

Texas Transnational Law Quarterly



**International
Law Section**

**THE
STATE
BAR
OF
TEXAS**

VOL. 22

DECEMBER 2008

NO. 1

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Submission of Articles

We welcome the submission of articles and recent developments for publication in the *TTLQ*. Authors may wish to check with the Editor about preemption of their topic. Articles should be approximately three to ten double-spaced pages inclusive of endnotes. Generally, citations should conform to the Bluebook form of citations. All articles should be submitted by email to Andrew.Melsheimer@tklaw.com.

Section Membership

If you are aware of attorneys who are not members of the International Law Section of the State Bar of Texas or who may have failed to renew their membership, please give them the membership information that is included in the back of the *TTLQ*.

Online

Access this and past issues of the *TTLQ* at <http://www.ilstexas.org/ttlq.htm>.

The opinions or views expressed in the Texas Transnational Law Quarterly do not necessarily represent the opinions or views of the State Bar of Texas, the International Section of the State Bar or the Council, unless specific approbative action has been taken by the relevant body.

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State Bar of Texas
International Law Section

**Please Mark Your Calendars
for the International Law Section's
21st Annual International Law Institute**

KEYNOTE SPEAKERS:

**Distinguished Panel of Multinational Corporate General Counsels,
including Alan Crain of Baker Hughes; Ted Frois of ExxonMobil;
Lori Auray Gobillot of Continental Airlines; Bill Lowrey of Shell Oil**

Current Issues in International Law

Duaine Priestley, Director,
U.S. Department of Commerce
and
Cody Sutton, Senior Vice President, International Business
Greater Houston Partnership

Trends in International Trade

March 5, 2009 (p.m.) - March 6, 2009 (a.m.)
Hyatt Regency Hotel, Houston, Texas

Topics Include:

**Addressing Corruption on a Global Basis, International Insolvency and Workouts,
International Human Rights Panel, Infrastructure Investment Opportunities in the
U.S. under the Obama Administration, U.S. International Trade Policy,
International Arbitration of Investment/ Contract Disputes and Much More!**

Join Speakers and Participants From:

**Andrews Kurth; Baker Botts; Baker Hughes; Baker & McKenzie; Continental
Airlines; Dell; Dewey & LeBoeuf; ExxonMobil; Haynes and Boone; Hunt Oil;
Marathon Oil; Mayer Brown; PetroSA; Pioneer Natural Resources; Pride
International; Shell Oil; Thompson & Knight; Vinson & Elkins –
Among Others!**

Register today at www.regonline.com/ils2009

For more information on ILS: www.ilstexas.org

[8.5 Hours CLE (including 1.5 hour ethics) pending]

State Bar of Texas
International Law Section



State Bar of Texas International Law Section

2008 Law Student Legal Writing Contest

The International Law Section of the State Bar of Texas has the privilege of announcing the following winners of its 2007-2008 Law Student Writing Contest:

First Place

Justin Waggoner

University of Kansas School of Law

The World Trade Organization: A Vacant Playground?

Second Place

Joseph L.V. Morrel

University of Texas School of Law

A Matter of Consistency: Prescriptive Comity and Abolishing Export Cartels

We are also pleased to announce that *The World Trade Organization: A Vacant Playground?* has been selected for publication as a student submission in this December 2008 issue of the TEXAS TRANSNATIONAL LAW QUARTERLY.

We sincerely thank all of the law students who participated in our writing contest and congratulate the winners! The judging this year was again made very difficult due to the high level of the submissions from entrants from various law schools. We encourage continuing law students to participate in our 2008-2009 Law Student Writing Contest and wish everyone much success. Detailed information can be found at: http://www.ilstexas.org/events/2009%20-%20Writing%20Competition/2008-09_writing_competition.htm.

