Intlaw library, Bnaitd file.

36. *Rules of Competition*, *supra* note 32.

37. *Cf. Draft*, *supra* note 30 (discussing the legislative history of the bill); *cf.* Rickards, *supra* note 35 (discussing the delay in passage of the Fair Trade Law caused by the inclusion of antitrust provisions).

38. Michael Boydell, *Economic Matchmaker*, FREE CHINA REV., May 1991, at 26.

39. F.T.L., *supra* note 29, at art. 1.

40. *See* Hsueh Li-Min, *Restructuring the SMEs*, FREE CHINA REV., May 1990, at 62.

number of SMEs in Taiwan is that most of the Taiwanese government is made up of mainlanders while much of the business community is made up of native Taiwanese. The more SMEs in existence, the more balanced is the power relationship between the native Taiwanese and those that came from the mainland. As a result, many Taiwanese have an ambivalence towards concentration of economic power that depletes their chances of maintaining equal power with the mainlanders.[41]

Despite the political motivations, Taiwan receives many economic benefits from SMEs. Taiwan has a low unemployment rate because most of the firms are labor intensive, and it also has equality of income between rural and urban laborers due to the various locations and large numbers of SMEs.[42] In addition, the dominance of SMEs in the Taiwanese economy has resulted in widely distributed asset ownership, "at least until recently."[43]

The benefits of Taiwan's rapid growth into a major player in the international economic market has not come without its cost. Social problems include "traffic congestion, environmental pollution, a rising crime rate, and a lack of cultural and recreational facilities."[44] Economic costs include labor shortages, a declining work ethic,[45] and the growth of major Taiwanese corporations that have stymied marketplace competition, resulting in fewer choices and higher prices for the consumer.[46] Many monopolies and oligopolies have started to form because of Taiwan's rapid economic development.[47] At least ten industries in 1981 had a market concentration rate of 90% or more.[48] Agreements to fix prices, restrict output, allocate sales territories and block competitors have been common practices among many Taiwanese industries.[49]

### *B. FTL is Economic Counterpart to Taiwanese Political Democratization*

Precursive to Taiwan's economic liberalization has been its political democratization. Government changes since 1987 have been nothing

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41. *See* Wheeler, *supra* note 25, at 487; *see* RESTORING INTERNATIONAL BALANCE, *supra* note 21, at 3.

42. *See* RESTORING INTERNATIONAL BALANCE, *supra* note 21, at 5.

43. *Id.*

44. *ROC Developmental Plan*, *supra* note 17, at 1.

45. *Id.*

46. *See Draft*, *supra* note 30.

47. *Id.*

48. *Id.*

49. *Rules of Competition*, *supra* note 32. Examples of industries in Taiwan that have conducted unfair trade practices include the cement, man-made fiber, glass, motorcycle, plastic material, building material, tire, home appliance and soap industries. *Id.*

short of fundamental and include: "the lifting of martial law restrictions, permission for the establishment of new political parties, an expansion of press freedom, a loosening of various travel limitations, and the implementation of . . . bureaucratic reforms."[50] The result of political democratization and economic liberalization has been an increase in both political and economic rights for the Taiwanese citizenry.

### C. *Appeasing Threats of Protectionism from Trading Partners*

The main reason for the passage of the FTL, however, was to relieve international pressure, especially from the United States, which has recently started to promote protectionist policies against some countries such as Taiwan.[51] Taiwan also faces pressure to liberalize its economy because of an expected increase in competition from newly industrialized Southeast Asian countries.[52] These international conditions have forced Taiwan to change its emphasis from exports and earning foreign exchange to liberalizing its economic system to match international standards.[53]

Other countries want Taiwan to meet import and duty standards under the General Agreement on Tariffs and Trade (GATT). Taiwan's recent application to GATT "demonstrate[s] the government's determination to intensify its already vigorous policy of economic liberalization and internationalization."[54] GATT membership will help provide Taiwan's labor-intensive economy with "competitive stimulation" and "technological know-how" that it so desperately needs to compete internationally.[55]

Taiwan's longing for international approval of its domestic economic policies most likely results from the time when many countries severed formal diplomatic ties with Taiwan in favor of recognizing the People's Republic of China.[56] Once diplomatic relations ceased with

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50. DOING BUSINESS, *supra* note 18, at 4.

51. *See* Kleykamp, *supra* note 7, at 12-13.

52. Paul S.P. Hsu, *International Trade and Investment Regulation: Developing Jurisprudence in Taiwan*, 11 MICH. J. INT'L L. 368, 390 (1990).

53. *Id.* at 392.

54. Philip Liu, *Knocking at GATT's Door*, FREE CHINA REV., Oct. 1990, at 38. Taiwan officially applied for GATT membership on January 1, 1990. *Id.*

55. *Id.* at 38-39.

56. *Cf.* Amy Lo, *Pragmatic Diplomacy, Creative Economics*, FREE CHINA REV., May 1991, at 5 (discussing the current status of Taiwan's diplomatic relations) [hereinafter *Pragmatic Diplomacy*]. Taiwan has formal diplomatic ties with 28 countries and semi-official and non-official relations with 120 countries. *Id.* at 7.

many countries in the early 1970s, Taiwan was forced to seek less formal alliances to keep its status as a world trader.[57] As a result, Taiwan is more sensitive to world opinion in its markets. Thus, because other countries such as the United States wanted Taiwan to establish an FTL, Taiwan was more likely to listen. "In this light, economic liberalization inevitably carries a tone of external orientation as the domestic market system is increasingly integrated with that of the outside world."[58]

## IV. TAIWAN'S FTL COMPARED WITH U.S. ANTITRUST LAW

Comparing the FTL with U.S. antitrust history and critical comment helps predict whether the FTL will succeed in its purposes.

> The United States itself has had second and even third thoughts about the wisdom of some of its own stricter antitrust initiatives. There have therefore been occasions in which foreigners have begun to adopt U.S. approaches from a previous decade while American government officials or academics were actively seeking to discourage such emulation on the ground that doctrine being copied was now viewed by many in the U.S. as having been substantially mistaken.[59]

Analyzing the plain language of the FTL will determine to a great extent its potential effectiveness. The Fair Trade Commission (FTC), established by the Executive Yuan to "administer matters . . . as set forth in this Law [FTL]," will also play a key role in the law's effectiveness.[60]

### *A. Definitions of Competition Compared*

Defining competition itself can help to determine the FTL's breadth. The FTL defines competition as "acts whereby two or more enterprises offer in the market more favorable price, quantity, quality, service or other terms in order to secure trading opportunities."[61] Competition as defined by the FTL would prevent an enterprise from cornering a market as other enterprises would siphon off consumers through lower prices or higher quality goods and services.

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57. *Id.* The United States broke off diplomatic relations with Taiwan in January of 1979. *Id.*

58. John C. H. Fei, *Economic Developments of Taiwan And The Mainland: 1986*, *in* SURVEY OF RECENT DEVELOPMENTS IN CHINA (MAINLAND AND TAIWAN), 1985 - 1986 73, 74 (Hungdah Chiu ed., 1987).

59. Joel Davidow, *The Worldwide Influence of U.S. Antitrust*, 35 ANTITRUST BULL. 603, 606 (1990).

60. F.T.L., *supra* note 29, art. 25.

61. *Id.* art. 4.

In the United States, enhancing and maintaining competition was the goal of early antitrust law.[62] Cases in the 1960s and early 1970s focused on competition as maintaining a market structure of balanced fragmentation. Thus, any movement away from fragmentation equaled a lessening of competition.[63] At the onset, then, both the FTL and U.S. antitrust laws were partially enacted to protect small businesses from market concentration.

### *B. Regulation of Monopolies Compared*

One of the primary reasons for the passage of the FTL was to regulate monopolies.[64] The FTL allows monopolies *per se* but prohibits certain monopoly practices. Under the FTL, a monopoly is defined as a "condition wherein an enterprise faces no competition or has an overwhelming position to enable it to exclude other competitiors [sic] in a particular market."[65] The term "particular market" in this definition refers to either "a geographic area or a sector wherein enterprises engage in competition in respect of a particular commodity or service."[66] In addition, "[w]hen two or more enterprises do not in fact compete with each other in pricing and their relations as a whole with other entities are such as specified in [the monopoly definition] . . . , such situation shall be deemed a monopoly."[67] Thus, not only are monopolies regulated by the FTL's monopoly provisions but also those enterprises that together act like monopolies.

Those Taiwanese enterprises that meet the above definitions for either a monopoly or oligopoly will be announced by the FTC.[68] However, the FTL does not automatically ban those enterprises designated as monopolies or oligopolies but rather prohibits their anticompetitive conduct. Anticompetitive conduct prohibited under the FTL includes the use of unfair trading methods to block entry into the

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62. Millon, *supra* note 2, at 143-44; Rowe, *supra* note 6, at 1521. Judge Learned Hand said in the 1945 *Alcoa* decision that "'[t]hroughout the history of these statutes it has been constantly assumed that one of their purposes was to perpetuate and preserve, for its own sake and in spite of possible costs, an organization of industry in small units which can effectively compete with each other.'" *Id.* (quoting Aluminum Co. of Am. v. United States, 148 F.2d 416, 429 (2d Cir. 1945)).

63. John R. Carter, *Actual Potential Entry Under Section 7 of the Clayton Act*, 66 VA. L. REV. 1485, 1494 (1980).

64. *See New Policy on Competition*, *supra* note 9.

65. F.T.L., *supra* note 29, art. 5.

66. *Id.*

67. *Id.*

68. *Id.* art. 10.

market, improper price fixing, causing a competitor to "provide preferential treatment", and "conducting other acts by abusing its market standing."[69] The inclusion of an oligopolistic definition reflects Taiwan's trouble with oligopolies engaging in anticompetitive acts such as "conscious parallelism" or "price leadership."[70] The FTL monopoly provisions are ambiguous on whether a "particular market" terminology can include foreign competition. Including foreign competition would expand the scope of the "particular market" definition and fewer enterprises would be considered monopolies, thereby resulting in less enforcement of the monopoly provisions. As a result of the ambiguity, the FTC will need to come up with guidelines to determine what constitutes a "particular market." In the United States, the changes in the 1984 update to the Justice Department's Merger Guidelines emphasized the inclusion of foreign firms when determining the relevant market size for merger decisions.[71]

The FTL's monopoly provisions differ from similar U.S. provisions in that under the Oligopoly Model,[72] monopolies and oligopolies were deemed per se illegal restraints on trade,[73] whereas the FTL allows monopolies and oligopolies but not their anticompetitive practices. The Oligopoly Model in the United States changed the focus of antitrust law from a Rule of Reason doctrine that judged "commercial arrangements in light of their context, purpose, and effects"[74] to one that judged commercial arrangements based on market shares and market structures.[75] By listing those activities considered monopolistic, the FTL, unlike the U.S., has given monopolies and oligopolies some flexibility in their business practices.[76]

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69. *Id.; see also* DOING BUSINESS, *supra* note 18, at 58.

70. *Draft*, *supra* note 30.

71. 1984 Merger Guidelines, 49 Fed. Reg. 26,827, 26,830 (Dep't Justice 1984).

72. The Oligopoly Model posited that a few firms in the same market could act together and create a monopoly-like effect. *See* Rowe, *supra* notes 6, at 1518-1543 (discussing the foundation of the Oligopoly Model in the United States).

73. Eleanor M. Fox, *The Future of the Per Se Rule: Two Visions at War With One Another*, 29 WASHBURN L.J. 200, 201 (1990).

74. *See* Rowe, *supra* note 6, at 1518. *Standard Oil Co. of N.J. v. United States*, 221 U.S. 1 (1911), created the Rule of Reason doctrine. *Id.*

75. *Id.* at 1524. The use of the Oligopoly Model resulted in challenges of trivial mergers and concentration in smaller product markets while large acquisitions by conglomerations were ignored. *Id.*

76. Many criticize the use of the Oligopoly Model in the United States because it addresses market situations that no longer exist. The Oligopoly Model might have proved useful for single product markets. However, it fails to comprehend the current

The insurance industry is an example of a Taiwanese monopoly that might be affected once the FTL goes into effect. Taiwan's largest insurance company, Tsai's Cathay Life Insurance Company, had a 59% share in the Taiwanese life insurance market in 1989.[77] The lack of competition has allowed insurance companies to keep premiums artificially high and to delay and hinder the paying of claims.[78] Many blame government because of its protection of the industry and lack of regulation enforcement.[79] Until recently, the government banned new insurance companies[80] which "left the customers at the mercy of existing insurers and denied them the improved services which new competition could have brought to the industry."[81] Fortunately, the Taiwanese government has started to open up the market more by allowing some limited foreign competition and regulating the amount of real estate investment in which insurance companies can engage. According to a Cathay official, the presence of foreign insurance firms has already increased competition, thereby benefiting domestic policyholders.[82] Premiums have been lowered and claims are paid faster.[83]

Taiwan's protection of its insurance industry is not unique. Since the passage of the McCarran-Ferguson Act in 1945, the U.S. insurance industry has received an antitrust exemption because Congress thought competition would ruin the industry.[84] However, just as in Taiwan, the effect of the exemption was a "mask for privilege and power."[85] The exemption allows all types of price fixing and colluding to divide territories and customers.[86]

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state of the U.S. economy with conglomerations ". . . compet[ing] against each other in criss-crossing encounters" where it is hard to tell when one market ends and another begins. *See id.* at 1542-43. Conglomerations tend to discount one of the Oligopoly Model's rationales: that an oligopolistic market creates higher barriers to entry. In fact, advances in transportation and communication in the last 50 years have significantly lowered barriers to entry as enterprises are now more mobile in their geographic and product markets. *See id.*

77. Osman Tseng, *Help From Complaints And Competition*, FREE CHINA REV. Oct. 1990, at 42.

78. *See id.* at 43.

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 45.

83. *Id.*

84. Walter Adams & John W. Brock, *The Political Economy of Antitrust Exemptions*, 29 WASHBURN L.J. 215, 216-17 (1990).

85. *Id.*

86. *Id.* at 219.

Under the FTL monopoly definition, the FTC would probably consider the Taiwanese insurance industry an oligopoly because it "has an overwhelming position [in the market] to enable it to exclude other competitors in a particular market."[87] Once the FTC deemed the insurance industry an oligopoly for FTL purposes, the FTC would then look at the industry's business practices.[88] Evidence indicates that the large Taiwanese insurance companies' concentration of the market has allowed them to keep prices high and output low,[89] thereby violating one of the FTL's prohibited monopoly acts of "improperly determining, maintaining or changing the prices of goods . . . ."[90]

Once a violation occurs, the FTC can conduct investigations either based on a complaint or *ex officio*.[91] In addition, the injured party may petition the FTC for elimination of the violation, "prevention thereof," or sue for damages.[92] The FTC can then impose both prison terms and fines[93] and a court can award up to treble damages or order an injunction for an ongoing violation.[94]

### C. *Regulation of Mergers Compared*

The FTL applies three tests to determine whether a merger violates its provisions. First, the FTL defines enterprise activity that would fall under its merger provisions. While the first test defines what constitutes a merger for FTL purposes, the second test determines which mergers must apply to the FTC for approval. The final test under the FTL's merger provisions applies a cost-benefit analysis as to the merger's effects on the Taiwanese economy.

#### 1. *FTL Defined Merger Activity*

First, the FTL defines those combinations that would fall under its merger provisions. In the FTL, the term "combination" refers to:

> whereunder an enterprise: (1) merges with another enterprise; (2) holds or acquires the shares or capital contributions of another enterprise to an extent of representing more than one-

87. F.T.L., *supra* note 29, art. 5.
88. *See id.* art. 10.
89. *See supra* note 77 and accompanying text.
90. F.T.L., *supra* note 29, art. 10.
91. *Id.* art. 26-27.
92. *Id.* art. 30-31.
93. *Id.* art. 35-44.
94. *Id.* art. 30-34.

> third of the total voting shares or the total capital stock of such other enterprise; (3) accepts a transfer of, or leases the whole or the major part of the business or properties of another enterprise; (4) frequently operates jointly with another enterprise or is entrusted by another enterprise to operate the latter's business; or (5) directly or indirectly controls the business operation, or the employment and termination of the personnel, of another enterprise.[95]

If an activity between two Taiwanese enterprises fails to meet the above criteria, it will not be regulated by the FTL's merger provisions.

### 2. *Mergers that Must Apply for FTC Approval*

If the following situations result from a "merger," the enterprises involved must request approval from the FTC:

> (1) as a result of the combination, the surviving enterprise will acquire a market share reaching one third (1/3); (2) an enterprise participating in the combination holds a market share reaching one fourth (1/4); or (3) the amount of sales in the preceding fiscal year of an enterprise participating in the combination exceeds the amount publicly announced by the central competent authority (Fair Trade Commission). The central competent authority shall announce those enterprises occupying more than one fifth of total market share.[96]

If any "merger" fails to rise to one of the percentage levels or to the total sales level announced by the FTC, the FTC requires no notification. However, the FTC will publish those enterprises "reaching one fifth" of a particular market.[97] The FTL's notification guidelines were taken from similar European guidelines.[98]

The U.S. also has notification requirements, although the Justice Department's Merger Guidelines (Merger Guidelines) use lower standards than those in the FTL. For example, the 1982 Merger Guidelines and the 1984 update state that the Justice Department will not challenge

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95. F.T.L., *supra* note 29, art. 6.
96. *Id.* art. 11.
97. *Id.*
98. *Draft*, *supra* note 30.

merging enterprises that result in a market percentage below 14% - 18% depending on the concentration of the market.[99] In addition, the Hart-Scott-Rodino Antitrust Improvements Act of 1976 requires notification for mergers that involve acquiring firms with over $100 million in assets and acquired firms with over $10 million in assets.[100]

*3. Cost-Benefit Analysis*

Even if the FTC determines that enterprise activity has resulted in a "combination" under the FTL and the "combination" meets one of the notification guidelines, the FTC still has discretion to allow the "combination" if "the benefit of the combination to the overall economy outweighs the disadvantages of its restraining competition."[101] Advantages to the national economy may include "econom[ies] of scale, reduction of production costs and rationalization of management."[102]

An example of merging enterprises that would meet the first test for "merger activity" and could meet the second test requiring notification and approval, yet still pass as beneficial to the national economy, is the Taiwanese textile industry. SMEs compose 90% of Taiwan's textile industry.[103] These SMEs find it harder to survive based on a labor shortage and a lack of capital to invest in Research and Development.[104] Unless these firms are able to merge their production processes, they will lose out to cheaper competition from China and South Korea.[105] For example, two of the largest textile conglomerates, Chung Shing Textile Co. and Far Eastern Textile Co., Ltd., are self-reliant because they have completed production lines.[106]

The FTL's final cost-benefit test is comparable to the Rule of Reason Doctrine used in U.S. antitrust laws.[107] The Taiwanese gov-

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99. Davidow, *supra* note 59, at 613. The amended guidelines raised the minimum percentage from the initial merger guidelines of 1968 which were between eight percent and ten percent depending on the concentration of the market. Rowe, *supra* note 6, at 1525.

100. Davidow, *supra* note 59, at 612; Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 1, 8, 15(c), 18(a) (1976).

101. F.T.L., *supra* note 29, art. 12.

102. *See New Policy on Competition*, *supra* note 9.

103. Jim Hwang, *Weaving a More Competitive Future*, FREE CHINA REV., June 1991, at 20.

104. *Id.*

105. *Id.*

106. *Id.* Chung Shing ranked 19th in the 1990 list of highest grossing manufacturers while Far Eastern ranked seventh. *Id.*

107. *See supra* notes 72-76 and accompanying text for discussion of U.S. Rule of Reason Doctrine.

ernment decided that the Rule of Reason Doctrine should be considered in every case and thereby codified the doctrine in its antitrust law. In contrast, the use of the Rule of Reason Doctrine in the United States has always depended on the policies of a particular administration in enforcement or the composition of the Supreme Court in judicial decisions.[108] The 1982 Merger Guidelines purported to recognize that most mergers are pro-competition and pro-consumer. The Guidelines also show a pro-business bias and promote businesses' freedom in order to enhance efficiency.[109] From 1981 through 1987, the Justice Department challenged only 26 out of the 10,723 pre-merger notifications received.[110] The Merger Guidelines have basically created an "exemption that is tantamount to the euthanasia of section 7 of the Clayton Act."[111] By putting the Rule of Reason Doctrine in the antitrust law itself, Taiwanese merger enforcement stands to be more consistent than past U.S. enforcement, which has depended on the administration or policies prevalent at a particular time. The FTC, violators and the complainants when making arguments for or against a certain action can rely on the plain language of the FTL which should not change significantly over time.[112]

### *D. Regulation of Concerted Actions and Vertical Restraints Compared*

The FTL also regulates concerted actions undertaken by enterprises in Taiwan.[113] Concerted action, defined in the FTL, refers to "an act to mutually restrict the activities of enterprises, such as an act by an enterprise that enters into a contract, agreement or other form of mutual understanding with other enterprises with whom it competes to jointly determine the prices of goods or services, or to restrict quantities, technology, products, equipment, trading counterparts or trading territories."[114] These concerted actions must then be approved by the

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108. *See* Charles F. Rule & David L. Meyer, *Toward a Merger Policy That Maximizes Consumer Welfare: Enforcement by Careful Analysis, Not by the Numbers*, 35 ANTITRUST BULL. 251, 254-55 (1990).

109. Adams & Brock, *supra* note 84, at 234.

110. *Id.* at 236.

111. *Id.* at 233.

112. Ruth Bader Ginsburg, *A Study Tour of Taiwan's Legal System*, A.B.A. J., Feb. 1980, at 167. Taiwan is a civil law system which relies on little court precedent. *Id.* at 167-170.

113. F.T.L., *supra* note 29, art. 14.

114. *Id.* art. 7; *see also New Policy on Competition*, *supra* note 9.

FTC. To meet approval, the concerted action need benefit the national economy and either: increase efficiency, unify standards, promote joint research and development, maintain orderly imports and exports, avoid bankruptcy or improve SME competitiveness.[115] The notification and approval requirements mirror the European model and differ from the United States which generally prohibits such practices.[116] The FTL collusion provisions resemble a Rule of Reason Doctrine that would decide illegality on an *ad hoc* basis, making it difficult for domestic companies to know initially what collusions fall within the exception.[117] On the other hand, the approval and notification requirements have the potential to make the newly established FTC a "potentially important agency."[118] The predictability problem will solve itself once enough cases are published in government gazettes as required by the FTL.[119]

The FTL's restrictions on vertical restraints as opposed to the provisions on "concerted actions" are much less flexible.[120] The vertical restraint provisions have no notice and approval requirements.[121] The

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115. *See* F.T.L., *supra* note 29, art. 14. The seven specific exceptions to the prohibition of concerted action between Taiwanese enterprises under the FTL include:

> (1) to unify the specifications or models of goods in order to reduce cost, improve quality or increase efficiency; (2) to jointly research and develop goods or markets in order to upgrade technical skills, improve quality, reduce costs or increase efficiency; (3) to engage in specialized areas of business in order to achieve the enterprise's rational operations; (4) to enter into an agreement in respect of the competition in overseas markets in order to secure or promote exports; (5) to take concerted action in respect of the importation of foreign goods in order to strengthen trading capability; (6) to take concerted action in imposing limitations restrictions on the quantity of production and sales, equipment or prices in order to adjust to orderly demand when the enterprises in a particular industrial sector suffer hardship to continue their business operations or over-production due to the fact that the market price of goods remains at a level below the average production cost during economic recession; or (7) to take concernted [sic] action in order to improve the operational efficiency or strengthen the competitiveness of the small and medium-sized enterprises concerned.

*Id.*

116. *Draft*, *supra* note 30.
117. *Id.*
118. *Id.*
119. *Id.*; F.T.L., *supra* note 29, art. 17.
120. *See id.*; *see also* F.T.L., *supra* note 29, art. 18-19.
121. *Draft*, *supra* note 30.

FTL voids any act contrary to its vertical restraint provisions.[122] The vertical restraint provisions restrict trade activity between enterprises to protect the freedom of trading partners to decide the prices of its commodities[123] and to prevent enterprises from improperly limiting the commercial activities of those with whom it transacts business as a condition to such business.[124] In addition, only goods for daily consumption and similar products sold in local markets under free competition are exempted from the vertical restraint provisions.[125] Unlike the many exceptions allowed under the FTL's concerted action provisions, the Taiwanese government has failed to allow for exceptions for vertical restraints that promote productive efficiency or the national interest.

### *E. Antitrust Enforcement Compared*

The FTL's penalty provisions including imprisonment of up to three years[126] and treble damages[127] compare favorably with similar U.S. antitrust provisions.[128] The severe penalties deter those companies that could easily pay lesser fines[129] and should serve as an effective remedy to those foreign corporations suing under the FTL.[130]

The FTL allows imprisonment of up to three years for violation of Articles 10, 14 and 20 dealing with monopoly practices and collusion activities.[131] The FTC has the power to dissolve, suspend or close enterprises that conduct merger activity when those enterprises fail to file an application for merger approval or if that application is denied.[132] Beyond the power to directly affect their business conduct, the FTC can fine merging enterprises who fail to apply or disregard disapproval between 100,000 in New Taiwan Dollars (NT$) and NT$1 million.[133]

The FTL has three different damage remedies depending on whether a violation was intentional or negligent and whether the infringer was

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122. F.T.L., *supra* note 29, art. 18.
123. *Id.*
124. *Id.* art. 19.
125. *Id.* art. 18. The FTC will publicly announce those items of daily products referred to in Article 18. *Id.*
126. *Id.* art. 35.
127. *Id.* art. 32.
128. *See* Sherman Act, *supra* note 3, §§ 2; *see* Clayton Act, *supra* note 4, §§ 15.
129. *See* Rickards, *supra* note 35.
130. *See* F.T.L., *supra* note 29, art. 47.
131. *Id.* art. 35.
132. *Id.* art. 13.
133. *Id.* art. 40.

unjustly enriched. An intentional violation can incur as much as treble damages.[134] Until 1988, when treble damages were applied to insider trading under the securities and exchange laws, there was no allowance of treble damages for any violation of any Taiwan law.[135] If the infringer has gained a profit from an FTL violation, compensation can be claimed for that amount.[136] However, with no discovery procedures, it will be difficult for victims of discriminatory practices to prove a defendant's unjust enrichment.[137]

An additional remedy that may serve as an effective deterrent includes a provision that would allow for the FTC to announce those enterprises holding at least a one-fifth market share[138] and publicize judgment amounts by request of the injured party in a suit.[139] In addition, continual fines of NT$1 million can be assessed until action ceases.[140]

One criticism of the enforcement provisions is the lightness of the FTL fines compared with the U.S. antitrust fines. A maximum fine in Taiwan, which would include an award for treble damages, would be close to $100,000 (U.S. dollars), while in the U.S., the Antitrust Amendments Act of 1990 increased fines under sections 1 and 2 of the Sherman Act from $1 million to $10 million for corporations and from $100,000 to $850,000 for individuals.[141]

The effectiveness of the FTL enforcement will depend on the FTC. "The FTC will have the power to investigate possible violations of the law and impose administrative sanctions."[142]

> Although it is possible that restrictive interpretations of the law could eviscerate some of its provisions, the current judicial approach to enforcement of the Trademark Law and other intellectual property laws provides good reason to anticipate that the Fair Trade Law will be interpreted in most instances in a manner that will not degrade its usefulness.[143]

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134. *Id.* art. 32.
135. *New Policy on Competition*, *supra* note 9.
136. F.T.L., *supra* note 29, art. 32.
137. Rickards, *supra* note 35.
138. F.T.L., *supra* note 29, art. 11.
139. *Id.* art. 34.
140. *Id.* art. 41.
141. *See* Lester M. Bridgeman, *Antitrust Amendments Act of 1990*, 58 TRANSP. PRAC. J. 254 (1991); Sherman Act, *supra* note 3, § 2.
142. *New Policy on Competition*, *supra* note 9.
143. Rickards, *supra* note 35.

Despite the lax enforcement of previous Taiwanese laws dealing with restraint of trade such as the Law Governing Agriculture, Mining, Commercial and Industrial Enterprises and the Foodstuff Laws,[144] there is reason to believe that Taiwan will enforce the provisions. This optimism is based on Taiwan's increased enforcement of intellectual property rights.[145]

The FTL's statute of limitations for individual action is fairly liberal, making the limit to file a complaint two years after discovery or ten years after the action occurred.[146] The United States only allows four years from the accrual of the action for individuals to file an action under the antitrust provisions.[147]

Foreign sovereignties may file a complaint or file suit if certain conditions are met.[148] The FTL requires reciprocity, meaning that a foreign enterprise's government must extend the same protection to Taiwanese enterprises as the FTL provides to the complaining foreign enterprise.[149] The "fairer and more open business environment"[150] created by the FTL should encourage U.S. companies to invest in Taiwan.

The FTL's reciprocity provision may have little effect, however, due to other Taiwanese laws that hinder foreign investment.[151] Foreign investment in Taiwan is governed by the Statute for Investment by Foreign Nationals and the Statute for Investment by Overseas Chinese.[152] The two statutes direct the Taiwanese Investment Commission to only approve foreign-invested projects that (1) produce needed goods and services; (2) "have an export market;" (3) will aid in development of Taiwanese "industrial, mining, or communications enterprises;" (4) are involved in "scientific research and development;" or (5) benefit the "social and economic development" of Taiwan.[153] These projects then receive favored tax treatment.[154] Without tax incentives, foreign-

144. *See Draft*, *supra* note 30 (discussing how these laws are rarely enforced).

145. DOING BUSINESS, *supra* note 18, at 55. Taiwan's Patent Law, amended in 1986, "increases protection available to patent holders and expand[s] the number and scope of inventions covered." *Id.* Taiwan's Copyright Law, revised in 1985, "provides wide-ranging protection for authors of almost all original works." *Id.* at 57. Also, Taiwan protects registered and even some unregistered trademarks. *Id.* at 56.

146. *See* F.T.L., *supra* note 29, art. 33.

147. Clayton Act, *supra* note 4, § 15(b).

148. *See* F.T.L., *supra* note 29, art. 47.

149. *See id.*

150. *Cf.* Hsu, *supra* note 52, at 378.

151. *See* Pierce, *supra* note 10, at 4-5.

152. *Id.* at 5.

153. *Id.*

154. *Id.*

invested projects falling outside of the five allowable categories is a rarity.[155] In addition, foreign investment is prohibited or restricted in Taiwanese industries such as inland transportation, public utilities and certain defense-related industries.[156]

## V. POSSIBLE DOMESTIC AND INTERNATIONAL EFFECTS OF FTL

Many argue that there is no need for the FTL because in the mid-1960s the island boomed and there has been little consolidation of smaller firms into larger ones. Mergers are a rarity in Taiwan. "[T]here is a strong tendency for small firms to persist and grow modestly over time."[157] A number of commentators, though, do suggest that the FTL antitrust provisions will have an effect on business practices in Taiwan.[158] The type of effect, however, will depend on the vigorousness of the FTC's enforcement. Regardless of the domestic impact of the law, enacting the FTL has already shown signs of pleasing the international community, especially the United States. Once the FTL becomes effective, the competent authority will need to maintain a very fine balance between domestic and international interests. Overly strict enforcement will retard domestic business growth, while lax enforcement will deplete the initial international goodwill bestowed on Taiwan for passage of an antitrust law.

### *A. FTL Effect on the Taiwanese Economy*

Strict domestic enforcement of the FTL's antitrust provisions may contradict Taiwanese policy on encouraging domestic high-technology investment and research and development growth.[159] Taiwan's current goals under a new six-year plan call for: "(1) raising national income; (2) providing sufficient resources for continued industrial growth; (3) promoting the balanced development of various regions; [and] (4) raising the national quality of life."[160] The current economic status of Taiwan is the result of exporting products from labor-intensive small businesses

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155. *Id.*

156. *Id.* at 16.

157. *Restoring International Balance*, *supra* note 21, at 10.

158. Hsu, *supra* note 52, at 378; Rickards, *supra* note 35; *New Policy on Competition*, *supra* note 9.

159. *Cf.* Wheeler, *supra* note 25, at 489-90 (discussing the conflict between Taiwanese government's policies and Taiwan's economic structure).

160. ROC DEVELOPMENTAL PLAN, *supra* note 17, at 2.

with low value-added. For the 1990s, the new six-year development plan recognizes the importance of creating more high-tech industries with a greater value-added.[161]

> [T]hese problems reflect inherent conflicts between policy goals and Taiwan's economic structure. For example, the small size of the average firm and broad-based entrepreneurial spirit have been key sources of Taiwan's flexibility and economic dynamism. Yet larger, professionally managed firms have become even more important to Taiwan's future as technology, capital, and global marketing have become more central to the state's most competitive exports.[162]

SMEs lack the requisite capital to stay competitive in the high-technology industries.[163] Any law, such as the FTL, which regulates the activities of business, may either hinder or help the government's goal of increasing Taiwanese competitiveness in high-technology industries depending on the frequency and arbitrariness of enforcement. If the FTC is overly aggressive in enforcing the FTL provisions, it could hamper the government's goal of encouraging enterprise growth to meet the demands of the international marketplace. To give the FTC some flexibility, the FTL allows many collusions between businesses.[164] Justifications for collusion include improving economic efficiency, joining resources for research and development, creating joint agreements on exports or imports and, in hard times, colluding to reduce production to increase prices.[165]

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161. *See id.* at 3-4. Specific methods the Taiwan government is using to increase the size of its firms include: (a) promoting larger firms; (b) giving tax benefits to those "firms that list on the stock exchange;" (c) providing tax benefits that support mergers; and (d) giving "incentives for firms to develop direct links with their subcontractors." *See* Wheeler, *supra* note 25, at 487; *see also* Boydell, *supra* note 36, at 29 (discussing how CETRA is starting a new program to help Taiwanese companies enter the merger and acquisition field and to ally with medium and large-sized firms abroad). *But see Much Ado about SMEthing*, FREE CHINA REV., May 1990, at 68 (stating, "'Internationalization is not a monopoly of big business, and SMEs can also go international if they put proper emphasis on both management and product development.'").

162. Wheeler, *supra* note 25, at 489. "Taiwan's great strength has been its highly successful small and medium-size companies, which possess great flexibility. But this strength is also a weakness: there is a shortage of large firms capable of moving into high technology areas requiring very large investments." *Id.* at 475.

163. *Id.* at 484.

164. *See* F.T.L., *supra* note 29, art. 14.

165. *Id.*

### B. *Taiwanese Government Control Over Economy Will Shape FTL Effect*

Because the Taiwanese government plays such a large role in the economy as compared to a more traditional free enterprise system such as the United States, it will be difficult to prove the effectiveness of the FTL. For instance, the FTL exempts from antitrust provisions all acts by "government enterprise[s], public utilit[ies] or communications and transportation enterprise[s] approved by the Executive Yuan for five years from the effective date of the FTL, February 4, 1992.[166] The five-year exception for public enterprises "is potentially controversial, in that the private sector may believe that the draft FTL does not treat private and public sector enterprises with an even hand."[167] Other exemptions include enterprises importing on a joint basis to maximize trade efficiency,[168] legal monopolies created through patent, trademark and copyright laws,[169] and "any act performed by an enterprise in accordance with other laws."[170] These exceptions leave large holes in the FTC's ability to enforce the FTL and achieve the purposes set out in the FTL's initial provisions.[171] However, when many of Taiwanese public companies become subject to FTL jurisdiction, the law will gain some bite.[172] It will make Taiwanese markets both more competitive as well as more efficient and will contribute to even more liberalization and internationalization of the Taiwanese economic system.[173]

### C. *FTL Will Positively Effect Taiwanese Trade Relationships*

Perhaps the largest benefit Taiwan will realize from the FTL will be international goodwill. Because of the international pressure for Taiwan to pass some type of fair trade law, passing the FTL will encourage and promote the Taiwanese export market as protectionist fears ease. However, "[a]lthough billed as a means of regulating monopolies, mergers and cartels and checking unfair business practices and competition, the proposal is a far cry from most Western codes governing these areas."[174]

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166. *Id.* art. 46.

167. *See Draft*, *supra* note 30.

168. *See Doing Business*, *supra* note 18, at 58.

169. F.T.L., *supra* note 29, art. 45.

170. *Id.* art. 46.

171. *See supra* note 39 and accompanying text for FTL's stated purposes.

172. *See New Policy on Competition*, *supra* note 9.

173. *See Doing Business*, *supra* note 18, at 58.

174. *Rules of Competition - General*, Investing Licensing & Trading, March 1, 1989 *available in* LEXIS, Europe library, Inlitr file.

## VI. CONCLUSION

The FTL provides a framework for balanced economic growth in Taiwan. On the surface, the FTL provisions balance the need to protect consumers from anticompetitive behavior and the need of Taiwanese business to compete internationally. The plain language of the FTL provides for enough flexibility in enforcement to benefit Taiwanese consumers and competitors while allowing enough mergers and business growth for Taiwan to continue to expand economically. Once the FTL applies to all Taiwanese companies, it will serve as an effective force for protecting foreign enterprises doing business in Taiwan. Along with other intellectual property rights improvements, the FTL should help ease U.S. protectionism threats.

The Taiwanese proverb, "It is better to be the head of a chicken than the tail of an ox," illustrates the importance of SMEs to Taiwan's continued growth. If the FTL accomplishes nothing else, it should protect the SMEs that have allowed Taiwan to achieve economic success.

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# Antitrust in the United States and European Community: Toward a Bilateral Agreement

## I. Introduction

Citing dramatically increased imports and decreased exports in the machine tool industry, semiconductor market, television market and auto parts industries, a U.S. Senator recently described America's industrial base as "in peril".[1] A widely held perception ascribes this decline in American business to foreign rivals' immunity from American antitrust laws.[2] Specifically, it is felt that foreign business rivals are permitted to prey on American consumers while remaining immune from the antitrust burden borne by American companies, and that this inequity renders domestic firms disadvantaged on the global market.[3]

These perceptions may be aggravated by the impending economic union in Europe. By December 31, 1992, twelve European Countries will join economic forces to become one of the most formidable entities in the economic world, the European Economic Community (EEC).[4] Companies operating in the United States will find themselves trading among and competing with a unified market of 325 million consumers with an average per capita income of $14,500.[5] It is predicted that European businesses will emerge in 1993 larger, more efficient, and more profitable than ever before in world economic history.[6] Given that the largest commercial partner of the United States is the European Community,[7] it is axiomatic that changes in the European Community

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1. *Hearing Before the Consumer Subcomm. of the Senate Commerce, Science, and Transportation Comm.*, 101 Cong., 1st Sess. [hereinafter *Hearings*] (statement of Senator Bryan).

2. *Id.*

3. *Id.* at 2.

4. The following countries have joined the EEC: France, Italy, Germany, Belgium, the Netherlands, Luxembourg, Denmark, Greece, Ireland, Portugal, Spain, and the United Kingdom. Caterina Cregor, *An Overview of the European Economic Community and Eastern Europe: Trade Opportunities,* International Law, Advising Clients Trading with EEC and Eastern Europe, Indiana Continuing Legal Education Foundation (1990) [hereinafter Cregor].

5. *Id.*

6. *Id.*

7. *Id.* In 1989, one of every four dollars of export earnings by United States companies was earned in trade with Europe, for a total of $87 billion. Moreover, direct world investment in the United States is led by Europe, as seven of the top ten investing countries are European. European investments in the United States are led by the United Kingdom, the Netherlands, and the Federal Republic of Germany. Export sales of EEC companies in the United States are close to $400 billion. *Id.*

will affect foreign as well as domestic operations of United States businesses.

While a strident commitment to free and open competition is one of the historical bedrocks of U.S. economic success,[8] the European Community has just begun to enter the market regulation arena. Relative to institutionalized U.S. merger control policies and law, which have matured throughout over a century of practical application, merger control in the European Economic Community is a new and developing phenomenon. Member states' commitment to free trade is evidenced in their unifying treaty, which, in Article 3, proclaims, "[t]he activities of the Community shall include. . . the establishment of a system ensuring that competition shall not be distorted in the Common Market. . . ."[9] Given that the volume of international commercial activity affecting both the United States and the European Economic Community is worth close to a trillion dollars annually,[10] domestic firms on both sides of the Atlantic are potentially subject to multiple antitrust reviews which apply differing criteria.

Although the EEC Merger Control Regulation has been in force just over one year,[11] Sir Leon Brittan, Vice President of the Commission of the European Communities, has already proposed a bilateral agreement between the United States and the European Community to provide for more uniform decisions in the competition field.[12]

Approaches to such a bilateral agreement could take innumerable shapes. This note will highlight the need for a bilateral agreement between the United States and the European Economic Community through an analysis of jurisdictional and substantive issues in the com-

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8. The Sherman Act was passed over one hundred years ago, in 1890, in response to rapid industrialization and increasing concentration in the petroleum, tobacco, cotton oil, linseed oil, and paper industries. D.M. RAYBOULD & ALISON FIRTH, COMPARATIVE LAW OF MONOPOLIES 11 (1991).

9. Treaty Establishing the European Economic Community (EEC), Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter Treaty of Rome] (elipse added).

10. Cregor, *supra* note 4.

11. Although the origins of the EEC Merger Control Regulations date to 1973, when the Council of the European Communities considered a proposal by the Commission of the European Communities to regulate the concentrations of undertakings in the EC, Council Regulation 4064/89 of 21 December 1989 on the Control of Concentrations Between Undertakings did not enter into force until September 21, 1990. *See* Mark Dassesse, *Selected Aspects of the European Economic Community Law on Investments and Acquisitions in Europe*, 25 INT'L LAW., 375, 376 (1991) *citing* 1990 O.J. (L 257) 13.

12. *Id.* at 386.

petition field, with an emphasis on mergers and acquisitions. The primary focus will be on the need to build a preliminary foundation of understanding in the areas of antitrust enforcement jurisdiction, substantive merger review, and international discovery needs. These three basic foundations are proposed as fundamental prerequisites to negotiations of a bilateral agreement; while by no means exhaustive, clarification of these three areas is offered as a preliminary framework upon which to base treaty discussions in the future.

## II. ANTITRUST ENFORCEMENT: JURISDICTIONAL PREMISES

While the need for an agreement allocating jurisdiction between U.S. and EEC authorities in competition cases has been expressed,[13] fruitful discussions on the proposal cannot be held until jurisdictional issues are viewed with uniformity by differing authorities within the same country. Treaty negotiators cannot expect to exact consensus on the allocation of jurisdiction between their respective states if they bring to the table discordant views of their own country's approach to such disputes.

### A. *Antitrust laws and jurisdiction in the United States*

United States free market competition was recognized as an important foundation of commercial success in the United States as early as 1890 with the passage of the Sherman Act.[14] Today, those principles are embodied in the U.S. antitrust laws, which solidly commit our nation to a free market economy "in which the competitive process of the market ensures the most efficient allocation of our scarce resources and the maximization of consumer welfare."[15] The primary thrust of Section 1 of the Act is to prohibit contracts, combinations, or conspiracies in restraint of trade or commerce.[16] The Act supplies the basis for extraterritorial application of the law by proscribing such acts as "among the several states or with foreign nations."[17] In Section 2, the Act makes it illegal for anyone to either attempt to or to monopolize any part of the United States interstate trade or commerce.[18] The Sherman Act is a criminal statute, but tends to be enforced in civil

13. *Id.*
14. RAYBOULD, *supra* note 8.
15. 6 THE DEPARTMENT OF JUSTICE MANUAL 7-1.100 (Supp. 1990-1).
16. RAYBOULD, *supra* note 8.
17. 15 U.S.C. § 1, Pub. L. No. 101-588, § 4(a), 104 Stat. 2880 (1988).
18. RAYBOULD, *supra* note 8.

proceedings brought by the Justice Department or by a State Attorney General.[19] Section 73 of the Wilson Tariff Act of 1894[20] prohibits an importer of goods into the United States from combining or contracting to create anti-competitive consequences in the domestic market. Section 5 of the Federal Trade Commission Act proscribes "unfair methods of competition" and "unfair or deceptive acts or practices,"[21] vesting enforcement authority under Section 5 with the Federal Trade Commission, although no private action exists under this Section.[22]

The most important antitrust statute to be passed after the Sherman Act is the Clayton Act of 1914.[23] Price discrimination by a seller of commodities of like grade and quality is proscribed, as is the conditioning of sales upon the agreement that the buyer not use or deal in products of competitors of the seller.[24] The Clayton Act confers subject matter jurisdiction over a "person engaged in commerce," and includes in that definition those "corporations and associations existing under or authorized by. . . the laws of any foreign country."[25] The burden of proof under the Clayton Act is said to be lighter than the burden under the Sherman Act, the latter requiring a showing of actual anti-competitive consequences.[26] In 1976, the Hart-Scott-Rodino Antitrust Improvement Act added a new Section 7(a) to the Clayton Act, requiring that plans for certain acquisitions and mergers be communicated to the

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19. *Id.* at 13. Additionally, a private suit seeking three times the actual damages may be brought by a victim harmed by the prohibited behavior. *See also supra* note 16, where the the role of the Antitrust Division of the Department of Justice is established first as an enforcement agency, prosecuting civil and criminal violations under the Sherman and Clayton Acts, and secondly as an advocater, appearing before Congressional committees and federal regulatory agencies to articulate pro-competitive policies.