Mexico Helps Reduce Transportation Costs: The Ciudad Juárez-El Paso Metro Area Is The Ideal Location

By
Humberto Guerrero

Introduction

High oil prices are significantly affecting U.S. and non-U.S. companies around the world. A U.S. company that manufactures a product 7,000 miles away from home is definitely running into cost problems due to unprecedented high transportation costs. Non-U.S. companies that distribute their products in the United States are also being hit by high transportation costs when shipping their products to the United States. Because of these high transportation costs, Mexico is still an optimal location to manufacture or assemble products to be distributed in the United States. According to a recent *Wall Street Journal* article, most U.S. companies are bringing back their operations to North America – and that includes Mexico.¹ An October 2008 article titled *Outsource Closer to Home* states that a good number of U.S. manufacturing executives are “likely to move production to Mexico” in the next few months.² The U.S.-Mexico border, in particular, is the ideal location for U.S. and non-U.S. companies to set up manufacturing or assembling operations to reduce their transportation costs. Since the 1960s, *maquiladoras* (factories located mostly in Mexican border cities) have been manufacturing and assembling products that are distributed throughout the United States and the rest of the world. *Maquiladoras* provide U.S. and non-U.S. companies savings on labor, a competitive Mexican workforce, and the convenience of being only a few miles from the continental United States.

Juárez and Borderplex

At the midpoint of the U.S.-Mexico border, a binational metropolitan area has emerged as a world-class manufacturing center in recent years. Ciudad Juárez, Mexico (known as “Juárez”) and El Paso, Texas comprise the so-called *borderplex* (which also includes prosperous suburbs in the state of New Mexico) with a combined population of over 2.5 million people. These two cities – connected by

bridges used annually by 15 million private vehicles – operate as one metro area that captures almost 20 percent of all the U.S.-Mexico trade. Juárez, which is home to dozens of *maquiladoras*, is now Mexico’s fifth most populous city and the largest employer in the manufacturing industry. *Maquiladoras* in Juárez assemble an extensive variety of products such as electronic components, appliances, medical devices, computer components, metal products, and even alternative energy products such as blades for wind turbines. A recent *New York Times* article stated that Juárez “is now absorbing more new industrial real estate space than any other North American city” due to its prosperous manufacturing activity.³ The *Foreign Direct Investment Magazine* – a publication of the Financial Times group – designated Juárez as the “city of the future” due to “its growing importance as a regional industrial and logistics centre on the border.”⁴ Its sister city, El Paso, which is one of the fastest growing cities in the U.S., operates as a premier logistics hub in which distribution centers are located to support the *maquiladoras* in Juárez. This sophisticated binational product-sharing system makes the *borderplex* one of the largest manufacturing centers in North America with over a quarter of a million people working in the industry.

Benefits – Proximity, Labor, etc.

Juárez offers enormous benefits for U.S. and non-U.S. companies to establish business operations there. Its proximity to the continental United States is its most significant advantage. A manufacturing facility in Juárez is only a few miles from a U.S. port of entry, which results in reduced transportation costs to and from the United States. In addition, the proximity results in convenience for executives of U.S. companies. Hundreds of these executives live in El Paso and commute to Juárez. The fact that El Paso Airport offers non-stop flights to most major U.S. cities means executives visiting facilities in Juárez from other regions in the U.S. can fly back home the same day. Besides these benefits, Juárez offers a very competitive and

experienced labor force at lower costs. Because of these and other benefits, over 70 Fortune 500 companies are currently located in the region. Recently, a Taiwan-based company announced the construction of a *maquiladora* that may hire about 30,000 people in the next few years. According to officials of Juárez, it will be the largest *maquiladora* in Mexico.⁵

Benefits – Governmental Incentives

The Mexican government continues to provide incentives to foreign manufacturers coming to invest in Mexico. In the last few years, Mexico's Ministry of Economy has issued various decrees for the manufacturing industry. The current applicable decree is the *Decreto para el Fomento de la Industria Manufacturera, Maquiladora y de Servicios de Exportación* ("IMMEX"). IMMEX provides benefits with regard to import duties and *Impuesto al Valor Agregado* ("IVA") – Mexico's sales tax payable on imports and purchases. Mexico's IVA rate is 15 percent, but it is only 10 percent if the company is located in a border city like Juárez. In addition, IMMEX allows inputs and components (incorporated into exported manufactured goods) and equipment and machinery (used in the production process) to be IVA exempt. With respect to import duties, NAFTA countries are exempt for inputs and components. A non-NAFTA country may be exempt from import duties on inputs and components if it has a trade agreement with Mexico that provides an import duty exemption. In addition to IMMEX, the *Programa de Promoción Sectorial* ("PROSEC") offers other benefits with regard to importing materials from a non-NAFTA country at a reduced or exempt duty.