20. 15 U.S.C. § 8 (1982). Violation of the Act is a misdemeanor, carrying a maximum penalty of $5,000 and/or one year in jail. Section 11 provides for seizure of the imported article. *See also* BARRY E. HAWK, UNITED STATES, COMMON MARKET, AND INTERNATIONAL ANTITRUST: A COMPARATIVE GUIDE 33 (2nd ed. 1986), noting, "The antitrust provisions of the Wilson Tariff Act have received little more than passing comment from the courts. Courts have treated the Act as simply a more specific application of the Sherman Act to import restraints."

21. 15 U.S.C. § 45(a)(1), Pub. L. No. 100-86, 101 Stat. 655 (1987).

22. *Id.*

23. 15 U.S.C. § 12, Pub. L. No. 94-435, 90 Stat. 1397 (1991).

24. *Id.*

25. *Id.* (elipse added).

26. RAYBOULD, *supra* note 8, at 61. This showing is not required in offenses under Section 1 of the Sherman Act providing for per se presumptions of anti-competitive effects. *Id.*

Federal Trade Commission and the Antitrust Division of the Department of Justice.[27]

The United States Department of Justice Antitrust Division and the Federal Trade Commission (FTC) are responsible for enforcing the federal antitrust laws. The Federal Trade Commission Act, provides authority of the FTC in section 5, giving the FTC jurisdiction over "unfair methods of competition in or affecting commerce."[28] The FTC also has enforcement responsibility under Sections 2, 3, 7, and 8 of the Clayton Act, covering price discrimination, tying and requirements contracts and anticompetitive acquisitions of stocks or assets, and interlocking directorates respectively.

The Antitrust Division of the Department of Justice is responsible for coordinating enforcement efforts, with jurisdiction to enforce proscriptions against private restraints of trade (such as price-fixing, bid-rigging, and other collusive arrangements among competitors) that unreasonably impede the free forces of the market.[29] While enforcement of the Sherman Act is the primary role of the Division, it also shares concurrent jurisdiction over Section 7 of the Clayton Act (mergers) with the FTC.[30]

These laws and enforcement authorities are not limited in their effects to the United States. Enforcement efforts of the Antitrust Division sometimes reach foreign defendants and conduct that occurs beyond the territorial boundaries of the United States.[31] The Foreign Trade

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27. *Id.* Title I (of the Act) is procedural: it amplifies the powers of the Department of Justice given under the Antitrust Civil Process Act 1962 to issue a civil investigative demand requiring disclosure of information prior to commencing any antitrust proceedings. Title II amends the Clayton Act Section 7 by requiring premerger notification. Title III provides for actions parens patriae on behalf of persons residing in a State by the State Attorney-General in respect of violations of the Sherman Act. *Id.*

28. 15 U.S.C. § 45(a)(1) (1987).

29. HAWK, *supra* note 20, at 32.

30. Although beyond the scope of this discussion, it may be argued that the FTC, since a legislatively mandated, independent agency, enjoys more autonomy than the DOJ Antitrust Division, which, as a part of the Executive branch, may be more susceptible to political persuasion.

31. ANTITRUST ENFORCEMENT GUIDELINES FOR INTERNATIONAL OPERATION, *supra* note 15, at 7-244.99.

> "Just as the acts of U.S. citizens in a foreign nation ordinarily are subject to the law of the country in which they take place, the acts of foreign citizens in the United States ordinarily are subject to U.S. law. The reach of the U.S. antitrust laws is not limited solely to conduct and transactions that occur within the United States, however. Conduct relating to U.S.

Antitrust Improvement Act provides that the Sherman Act applies to anti-competitive export conduct of U.S. firms when that conduct would have a direct, substantial, and reasonably foreseeable effect on trade or commerce within the United States or on import trade or commerce.[32]

B. *Antitrust laws and jurisdiction in the EEC*

The Treaty of Rome[33] establishes a common market of goods, services and agricultural products. The EEC is targeted to materialize December 31, 1992 among twelve European countries.[34] Article 3 of the Treaty provides that the EEC will, among other activities, establish "a system ensuring that competition shall not be distorted in the Common Market."[35] Importantly, Community law is said to enjoy primacy over national laws of the respective member states, each of which have varying standards and interpretations of free market competition. "By contrast with ordinary international treaties, the EEC Treaty has created its own legal system, which, on the entry into force of the Treaty, became an integral part of the legal systems of the Member States and which their Courts are bound to apply."[36]

Promotion of free markets and the preservation of competition within the European markets unified under the treaty fall largely under

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> import trade that harms consumers in the United States may be subject to the jurisdiction of the U.S. antitrust laws regardless of where such conduct occurs or the nationality of the parties involved.

*Id.*

32. *Id.* at 7-244.101. *But cf.* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES (1987) § 808-2 (Emergency Action to Protect Domestic Producers):

> Under the law of the United States, upon a finding by the International Trade Commission that increased imports are a substantial cause of serious injury or threat of serious injury to domestic producers, the President may provide relief to affected domestic parties by (a) restricting imports through tariffs or quantitative restrictions, or (b) negotiating an orderly marketing agreement.

With respect to the latter, the Trade Expansion Act of 1962, 19 U.S.C. § 1982, authorizes the President to negotiate marketing agreements with foreign countries, while an agreement with private foreign producers is not within the President's authority under the Act, and such an arrangement might constitute restraint of trade in violation of the Sherman Act. *Id.*, reporters' note 5, *citing* Consumers Union v. Kissinger, 506 F.2d 136 (D.C. Cir. 1974), *cert. den.*, 421 U.S. 1004 (1975).

33. Treaty of Rome, *supra* note 9.

34. Cregor, *supra* note 4, at 4.

35. Treaty of Rome, *supra* note 9, art. III.

36. RAYBOULD, *supra* note 8, at 184, *citing* Case 6/64, Coasta v. Enel, C.M.L.R. 455, 456 (1964).

the ambit of articles 85 and 86. Article 85 declares agreements among undertakings that substantially restrict competition within the EEC void.[37] Prohibited are cartel-type arrangements between two or more undertakings having an anti-competitive object or effect, and which may affect interstate trade.[38] The prevention, restriction, or distortion of competition within the common market is specifically prohibited.[39] Nevertheless, the prohibition may be declared inapplicable under paragraph 3 of article 85 when the activity contributes "to the improvement of the production or distribution of goods or to the promotion of technical or economic progress. . . ."[40]

Article 86 prohibits abuse of a dominant position within the EEC,[41] and unlike article 85 contains no exceptions for behavior the positive effects of which outweigh the negative.[42] Article 86 prohibitions apply to abuses which occur within the Common Market, prohibiting them insofar as they may affect trade between Member States.[43]

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37. Marc Dassesse, *Selected Aspects of European Economic Community Law on Investments and Acquisitions in Europe* 25 INT'L LAW. 375, 376 (1991).

38. RAYBOULD, *supra* note 8, at 186.

39. Treaty of Rome, *supra* note 9, art. 85 provides in relevant part:

1. The following shall be deemed to be incompatible with the Common Market and shall hereby be prohibited: any agreements between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to affect trade between the Member States and which have as their object or result the prevention, restriction or distribution of competition within the Common Market, in particular those consisting in:

a. the direct or indirect fixing of purchase or selling prices or of any other trading conditions;

b. the limitation or control of production, markets, technical development or investment;

c. market-sharing or the sharing of sources of supply;

d. the application of parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

e. the subject of the conclusion of a contract to the acceptance by a party of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

2. Any agreements or decisions prohibited pursuant to this Article shall be null and void.

40. Treaty of Rome, *supra* note 9, art. 85, ¶ 3.

41. Dassesse, *supra* note 38, at 377.

42. *Id.* at 376.

43. RAYBOULD, *supra* note 8, at 187. The full text of Article 86 provides: To the extent to which trade between any Member States may be affected

The sufficiency of articles 85 and 86 in their ability to protect free markets has been reviewed and found wanting. According to a European professor of law, "[articles 85 and 86] are limited and technically inadequate to do the job. For example, article 86 may not apply if there is no preexisting dominant position, and article 85 may not apply if there is no agreement between undertakings to start with."[44]

Moreover, mergers of companies the effects of which reach beyond the borders of the host nation have been potentially subject to review by a number of EEC competition authorities, both at the Commission and the Member State levels.[45] Perhaps arising from exigencies noted above, the EEC Merger Control Regulation, which entered into force on September 21, 1990, clearly delineates jurisdiction and authority over mergers, providing circumstances under which the Commission of the European Communities has sole jurisdiction over merger regulations, subject to review by the Court of Justice.[46]

The principal institutions of competition enforcement are the Council of Ministers, the Commission, the Directorate General IV, and the

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thereby, action by one or more enterprises to take improper advantage of a dominant position within the Common Market or within a substantial part of it shall be deemed to be incompatible with the Common Market and shall hereby be prohibited. Such improper practices may, in particular, consist in:

a. the direct or indirect imposition of any inequitable purchase or selling prices or of any other inequitable trading conditions;

b. the limitation of production, markets or technical development to the prejudice of consumers;

c. the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

d. the subjecting of the conclusion of a contract to the acceptance, by a party, of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

44. Dassasse, *supra* note 37, at 377.

45. *Id.* at 378.

46. *Id., citing* Council Regulation 4064/89 of 21 December 1989 on the Control of Concentrations between Undertakings, 1990 O.J. (L 257) 33 [hereinafter Council Regulation]. The Council Regulation provides, in art 21:

1. Subject to review by the Court of Justice, the Commission shall have sole jurisdiction to take the decisions provided for in this regulation [for mergers exceeding the minimum turnover criteria laid down by the Regulation and thus having a "community dimension".]

2. No member state shall apply its national legislation on competition to any consideration [concentration] that has a community dimension.

Court of Justice of the European Communities.[47] Competition rule-making authority rests with the Council of Ministers.[48] Enforcement of EEC competition policy rests with the Commission and the Directorate General IV.[49] Finally, as noted above, the Court of Justice has the authority to review decisions rendered by the Commission.

### C. *Extraterritorial Jurisdiction and Customary International Law*

Were international competition regulations in accord throughout the world, and were extraterritorial jurisdictional provisions among the states clearly and historically delineated, customary international law would neatly prescribe jurisdictional and substantive disposition of international merger disputes. "It would be difficult, perhaps impossible, to find a national legal system the courts of which arbitrarily refused to apply rules of customary international law not in conflict with domestic law. . . ."[50] However, there is relatively little customary international law of economic relations,[51] and developing theories supporting application of domestic law to foreign transactions reflect ambiguous and sometimes conflicting approaches.

While the Sherman Act expressly applies to restraints of trade with foreign nationals,[52] a federal court first held the Sherman Act applicable to conduct outside the United States where acts evidenced both an intent to and an effect on United States domestic or foreign commerce.[53] Likewise, in *Beguelin Import Co. v. S.A.G.L. Import Export*, an action challenging an exclusive distribution agreement between a Common Market state and a non-common market state, the European Court of Justice held, rather summarily, that effects *felt* within the European Community sufficed to give the court jurisdiction to adjudicate the

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47. 2 BARRY HAWK, UNITED STATES, COMMON MARKET, AND INTERNATIONAL ANTITRUST: A COMPARATIVE GUIDE 3-5 (2d. ed. Supp. 1990).

48. Treaty of Rome, *supra* note 9, art. 87.

49. Hawk, *supra* note 48, at 4.

50. JOSEPH M. SWEENEY ET AL., THE INTERNATIONAL LEGAL SYSTEM, CASES AND MATERIALS 9 (3d ed. 1988).

51. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES 261 (Introductory Note 1987).

52. *See supra* note 17 and accompanying text.

53. United States v. Aluminum Co. of America, 148 F.2d 416, 443 (2d. Cir. 1945), stating that "any state may impose liabilities, *even upon persons not within its allegiance*, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize." *Id.* (emphasis added).

matter within article 85 of the Treaty of Rome.[54] While the *Beguelin* Court was primarily concerned with whether the parent-subsidiary company relationship satisfied the article 85 requirement of an agreement between undertakings and whether the exclusive dealership was amenable to an exception provided in an implementing regulation, it simply concluded that the fact that one of the firms involved was a Japanese firm was of no importance so long as it was established that competition within the territory of the Community suffered and that the agreements in question affected trade between Member States.[55] In this case, a Japanese firm, Oshawa, had granted exclusive distribution rights to Beguelin Imports[56] for the distribution in France and Belgium of lighters bearing the Oshawa mark. The European Court of Justice found the exclusive agency agreement between a non-EEC member producer and EEC distributor prohibited by article 85 (1) when it obstructs, "de jure or de facto" the distributor's re-exportation of the products in question to other member-states, or when it prevents the product from being imported from other member-states into the protected zone and being distributed there by persons other than the concessionnaire or his customers.[57]

Both the United States *Alcoa* case and the European Court of Justice *Beguelin Import* case support application of domestic antitrust laws to conduct involving foreign firms pursuant to the "effects doctrine." Both approaches are consonant with international law as articulated in the Restatement of Foreign Relations, which provides that "[A] state has jurisdiction to prescribe law with respect to . . . conduct outside its territory that has or is intended to have substantial effect within its territory."[58]

Within this broad parameter, however, remains a great deal of latitude for weighing when and in what circumstances domestic antitrust

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54. Case 22/71, Beguelin Import Co. v S.A.G.L. Import Export, 1971 E.C.R. 949, 1972 C.M.L.R. 81.

55. *Id.* at 954.

56. While the original agreement was with the Belgian parent company, the French subsidiary Beguelin Import Co. of France, took over the exclusive concession in France. The dispute arose when Beguelin sought injunctive relief to prevent a third company, G.L. Import Export, of Nice, from marketing the articles in France. G.L. Import Export responded to the injunction by asserting that the exclusive concession between Oshawa and Beguelin France violated Art. 85, as constituting an obstacle to freedom of trade within the Community. *Id.* at 950, 951.

57. *Id.* at 970.

58. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402 (1987).

laws will be applied to conduct occurring within the territory of another nation when the interests of both (or multiple) nations are affected. It is in this arena— where dual and equal grounds exist to support application of jurisdiction— where the most difficulty lies. It follows that a firm understanding of the varying approaches to answer this question is an absolute prerequisite to any bilateral agreement preemptively allocating jurisdiction between European Community and United States fora.

In 1984, in *Timberlane Lumber v. Bank of America*, the United States Court of Appeals sanctioned a seven-step balancing approach to determine whether to apply domestic antitrust laws in a private action seeking damages from an alleged conspiracy instituted and conducted in Honduras.[59] While ultimately declining to exercise jurisdiction, the decision on review kept intact a seven-step weighing approach formulated in the earlier decision.[60] In weighing whether to exercise jurisdiction, the Ninth Circuit Appellate Court considered: the degree of conflict with foreign law or policy, the nationality or allegiance of the parties and the locations of principal place of business, the extent to which enforcement can be expected to achieve compliance, the relative significance of effects on the United States as compared with those elsewhere, the extent of explicit purpose to harm or affect American commerce, the foreseeability of such effect, and finally, the relative importance to the violations charged of conduct within the United States as compared with conduct abroad.[61]

Within the year, a conflicting decision eschewing this balancing approach was handed down by another United States Court of Appeals, this time from the District of Columbia.[62] In *Laker Airways v. Sabena, Belgian World Airlines*, a British airline operating in the United States was allegedly forced into bankruptcy by antitrust violations by other airlines, and sought remedy under U.S. antitrust laws. In a series of rather complicated maneuvers, three months after Laker Airways filed the antitrust action in the United States, several of the defendants sought and were granted an injunction by the High Court of Justice of the United Kingdom to forbid Laker Airways from proceeding with

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59. Timberlane Lumber Co. v. Bank of America, 749 F.2d 1378 (9th Cir. 1984) (Timberlane II) *cert. den.*, 472 U.S. 1032 (1985).

60. Timberlane Lumber Co. v. Bank of America, 549 F.2d 597 (9th Cir. 1976) (Timberlane I).

61. Timberlane v. Bank of America, 749 F.2d 1378, 1383-1386 (9th Cir. 1984).

62. Laker Airways Ltd. v. Sabena, Belgian World Airlines, 731 F.2d 909 (D.C. Cir. 1984) [hereinafter Laker].

its American antitrust claim against them.[63] Fearing that the remaining two defendants would seek similar relief, Laker Airways sought and was granted injunctive relief from the U.S. District Court which barred the remaining defendants from seeking British injunction to force Laker to dismiss its suit against them.[64]

Then, on May 20, 1983, the High Court of Justice held that the application of the American antitrust laws to companies carrying on business in the United States *was not contrary to British sovereignty*, with the disclaimer that in the event the English Secretary of State should declare that Britain's trading interests were negatively implicated, that holding could change.[65] Such a determination was made,[66] and in the next month the British Government invoked the British Protection of Trading Interests Act,[67] requiring all persons conducting business in the United Kingdom to "disobey all foreign orders and cease all compliance with the foreign judicial or regulatory provisions designated by the Secretary of State."[68] The Act sought to prevent United Kingdom courts from cooperating with foreign tribunals' requests for documents, and forbade enforcement of treble damage awards or antitrust judgments as specified by the Secretary of State.

In deciding to proceed with the United States antitrust suit, the District of Columbia Circuit acknowledged that sufficient contacts existed within both the United States and England to support concurrent prescriptive jurisdiction.[69] The court noted that "the mere existence of dual grounds of prescriptive jurisdiction does not oust either one of the regulating forums. Thus, each forum is ordinarily free to proceed to a judgment."[70] However, in examining both the motive of the defendants in seeking injunctive relief from the British High Court,[71]

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63. *Id.* at 915.

64. *Id.*

65. *Id.* at 919, (emphasis added).

66. *Id.* at 920.

67. Protection of Trading Interests Act, 1980, ch. 11, Appendix of Record Excerpts Submitted on Behalf of Appellants Sabena and KLM at Tab 5, cited in *Id.* at 918.

68. *Id.* at 920.

69. *Id.* at 926.

70. *Id.*

71. *Id.*

"Appellants . . . are not interested in concurrent proceedings in the courts of the United Kingdom-they want only the abandonment or dismissal of the American action against them. . .[that they did not pursue a limited injunction that would have permitted the United States proceedings to

and in reasoning that the result of granting jurisdiction to England would be to render the plaintiff without remedy,[72] the Court found that it could not decline jurisdiction without totally abdicating its responsibility to protect businesses operating in the United States. Recognizing the opposition of the British Government to the right of the United States to apply its antitrust laws to British air carriers operating in the United States, the court held the antisuit injunction to be necessary to protect United States jurisdiction.[73] In giving what it termed serious consideration to comity principles, the court held:

> When the foreign act is inherently inconsistent with the policies underlying comity, domestic recognition could tend either to legitimize the aberration or to encourage retaliation, undercutting the realization of the goals served by comity. No nation is under an unremitting obligation to enforce foreign interests which are fundamentally prejudicial to those of the domestic forum. Thus, from the earliest times, authorities have recognized that the obligation of comity expires when the strong public policies of the forum are vitiated by the foreign act.[74]

While the court literally dismissed the balancing approach of *Timberlane* as inadequate as a basis for selecting one forum's prescriptive jurisdiction over that of another,[75] it could be argued that the *Laker* analysis also involves an interest balancing approach, albeit of a different color. Essentially, the *Laker* court employed an interest balancing approach in juxtapositioning the intent behind the defendant's seeking injunctive relieve from the British tribunal and the British motive in supporting it against the interest of the United States in enforcing its

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continue] indicate[s] that they are only interested in interfering with the antitrust action, and not in adjudicating the existence of an unlawful conspiracy under British law."

*Id.* at 930.

72. *Id.*

"Appellants characterize the district court's injunction as an improper attempt to reserve to the district court's exclusive jurisdiction an action that should be allowed to proceed simultaneously in parallel forums. Actually, the reverse is true. The English action was initiated for the purpose of reserving exclusive prescriptive jurisdiction to the English courts, even through the English courts do not and can not pretend to offer the plaintiffs here the remedies afforded by the American antitrust laws."

*Id.*

73. *Id.* at 934.

74. *Id.* at 937.

75. *Id.* at 948.

antitrust laws. In finding the latter outweighed other considerations, including that of comity, the court's result rested on a weighing analysis.[76]

Of particular importance to a discussion on the need for a bilateral jurisdiction agreement in antitrust cases are tribunals' reluctance to decide the relative merits of the antitrust laws of the United States and England. "We are in no position to adjudicate the relative importance of antitrust regulation or nonregulation to the United States and the United Kingdom. . .the judiciary. . .must weight these issues in the limited context of adversarial litigation. . . ."[77] This language supports resolution of these disputes not in the judicial forum, but in the forum best equipped to weigh foreign policy proposals. Both tribunals' reluctance to formulate foreign policy with respect to antitrust matters, and their frustration in having to adjudicate in an area fraught with diplomatic complexities lends much credence to the call for a bilateral agreement in this area. In short, by refraining from deciding which nation's interests should prevail, the court declined to do by judicial fiat what arguably must be done by a bilateral treaty.