Investment Vehicles for Establishing Manufacturing or Assembling Operations in Juárez

A foreign company typically has the following options when manufacturing in Mexico: (a) establishment of *maquiladora*, (b) shelter operation, or (c) contract manufacturing.

Establishment of *Maquiladora*. If the foreign company decides to establish a *maquiladora*, it will create a subsidiary in Mexico. The foreign company, as a shareholder or partner of the subsidiary, is ordinarily not liable for corporate indebtedness in Mexico. The most common

business entities in Mexico to establish a subsidiary are the *Sociedad Anónima* and the *Sociedad de Responsabilidad Limitada*. Both entities may be 100 percent foreign-owned. The latter has become popular for U.S. companies due to the "pass through" benefits that it offers with respect to the U.S. entity. The subsidiary will be taxed in Mexico as is any other business entity, but the foreign company is not considered a taxpayer in Mexico. The subsidiary may purchase (or lease) land for its operations anywhere in Mexico. If the property is located in a *zona restringida* (restricted zone),⁶ the subsidiary may purchase the land directly as long as it is for commercial or industrial purposes.

Shelter Operation. Under the shelter program, a foreign company enters into an agreement with a shelter operator for the manufacturing of certain products. The foreign company, which does not have legal presence in Mexico, is normally responsible for providing raw materials, equipment, managers and supervisors, and quality control processes.

Contract Manufacturing. Under the contract manufacturing method, a foreign company hires a third-party operator, and the former is normally responsible for providing raw materials and equipment.

Operators in shelter and contract manufacturing will charge a fee for their services plus the cost of the operation.

Conclusion

The Juárez-El Paso metro area offers to U.S. and non-U.S. companies the ability to reduce their transportation costs by shortening their supply chain. In addition to the transportation benefits, the *borderplex* offers travel and residence convenience for companies' executives, competitive labor force at lower costs, and experienced legal and customs services. The incentives that the Mexican government provides through IMMEX and PROSEC facilitate the foreign companies' establishment of their operations in Mexico. For these reasons, Mexico, and specifically the Ciudad Juárez-El Paso region, is the ideal location for U.S. and non-U.S. companies to establish manufacturing or assembling operations there to reduce their transportation costs.

Author: Humberto Guerrero is a partner in the Mexican law firm of Guerrero Gómez, S.C and may be contacted at hguerrero@gro.com.mx.

¹ Timothy Aepfel, *Stung by Soaring Transport Costs, Factories Bring Jobs Home Again*, WALL ST. J., June 13, 2008, at A1, A9.

² Gail Dutton, *Outsource Closer to Home*, ENTREPRENEUR MAGAZINE, Oct., 2008, at 22.

³ Lisa Chamberlain, *2 Cities and 4 Bridges Where Commerce Flows*, N.Y. TIMES, Mar. 28, 2007, available at <http://www.nytimes.com/2007/03/28/realestate/commercial/28juarez.html>.

⁴ *North American Cities of the Future 2007/08*, FOREIGN DIRECT INVESTMENT MAGAZINE, Apr. 25, 2007, available at http://www.fdimagazine.com/news/fullstory.php/aid/1974/North_American_Cities_of_the_Future_2007_08.html.

⁵ Diana Washington, *Maquila bordering New Mexico to employ up to 30,000*, EL PASO TIMES, July 22, 2008, at A1.

⁶ *Zona restringida* is the area of 50 km (31 miles approximately) inland from the coastline and 100 km (62 miles approximately) from any border. For residential purposes, foreigners may acquire the effective use of land in the *zona restringida* only through a trust.

In Bad Economic Times, Mexico Is Here To Help: The Ciudad Juárez-El Paso Region Is The Ideal Location

By
Humberto Guerrero

Introduction

Faced with the current economic slowdown, U.S. companies should explore alternatives to their existing operation models to reduce costs and stay competitive. Outsourcing has proven to be a viable alternative. In the last few years, outsourcing has gained enormous importance in the world's economy. Although outsourcing is a controversial topic, the fact is that, in a globalized economy, in which companies and individuals compete with everyone from everywhere around the world, outsourcing is a reality that all countries are now facing. Even India – known for being the world's outsourcing recipient – is now “outsourcing outsourcing” to countries like Mexico.¹ Because of its proximity to the United States, Mexico is an optimal location to help U.S. companies reduce their costs through outsourcing, in particular, by establishing Business Process Outsourcing (BPO) operations. The U.S.-Mexico border, in particular, is the ideal location for BPO operations. U.S. companies should pay close attention to the binational metropolis of Ciudad Juárez, Mexico and El Paso, Texas for BPO opportunities.