### D. *Conclusion*

In visiting some of the existing jurisdictional disputes, it is clear that while they are not voluminous to date, the frustration illustrated in *Laker* suggests that similar jurisdictional dilemmas may become more prevalent in the future. While the United States has the benefit of over 100 years of application under the Sherman Act, the EEC's competition regulation dates back only to 1957 and the Treaty of Rome, prior to which competition was regulated individually by the respective member states. Application of domestic antitrust laws has not been limited to acts occurring in the domestic territory of either the United States or the EEC. As discussed, the textual provisions of the relevant statutes of both sides provide language which, if the other criteria are met, will allow for extraterritorial application of the law.

While principles of international comity dictate a weighing of factors prior to extraterritorial application of laws, these factors are not always dispositive of the question: with which nation should jurisdiction over this case rest? That is because a sound and objective weighing can

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76. *But see* Deborah K. Owen and John J. Parisi, International Mergers and Joint Ventures: A Federal Trade Commission Perspective, 8 FORDHAM CORPORATE LAW INSTITUTE (B. Hawk, ed., 1991), supporting the reading of Laker as rejecting the interest balancing analysis adopted by the Ninth Circuit in the Timberlane cases.

77. Laker, 731 F.2d at 949, 950.

result in a decision that *both* have equal grounds for prescriptive and enforcement jurisdiction. Specifically, parties may reside and conduct business in both jurisdictions, and the importance to each of the respective authorities in challenging or leaving intact the activity may be equal. This anomaly rests equally with the classic "effects doctrine" of international law, under which a nation has jurisdiction to enforce its laws in response to activities causing substantial effects within its territories. Again, assuming measurability, economic effects of business actions can have an impact in several national economies, thus elevating all parties to equal status in putative disputes.

A classic discussion of why judicial resolution of antitrust jurisdictional disputes on principles of international law is inadequate was provided in *Laker*, where tacit support for discussions between the executive branches of the governments involved was evident. The courts on both sides expressed frustration at being faced with an issue that clashes in the judicial setting due to a failure to act on the part of the executive: both were merely carrying out legislative and administrative directives of their respective countries, and both expressed perceived inadequacies of this approach.

That jurisdictional issues must play a dominant role in bilateral treaty negotiations is therefore evident. Very recently, Sir Leon Brittan, Vice President of the European Economic Community Commission, has called for such bilateral agreement between the United States and the EEC. It is hoped that discussions pursuant to this proposal will prevent a recurrence of judicial frustration of *Laker* magnitude in the future. Granted, consideration of ex ante jurisdiction allocation in the antitrust area will be a delicate and difficult task absent the use of a tangible set of circumstances such as is present in a judicial setting. Any attempt to determine—in advance of a dispute—which nation's laws will prevail must mix the established international doctrines of effect and comity, and leaven them with reasonableness premised upon a desire to promote economic health between the parties. Nonetheless, domestic economies depend upon reasonable certainty for their growth; before domestic businesses operating abroad can plan to accommodate competition regulations, they must know under whose jurisdiction their conduct will fall. To that end, discussions of a bilateral agreement are imperative.[78]

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78. For a perspective limiting these concerns due to overriding practical considerations, *see* Owens and Parisi, *supra* note 76, at 6. (Referring to foreign parties' willingness to accommodate the U.S. Federal Trade Commission in its investigations of antitrust activity, through the use of a consent agreement, as a way to smooth entry into the U.S. business arena).

## III—SUBSTANTIVE VARIATIONS IN MERGER CONTROL REGULATIONS

Part II explored conflicting approaches to assertions of domestic jurisdiction to antitrust behavior conducted by foreign actors. While the difficulty in judicial resolution of antitrust jurisdiction issues may lie, as suggested, in the reality that antitrust policy is customarily set by executive directives, an equally problematic area lies in the substantive approach of the differing jurisdictions. Part III will be devoted to an exploration of the substantive considerations that support decisions on either side of the Atlantic to either challenge or leave intact potentially monopolistic plans. Discussion in this section is limited to the area of mergers. Discussion of merger review in the United States is largely drawn from the Department of Justice Merger Guidelines;[79] discussion of activity in the European Economic Community is drawn from the EEC Regulation on the Control of Concentrations Between Undertakings.[80]

### A. *Product and Market Definition in the United States*

Although critical to any analysis of the possible effects of proposed or enacted mergers, there is little conformity on the identification of domestic and international geographic markets or suitable product alternatives. Thus little uniformity exists in predicting how international markets will react in response to mergers, since these predictions are ordinarily based upon market and product considerations.

In establishing the groundwork fundamental to bilateral treaty discussions in the area of antitrust, an understanding of substantive criteria used by the respective authorities to measure the legality of proposed activity is essential.[81] Recalling from Part II that the United

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79. DEPARTMENT OF JUSTICE MERGER GUIDELINES, *supra* note 31, at 7-19.

80. Council Regulation, *supra* note 46.

81. For a discussion of United States Department of Justice antitrust analysis of mergers having international dimensions, *see generally*, ANTITRUST ENFORCEMENT GUIDELINES FOR INTERNATIONAL OPERATIONS, in 6 THE DEPARTMENT OF JUSTICE MANUAL, *supra* note § 15, at 7-243. (Recognizing that some mergers present procompetitive efficiencies, the Department outlines a four step analysis to identify potential anticompetitive harms. The first step focuses on the markets in which the merged operations operate; step two focuses on other markets in which the parties are actual or possible competitors; step three assesses whether anticompetitive effects of any vertical restraints may arise from the merger [even if parties to the merger are not competitors, vertical relationships can create horizontal problems- see *infra* note 89]; and if steps one through three uncover significant anticompetitive risks, step four allows the Department to consider any efficiencies which would result from the transaction.) *Id.* at 7-244.3.

States Department of Justice enforces antitrust policy pursuant to the Sherman Act and the Clayton Act, acquisitions and mergers are subject to section 1 of the Sherman Act[82] and section 7 of the Clayton Act.[83] A quick glance at the language in these Acts reveals the latitude left in determining whether activities fall into the proscriptions; virtually no guidance in determining violations is given in either Act. Accordingly, the Department of Justice's (the Department) Merger Guidelines set forth merger enforcement policies.

Any review of a proposed merger requires an analysis of market power, which is a function of the firms' product market and geographic market. The Department employs these two concepts to assess the economic impact of a proposed merger to determine whether competition will be lessened as a result of the merger. To focus the analysis on the companies involved in the review, the Department restricts its analysis to economically meaningful markets. The essential inquiry is whether the merged firms could impose and sustain price increases in those markets.[84] Four factors influence whether price increases would be tolerated by the market, and therefore must be assessed in merger reviews: 1) consumers may switch to other products; 2) they may use the same product produced by other firms in other areas; 3) producers of other products could switch existing facilities to the production of the product; or 4) producers could enter into the production of the product by modifying existing facilities or constructing new facilities.[85]

1. *Product Market Definition*

To assess potential effects on competition of proposed mergers, the Department first measures the market for each product (or service)

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82. 15 U.S.C. § 1 (1982). Section 1 prohibits mergers comprising a "contract, combination. . ., or conspiracy in restraint of trade" among the several states of with foreign nations." *Id.*

83. 15 U.S.C. § 18, Pub. L. No. 98-443, 98 Stat. 1708 (1982). Section 7 prohibits mergers if their effect "may be substantially to lessen competition, or to tend to create a monopoly." *Id.*

84. MERGER GUIDELINES, *supra* note 15, at 7-31-32.

> "Formally, a market is defined as a product or group of products and a geographic area in which it is sold such that a hypothetical, profit-maximizing firm, not subject to price regulation, that was the only present and future seller of those products in that area would impose a 'small but significant and nontransitory' increase in price above prevailing or likely future levels."

*Id.* at 7-32.

85. *Id.* at 7-32.

of the firms involved.[86] They create as a tool for their an analysis a hypothetical firm which as the only present and future seller of those products could "profitably impose a small but significant and non-transitory" price increase.[87] The inquiry here is whether there are sufficient product substitutes to enable consumers to switch to other products. If sufficient shifting occurs in the analysis, the Department adds to the product group the next best substitute for the merging firm's product, and goes through the same analysis again. This continues until a group of products is identified for which the hypothetical monopolist could impose the price increase. In general, prevailing market prices are used in the analysis; the price increase applied is five percent and it is presumed to last one year.

For purposes of this discussion, it is important to note the evidence employed by the Department in these analyses. Fundamental to an understanding of how these measurements work is the concept of using historical data as indicators of future activity. In using present market price, the Department acknowledges that changes in price may occur irrespective of the proposed merger. Namely, prices may change in an ultimate reflection of changes in product or environmental regulations. The Department's analysis of the effects of price increases is inferential, and is based on several types of circumstantial evidence, including purchasing trends, historical analyses of pricing, comparisons of characteristics of the products, and evidence of sellers' perceptions regarding whether the products are or are not substitutes. Finally, the Department includes firms in the hypothetical market which could easily convert existing productive and distributive facilities to produce and sell the relevant product within one year in response to the price increase.[88]

2. *Geographic Market Definition*

A similar approach is employed to define the boundaries of the geographic market which would be affected by the merger. First, the Department determines the geographic market (markets) in which that

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86. *Id.*

87. *Id.*

88. *Id.* at 7-34-35. The manual notes that some firms could easily convert their facilities from the production of one product to another, but that these same firms may have difficulty in establishing distribution or marketing strategies in such a short time. These firms are not included in the market analysis. For a discussion of the Department's methods in identifying foreign firms whose production capacity *does* suggest the ability to convert to production of the product in question, *see infra* note 107.

firm sells; the geographic boundaries could be atomistic or as large as the entire world.[89] Again, the analysis seeks to identify the geographic area such that the hypothetical firm, as the only present or future producer or seller of the product in that area, could profitably impose a "small but significant and nontransitory"[90] price increase. If there are plenty of other firms located elsewhere which could provide the relevant product to the consumers at a similar price (building in the cost of transporting the goods into the area) the geographic area will be expanded to include those firms. The analysis continues adding firms from surrounding locations in this manner until the geographic area in which the price increase could be imposed is obtained.

In *United States v. Waste Management,*[91] the Second Circuit cited the Merger Guidelines in their reversal of a district court's decision that a merger of two commercial waste haulers violated section 7 of the Clayton Act.[92] While agreeing with the District Court's finding that the relevant geographic market was Dallas County excluding Fort Worth as part of the relevant geographic market,[93] the Second Circuit nonetheless considered whether firms located *outside* Dallas County could successfully enter the Dallas County geographic market.[94]

The Second Circuit acknowledged there would be increased costs of daily travel between Fort Worth and Dallas which would not be present for Dallas-based companies, but found "no barrier to Fort Worth haulers' acquiring garage facilities in Dallas" which would permit the Fort Worth companies to keep some of their trucks stationed in Dallas.[95]

What *Waste Management* indicates with respect to the geographic market definition is that the ease of entry analysis will not be confined to those firms already or potentially operating in the court-defined geographic market. Indeed, the relative ease of entry into the trash collection business was sufficient to overcome the district court's finding of a post-merger share of 48.8% of the market, which is sufficient to establish prima facie illegality under Section 7 of the Clayton Act.[96] Invoking the Merger Guidelines, (Guidelines) the Second Circuit held

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89. *Id.* at 7-36.
90. *Id.*
91. United States v. Waste Management, 743 F.2d 976 (2d Cir. 1984).
92. *Id.* at 982.
93. *Id.* at 980.
94. *Id.* at 983 (emphasis added).
95. *Id.*
96. *Id.* at 977.

that ease of entry is so relevant to determining how a merger will affect competition that it "may override all other factors."[97]

Again, the quality of the evidence used in the geographic market definition process is critical to an accurate assessment of the merger's effects. The Department, in using the "small but significant and non-transitory" price increase as an objective guide considers historical evidence of: shipment patterns of considered firms and their competitors; evidence that consumers have shifted their purchases to sellers at different locations; differences or similarities in the price movements of the relevant product which are not caused by causative factors in the differing areas; transportation costs; local distribution costs; and excess capacity of those firms outside the merging firms' location.[98] Foreign competitors are included in the geographic market, if relevant, and market shares are assigned to them in the same manner they are assigned to domestic firms (e.g., dollar sales, shipments to the relevant market, physical production capacity, reserves, or dollar production).[99]

3. *Market Shares and Market Concentration*

The primary index of a firm's market power is the statistical evidence reflecting its shares of the respective market, computed by using the factors outlined above. Concentration of the market is the lead indicator of market power; controlling for other factors, the larger the percentage of total product supply controlled by one firm, the more readily the firm can restrict output in order to support a price increase in that product.[100]

After defining the appropriate product and geographic market, the Guidelines provide a three-tiered threshold by which to assess preliminarily the competitive effects of the proposed horizontal merger. For these purposes, mergers of firms in the same product and geographic market are considered horizontal.[101] The three level approach uses the

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97. *Id.* at 982.

98. *See supra* note 15, at 7-38.

99. *Id.* at 7-38. It is noted that while quotas may prohibit the increase of imports of the relevant product, those quotas may be offset by production in countries *not* subject to the quota. Thus quotas do not per se exclude any country from the geographic definition, and the effects of quotas are considered separately in Section 3.23 of the manual. *Id.* at 7-44.

100. *Id.*

101. *Id.* at 7-40. Vertical mergers involve firms at different levels of the production scheme; conglomerate mergers involve everything else. Although by definition non-horizontal mergers will not change the HHI concentration level, they are still subject to challenge because the merger of a firm already in the market with a firm that could enter the market after the merger may affect competition as well.

Herfindahl-Hirschman Index (HHI) to compute market concentration.[102] Simply put, the HHI sums the squares of the individual market shares of all the firms identified as part of the market (including in the computations the proposed merger). Thus, a market of four firms with market shares of 40 percent, 30 percent, 20 percent, and 10 percent would yield an HHI of 3,000. ($40^2 + 30^2 + 20^2 + 10^2 = 3{,}000$.) The Guidelines provide that the thresholds are characterized as unconcentrated when the HHI is below 1,000, moderately concentrated when the HHI is between 1,000 and 1,800, and highly concentrated when the HHI is above 1,800.[103] Additionally, the Department evaluates the *increase* in concentration that would result from the merger. Simply, the market shares of the merging firms are multiplied, then doubled.[104]

Armed with these two calculations, the Department in general follows these standards: For post-merger HHI below 1000, the Department will usually not challenge the merger. For post-merger HHI between 1,000 and 1,800 the Department will not likely challenge the merger, unless the increase in HHI is greater than 100.[105] Finally, for post-merger HHI over 1,800 and producing an increase of over 50 points, the Department will likely challenge the merger.[106]

However, *in re Echlin Manufacturing Co.*, a case decided after publication of the Merger Guidelines, the Federal Trade Commission found

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102. *Id.*

103. *Id.* at 7-41. Note in the hypothetical that the market is highly concentrated. This is presented for simple illustrative purposes only; a realistic merger analysis would have many more firms, ascribing a lower market share to each. Thus, the first blush impression that under this analysis virtually all mergers would be suspect is illusory, and made so only by the simple four firm illustration.

104. *Id.* The guidelines provide this example: The merging firms have shares of 5 percent and 10 percent; the HHI is increased by 100 from the merger. (5 X 10 X 2 = 100). It explains: "In calculating the HHI before the merger, the market shares of the merging firms are squared individually: $(a)^2 + (b)^2$. After the merger, the sum of those shares would be squared: $(a + b)^2$, which equals $a^2 + 2ab + b^2$. The increase in the HHI therefore is represented by 2ab." *Id.*

105. *Id.* .7-50. This challenge will be made only after taking into account various other factors that affect the significance of market shares and concentration, like changing market conditions, financial conditions of firms in that market, and domestic or foreign firms' ability to enter or increase their presence in the market. Also, and importantly, the Department recognizes that some mergers in this rating will enhance efficiencies, thus, the parties' showing by clear and convincing evidence that a merger will achieve significant net efficiency may ameliorate this rating and reduce the likelihood of challenge. *Id.*

106. *Id.* The same factors outlined in *supra* note 105 are taken into consideration here.

no violation even where these thresholds were exceeded by the merger.[107] In *Echlin*, the top six firms in the industry accounted for 95% of sales, for a postmerger HHI of around 3,000 and a concentration increase as a result of the merger of around 750 points.[108] In *Echlin*, the combination of a high HHI and high concentration increase was outweighed by considerations of ease of entry, with the court taking a very narrow view of barriers to entry.[109] While *Echlin* has been noted as reflecting the Federal Trade Commission's enforcement policy under the Merger Guidelines,[110] how the ease of entry analysis will be viewed against the HHI thresholds in different fact situations remains to be seen.

4. *Cross-elasticity of Product and Demand*

As noted, the ability of consumers to switch products, and the ability of other players to enter the market in response to a price increase, is the underlying economic construct of these analyses. The importance of a high HHI may be totally obviated if other firms can switch their production and distribution plans quickly enough to accommodate the customers that would otherwise have been harmed by a price increase.

> The potential market power possessed by a group of producers functioning as a cartel is summarized by the elasticity of demand they face. Typically, the elasticity of demand facing a potential cartel increases as members of the group are placed outside the cartel. Thus, in specifying the smallest profitable cartel, the Guidelines are implicitly specifying a critical value for the elasticity of demand facing the cartel. Since economic theory predicts that the viability of a cartel is negatively correlated with the numbers of its members, focusing on the smallest profitable cartel will usually be dispositive on the likelihood of anti-competitive effects.[111]

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107. Robert Pitofsky, *New Definitions of Relevant Market and the Assault on Antitrust*, 90 COLUM. L. REV. 1805, 1825 (1990) *citing* Re Echlin Manufacturing Co., 105 F.T.C. 410 (1985).

108. For a discussion of HHI calculations, *See supra* note 104 and accompanying text.

109. Pitofsky, *supra* note 107. The court in its formulation listed only government licenses and patents as barriers to entry. *Id.*

110. *Id.* at 1825.

111. David Scheffman and Pablo Spiller, *Geographic Market Definition Under the U.S. Department of Justice Merger Guidelines*, 30 J.L. & ECON. 123, 126 (1987).

However, no single source exists to identify potential foreign sources of competition- either from existing firms' abilities to alter their facilities, or from new firms' potential to enter the market. Limitations on data available concerning foreign firms' capacity to devote new, revised, or increased production outputs to export to the United States make these analyses indefinite, and, perhaps unavoidably, quantitatively imprecise. Thus, qualitative assumptions about potential foreign responses must be made. In general, the Department "attempts to identify those foreign firms whose output *may be* relevant to the analysis, by talking to the professionals involved in the proposed merger and consulting relevant Trade Associations."[112]

### B. *Merger Control in the European Economic Community*

The EEC Merger Control Regulation (Regulation)[113] which became effective in September, 1990, was implemented to satisfy the questions of conflicting applications and voids of articles 85 and 86 of the Treaty of Rome noted in part II.[114] Significantly, article 2 of the Regulation provides for a one-step appraisal, whereas under article 85, two inquiries were made. The inquiry sought first to establish prohibited activity under 85(1), then to exempt the prohibition in circumstances where the activity improved the production or distribution of goods or technical progress under 85(3).[115]

#### 1. *Dominant Position within the Relevant Geographic Area*

The preamble to the regulation suggests that the regulation will be applied "according to the geographical area of activity of the undertakings concerned and be limited by quantitative thresholds in order to cover those concentrations which have a Community dimension. . . ."[116] Article 2(3) provides that a merger will be declared incompatible with the common market if:

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112. Telephone Interview with Charles Stark, Chief of the Foreign Commerce Section, Antitrust Division, United States Department of Justice (October 18, 1991). According to Mr. Stark, the Antitrust Division is confident that persons working in the firm under evaluation can be readily relied upon to identify actual and potential, domestic and foreign competitors. *Emphasis added.*

113. MERGER GUIDELINES, *supra* note 15. The regulation provides much of the basis for discussion in this section.

114. *See supra* note 39 for the full text of Art. 85; *supra* note 43 for the full text of art. 86.

115. Treaty of Rome, art. 85, art. 86, *supra* note 9.

116. Council Regulation, *supra* note 46.

the merger creates or strengthens a dominant position with the result that effective competition would be significantly impeded in the common market (or in a substantial part of it).

Within the geographic market boundaries established, a concentration meeting the certain threshold criteria will be subject to review by the Commission, and will be declared incompatible with the common market if it creates or strengthens a dominant position resulting in a significant impediment to competition. Nowhere in the Treaty or Regulation is dominance defined. As Sir Leon Brittan, Vice President of the Commission, recently expounded regarding the amorphous phrase "dominant position":

> Let there be no doubt: the fundamental analysis to be carried out by the Commission is whether the merger impedes competition. A dominant position analysis, [pursuant to article 86] will be necessary in all cases in order to see whether the merged company has a sufficient degree of market power to stand in the way of competition by acting without the restraints which competition imposes in normal circumstances. . . our concern will be whether the merged company could raise prices, discriminate unfairly or restrict output with impunity or in a way which would not be possible in normal competitive conditions.[117]

2. *Allocation of Jurisdiction according to Turnover*

The quantitative thresholds alluded to in the preamble essentially provide a division of jurisdiction between Member States and the Commission of the European Communities, reserving to the latter jurisdiction over concentrations having a Community dimension, defined where: 1) the combined aggregate worldwide turnover of all the undertakings concerned totals more than 5,000 million ECU;[118] and 2) the aggregate Community-wide turnover of each of at least two of the undertakings involved is more than 250 million ECU, unless each of the undertakings achieves more than two-thirds of its aggregate Com-

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117. Sir Leon Brittan, Vice President of the Commission of the European Communities, The Law and Policy of Merger Control in the EEC, Address Before the Bar European Group, (May 3, 1990) in 15 Eur. L. Rev. 351, 352. Sir Brittan commented, "In my view, we are at the beginning of a new legal development and the Council did not wish to create a pure dominant position test." *Id.*

118. The E.C.U. was valued at ECU = $1.31 in September, 1990. Cregor, *supra* note 4, at 8.

munity-wide turnover within "one and the same Member State."[119] Concentrations in this context refer to mergers and acquisitions of joint control.[120]

The Commission, in determining whether the proposed concentration is compatible with the common market preservation goals articulated in article 2 of the Treaty of Rome,[121] will consider the structure and position of the markets concerned, including that of actual and potential competition both within and without the Community, the availability of product (or service) alternatives,[122] and historical market trends. Calculations of turnover are conducted within a geographical reference market, defined as an area

> [I]n which the undertakings concerned are involved in the supply and demand of products or services, in which the conditions of competition are sufficiently homogeneous and which can be distinguished from neighboring areas because, in particular, conditions of competition are appreciably different in those areas. This assessment should take account in particular of the nature and characteristics of the products or services concerned, of the existence of entry barriers of of (sic) consumer preferences, of appreciable differences of the undertakings' market shares between the area concerned and neighboring areas or of substantial price differences.[123]

Data supporting the turnover calculations are amounts derived by the involved firms' sales and services from the preceding financial year. The amounts are those after deduction of sales rebates and of taxes directly related to the turnover.[124]

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119. Council Regulation, *supra* note 46, art. I. Pursuant to ¶ 3, however, these ceilings will be reviewed and possibly lowered by the end of 1993.

120. *Id.* art. III.

121. Treaty of Rome, *supra* note 9.

122. Included in the availability analysis will be a consideration of the alternatives' access to the markets, which necessarily invokes consideration of barriers to entry. Council Regulation, *supra* note 46, art. II.

123. *Id.* art. IX, ¶ 7.

124. *Id.* art. V. Included in the calculations are the respective turnovers of (a) the undertaking concerned; (b) those undertakings in which the undertaking concerned, directly or indirectly owns more than half the assets, has the power of over half the voting rights, has power of appointment of over half the members of the controlling board, or has the right to manage the undertakings' affairs. However, sales and services as provided between these undertakings are not included in the turnover calculations. *Id.*

3. *Practical Application of the EEC Merger Criteria*

A practical assessment of the Regulation's effects is made difficult due to its relative newness. However, the Regulation cannot abrogate the Treaty of Rome, as it was specifically promulgated pursuant to it, as evidenced by the recitals found at the beginning of the text. Given that the Treaty is the Constitution of the EC and thereby the preeminent authority,[125] an assessment of how articles 85 and 86 have been constructed by the courts in the past is helpful to a projection of how they will be handled under the new Regulation.

The Regulation's relationship to articles 85 and 86 of the Treaty, and its effect on national authorities' sovereignty to handle internal mergers is a developing area. The three-tiered threshold recognizes implicitly that some mergers, the effects of which are confined to one member state, are better left to that state to handle; concomitantly, mergers affecting several member states are more suitably dealt with by a supranational institution.[126] Recall that article 85 prohibits any agreement among undertakings that significantly restricts competition within the EEC, but provides an exception, while article 86 prohibits the abuse of a dominant position but provides for no exemptions.[127] Indeed, it has been held[128] that an "infringement of Article 85 can precede and thereby facilitate infringement of Article 86."[129]

In addition, the Regulation expressly provides that a previously passed regulation[130] regarding concentrations will not apply to concentrations as defined in article 3 of the new Regulation, echoing the 1986 *Ministere Public v. Asjes* decision.[131] *Ministere Public* held that national courts had no authority to declare void an agreement or concerted practice under article 85, paragraph 1 of the Treaty, as long as article 87's requirement of implementing rules for article 85 had not been adopted.[132] The upshot of this provision is to make third party challenges

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125. Dassesse, *supra* note 37, at 380.

126. Brittan, *supra* note 117.

127. *See supra* notes 39 and 43, and accompanying text.

128. Italian Flat Glass, 4 C.M.L.R. 535 (1990). (Censuring parties' formation of a cartel and preventing customers from bargaining on prices.)

129. RAYBOULD, *supra* note 8, at 190.

130. Dassesse, *supra* note 37, at 380, *citing* Council Regulation No. 17/62, O.J. Eng. Spec. Ed. 1959-62, at 87.

131. *Id.* at 381, *citing* Ministere Public v. Asjes and Others (Nouvelles Frontieres) E. Comm. Ct. J. Rep. 1425 (1986).

132. *Id.*

pursuant to article 85, of concentrations authorized by the national control authorities, impossible.[133]

However, article 86, which requires no implementing authority,[134] may still be applicable even though parties are exempt under article 85, as evidenced by a recent appeal of a Commission decision in *Tetra Pak*.[135] In that case, appellants' proposed acquisition of an exclusive license to filling equipment for liquid food products, through purchase of a company holding the license, was held to constitute an infringement of article 86, even though an exemption pursuant to article 85(3) had been granted. Although Tetra Pak had abandoned all claims to the exclusivity of the license after the Commission objected, the Commission issued the decision *afterward* to clarify its position. On appeal, appellants urged the Court of First Instance to hold that article 86 could not be applied to conduct which had been exempted pursuant to article 85. Appellant relied in their argument on an earlier decision in *Europemballage Corporation and Continental Can,*[136] which held that articles 85 and 86 could not be interpreted in a contradicting way, since they both serve to achieve the same goal. The *Continental Can* decision reasoned:

> Articles 85 and 86 seek to achieve the same aim on different levels, viz. the maintenance of effective competition within the Common Market. The restraint of competition which is prohibited if it is the result of behavior falling under Article 85, cannot become permissible by the fact that such behavior succeeds under the influence of a dominant undertaking and results in the merger of the undertakings concerned. . . In any case Articles 85 and 86 cannot be interpreted in such a way that they contradict each other, because they serve to achieve the same aim.[137]

In addition, the appellants argued that while the court in *Hoffmann-LaRoche and Company v. E. C. Commission*[138] held that the operation of article 86 was not precluded if agreements fell within the ambit of

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133. Dassesse, *supra* note 37, at 381.

134. *Id.* at 382.

135. *Id. citing* Case T-51/89, Tetra Pak Rausing SA v. E.C. Commission, 4 C.M.L.R. 334 (1990) [hereinafter Tetra Pak].

136. Tetra Pak at 345 *citing* Case 6/72, Europemballage Corp. and Continental Can Co. v. E.C. Comm'n, E.C.R. 215, C.M.L.R. 199, ¶ 25 (1973).

137. *Id.*

138. Tetra Pak at 342 *citing* Case 85/76, Hoffman-La Roche and Co. Ag. v. E.C. Comm'n, 13 E.C.R. 461, 3 C.M.L.R. 211 (1979).

article 85, the *Hoffman* court concomitantly suggested that the conduct might be saved by the exemption proviso of article 85(3).[139]

The *Tetra Pak* court was not persuaded, and invoked Article 3(f) of the Treaty of Rome, holding that the common aim of both provisions-the institution of a system to ensure undistorted competition in the Common Market must prevail.[140] Accordingly, the court held that the two provisions had to be interpreted pursuant to that objective, and that it would be sufficient for that purpose for only one provision to be applied.

Extraterritorial application of the regulation is textually implicit as well in the aggregate turnover criteria. Recall that concentrations will have "community dimensions," thus engaging the jurisdiction of the Commission, where the aggregate worldwide turnover amount is more than 5,000 million ECU and the Community-wide turnover is more than 250 million ECU.[141] This language does not limit the application to mergers taking effect within the EEC territory; rather, EEC jurisdiction will be engaged if the net sales (turnover) are sufficiently high on a global and community scale. "By this test, the Community apparently claims jurisdiction over operations which have significant effects in the Community: any concentration between two undertakings situated outside the Community which meet the ECU five billion test and which have ECU 250 million turnover in the Community will. . . require notification."[142]

Indeed, in 1988 in *Alstrom v. Commission* (Wood Pulp),[143] it was made clear that concentrations located entirely outside the territory of the EEC can have an EEC dimension and thus invoke the jurisdiction of the Community.[144] While it is clear that the Regulation is concerned only with effective competition within the Community,[145] it is equally clear that competition may be affected by activities conducted entirely

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139. *Id.*

140. Tetra Pak at 445.

141. *See supra* note 113 and accompanying text for relative U.S. valuation.

142. Christopher Jones, *The Scope of Application of the Merger Regulation*, INTERNATIONAL MERGERS AND JOINT VENTURES, FORDHAM CORP. L. INST. 385, 387. (B. Hawk, ed., 1990).

143. Alstrom v. Commission, E. Comm. Ct. J. Rep. 5193, 1985 O.J. (L 85/1).

144. *Id.*

145. Bernd Langeheine, *Substantive Review Under the EEC Merger Regulation,* INTERNATIONAL MERGERS AND JOINT VENTURES, FORDHAM CORP. L. INST., 481, 493. (B. Hawk, ed., 1990).

outside of the EEC, where the threshold criteria and abuse of dominant position test are met.

C. *Comparative Analysis*

The willingness of courts both in the United States and the EEC to assert jurisdiction to activity occurring outside the boundaries of their domestic territories makes imperative an understanding of how the substantive review criteria employed in each of the regulations concur and diverge.

The general tenor of both the EEC Merger Regulation (regulation) and the U.S. Merger Guidelines (guidelines) are the same: consumers are best protected when producers vying for their dollars have to compete for them. Both instruments attempt to gauge the merger's future effect on the domestic market by evaluating underlying, and largely historic, economic indicators. Thus, in both approaches the accuracy of predictions of future market reactions depends on the accuracy of the data built into the economic formulae as well as the validity of the models' assumption: that past activity is an accurate indicator of future behavior. Unfortunately for this discussion, nothing in the literature suggests that merger control decisions (whether to challenge or leave intact) are routinely inserted back into the formulae, after sufficient passage of time, to check the accuracy of the assumptions or the model supporting the decision. Nonetheless, underlying premises of the two models are, at least in concept, in accord.

Likewise, the data supporting the analyses are similar. The Merger Guidelines instruct that specific sales, import-export trends, market trends, and historical pricing trends in the respective industry will be evaluated to infer likely competitive effects of the merger. The Merger Regulations also specify that the sales volumes, pricing trends, import-export figures, and historical pricing indices will be taken into account in assessing the impact of the merger. Both attempt to take into account the ability of firms not then competing in the relevant market to enter the market, either through adjustments to then extant production facilities or through the creation of new production facilities.

The numeric thresholds employed in each regulation are, however, different both in the mathematical relationships reflected and in the purpose behind the exercise. Regarding the relationships reflected, under the U.S. guidelines, the Hershman-Hinderfahl Index reflects total market concentration, taking into account all those products which are similar enough to function as product substitutes in the event of a price increase, and limiting the inquiry to the geographic region deemed most reflective of the true market, be it a portion of a city or the

entire world. The index is essentially a test of market concentration. Both the existing concentration levels and the increase in the concentration levels resulting from the merger are employed in the analysis, which is supported by the proposition that the more highly concentrated the market already is, and the more the merger increases that concentration level, the more readily a hypothetical firm could manipulate the market and raise prices.

In contrast, the numerical threshold employed by the EEC Merger Regulations takes no account of shares of market presented by the parties to the merger. Rather, the turnover criteria provided in the regulation take an overall measurement of sales or services provided in the preceding year by the firms in question, again after taking steps to insure that those companies competing in the market are accounted for in the analysis. Here the assumption is largely parallel to the U.S. counterpart: the larger the firms' shares in the market under evaluation, the more ability those firms will have to exercise their market power and raise prices at the expense of the consumer. However, the regulation is based on an outright measurement of the market activity without regard to concentration levels. A finding that the firms involved produced the requisite turnover the preceding year will invoke the jurisdiction of the Commission, regardless of the degree to which that market is concentrated. So, the measurements employed by the two jurisdictions vary in this way: the U.S. index reflects a measurement of market concentration, while the EEC thresholds reflect a quantitative measurement of market activity.

The purposes for which the respective threshold levels are used are fundamentally different as well. In the United States, the HHI is used primarily as an indicator, after weighing other factors regarding whether the merger is likely substantially to lessen competition, of the *probability* that the merger will be challenged. In contrast, the turnover thresholds provided in the EEC's guidelines were conceived as a way to allocate merger regulation jurisdiction between the authorities of the member states and the EEC Commission. Simply stated, a low turnover or a community-wide turnover which is confined primarily to the boundaries of a single member state will be regulated by that member state.

Perhaps the most substantive comparison is that of the concept used to express the likelihood that the merger will have undesirable effects on competition. In the United States, the HHI and all the other considerations discussed are tools of inquiry to answer this question: Will this merger threaten competition? Inherent in that question is the subquestion, "could a 'monopolist' profitably impose a small but sig-

nificant and nontransitory price increase?" If the answer is yes and the requisite HHI level is met, the merger is likely to be challenged. In the EEC, the turnover thresholds and the other considerations taken into account in the merger analysis are employed to answer: Will this merger impede competition? The subquestion here is whether the merging firms hold a sufficiently dominant position in the market that they could engage in restrictive behavior. Fundamental to both inquiries is an assessment of whether enough market power is present to enable the firm to exploit consumers; the semantic differences notwithstanding, the concepts underlying the substantive goals are the same.

### D. *Conclusion*

Because international mergers are common and likely to become more so, an understanding of where the two approaches agree and diverge is important not only to business operating in the international sphere but to negotiators embarking on a treaty that could dramatically change the way international mergers are conducted. While application of both regulations involves complexities and a Herculean assessment of what could happen given a hypothetical merger, the United States' guidelines are perhaps more sophisticated. This may be attributed to the relative maturity of the U.S. antitrust system, as well as to a function of the EEC Regulation that is entirely missing from the U.S. Guidelines: a division of jurisdiction over mergers. The three-tiered turnover threshold of the EEC's regulation represents not a likelihood of challenge of the merger, as provided in the U.S. HHI, but an indication of which authority—that of the member state or that of the European Commission—will preside over any challenge to the merger.

Even though there are quantitative differences between the two approaches, the spirit is the same: to apprehend those mergers which, due to significant market power presented by the merger, may be able to exert enough influence on the market to impede free competition. Given that any bilateral agreement between the EEC and the United States is not likely to succeed if it attempts to unravel what is on both sides the culmination of years of internal debate, it behooves convention negotiators to come to the table well versed in the nuances reflected in merger policies of both sides.

## IV. DISCOVERY PROBLEMS IN INTERNATIONAL ANTITRUST ENFORCEMENT

As alluded to in Part III, collecting specific information regarding internal production capabilities and marketing strategies of companies

is preliminary homework to an investigation of a proposed merger involving those companies or their competitors. However, in an international context, companies located abroad are sometimes reluctant to comply with discovery information requests of foreign origin. This section will highlight some of the problems existing in international merger control with respect to obtaining information necessary to conduct a merger analysis, and will examine the need for an agreement in this area between the United States and the European Community.

Foreign discovery conducted by the United States pursuant to antitrust statutes, whether through the government or private parties, has caused conflicts for some time.[146] Specifically, several foreign governments have invoked commercial secrecy laws or adopted blocking statutes in response to American antitrust discovery. These statutes bar foreign discovery by either controlling or prohibiting companies located within their territory from complying with information requests of foreign enforcement authorities or courts. In 1980 France enacted a statute imposing criminal liability, subject to an exception provided under international treaties, on any foreign national seeking discovery in connection with foreign judicial or administrative proceedings;[147] the United Kingdom enacted the Protection of Trading Interest Act in 1980;[148] and Switzerland specifically forbids the transmission of or attempt to obtain a manufacturing or business secret in order to make it available to a foreign private or official body, to name a few such statutes.[149]

Because some foreign governments view subpoenas as an intrusion and, worse, an infringement of their sovereignty, the Bureau of Competition of the Federal Trade Commission strives to seek only that information which cannot be obtained domestically. Voluntary cooperation is the preferred avenue for obtaining information and evidence located abroad. However, "[the Bureau's] experience has not been trouble-free. Foreign discovery has caused delays and occasionally complicated investigations and adjudicative procedures. . . subpeonas for testimony of foreign nationals or for documents located abroad continue, on occasion, to generate strong objections, and have resulted in motions to quash."[150] Those motions to quash contest the Commission's exercise

146. Hearings, *supra* note 1, at 8 (statement of Kevin J. Arquit, Director, Bureau of Competition, Federal Trade Commission).

147. *Id.* at 14, n. 6, 7, 8.

148. *Id.* at 15, n. 7.

149. *See* fn. 148, n.8.

150. *Id.*

of personal jurisdiction and its method of service of process. While one tool at the Commission's disposal is to issue subpeonas to the foreign corporation and serve process on the firm's American subsidiary, these avenues are time-consuming and are said to highlight the Commission's difficulty in effecting extraterritorial service directly on foreign firms and foreign nationals.[151] In sum, the appropriate procedure for obtaining foreign discovery in countries with commercial secrecy laws is not yet certain.

### A. *Organization for Economic Cooperation and Development*

The U.S. antitrust enforcement agencies have entered into agreements with foreign authorities in an effort to ameliorate some of these discovery problems. These voluntary bilateral and multilateral agreements, whose terms cover discovery procedures, provide for prior notification, consultation, and cooperation in antitrust enforcement actions which could affect foreign interests. No country which is a party to such an agreement has invoked a blocking statute since entering into the agreement.[152] The multilateral agreements have been in existence for some time, having first been issued in 1967, and revised in 1973, and 1979.[153] The agreements are currently under the Organization for Economic Cooperation and Development (OECD), adopted by the Council of the OECD on May 21, 1986.[154] The current OECD agreement specifies that competition agencies notify foreign party states, if at all possible, in advance of taking any action which could affect interests of those states. The latest version also includes an appendix containing guiding principles on restrictive business practices which affect international trade, providing for notifications, exchanges of information, and consultation recommendations.[155] Also included are guidelines for conciliation between states who are unable to agree on a particular matter, and the provision of the use of the Committee on Competition Law and Policy.[156]

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151. *Id.* at 18.

152. *Id.* at 16.

153. Edward F. Glynn, Jr., *International Agreements to Allocate Jurisdiction Over Mergers*, INTERNATIONAL MERGERS AND JOINT VENTURES, FORDHAM CORP. L. INST 35, 38 (B. Hawk, ed., 1990).

154. *Id.*

155. *Id.* at 38.

156. *Id.* To date, there is no public record of any members having taken advantage of the office of the Committee to settle disputes. *Id.* at 39.

The OECD agreement, multilateral in nature, is different from existing bilateral agreements. Currently, the United States is party to only one bilateral agreement with a European Community state—Germany[157]—while both the United States and the EEC are parties to the 1986 OECD Recommendation. What is unclear, however, is how such bilateral agreements of the future will be affected by the Treaty of Rome and the Merger Regulation discussed herein. Given the thresholds providing exclusive jurisdiction of some mergers with the European Commission rather than the enforcement agencies of member states, it is likely that notification requirements under existing bilateral agreements will cede to a future agreement between the United States and the EEC. This is necessarily so under the Merger Regulation, because if member states' jurisdiction to review mergers is vested with the Commission after a certain monetary threshold is met, it follows that procedures pursuant to the merger review will vest with the Commission as well. The extent to which the Commission will proceed to comply with information agreements entered into by individual member states and nonmember states is at present unknown.

In addition, the existing agreements provide for consultation and notification under a "quasi-adversarial" scheme.[158] When one party who is in charge of investigating or prosecuting antitrust breaches submits a notification, it will typically be submitted *not* to that country's antitrust enforcement agency but to its commercial or foreign affairs ministry. That is because the "protective interests" in the nation's own commercial, economic or legal interests generally fall under a different organ than that country's antitrust enforcement agency. For this reason, the EEC itself rarely if ever receives the notification from an investigating OECD member. Rather, because these protective interests rest primarily with the national member states of the EEC, the commercial ministry of the country where the involved company is located receives the notice. "There is, in short, no 'protective interest,' at least under existing rules, that would trigger an obligation to notify by the United States. The notification of proposed investigation or enforcement action goes not to the Community but to the national authority."[159]

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157. *Id.* at 37, *citing* Bilateral Agreement with the Federal Republic of Germany, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,501.

158. *Id.* at 42.

159. *Id.* at 45.

B. *Hart-Scott-Rodino*

As mentioned in Part II, the Hart-Scott-Rodino (HSR) Act[160] provides assistance in merger and acquisition discovery procedures. Pursuant to HSR, parties to mergers amounting to certain dollar levels are required to give notice in advance to the Federal Trade Commission, and to wait a specified period before proceeding with the merger. Given foreign firms' desire to conduct business in the United States, their cooperation with this procedure has been good. As noted before a Senate hearing on the matter, "[i]n general, foreign governments perceive the HSR filing requirements as a legitimate prerequisite to any foreign firms wishing to make an acquisition affecting the U.S. market. Because parties cannot complete their deal without submission of the appropriate material, they have strong incentives to comply with requests for information."[161] However, difficulties in obtaining all the necessary information pursuant to the merger analysis persist due to foreign discovery problems encountered when seeking to complete documents supplied domestically with sources located abroad.[162]

A larger problem in HSR discovery, alluded to in Part III, is that of obtaining information from third parties to the merger. Recall the discussion of market and production elasticity, and the importance of projecting not only how consumers would respond to a price increase, but how other firms would respond. Some firms which are totally out of the computations of market share and competition might find it profitable to either alter or switch production facilities entirely in order to enter the market following such a price increase. While third parties are routinely surveyed for information about market shares and ease of entry,[163] these firms usually have an interest adverse to the acquisition, and so have no incentive to help the merger be accomplished quickly. As explained, "[f]oreign competitors may view as overly intrusive discovery requests for sales and production information, including future plans; such data is often needed in merger investigations to define the relevant market in which to predict competitive effects."[164]

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160. Hart-Scott-Rodino Act of 1975, 15 U.S.C. § 18(a), Pub. L. No. 101-73, 103 Stat. 529 (1989).

161. Arquit, *supra* note 146, at 19.

162. *Id.* at 20. "However, as with the substantive response, it is difficult to prove a negative: that relevant documents were omitted from the submission." *Id.* n. 13.

163. *Id.* at 21.