Juárez and Borderplex

At the midpoint of the U.S.-Mexico border, a binational metropolitan area has emerged as a world-class manufacturing and outsourcing center in recent years. Ciudad Juárez (known as “Juárez”) and El Paso comprise the so-called *borderplex* (which also includes prosperous suburbs in the state of New Mexico) with a combined population of over 2.5 million people. These two cities – connected by bridges used annually by 15 million private vehicles—operate as one metro area that captures almost 20 percent of all the U.S.-Mexico trade. Juárez, which is home to dozens of *maquiladoras* (manufacturing factories located mostly in Mexican border cities), is now Mexico's fifth most populous city and the largest employer in the manufacturing industry. The *Foreign Direct Investment Magazine* – a publication of the

Financial Times group – designated Juárez as the “city of the future” due to “its growing importance as a regional industrial and logistics centre on the border.”² Historically, industrial activity in Juárez is limited to manufacturing, but recently there has been an important presence of companies in the outsourcing services industry. Its sister city, El Paso, which is one of the fastest growing cities in the U.S., operates as a major logistics hub in which distribution centers are located to support the *maquiladoras* in Juárez. Both cities possess a sophisticated binational product-sharing system in which operations take place on both sides of the border.

Benefits – Proximity, Labor, etc.

Juárez offers numerous benefits for U.S. companies to establish BPO operations there. Its proximity to the continental United States is its most significant advantage. A facility in Juárez is typically only a few miles from a U.S. port of entry. In addition, the proximity results in convenience for executives of U.S. companies. Hundreds of these executives live in El Paso and commute to Juárez. The fact that El Paso Airport offers non-stop flights to most major U.S. cities means executives visiting facilities in Juárez from other regions in the United States can fly back home the same day. In addition to these benefits, Juárez offers a very competitive and experienced labor force at lower costs.

Benefits – Governmental Incentives

The Mexican government continues to provide incentives to the foreign manufacturers coming to invest in Mexico. In the last few years, Mexico's Ministry of Economy has issued various decrees for the manufacturing industry. Because the government is aware of the importance of BPO services, the current applicable decree for the industry – *Decreto para el Fomento de la Industria Manufacturera, Maquiladora y de Servicios de Exportación* (“IMMEX”) – also covers BPO services. On July 6, 2007, the government published in the *Diario*

Oficial de la Federación (Mexico's Federal Register) regulations that include various BPO services which may receive the benefits of IMMEX.³ IMMEX provides benefits with regard to import duties and *Impuesto al Valor Agregado* ("IVA") – Mexico's sales tax payable on imports and purchases. Mexico's IVA rate is 15 percent, but it is only 10 percent if the company is located in a border city like Juárez. In addition, IMMEX allows inputs and components (incorporated into exported manufactured goods) and equipment and machinery (used in the production process) to be IVA exempt. With respect to import duties, NAFTA countries are exempt for inputs and components. A non-NAFTA country may be exempt from import duties on inputs and components if it has a trade agreement with Mexico that provides an import duty exemption. In addition to IMMEX, the *Programa de Promoción Sectorial* ("PROSEC") offers other benefits with regard to importing materials from a non-NAFTA country at a reduced or exempt duty.

Benefits for Establishing Outsourcing Operation in Juárez

Customer Care Outsourcing. Customer Care Outsourcing is an area in which Juárez may offer numerous benefits. For example, sales support may help U.S. companies reduce their costs. Mexican nationals who are raised in Mexico's border cities have a good understanding of U.S. culture and tradition. According to a *New York Times* article, the *borderplex* possesses "the largest bilingual, binational work force in the Western Hemisphere."⁴ Because the U.S. Hispanic market is the fastest growing segment of the population and its purchasing power is in the hundreds of billions of dollars, excellent Spanish speakers in Juárez, who understand the American culture due to Juárez's proximity to the United States, may be the most suitable to serve this profitable market.