164. *Id.* In these cases, the Commission resorts to subpoena enforcement pro-

As a final note, it may help in the analysis to understand some of the practical requirements involved in complying with merger enforcement regulations in both the United States and the EEC. First, both jurisdictions require that certain plans to merge be made known to the reviewing authority before the merger takes place. In the EEC, a merger with a Community dimension must be notified not more than one week after the conclusion of the agreement, the announcement of the public bid, or the acquisition of a controlling interest, whichever is earlier.[165] In the United States, a thirty-day waiting period exists before the acquisition can take place. The United States provides for time extensions; the EEC does not. Both entities require that a standard form be used in the pre-notification, and the volume of information required on the forms makes it prudent to start collecting the necessary data well in advance of the deadline.[166]

With respect to confidentiality, in the United States, pre-merger notification filings may not be made public, unless relevant to administrative or judicial actions. Disclosure can also be made to Congress.[167] In the EEC, professional secrecy rules dictate that information received can only be used for purposes related to the request, investigation, or hearing. The Commission has to provide copies of all notifications to authorities of the member states, and must publish the fact of notification (where the merger falls under the scope of the Regulation). Included in that publication are the names of the parties, nature of the merger, and the economic sector involved. However, the publication must take into account the legitimate professional secrecy interests of the undertakings involved.[168]

### C. *Information Agreements in the Competition Area: Possible Approaches*

An understanding of some of the problems encountered in antitrust foreign discovery efforts, and an overview of what pre-merger filing requirements exist in the United States and EEC, permits now a look

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ceedings in federal district court, sometimes taking months before the order is issued. *Id.*

165. J. William Rowly, *International Mergers: Antitrust Notification Requirements,* INTERNATIONAL MERGERS AND JOINT VENTURES, FORDHAM CORP. L. INST. 221, 236 (B. Hawk, ed., 1990), previewing Rowly, INTERNATIONAL MERGERS-ANTITRUST GUIDE (Sweet & Maxwell, eds.).

166. *Id.* at 236, 265.

167. *Id.* at 268 *citing* 15 U.S.C. § 18(a)(h).

168. *Id.* at 240.

at some of the options which could afford greater cooperation in this area between the United States and the EEC.

Perhaps at the modest end of the scale, competition authorities involved might explore how to improve their communication among themselves.[169] This may help alleviate the anomalous reality mentioned above where the dialogue exists between the competition authority of one state and the commerce ministry of the other under the "protective interest" analysis. However, the Justice Department has noted,

> [t]he amount of information that can be shared among authorities is severely limited by confidentiality provisions in our respective national laws. Accordingly, if much additional information is to be shared by the various merger control authorities, the types of information sought to be exchanged would have to be identified with some specificity, and national laws would have to be amended.[170]

An assessment of the various confidentiality laws extant in members of the EEC, and the relationship of those laws to the Merger Regulation and ultimately to the Treaty of Rome, would require analysis of sensitive member state sovereignty issues; while worthy of exploration, this is clearly beyond the scope of this discussion.

Another option presented is to rely more heavily on obtaining foreign information from parties other than the competition authorities, while at the same time seeking an agreement among competition authorities to help their foreign counterparts by producing locally held information.[171] Again, however, this appears to beg the question, for ultimately the information comes not from foreign antitrust authorities but from parties outside the merger agreement. This is obviously so in terms of relying on third party information to evaluate elasticities.

Proposals for information sharing agreements pursuant to competition regulation have not been one-sided. Preeminent in this discussion must be the recent United States—EEC antitrust cooperation proposal by European Commission Vice President Sir Leon Brittan. In a speech at Cambridge University, Sir Brittan said:

> I personally favour, to start with, a treaty between the European Community and the U.S.A. It would provide for con-

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169. Charles Stark, *International Mergers and Joint Ventures: A View from the Justice Department,* INTERNATIONAL MERGERS AND JOINT VENTURES, FORDHAM CORP. L. INST., 21, 31 (B. Hawk, ed., 1990).

170. *Id.*

171. *Id.*

> sultations, exchanges of non-confidential information, mutual assistance, and best endeavours to cooperate in enforcement where policies coincide and to resolve disputes where they do not. Disagreements should be discussed frankly and, wherever possible, only one party should exercise jurisdiction over the same set of facts.[172]

While this language imparts greater purpose to the agreement than the exchange of notifications and consultations under OECD and the bilateral agreements discussed above, it is clear that a prominent feature of any US/EEC bilateral agreement in the area of antitrust must include information sharing provisions.

It could be that with the passage of time, parties will perceive their notification and consultation needs met through existing channels of the OECD agreement. However, as already discussed, information from third parties remains a critical issue, as they, not the parties to the transaction, have "the most reliable evidence on entry barriers, the ability of customers to substitute, and ability of foreign parties to enter the market in response to a price increase and other matters which drive the elasticity analysis."[173] Elasticity concerns are not confined to analyses under the U.S. Merger Guidelines; as noted in part I, article 2 of the EEC's Merger Regulation requires the European Commission to factor in "the structure of all the markets concerned and the actual or potential competition from undertakings located either within or (outside of) the Community."[174] Specifically, the Commission is to consider the market positions of the firms concerned, the alternatives available to suppliers and users, their access to supplies or markets, and any barriers to entry in assessing whether the proposed merger is compatible with the Common Market.[175]

One approach recommended to establish a ready supply of third party information to foreign discovery requests is that of an international convention providing for mutual provision of product and market information sought by foreign authorities.[176] Again, however, given the passage of time this approach may duplicate provisions under the

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172. GLYNN, *supra* note 153, at 44, *citing Jurisdictional Issues in EEC Competition Law,* Address by the Right Honorable Sir Leon Brittan, Hersch Lauterpacht Memorial Lecture, Cambridge University (February 8, 1990).

173. *Id. citing* Glynn & Tahyar, *Obtaining Data on Elasticities and Foreign Competitors under Hart-Scott-Rodino*, 1988 FORDHAM CORP. L. INST. 3-1 (B. Hawk, ed., 1989).

174. COUNCIL REGULATION, art. II, *supra* note 46.

175. *Id.*

176. GLYNN, *supra* note 153, at 48.

OECD. It may be possible to simply amend the OECD to bring third parties to mergers under the proposal, and to provide that data from those firms routinely will be made available to requests from other member states.

Ancillary to these proposals is a review of the procedures under which *results* of antitrust investigations are reported to the public. The factors supporting a competition authority's decision in individual merger cases, thumbs up or down, should be made available to to help guide involved parties' future conduct. In this arena, there is room for improvement within the United States, as explained thusly in a panel on international mergers and joint ventures:

> If (the Department of Justice or the Federal Trade Commission) elects not to challenge a transaction, there will be no complaint and no published opinion, and the basis on which (they) elected to bring a challenge will typically be known only to (them), and to some extent, to the lawyers and economists for the merging parties who participated in persuading (them) not to bring the action. On the other hand, if the (Department of Justice or the Federal Trade Commission elects) to challenge a transaction, in most instances the parties will call off the transaction.[177]

This shroud of secrecy is a side effect of the unique nature of merger control in the United States, as explained in Part II. Because of the court's limited role in merger reviews, the reviews generate relatively few judicial opinions. While there may be indirect ways of learning what factors drove the decisions to challenge or leave intact the proposed mergers, "[I]n the final analysis, while the main instrument of merger policy in the United States is the agency's decision whether or not to prosecute, there is no regular mechanism for reporting the analysis that underlies such a decision."[178] Even though none of the proposals reviewed calls for the uniform sharing of factors that underlie enforcement decisions, it is a safe bet that parties to the agreement who provide information will want to witness the use of that information when it produces a result adverse to the providing parties' interests.

Whether any of these proposals or conventions could serve as a catalyst for an international commerce ministry is unknown. Such a

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177. George Hay, Panel Discussion: *International Mergers and Joint Ventures,* INTERNATIONAL MERGERS AND JOINT VENTURES, FORDHAM CORP. L. INST., 95, 97 (B. Hawk, ed., 1990).

178. *Id.*

ministry could be responsible for documenting production facilities of all firms located in party states, and could serve as a central repository for import-export data. In addition, depending on the sophistication and level of automation of such a ministry, a data base built on international product characteristics and consumer profiles could be maintained. If market prices and trends are built into the data base, it should be possible to quantify product elasticity to project international market responses in a more standardized fashion. Indeed, the development of such a data base would lend itself greatly to an after-the-fact analysis of the effects of merger decisions, an exercise not routinely performed now, as mentioned earlier. Given limitations on domestic data sources, however, it may be difficult to conceive of how such a model could be built in an international setting, accommodating differing languages, different units of measurement, differing currencies, and qualitatively different consumer cultures. Nonetheless, it is convincing that since market and product data are at the core of merger analyses, the trend in the future will be away from ad-hoc assessments of elasticity, which take into account whatever information happens to be available, and toward uniform, international assessments driven by sophisticated and well maintained data bases.

## V. CONCLUSION

It is clear that both the United States and the European Community recognize that anticompetitive activity abroad can profoundly affect domestic economies. As a result, there is authority on both sides to apply domestic antitrust regulations to foreign activity. Under international law, countries exercise jurisdiction only when sufficient effects within the acting state are felt from the activity under review. As a principle of comity, as well, states will respect the sovereignty of other nations and refrain from exercising jurisdiction under certain circumstances. As shown, however, neither of these principles is adequate for addressing which state should exercise antitrust enforcement where grounds for asserting jurisdiction are equally divided.

In analyses conducted under both the EEC Merger Regulation and the U.S. Merger Guidelines, it is clear that markets and suppliers of firms are becoming increasingly international in nature. Thus, the likelihood that merger reviews conducted internally will focus on factors located outside domestic boundaries is increasing. It is clear that before jurisdiction can be allocated, sufficient discovery must be conducted to see where the predominant acts and effects take place. Likewise, substantive review relies entirely on the accuracy of the data utilized in computing market share, geographic markets, product profiles, and

market elasticity. Especially in the latter category, it is critical that data from foreign firms, often third parties to the merger under review, be obtained. The difficulty experienced in procuring these data from foreign sources underscores the necessity for a bilateral agreement to cooperate, (or at minimum not obstruct through blocking statutes) in antitrust investigations. It is hoped that, through the exploration of the complexities involved in international regulatory schemes, skepticism about the possibilities of an agreement have been preempted by an understanding of the need to agree, if on nothing else than to agree, before 1993 arrives.

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# Was the Stela "Stolen"?

?Solo así he de irme?
?Como las flores que perecieron?
?Nada queda en mi nombre?
?Nada de mi fama aquí en la tierra?
!Al menos flores, al menos cantos!
—Cantos de Huexotzingo[1]

## I. INTRODUCTION

Mexico is a country rich in archaeological monuments and artifacts. This is evidenced by the ancient Mayan ruins dotting the Yucatan peninsula[2] and the numerous Aztec sites such as Teotihuacan in the heart of the country near Mexico City. Of great concern to the Mexican government is the flow of its cultural patrimony to museums, art dealers, and private collections outside the country's borders, and the resulting plunder of its archaeological sites due to the work of thieves and looters.[3] Partly because one of the strongest markets for pre-Columbian[4] artifacts exists in the United States,[5] and because Mexico is an art-rich country in terms of pre-Columbian art, a wealth of law has developed on the subject. All parties concerned — the Mexican and U.S. governments,

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1. Must I leave in this way?
Like the flowers that have perished?
Nothing remains in my name?
Nothing of my fame here on Earth?
At least flowers, at least songs!

(Author's translation.) This song is of pre-Columbian origin and is engraved over the entrance of an exhibition hall in the National Museum of Anthropology in Mexico City.

2. Wilbur E. Garrett, *La Ruta Maya*, 176 NAT'L GEOGRAPHIC 424 (1989).

3. SHARON A. WILLIAMS, THE INTERNATIONAL AND NATIONAL PROTECTION OF MOVABLE CULTURAL PROPERTY 112 (1978).

4. The term "pre-Columbian" means "of, relating to, or originating in the Americas before the voyages of Columbus." AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 1031 (new college ed. 1980). Some of the pre-Columbian civilizations of Mexico include the Mayans, the Aztecs, the Olmecs, the Zapotecs, and the Teotihuacanos. TIME-LIFE BOOKS, INC., TIME FRAME: AD 200-600, EMPIRES BESIEGED 141-162 (1988).

5. 1 LYNDEL V. PROTT & P.J. O'KEEFE, LAW AND THE CULTURAL HERITAGE, DISCOVERY AND EXCAVATION 57 (1984).

museum curators and museum-goer's, art dealers, collectors, archaeologists, scholars, and other interested persons — would all agree that cultural property[6] should be preserved and protected. How this is best accomplished is a source of great debate.

The arguments often allude to the idea of cultural value. As this Note will explore, the "specific cultural value"[7] of an object to the society from which it came competes with the cultural value of that

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6. The definition of "cultural property" includes objects of artistic, archaeological, ethnological or historical interest, to name only a few. Treaties and statutes concerning the subject generally set out a specific definition, such as the UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property, Nov. 14, 1970, art. 1, 823 U.N.T.S. 231, 10 I.L.M. 289 [hereinafter UNESCO Convention]:

> For the purposes of this Convention, the term "cultural property" means property which, on religious or secular grounds, is specifically designated by each State as being of importance for archaeology, prehistory, history, literature, art or science and which belongs to the following categories:
> (a) Rare collections and specimens of fauna, flora, minerals and anatomy, and objects of palaeontological interest;
> (b) property relating to history, including the history of science and technology and military and social history, to the life of national leaders, thinkers, scientists and artists and to events of national importance;
> (c) products of archaeological excavations (including regular and clandestine) or of archaeological discoveries;
> (d) elements of artistic or historical monuments or archaeological sites which have been dismembered;
> (e) antiquities more than one hundred years old, such as inscriptions, coins and engraved seals;
> (f) objects of ethnological interest;
> (g) property of artistic interest, such as:
> (i) pictures, paintings and drawings produced entirely by hand on any support and in any material (excluding industrial designs and manufactured articles decorated by hand);
> (ii) original works of statuary art and sculpture in any material;
> (iii) original engravings, prints and lithographs;
> (iv) original artistic assemblages and montages in any material;
> (h) rare manuscripts and incunabula, old books, documents and publications of special interest (historical, artistic, scientific, literary, etc.) singly or in collections;
> (i) postage, revenue and similar stamps, singly or in collections;
> (j) archives, including sound, photographic and cinematographic archives;
> (k) articles of furniture more than one hundred years old and old musical instruments.

7. John H. Merryman & Albert E. Elsen, *Hot Art: A Reexamination of the Illegal International Trade in Cultural Objects*, J. ARTS MGMT & L., Fall 1982, at 5, 8 [hereinafter *Hot Art*].

object to people *outside* the nation of origin of the art. The assumption underlying the notion that the "export . . . of cultural property is one of the main causes of the impoverishment of the cultural heritage of the countries of origin"[8] is that the inhabitants of the country of origin have a property right or an interest in the object which is not shared by peoples of nations outside the country of origin. It is a way of thinking about cultural property as a part of a *national* cultural heritage.[9] Another way to view cultural property is as "components of a common human culture, whatever their places of origin or present location, independent of property rights or national jurisdiction."[10] This idea is embodied in the preamble to the Hague Convention:

> Being convinced that damage to cultural property belonging to any people whatsoever means damage to the *cultural heritage of all mankind*, since each people makes its contribution to the culture of the world;
>
> Considering that the preservation of the cultural heritage is of great importance *for all peoples of the world* and that it is important that this heritage should receive international protection . . . .[11]

This Note will describe the current state of the Mexican-American antiquities law and evaluate whether the existing law helps or harms the preservation of this "cultural heritage of all mankind."[12]

## II. EXISTING STATE OF THE LAW

### A. *The UNESCO Convention*

Most of the current law regarding the protection of cultural property in time of peace[13] has grown out of the United Nations Educational,

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8. UNESCO Convention, *supra* note 6, art. 2, 823 U.N.T.S. at 236.

9. John H. Merryman, *Two Ways of Thinking About Cultural Property*, 80 AM. J. INT'L L. 831, 832 (1986) [hereinafter *Two Ways of Thinking*].

10. *Id.* at 831.

11. Convention for the Protection of Cultural Property in the Event of Armed Conflict, May 14, 1954, pmbl., 249 U.N.T.S. 240, 20 I.L.M. 1282 [hereinafter Hague Convention] (emphasis added). The Hague Convention deals with the protection of cultural property from the acts of belligerents in time of war, but the propositions that cultural property is "the cultural heritage of all mankind," and that it has special importance which justifies special measures to ensure its preservation are principles of general applicability, not limited to controlling the conduct of belligerents in time of war or conflict. *Two Ways of Thinking*, *supra* note 9, at 841.

12. Hague Convention, *supra* note 11.

13. The problems associated with the protection of cultural property during

Scientific, and Cultural Organization (UNESCO)[14] Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property.[15] The UNESCO Convention is a multilateral treaty designed to protect the cultural property of the countries which are parties to the agreement against the dangers of theft, clandestine excavation, and illicit export.[16]

The underlying theme of the UNESCO Convention is that cultural property is a part of a "national cultural heritage."[17]

> The basic purpose . . . is to inhibit the "illicit" international trade in cultural objects. The parties agree to oppose the "impoverishment of the cultural heritage" of a nation through "illicit import, export and transfer of ownership" of cultural property (Article 2), agree that trade in cultural objects exported contrary to the law of the nation of origin is "illicit" (Article 3), and agree to prevent the importation of such objects and facilitate their return to source nations (Articles 7, 9 and 13).[18]

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armed conflict is a related subject and encompasses a somewhat different set of problems not dealt with in this paper. *See* LEONARD D. DUBOFF, THE DESKBOOK OF ART LAW 129-186 (1977 & Supp. 1984, V 1-19).

14. UNESCO's Constitution provides that one of the purposes and functions of the organization is to "[m]aintain, increase and diffuse knowledge . . . by assuring the conservation and protection of the world's inheritance of books, works of art and monuments of history and science, and recommending to the nations concerned the necessary international conventions." UNESCO CONST. art. I, § 2(c) (adopted Nov. 16, 1945), *reprinted in* WALTER H.C. LAVES AND CHARLES A. THOMSON, UNESCO: PURPOSE, PROGRESS, PROSPECTS 416 (1957).

15. UNESCO Convention, *supra* note 6.

16. *Id.* at pmbl. The UNESCO Convention is one of the most influential and most widely adopted international agreements. 1 JOHN H. MERRYMAN & ALBERT E. ELSEN, LAW, ETHICS, AND THE VISUAL ARTS 91 (2d ed. 1987) [hereinafter VISUAL ARTS]. To date, 65 countries have signed the UNESCO Convention, most of which are "third world" nations. Of the major art-importing countries — Japan, Britain, Germany, France, Switzerland, and the United States — only the United States has signed. William Grimes, *The Antiquities Boom — Who Pays the Price?*, N.Y. TIMES, July 16, 1989, S. 6, at 17. Having signed the UNESCO Convention, a country is bound by it. Gerard Bolla, *Keynote Address*, 15 N.Y.U. J. INT'L L. & POL. 765 (1983). It is interesting to note that the great majority of countries which are parties to the UNESCO Convention are primarily considered as "exporters" of cultural property and only a small minority can be considered as "importers-exporters." *Id.* at 768.

17. *Two Ways of Thinking*, *supra* note 9, at 832.

18. *Id.* at 843. The UNESCO Convention also requires the parties to take steps to ensure the protection of their own cultural property by setting up appropriate

The main thrust of the UNESCO Convention is to get the signatory nations to support the export and import restrictions on the items each country has designated as forming a part of its "cultural heritage."[19]

### *B. The U.S.-Mexico Treaty of Cooperation*

In 1970, the United States and Mexico signed a bilateral treaty providing for the recovery and return of stolen archaeological, historical, and cultural properties.[20] The treaty addresses only "properties of archaeological, historical or cultural importance."[21] "If a dispute arises over the importance of a particular object, the treaty provides a mechanism for this determination. The country in which a smuggled object is found is required to assist in obtaining its return."[22]

### *C. Mexican Law*

Mexico, like most art-rich countries, has enacted legislation designed to prevent or severely limit the export of cultural property.[23]

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agencies to carry out various functions such as drafting model laws, regulations, and ethical rules in conformance with the Convention, establishing a list of the national inventory of works of major cultural importance, supervising excavations, and making public any disappearances of cultural property. UNESCO Convention, *supra* note 6, art. 5, 823 U.N.T.S. at 238. In accordance with the provisions under Article 5, the United States Congress enacted the Cultural Property Act. *See infra* text accompanying notes 58-74. The United States has also set up under the U.S. Information Agency a staff of two officials and a secretary, counseled by a Cultural Property Advisory Committee, to oversee the U.S. implementation of the UNESCO Convention. Stanley Meisler, *Art and Avarice; In the Cut-Throat Art Trade, Museums and Collectors Battle Newly Protective Governments Over Stolen Treasures*, L.A. TIMES, Nov. 12, 1989, (Magazine), at 8.

19. The smuggling of archaeological material from Latin America to the United States has been greatly curtailed as a result of the UNESCO Convention and due to the efforts of the U.S. Information Agency and the U.S. Customs Service. James Walsh, *It's a Steal*, TIME, Nov. 25, 1991, at 86, 88.

20. Treaty of Cooperation between the United States of America and the United Mexican States Providing for the Recovery and Return of Stolen Archaeological, Historical, and Cultural Properties, July 17, 1970, U.S.-Mex., 22 U.S.T. 494, T.I.A.S. No. 7088, 1971 [hereinafter Treaty of Cooperation]. The treaty was self-executing, and took effect on March 24, 1971. *Id.* The United States has entered into similar bilateral agreements with Guatemala, Peru, and Ecuador. Consequently, the flow of pre-Columbian artifacts, particularly monumental work, into the United States has been significantly reduced. William Grimes, *The Antiquities Boom — Who Pays the Price?*, N.Y. TIMES, July 16, 1989, S. 6, at 17.

21. Treaty of Cooperation, *supra* note 20.

22. DUBOFF, *supra* note 13, at 104.

23. WILLIAMS, *supra* note 3, at 110.

Since 1897, Mexico has had laws protecting its cultural heritage by vesting ownership of archaeological monuments in the Mexican government and prohibiting their removal "without express authorization of the Executive of the Union."[24] The most recent Mexican statute[25] defines "archaeological monuments" as movable and immovable objects which are a product of the cultures prior to the establishment of the Spanish culture in Mexico[26] and declares that these archaeological monuments are the inalienable and imprescriptible property of Mexico.[27] The effect of this type of statute is that it gives the Mexican government standing to bring legal action in a foreign court for recovery of the object since the government is, by law, the owner.[28] The export of any "archaeological monument" is expressly prohibited by the statute, except for exchanges or gifts to foreign governments or scientific institutes by agreement of the President of Mexico.[29] The statute also creates a "Public Register of Archaeological and Historical Zones and Monuments" for the registration and declaration of these types of zones and monuments[30] and prescribes fines and penalties for violation of the statute.[31] Thus, the Mexican statute is virtually a total ban on the export of pre-Columbian art from Mexico.

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24. Ley Sobre Monumentos Arqueologicos, [Law On Archaeological Monuments], art. 1, Diario Oficial de la Federacion [D.O.] (May 11, 1897), *reprinted in* DUBOFF, *supra* note 13, at 975. Similar Mexican statutes redefined "archaeological monuments" and expanded the scope of the statutory scheme in 1930 (Law on the Protection and Conservation of Monuments and Natural Beauty, 58 D.O. 7 (Jan. 31, 1930), *reprinted in* DUBOFF, *supra* note 13, at 976-980 (1977)), 1934 (Law for the Protection and Preservation of Archaeological and Historic Monuments, Typical Towns and Places of Scenic Beauty, 82 D.O. 152 (Jan. 19, 1934), *reprinted in* DUBOFF, *supra* note 13, at 972-974 (1977)), and 1970 (Federal Law Concerning Cultural Patrimony of the Nation, 303 D.O. 8 (Dec. 16, 1970), *reprinted in* DUBOFF, *supra* note 13, at 962-971 (1977)). For a review of the Mexican statutes, see United States v. McClain, 545 F.2d 988, 997 (5th Cir. 1977) (*opinion by* J. Wisdom).

25. Ley Federal Sobre Monumentos y Zonas Arqueologicos, Artisticos e Historicos [Federal Law Regarding Archaeological, Artistic and Historic Monuments and Zones], 312 Diario Oficial de la Federacion [D.O.] 16, *reprinted in* DUBOFF, *supra* note 13, at 958-961 (1977).

26. *Id.* art. 28.

27. *Id.* art. 27.

28. VISUAL ARTS, *supra* note 16, at 115.

29. Federal Law Regarding Archaeological, Artistic and Historic Monuments and Zones, *supra* note 25, art. 16.

30. *Id.* art. 21.

31. *Id.* art. 47-55.

*D. U.S. Law*

The National Stolen Property Act (NSPA) prohibits the transport in interstate or foreign commerce of any goods worth $5,000 or more with knowledge that the goods were stolen, converted or taken by fraud.[32] The NSPA subjects to criminal liability anyone who receives, conceals, stores, barters, sells, or disposes of any goods worth $5,000 or more, or which constitute interstate or foreign commerce, with knowledge that the goods were stolen, unlawfully converted, or taken by fraud.[33] The NSPA does not specifically deal with cultural property, but rather with stolen goods. Congress' intent in enacting the NSPA, which has been in effect since 1934,[34] was to discourage theft and the receiving of stolen goods and to "aid the states [and foreign nations], which, because of jurisdictional limitations, could not prosecute the receivers or thieves of stolen property after that property moved across state lines."[35]

The NSPA has been applied in two important U.S. court cases involving pre-Columbian cultural property imported into the United States. The first of these was *United States v. Hollinshead*.[36] In 1971, the government of Guatemala brought a civil action against Clive Hollinshead, an American art dealer, in a California state court for the return of Machaquila Stela II,[37] a Mayan stela[38] claimed by Guatemala to be its own. Under Guatemalan law, all pre-Columbian archaeological monuments are owned by the State and may not be removed without the government's permission.[39] Subsequent to the civil action being brought, Hollinshead and two co-conspirators were indicted by a federal grand jury for transporting and conspiring to transport in interstate and foreign commerce property stolen from Guatemala. In 1973, Hol-

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32. 18 U.S.C. § 2314 (1976).

33. *Id.* § 2315.

34. Paul M. Bator, *An Essay on the International Trade in Art*, 34 STAN. L. REV. 275, 344 (1982).

35. United States v. McClain, 545 F.2d 988, 994 (5th Cir. 1977).

36. United States v. Hollinshead, 495 F.2d 1154 (9th Cir. 1974).

37. "Machaquila" is the name of a Mayan archaeological site in Guatemala. See drawing of the stela done by archaeologist, Ian Graham, *in* DUBOFF, *supra* note 13, at 93.

38. Stelae are stone slabs, sometimes up to forty feet tall and weighing up to five tons, which are ornately carved with figures and hieroglyphs, erected in religious ceremonial centers. Bator, *supra* note 34, at 278. Mayan stelae are of major importance in deciphering the Mayan language. DUBOFF, *supra* note 13, at 69.

39. DUBOFF, *supra* note 13, at 91.

linshead and one of the co-conspirators were found guilty.[40] The main issue of the criminal case was whether the defendants knew the stela was "stolen." The court had received expert testimony as to the law of Guatemala regarding artifacts such as Machaquila Stela II, and there was also "overwhelming evidence that the defendants knew that it was contrary to Guatemalan law to remove the stele, and that the stele was stolen."[41] The Court of Appeals for the Ninth Circuit affirmed the convictions in 1974.[42]

Another important case involving the application of the NSPA was *United States v. McClain*.[43] In that case, five individuals were convicted of conspiring to transport, receive, and sell stolen Mexican pre-Columbian artifacts, mostly small ceramics,[44] to an undercover FBI agent in interstate commerce in violation of the NSPA.[45] They were also convicted on other counts in violation of the same Act.[46] The *McClain I* court held:

> [A] declaration of national ownership is necessary before illegal export of an article can be considered theft, and the exported article considered "stolen", within the meaning of the National Stolen Property Act. Such a declaration combined with a restriction on exportation without consent of the owner (Mexico) is sufficient to bring the NSPA into play.[47]

This holding marked a "sharp departure"[48] from the general rule that had been accepted until then that it was not illegal to import a work of art into the United States simply because the work was illegally

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40. Bator, *supra* note 34, at 346. The civil case was settled out of court by agreement. *Hot Art, supra* note 7, at 21.

41. United States v. Hollinshead, 495 F.2d 1154, 1155 (9th Cir. 1974).

42. Bator, *supra* note 34, at 346.

43. United States v. McClain, 545 F.2d 988 (5th Cir. 1977) *[McClain I], rehearing denied*, 551 F.2d 52 (5th Cir. 1977) (per curiam); United States v. McClain, 593 F.2d 658 (5th Cir. 1979) *[McClain II], cert. denied*, 444 U.S. 918 (1979).

44. The artifacts included terra cotta figures and pottery, beads and a few stucco pieces. *Hot Art, supra* note 7, at 28.

45. *McClain I*, 545 F.2d 988, 992 (5th Cir. 1977).

46. *Id.* The defendants appealed and the Court of Appeals for the Fifth Circuit reversed the convictions and remanded due to an erroneous jury instruction regarding the Mexican government's ownership of the artifacts. *Id.* at 1000.

47. *Id.*

48. James R. McAlee, *The McClain Case, Customs, and Congress*, 15 N.Y.U. J. INT'L L. & POL. 813, 824 (1983).

exported from another country.[49] Consequently, the *McClain* case eroded the distinction between "stolen" and "illegally exported." "Illegal export, after the adoption of the declaration [of state ownership of all antiquities], suddenly becomes 'theft'."[50]

Prior to the *McClain* decisions, Congress enacted, in 1972, legislation prohibiting the import into the United States of monumental pre-Columbian sculpture or murals exported illegally from their country of origin.[51] This statute, like the *McClain* holding, is an abrogation of the long-standing and generally accepted rule that it is not a violation of U.S. law to import an item simply because it has been illegally exported from another country.[52] Thus, the statute is triggered not by a showing that the artifacts were *stolen*, but rather that they were *illegally exported*.[53] The statute applies, however, only to pre-Columbian "monumental or architectural" sculpture or mural[54] — a limited category of works.[55] The statute also provides a means for the country of origin to recover the object in question.[56] Any pre-Columbian monumental

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49. *Id.* The case was remanded to determine when the pre-Columbian artifacts had been exported from Mexico and to apply the appropriate Mexican law to that export. *McClain I*, 545 F.2d 988, 1003 (5th Cir. 1977). At the retrial, the defendants were again convicted for violating the NSPA. *McClain II*, 593 F.2d 658 (5th Cir. 1979). The defendants again appealed, arguing that "Congress never intended the NSPA to reach items deemed 'stolen' only by reason of a country's declaration of ownership." *McClain II*, 593 F.2d at 663. The appellants also argued that "due process is violated by imposing criminal penalties through reference to Mexican laws that are vague and inaccessible except to a handful of experts who work for the Mexican government." *McClain II*, 593 F.2d at 664. A different panel from the Court of Appeals for the Fifth Circuit rejected their arguments and upheld the convictions on the conspiracy count, but reversed the convictions on the substantive count on due process grounds. *McClain II*, 593 F.2d at 672. The court agreed with the earlier (*McClain I*) court's holding that, "[I]n addition to the rights of ownership as understood by the common law, the NSPA also protects ownership derived from foreign legislative pronouncements." *McClain II*, 593 F.2d at 664.

50. Bator, *supra* note 34, at 350.

51. Regulation of Importation of Pre-Columbian Monumental or Architectural Sculpture or Murals, Pub. L. No. 92-587, §§ 201-205, 86 Stat. 1297-98 (1972) (codified at 19 U.S.C. §§ 2091-2095 (1976)) [hereinafter Pre-Columbian Monumental Sculpture].

52. Bator, *supra* note 34, at 287.

53. *Id.* at 288.

54. Pre-Columbian Monumental Sculpture, *supra* note 51, § 202(a).

55. Hence, this statute was not used in the *McClain* indictments.

56. "Any pre-Columbian monumental or architectural sculpture or mural which is forfeited to the United States shall first be offered for return to the country of origin and shall be returned if that country bears all expenses incurred incident to such return and complies with such other requirements relating to the return as the Secretary shall prescribe." Pre-Columbian Monumental Sculpture, *supra* note 51, § 203(b)(1).

or architectural sculpture or mural imported into the United States in violation of the statute is subject to seizure by customs officials and forfeiture under the customs laws.[57]

A third U.S. statute which deals with the matter of cultural property is the Convention on Cultural Property Implementation Act (Cultural Property Act).[58] When the United States Senate ratified the UNESCO Convention in 1972, it did so subject to one "reservation" and six "understandings."[59] One of the "understandings" was that the provisions of the UNESCO Convention were not self-executing.[60] This

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57. *Id.* § 203(a).

58. Convention on Cultural Property Implementation Act, Pub. L. No. 97-446, §§ 302-314, 96 Stat. 2350, 19 U.S.C.A. §§ 2601-2614 (1983) [hereinafter Cultural Property Act] *reprinted in* VISUAL ARTS, *supra* note 16, at 97-106.

59. Bator, *supra* note 34, at 370.

60. The one "reservation" and six "understandings" were:

The United States reserves the right to determine whether or not to impose export controls over cultural property.

The United States understands the provisions of the Convention to be neither self-executing nor retroactive.

The United States understands Article 3 not to modify property interests in cultural property under the laws of the states parties.

The United States understands Article 7(a) to apply to institutions whose acquisition policy is subject to national control under existing domestic legislation and not to require the enactment of new legislation to establish national control over other institutions.

The United States understands that Article 7(b) is without prejudice to other remedies, civil or penal, available under the laws of the states parties for the recovery of stolen cultural property to the rightful owner without payment of compensation. The United States is further prepared to take the additional steps contemplated by Article 7(b)(ii) for the return of covered stolen cultural property without payment of compensation, except to the extent required by the Constitution of the United States, for those states parties that agree to do the same for the United States institutions.

The United States understands the words "as appropriate for each country" in Article 10(a) as permitting each state party to determine the extent of regulation, if any, of antique dealers and declares that in the United States that determination would be made by the appropriate authorities of state and municipal governments.

The United States understands Article 13(d) as applying to objects removed from the country of origin after the entry into force of this Convention for the states concerned, and, as stated by the Chairman of the Special Committee of Governmental Experts that prepared the text, and reported in paragraph 28 of the Report of that Committee, the means of recovery of cultural property under subparagraph (d) are the judicial actions referred to in subparagraph (c) of Article 13, and that such actions

meant that the UNESCO Convention would not have legal force in the United States until Congress enacted implementing legislation.[61] After nearly ten years of debate in Congress over how best to implement the UNESCO Convention, the Cultural Property Act was finally passed in late 1982.[62] One of the reasons it took nearly ten years to enact the implementing legislation is that under the UNESCO Convention, the nation of origin is given the power to define "illicit" as it pleases.[63] Article 3 of the UNESCO Convention defines "illicit" as any trade in cultural property that is "effected contrary to the provisions adopted under this Convention by the States Parties thereto."[64] Therefore, if Mexico adopted legislation that prohibited the export of all pre-Columbian artifacts (as it has done), then the export of *any* pre-Columbian object from Mexico would be "illicit" under the UNESCO Convention.[65] Art importing nations such as the United States have called this the blank check feature of the UNESCO Convention.[66]

The heart of the Cultural Property Act provides that the President may, upon the request of any "State Party,"[67] enter into agreements to impose import restrictions on specified archaeological or ethnological material.[68] Before entering into any such agreement, the President must first determine that: (1) the cultural patrimony of the State Party is

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are controlled by the law of the requested State, the requesting State having to submit necessary proofs.

VISUAL ARTS, *supra* note 16, at 95-96.

61. *Id.* at 96.

62. For an account of the history leading to the passage of the Cultural Property Act, *see* McAlee, *supra* note 48, at 813-820.

63. *Two Ways of Thinking*, *supra* note 9, at 845.

64. UNESCO Convention, *supra* note 6, art. 3.

65. *Two Ways of Thinking*, *supra* note 9, at 844. *See also* McAlee, *supra* note 48, at 815.

66. *Id.*

67. A "State Party" is any nation which has ratified, accepted, or acceded to the UNESCO Convention.

68. Cultural Property Act, *supra* note 58, § 303(a)(2). The U.S. has only done so twice. In 1987, the U.S. Information Agency imposed emergency restrictions on the importation of pre-Columbian ceramic and stone artifacts from the Cara Sucia region of El Salvador, and in 1989, it imposed emergency restrictions on the importation of antique textiles from the Bolivian community of Coroma. The agency is considering a request by Canada for an agreement that would stop the flow of Canadian Indian and Eskimo artifacts to the U.S., and a request by Peru for emergency restrictions on the importation of artifacts looted from burial grounds of the Moche Kingdom in northern Peru. Stanley Meisler, *Art and Avarice; In the Cut-Throat Art Trade, Museums and Collectors Battle Newly Protective Governments Over Stolen Treasures*, L.A. TIMES, Nov. 12, 1989, (Magazine), at 8.

in jeopardy due to the pillage of its archaeological or ethnological materials;[69] (2) the State Party has taken measures consistent with the UNESCO Convention to protect its cultural patrimony;[70] (3) the import restrictions would be of substantial benefit in deterring a serious situation of pillage and less drastic remedies are not available;[71] and (4) the import restrictions are consistent with the general interest of the international community.[72] Further, the Cultural Property Act restricts the President from entering into any agreement unless the import restrictions are "applied in concert with similar restrictions"[73] by nations having a significant import trade in such archaeological or ethnological material.[74]

## III. THE ARGUMENTS

### A. *Cultural Value*

Certain works of art and cultural objects have a specific cultural value to the society from which they came.[75] Probably one of the most well known and most controversial examples is the "Elgin Marbles,"[76] so named after Lord Elgin,[77] the British Ambassador to Constantinople,[78] who removed a tremendous quantity of ancient Greek marble statues, sculptures, slabs of frieze, and other antiquities from the Parthenon in Athens (with the permission of the Turkish government, which controlled Greece at the time) and sold them to the British government.[79] Although the Greek government has formally requested

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69. Cultural Property Act, *supra* note 58, § 303(a)(1)(A).
70. *Id.* § 303(a)(1)(B).
71. *Id.* § 303(a)(1)(C).
72. *Id.* § 303(a)(1)(D).
73. *Id.* § 303(c)(1).
74. *Id.*
75. *Hot Art, supra* note 7, at 8.
76. *See generally* DUBOFF, *supra* note 13, at 65-69, and WILLIAMS, *supra* note 3, at 9.
77. Scotsman Thomas Bruce, 7th Earl of Elgin (1766-1841), was a member of the British House of Lords and a career diplomat who had a strong desire to improve the position of fine arts in Great Britain by introducing British artists to ancient Greek art. VISUAL ARTS, *supra* note 16, at 4.
78. The former name for Istanbul, Turkey. AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 285 (new college ed., 1980). Constantinople was the capital of the Ottoman Empire (1299-1919). *Id.* at 931. Athens, Greece, was also a part of the Ottoman Empire. VISUAL ARTS, *supra* note 16, at 4.
79. *See generally* WILLIAM ST. CLAIR, LORD ELGIN AND THE MARBLES 99-120, 250-62 (1983). *See also* JEANETTE GREENFIELD, THE RETURN OF CULTURAL TREASURES 62, 67 (1989).

their return,[80] the marbles are still in the hands of the British government and on display in the British Museum in London.[81]

"Objects charged with cultural significance, the loss of which deprives a culture of one of its dimensions,"[82] should be repatriated to their country of origin. This idea is embodied in Article 2 of the UNESCO Convention: "The States Parties to this Convention recognize that the illicit import, export and transfer of ownership of cultural property is one of the main causes of the impoverishment of the cultural heritage of the countries of origin of such property . . . ."[83] Greece has claimed that the taking of the Elgin Marbles was both illegal and immoral[84] and has attempted in vain to obtain the return of the marbles.[85] Because the Parthenon is a symbol of the cultural identity of the Greek people, the absence of its marbles is "psychologically most intolerable."[86]

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80. VISUAL ARTS, *supra* note 16, at 13. The poet, Byron, attacked Lord Elgin in his poem, *Childe Harolde*:

> But most the modern Pict's ignoble boast,
> To rive what Goth, and Turk, and Time hath spared:
> Cold as the crags upon his native coast,
> His mind as barren as his heart is hard,
> Is he whose head conceived, whose hand prepared,
> Aught to displace Athena's poor remains:
> Her sons too weak the sacred shrine to guard,
> Yet felt some portion of their mother's pains,
> And never knew, till then, the weight of despot's chains.
> What! shall it e'er be said by British tongue,
> Albion was happy in Athena's tears?
> Though in thy name the slaves her bosom wrung,
> Tell not the deed to blushing Europe's ears;
> The ocean queen, the free Britannia, bears,
> The last poor plunder from a bleeding land:
> Yes, she, whose generous aid her name endears,
> Tore down those remnants with a harpy's hand,
> Which envious Eld forbore, and tyrants left to stand.

*Id.* at 12.

81. *Id.* at 137. The term "Elginism" was coined by the French to refer to a form of vandalism of cultural objects. *Id.* at 13.

82. Robert Browning, *The Case for the Return of the Parthenon Marbles*, 36 MUSEUM 38 (1984), *reprinted in* VISUAL ARTS, *supra* note 16, at 135 [hereinafter Browning].

83. UNESCO Convention, *supra* note 6, art. 2.

84. VISUAL ARTS, *supra* note 16, at 13.

85. *See supra* notes 80-81 and accompanying text.

86. The Director General of UNESCO defined "cultural property" as a people's "irreplaceable cultural heritage, the most representative works of a culture, which the dispossessed regard as of highest importance, and the absence of which is psychologically most intolerable." Browning, *supra* note 82.

Another example of a piece of cultural property which has a specific cultural value to the society from which it came, but which, unlike the Elgin Marbles, has been returned to its people is the Afo-A-Kom, a wooden statue of religious and cultural importance to the Kom (a tribe in the West African country of Cameroon).[87] The Afo-A-Kom was acquired by a New York art dealer and was on exhibit in 1973 when officials of the Cameroon Embassy learned of the statue's whereabouts.[88] The Ambassador from Cameroon in Washington explained the significance of the Afo-A-Kom this way: "It is beyond money, beyond value. It is the heart of the Kom, what unifies the tribe, the spirit of the nation, what holds us together."[89] After only a few days and a lot of publicity about the matter, the dealer returned the statue to the tribe.[90]

The Afo-A-Kom for the Kom, the Elgin Marbles for the Greeks, perhaps the Aztec Calendar Stone for the Mexicans and the Liberty Bell for Americans are examples of objects that have cultural importance for the society quite distinct from their value as works of art, as antiquities, or as materials of scholarship.[91]

There is a competing interest at play in this idea of the "specific cultural value"[92] of an object to the society from which it came, which is the cultural value to people outside the nation of origin of the art. The assumption underlying the notion that the "export . . . of cultural property is one of the main causes of the impoverishment of the cultural heritage of the countries of origin"[93] is that the inhabitants of the country of origin have a property right or an interest in the object which is not shared by peoples of nations outside the country of origin. It is a way of thinking about cultural property as a part of a *national* cultural heritage.[94]

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87. VISUAL ARTS, *supra* note 16, at 56.

88. *Id.*

89. Official Statement made by His Excellency Francois-Xavier Tchounqui, the Ambassador of the United Republic of Cameroon on the Occasion of the Restoration of the Cameroon Sacred Statue, DUBOFF, *supra* note 13, at 119.

90. VISUAL ARTS, *supra* note 16, at 56-57. The trade and "widespread looting" of African cultural property is currently of great concern to many people. Ade Obayemi, director of museums and monuments in the West African nation of Nigeria recently stated, "Placing monetary values on these things [cultural property] is outrageous. They are not *objets d'art*. For us, they have spiritual and religious dimensions. They are our cultural heritage." Michelle Faul, *Widespread Looting of Antiquities Robs Africa of Its Cultural Heritage*, L.A. TIMES, Mar. 24, 1991, at A9.

91. *See, e.g., Hot Art, supra* note 7, at 8.

92. *Hot Art, supra* note 7, at 8.

93. UNESCO Convention, *supra* note 6, art. 2.

94. *Two Ways of Thinking, supra* note 9, at 832.

A better way to view cultural property is as "components of a common human culture, whatever their places of origin or present location, independent of property rights or national jurisdiction."[95] This idea is embodied in the preamble to the Hague Convention:

> Being convinced that damage to cultural property belonging to any people whatsoever means damage to the *cultural heritage of all mankind*, since each people makes its contribution to the culture of the world;
>
> Considering that the preservation of the cultural heritage is of great importance *for all peoples of the world* and that it is important that this heritage should receive international protection . . . .[96]

Certain works of art or artifacts such as the Afo-A-Kom or the Liberty Bell probably should remain in their country of origin because they have a unique religious or historical significance to the people of that particular nation which is not shared by people of other nations. The item embodies a religious bond unique to one group of people, such as the Afo-A-Kom, or symbolizes a monumental historical event, such as the Liberty Bell — it cannot be replaced. In many other instances, however, the cultural property is duplicated and a great number of those types of works exist, such as the Greek marbles and Mexican pre-Columbian pots.