Transaction Process Outsourcing. Transaction Process Outsourcing (TPO) is another area in which Juárez may offer some advantages. TPO includes data entry centers, processing of credit card applications, transfer of payments, records management, document processing, and order processing. A major company in the TPO industry has established a significant presence in Juárez, relying on "the educational and training facilities, talent pool and positive

business climate" of Juárez.⁵ A Fortune 500 company that provides TPO services also operates in Juárez. Some of its services include transaction processing, finance and accounting, and call centers.

Engineering and Design Centers. In addition to Customer Care Outsourcing and TPO services, Mexico is also attracting engineering and design centers to support U.S. companies. For example, a major automobile parts supplier, which employs thousands of workers in manufacturing facilities in Juárez, also possesses a sophisticated technical center in Juárez which employs dozens of Mexican engineers and design experts.

Investment Vehicles for Establishing Outsourcing Operation in Juárez

A foreign company will typically create a subsidiary in Mexico to operate an outsourcing facility. The foreign company, as a shareholder or partner of the subsidiary, is ordinarily not liable for corporate indebtedness in Mexico. The most common business entities in Mexico to establish a subsidiary are the *Sociedad Anónima* ("S.A.") and the *Sociedad de Responsabilidad Limitada* ("S.R.L."). Both entities may be 100 percent foreign-owned. The latter has become popular for U.S. companies due to the "pass through" benefits that it offers with respect to the U.S. entity. The S.A. provides free transferability of ownership interests through share certificates. In the case of S.R.L., some restrictions may apply in the transferability of ownership interests. The subsidiary is a legal entity in Mexico that is taxed as is any other business entity, but the foreign company is not considered a taxpayer in Mexico. The subsidiary may purchase (or lease) land directly for its operations anywhere in Mexico. If the property is located in a *zona restringida* (restricted zone),⁶ the subsidiary may purchase the land as long as it is for commercial or industrial purposes.

Conclusion

Outsourcing is now a world reality. Companies and individuals compete with everyone from everywhere around the globe. The *borderplex* offers excellent benefits for U.S. companies in order to reduce their costs by establishing outsourcing facilities in the region. Some of these benefits include reduction of transportation

costs, proximity to the U.S., travel and residence convenience for executives, competitive labor force at lower costs, and experienced legal and customs services. In addition, the Mexican government provides IMMEX and PROSEC as business-friendly incentives to help companies establish themselves in Mexico. By shortening the supply chain, U.S. companies may significantly reduce their costs when they establish outsourcing operations in the Ciudad Juárez-El Paso metro area.

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¹ Anand Giridharadas, *Outsourcing Works, So India is Exporting Jobs*, N.Y. TIMES, Sept. 25, 2007, available at <http://www.nytimes.com/2007/09/25/business/worldbusiness/25outsource.html>.

² *North American Cities of the Future 2007/08*, FOREIGN DIRECT INVESTMENT MAGAZINE, Apr. 25, 2007, available at http://www.fdimagazine.com/news/fullstory.php/aid/1974/North_American_Cities_of_the_Future_2007_08.html.

³ *Acuerdo por el que la Secretaría de Economía emite reglas y criterios de carácter general en materia de Comercio Exterior, Anexo 3.2.4, Diario Oficial de la Federación* (Mexico's Federal Register) (July 6, 2007).

⁴ Lisa Chamberlain, *2 Cities and 4 Bridges Where Commerce Flows*, N.Y. TIMES, Mar. 28, 2007, available at <http://www.nytimes.com/2007/03/28/realestate/commercial/28juarez.html>.

⁵ Press Release, Genpact, Genpact to Open Latin America Headquarters in Juárez, Mexico (September 18, 2007), available at http://www.genpact.com/genpact/pdf/pr/Genpact_Latin_America_headquarters_Mexico_091807.pdf.

⁶ *Zona restringida* is the area of 50 km (31 miles approximately) inland from the coastline and 100 km (62 miles approximately) from any border. For residential purposes, foreigners may acquire the effective use of land in the *zona restringida* only through a trust.