> Early man . . . had a vivid belief in a concrete afterlife. Therefore, the tombs of notables were richly filled with the accoutrements of wealth and the symbols of rank. To insure proper service in the afterlife, slaves and wives were killed in very early times but, happily, in later and higher cultures, effigy statues were placed in the tombs in lieu of living retinue. Such tomb furnishings form the overwhelming bulk of the archaeological material which is found today in museum and private collections and in dealers' galleries.[97]

It would serve the cultural interest of mankind better if duplicated artifacts were available to museums, scholars, and collectors throughout the world, rather than only being available in the country of origin.

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95. *Id.* at 831.

96. Hague Convention, *supra* note 11 (emphasis added).

97. Letter from Andre Emmerich to the Washington Post (July 6, 1977) *reprinted in* VISUAL ARTS, *supra* note 16, at 72, 73; *see also* Walter Alva, *Discovering the New World's Richest Unlooted Tomb*, 174 NAT'L GEOGRAPHIC 510 (1988).

If an art-rich country, like Mexico, "indiscriminately retain[s] duplicates of objects beyond any conceivable domestic need, while refusing to make them available to museums, collectors and dealers abroad, [then it contributes to the] cultural impoverishment of people in other parts of the world."[98]

> It is generally known that Mexico possesses large quantities of antiquities that are simply hoarded. They duplicate works already fully represented in Mexican museums; they are not exhibited; they are not needed for and, in any case, are not available for study. They are and will remain unused and anonymous.[99]

Access to the cultural objects is another related consideration. Assuming that cultural objects are a part of the "cultural heritage of all mankind," then mankind's cultural interest is best served if a greater number of people have access to the objects. The works of a culture should be widely distributed rather than concentrated in one place. "If all Aztec antiquities were kept in Mexico, that part of 'the cultural heritage of all mankind' would be, in practical terms, inaccessible to most of mankind."[100] Additionally, if all of the source nations' cultural property were repatriated, the world's museums would be emptied. Great collections such as those of the British Museum in London, the Louvre in Paris, and the Smithsonian Institute in Washington D.C. would be dismantled if the precedent of return were ever established.[101]

### *B. Archaeological Value*

Another argument for the retention of cultural property is to prevent the destruction of the records of civilization.[102] For example, archaeologists studying the ancient Mayans — a civilization whose complex hieroglyphic language is still largely undeciphered[103] — can only understand the significance of their monumental architecture and sculpture by examining it at the site.[104] Deciphering the Mayan language requires knowing the source of the glyphs and the location of the stela

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98. *Two Ways of Thinking, supra* note 9, at 847.
99. *Hot Art, supra* note 7, at 16.
100. VISUAL ARTS, *supra* note 16, at 62.
101. *See* Godfrey Hodgson, *Bringing Home the Works That Went Astray*, INDEPENDENT, Mar. 21, 1990, at 21 (book review).
102. *Hot Art, supra* note 7, at 9.
103. Bator, *supra* note 34, at 279.
104. *Hot Art, supra* note 7, at 9.

they came from — even within a particular Mayan site — so that the glyphs can be cross-related with pictures and with each other.[105] Removing the sculpture or a part of it "takes it out of context and diminishes its meaning as a record of civilization."[106] When studied in context, such artifacts can give significant information about the Mayan civilization; when unrecorded and separated from their original context, their historical and cultural value is almost nil.[107]

The problem is that unauthorized, clandestine excavations and removals are almost always undocumented.[108] "Not only do the Mayan articles lose much of their archaeological significance when removed from their sites, but many of the articles are sent "underground" to private collections to which concerned scholars have no access."[109]

Also, in the case of the Mayan stelae, because they are such enormous monuments,[110] they must be cut or broken into smaller pieces in order to be removed and transported away from the site. In so doing, *esteleros*[111] often damage and mutilate the stelae.[112] One technique, called "thinning," involves sawing (often with a chainsaw), hacking, splitting apart with crowbars, or simply smashing the stela into movable pieces.[113] Another author has described the damage this way:

> The stelae are certainly not lightweight items. They measure up to twenty feet and weigh up to several tons. The plunderers have therefore had to develop techniques of removal, so as not to damage the means of their profit. Power saws are generally used. The stela is cut through vertically and the face removed. This is then cut into smaller segments, for transportation purposes and in order to multiply the profit by selling the pieces separately.[114]

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105. Bator, *supra* note 34, at 279.

106. *Hot Art, supra* note 7, at 9. *See also* DUBOFF, *supra* note 13, at 69.

107. Grace Glueck, *Issue and Debate: Should Trade in Ancient Artifacts Be Restricted*, N.Y. TIMES, June 5, 1984, at C13.

108. *Two Ways of Thinking, supra* note 9, at 843.

109. DUBOFF, *supra* note 13, at 69.

110. *See* Bator, *supra* note 34, at 278.

111. An *estelero* is a looter who steals or mutilates a stela. (Author's translation.)

112. Bator, *supra* note 34, at 278.

113. *Id.* In Mexico, armed looters have used heavy machinery to hack apart ancient monuments, and have opened fire on strangers who disturbed their pillaging. *Black Market Flourishes Despite Law on Art Relics*, CHI. TRIB., Nov. 28, 1985, at Tempo 14D.

114. WILLIAMS, *supra* note 3, at 113.

Another method is to heat the stone with fire and then pour water on it until it shatters.[115] The looters are generally after the pictorial stone carvings rather than the glyphs on the stelae because the carvings are more valuable on the market.[116] Consequently, the glyphs are destroyed in the process of thinning, and some of the most important records of the Mayan civilization are lost forever.

The concern with de-contextualization is an important one which deserves protection, especially with regards to undocumented archaeological objects.[117] Dr. Clemency Coggins, an art historian specializing in pre-Columbian art, was the first to decry the Maya crisis to the art world:

> In the last ten years there has been an incalculable increase in the number of monuments systematically stolen, mutilated and illicitly exported from Guatemala and Mexico in order to feed the international art market. Not since the sixteenth century has Latin America been so ruthlessly plundered.[118]

The archaeologist's concern with the loss of information is certainly a valid one. The archaeological interest should be protected. However, objects which have been properly excavated and fully documented or artifacts which are movable without a significant loss of information (such as sculptures, ceramics, coins, beads, jewelry, etc.) should not be unavailable for sale and export. Their absence will not destroy or damage any records of civilization, and allowing their export will likely foster further interest and scholarship in the civilization.

Another interest in Mexico's retention of its pre-Columbian art is in preserving the integrity of the archaeological site. Not only is archaeological and ethnological value[119] lost, but some of the aesthetic value of the site is lost if the stelae and other artifacts are dismembered and removed from the site. This interest in preserving the integrity of the site is expressed in the preamble of the UNESCO Convention:[120] "Considering that cultural property constitutes one of the basic elements of civilization and national culture, and that *its true value can be appreciated*

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115. DUBOFF, *supra* note 13, at 70.

116. Bator, *supra* note 34, at 279.

117. *Two Ways of Thinking, supra* note 9, at 844.

118. Clemency Coggins, *Illicit Traffic of Pre-Columbian Antiquities*, 29 ART J. 94, 94 (1969).

119. *See supra* notes 102-107 and accompanying text.

120. *See supra*, text accompanying notes 15-19.

*only in relation to the fullest possible information regarding its origin, history and traditional setting. . . .*"[121]

It is true that cultural objects can be appreciated in their traditional setting. To be able to stand among the pillars of the Parthenon atop the Acropolis and behold its marble statuary and architectural ornaments would certainly inspire an appreciation of the ancient Greek civilization. However, it is a mistake to say that one would have *no appreciation* for the true value of the Parthenon's sculptures simply because they are being viewed in a British museum and not in Athens. To be able to view relics of the Mayas and the Aztecs at their original archaeological sites would be optimal aesthetically, but it is certainly possible to appreciate them away from their traditional settings as well.

### C. *The Black Market*

As a result of the total prohibition on the sale or exchange of pre-Columbian works of art and cultural property between Mexico and the United States,[122] the market for those objects can only be satisfied illegally.[123] Consequently, the current state of the law regarding pre-Columbian art has created a black market and the effect is contrary to Mexico's own best interest.

One of the consequences of an illicit market is a loss of control over the traffic in this type of art.[124] If there were an open and legal market, the trade could be regulated. Under the current state of the law, excavation is frequently done clandestinely and hurriedly by amateurs, resulting in damage to the artifacts and sites and a loss of archaeological information.[125]

> The dealers in pre-Columbian art make use of local peasants who know the jungle. In areas where the daily wage is under $2.00, it is not difficult to hire men to remove the Mayan art. When a stela may be valued at over $100,000 in New York or Los Angeles, the incentives to locate ruins are enormous.[126]

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121. UNESCO Convention, *supra* note 6, pmbl. (emphasis added).

122. *See supra* notes 13-74 and accompanying text for a discussion on the current state of the law in the U.S. and Mexico regarding pre-Columbian cultural property.

123. VISUAL ARTS, *supra* note 16, at 53.

124. *Hot Art, supra* note 7, at 16.

125. *Id.*

126. DUBOFF, *supra* note 13, at 70.

An open market would redirect the profit so that supervised excavations could be carried out and be properly conducted by responsible and professionally-trained people.[127] The local Mexican labor force could be legally employed in this manner and earn legitimate wages.

The problem of an illicit trade in stolen art and cultural property will not be solved unilaterally. The steps taken by the United States to stop the import of pre-Columbian art has simply resulted in a redirection of the flow of artifacts to Europe.[128]

> [M]ere American self-restraint will do no good in this area. In many sectors of the art market, the Japanese are already spending more than American collectors. And before much time has passed, this will be true of *every* sector of the art market. In addition, pre-Columbian objects also command very high prices in Europe, especially in Germany and Switzerland. Unless a self-denying ordinance is truly international, in fact, it will merely have the effect of denying the United States what other people will then snap up.[129]

The United States has significantly reduced the importation of pre-Columbian artifacts into the country, but the trade still continues to flourish — elsewhere.[130] Andre Emmerich, a prominent New York art and antiquities dealer (who no longer deals in pre-Columbian art) has said, "It all goes to Geneva now. Don't kid yourself. The market continues, but not here."[131]

### *D. Physical Safety*

Concern for the physical safety of pre-Columbian stelae and other cultural property may even justify their removal from the site to protect them from the damage of looters.[132] The international museum community plays an important role in protecting and preserving cultural patrimony.[133] The Elgin Marbles,[134] for example, located in the British

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127. *Hot Art, supra* note 7, at 18.

128. Meisler, *supra* note 18, at 8 (statement by Constance Lowenthal, Executive Director of the International Foundation for Art Research).

129. KARL E. MEYER, THE PLUNDERED PAST 168 (1973) (quoting a statement made in a letter to the author by columnist Joseph Alsop).

130. Grimes, *supra* note 16.

131. *Id.*

132. *See supra* notes 110-116 and accompanying text.

133. Glueck, *supra* note 107.

134. *See supra* text accompanying notes 76-86.

Museum have been protected from the ravages of atmospheric pollution in Athens and the effects of the elements.[135]

Andre Emmerich, the prominent New York dealer in both contemporary art and antiquities,[136] maintains that ethnological material, which consists largely of abandoned tribal ritual art such as masks, shields, and other ceremonial objects, would simply be "left to rot" if not salvaged by dealers, collectors, and museums.[137]

The deplorable condition of some museums in developing countries is an additional reason to remove the trade restrictions on pre-Columbian cultural property. Museums which are under-funded, under-staffed, and which lack adequate climate control and theft control produce detrimental effects on the well-being and preservation of artifacts housed under those conditions. Pre-Columbian antiquities are sometimes better off outside the country of origin in the care of foreign museums, dealers, and collectors. The problem in Peru is especially critical.[138] Ceramics, textiles, and other objects have been stored in museums and storehouses without humidity controls and have been destroyed or seriously damaged by the humidity, termites, fungi, and rats.[139] Theft from inadequately guarded museums is another problem.[140]

### *E. Economic Concerns*

An economic interest is served in the retention and repatriation of pre-Columbian art.[141] The presence of pre-Columbian works of art and archaeological sites in Mexico attracts tourists and their money and thereby enriches the nation's economy. Economically, *whoever* has pre-Columbian art and artifacts has something of value, and possession is necessary in order to enjoy the economic benefit. Therefore, it is

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135. *See* photos comparing a metope from the Parthenon which has been in the British Museum with a metope in ruined condition which, until recently, was on the Parthenon in Athens. VISUAL ARTS, *supra* note 16, at 133.

136. *See supra* text accompanying note 131.

137. Letter from Andre Emmerich to the Washington Post (July 6, 1977), *reprinted in* VISUAL ARTS, *supra* note 16, at 72.

138. *See* Edward Schumacher, *Peru's Rich Antiquities Crumbling in Museums*, N.Y. TIMES, Aug. 15, 1983, at 14.

139. *Id.*

140. *Id.* According to U.S. government estimates, art theft is a $2 billion a year business. According to one British estimate, it amounts to $6 billion a year, making art theft one of the world's most profitable criminal enterprises behind the illegal drug business. James Walsh, *It's a Steal*, TIME, Nov. 25, 1991, at 86, 86-87.

141. *Hot Art, supra* note 7, at 10.

really a question of legal ownership as to who should enjoy the economic value of the cultural property.

Mexico possesses large quantities of antiquities and is considered to be an art-rich nation.[142] However, it is considered to be a poor nation in terms of gross national product and per capita income. If Mexico treated its cultural treasury as an "exploitable natural resource" which could be "mined" as a source of income, its national economy could be enhanced.[143] Unique or monumental finds which are important to the country's history or culture could be maintained in the country, but duplicate artifacts such as pots, carvings, and jewelry which are already well represented in Mexican museums could be sold on the international market or traded for other artifacts which are not currently represented in Mexican museums. "The prices paid in the international market for such works would finance further exploration, preservation and scholarship."[144]

### *F. Artistic Value*

"There is also an important national artistic interest in retaining works of art."[145] The presence of art from the past of the homeland can be an inspiration to living artists. At the beginning of the Mexican revolution in 1911, a group of young Mexican painters looked to the native heritage of pre-Columbian art and incorporated it into a national style.[146] An example of the work of one of these painters, Jose Clemente Orozco, can be seen on a mural cycle at the University of Guadalajara in Mexico.[147] Besides inspiring artists, viewing a great work of art enriches the life of anyone who views it.[148] "A society deprived of its artworks is an impoverished society."[149] However, there is no reason that the artistic interest should be halted at national boundaries.

### *G. Moral Correctness*

In 1977, Abner Mikva, a U.S. Congressman who sponsored legislation to implement the UNESCO Convention,[150] was quoted as

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142. *Id.* at 16.
143. *Id.* at 18.
144. *Id.*
145. *Id.* at 11.
146. H.W. JANSON, HISTORY OF ART 651 (2d ed. 1977).
147. *Id.*
148. McAlee, *supra* note 48.
149. *Id.*
150. *See supra* notes 58-63 and accompanying text.

saying, "We're either a moral nation or we're not."[151] This line of reasoning has been used (unsuccessfully) by Greece in arguing for the return of the Elgin Marbles[152] from Britain. The problem lies in defining "moral".

Mexico, for example, has legislatively declared that all pre-Columbian objects located within the country are the property of Mexico and to remove them from the country is, essentially, theft.[153] Consequently, if an American tourist purchased and took out of Mexico an artifact such as a Mayan ceremonial mask which came from a tomb that a Mexican landowner had discovered on his own property and sold to the tourist, the tourist would have not only violated Mexican law, but under the *McClain* decision,[154] would also be guilty of theft under U.S. law.[155] "Moral" is thus determined in this case by Mexican law. However, the Mexican government should not have a superior moral or property right over the very artifacts that the majority of the Mexican population's ancestors (the Spanish conquistadors) attempted to destroy.[156]

### *H. The Ambassadorial Value*

Finally, and perhaps the most compelling argument for free trade in pre-Columbian art is that "art is a good ambassador, creating an

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151. George Lardner, Jr., *Stolen Art Traffic Bill Causes Flap; Dealers Oppose Bill to Curb Traffic in Stolen Art*, WASH. POST, May 18, 1977, at A1.

152. *See supra* text accompanying notes 76-85.

153. *See supra* text accompanying notes 23-31.

154. *See supra* text accompanying notes 43-50.

155. *Id.*

156. Speaking at a College Art Association symposium in 1971 on the international illicit traffic in art, Andre Emmerich (*see supra* text accompanying note 131) stated:

> Like everyone else I would like to be on the side of virtue, motherhood, and so forth. I am not quite sure on which side virtue lies. . . . Do the descendants of the Turks who drove out the Greeks from Asia Minor have a better right to the art made by the ancestors of the Greeks? Do the destroyers of the Maya civilization [have more right] to its remnants than we do? I propose that it's a basic moral question. I beg the obvious fact that the art of mankind — the art of ancient mankind — is part of mankind's cultural heritage, and does not belong exclusively to that particular geographic spot where ancient cultures flourished. I think that this country more than any other has a special claim to the arts of all mankind. . . . American institutions have bought the objects they have acquired, and have not only paid with money, but we have paid with the debt of scholarly contributions. . . . I would say that probably the majority of work on pre-Columbian art has been done by American scholars. So I think we have paid our way.

MEYER, *supra* note 129, at 28-29.

understanding of, interest in and admiration for the country of origin. . . . Movement of art internationally also broadens tastes and sensibilities, eliminating parochialism and ignorance, and promoting international understanding."[157]

## IV. CONCLUSION

In an attempt to stop the destruction of archaeological monuments and the flow of pre-Columbian cultural property outside Mexican national boundaries, the Mexican and United States governments have put into effect an unusually restrictive legal scheme. There is a virtual ban on the trade in pre-Columbian antiquities between the two countries. All parties concerned — the Mexican and U.S. governments, museum curators and museum-goer's, art dealers, collectors, archaeologists, scholars, and other interested persons — would all agree that cultural property should be preserved and protected. The current state of the law most certainly has restricted the flow of pre-Columbian antiquities into the United States, and the Mexican *national* interest is being protected. However, because of a larger *international* interest, for the reasons stated in this Note, it does not appear to be the best way of treating the "cultural heritage of all mankind."

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157. DUBOFF, *supra* note 13, at 75.

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# BOOK REVIEW

*From Helsinki To Vienna: Basic Documents of The Helsinki Process.* Edited by Arie Bloed. Dordrecht/Boston/London: Martinus Nijhoff Publishers. 1990. Pp. xiv, 285. $87.50 (Hardbound).

On August 1, 1975, a non-treaty was adopted at Helsinki, Finland, by all the heads of state or government of Europe, except Albania, plus Canada and the United States. The Helsinki Final Act, also known as the Helsinki Accord, was the fruit of the Conference on Security and Cooperation in Europe (CSCE), the culmination of multilateral preparatory discussions begun two years earlier. What East European politicians regarded as merely a political document heralded an ongoing process that has contributed in no small measure to the great changes that have already changed the map of Europe.

Thus far, the ongoing CSCE has completed three major follow-up conferences, each ending with the adoption of a concluding document. These conferences were held at Belgrade (1977-78), Madrid (1980-83), and Vienna (1986-89). The fourth follow-up conference is scheduled to take place in Helsinki in March 1992. The pace of co-operation, implementation of undertakings and innovations by the parties were reviewed at these gatherings and may be measured in these documents. Of course, these follow-up conferences were the main events when the world watched most intently. Aside from these accomplishments other important meetings took place, with positive results, although without the glare of publicity accorded the follow-up conferences.

This book serves two functions. First, Dr. Bloed, who is a Senior Lecturer of the Law of International Organizations at the Europa Institute, University of Utrecht, and General Secretary of the Netherlands Helsinki Committee, provides an excellent concise overview of the Helsinki process from its genesis to the end of the Vienna CSCE Follow-Up Conference. He also sets out a schedule of the planned meetings to be held through March 1992, to keep the reader apprised of the ongoing process. This part of the book will be most beneficial to the neophyte who wishes to embark upon a study of the CSCE process. His informative essay could have been of greater assistance to the newcomer had Dr. Bloed used footnotes to direct the reader to the appropriate extensive literature on each topic.

The second function of the book is to provide the reader with a portable library of the important documents that have emerged. In this

regard, one finds what can be called twelve of the most essential substantive documents necessary to study and assess the CSCE. Not all of the documents are easily accessible to scholars elsewhere, for example the Document of the Bonn Conference on Economic Cooperation in Europe adopted on April 11, 1990. Interestingly, in the selected bibliography, Dr. Bloed gathers references to works in five languages, but for some unexplained reason he has been rather stingy with these sources given the rich literature which now exists.

Besides the three Concluding Documents of the Follow-Up Conferences, Belgrade (1978), Madrid (1983) and Vienna (1989), and the Helsinki Final Act (1975), there are the reports of specialized meetings on Peaceful Settlement of Disputes at Montreux (1978) and at Athens (1984), on Co-operation in the Mediterranean at Valletta (1979), on the Scientific Forum at Hamburg (1980), and the Document of the Stockholm Conference on Confidence-and Security-Building Measures and Disarmament in Europe (1986). Main procedural rules and organizational modalities used in all the meetings and conferences are found in the Document on Final Recommendations of the Helsinki Consultations adopted at Helsinki (1973), and the annexes to the Vienna Concluding Document (1989).

During November 19-21, 1990, the heads of state or government met at the Paris meeting of the CSCE and adopted the "Charter of Paris for a New Europe," which provided for the creation of the first permanent CSCE institutions, namely, a small secretariat, a conflict prevention center and an office of free elections. To comprehend the present role of the CSCE, one needs to look at its antecedents. The process underscores a commitment to human rights, economic liberty, mutual security, environmental protection, democracy, and friendly relations between states. Dr. Bloed's essay and relevant documents admirably assist the reader to comprehend what has transpired in order to follow the future of the CSCE.

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