Privilege Is As Privilege Does

By
E. Earl Harcrow and Charlotte A. Scott

Americans are serious about our privacy, except when we're not. We guard our social security numbers fiercely, yet post the most intimate details of our lives on MySpace. We shake our heads at the growing menace of tabloid journalism as we bury our noses in the weekly rag. We expect the things we tell our preachers and our lawyers to be held in the utmost confidence while constantly creating exceptions to the rules. Are we, then, truly serious about our privacy or do we even understand what privacy really means?

In May 2008, a Maryland law firm filed a lawsuit against Acumen Legal Services, a legal process outsourcing company based in India, alleging that because the Fourth Amendment does not cover foreign nationals residing overseas, the electronic transmission of information to legal process outsourcers (LPO) overseas would effect a waiver of otherwise attorney-client privileged communications. The industry caught its breath, for about two seconds. That's about how long it took SDD Global Solutions, an India-based LPO founded by a U.S. law firm and hired by Acumen, one of the named defendants in the suit, to draft a motion to dismiss and to convince Joseph Hennessey to dismiss his lawsuit against, among others, President George W. Bush.¹

In short order, the American Bar Association Standing Committee on Ethics and Professional Responsibility definitively decreed that sending legal work overseas is ethically permissible as long as the lawyer doing the outsourcing takes steps to ensure protection of client confidences and preservation of the attorney-client privilege.² "There is nothing unethical about a lawyer outsourcing legal and nonlegal services, provided the outsourcing lawyer renders legal services to the client with the 'legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation as required by Rule 1.1.'"³ Ethics panels from Florida, North Carolina, Los Angeles County, New York City and San Diego had previously come to the same conclusion on legal process outsourcing.⁴

Wait a minute! How does that sweeping edict change the legal landscape?

It doesn't. Lawyers have long been held to rules requiring competence, supervision, protection of confidential information, reasonable fees and not assisting the unauthorized practice of law. The attorney-client privilege has been extended to secretaries, paralegals, investigators and other "agents" of attorneys. What the ABA has done is make it clear that the attorney-client privilege is not so much about where the information goes (overseas) as it is about how the information is transmitted and safeguarded. Privilege is as privilege does.

Clearly, the practice of law itself is not outsourceable, but certain legal support services are well suited to an offshore model, without negatively affecting the personnel who currently perform these services. If the idea of outsourcing offends one's sense of patriotism, the key to understanding legal outsourcing is that it allows U.S. lawyers and legal professionals to focus on the higher-value tasks they enjoy (and for which they can bill higher rates) while leaving the lower-value tasks to offshore attorneys who demand a lower hourly rate. That savings is then passed on to the client. When properly managed, a successful outsourcing relationship can allow a firm or corporate legal department to actually take in *more* work because it is working smarter, not just faster.

Key examples of legal support services that have proven to be appropriate for outsourcing include first-pass document review for privilege and relevance, contract management, legal research, competitive intelligence gathering, electronic document management, and other time consuming "commodity" work that, while necessary for effective client representation, is not the bread and butter of any law practice. These support services do not require the use of a licensed U.S. attorney but are traditionally performed by junior associates at alarming hourly rates. By transferring these behind-the-scenes tasks to a low-cost operation overseas,

associates and paralegals are allowed to spend more time interacting with their clients and tending to their needs. It is really a matter of efficiently managing time and resources.

So what can American law firms do to ensure they comply with their ethical obligations as well as maintain their ability to represent their clients effectively and efficiently?

1. Partner with an LPO that shares your values and client-centric point of view. It's your license on the line; don't trust it to an organization that does not respect the gravity of the responsibility you share. Not all legal process outsourcing companies are created equal. Look for one that offers state of the art information security, communication mechanisms, and facilities. A successful LPO will invest wisely in the proper selection and retention of legal talent.
2. Take your responsibility to supervise seriously. This means having a basic understanding of the legal education system in the country to which you are outsourcing, interviewing foreign lawyers, and evaluating the hiring procedures, security, and resources available to the outsourcing organization. Build a relationship with your entire team, whether they are in the office around the corner or across the ocean.
3. Tell your client. It's their information and their privilege. But why just tell when you can educate? General Counsel of large and small companies across the country report that one of the most important issues they face is cost control. With rising associate salaries and increased service costs across the board, the days of maintaining the status quo are numbered. After decades of requesting outside counsel to find lower-cost alternatives to providing legal services, clients are now demanding firms do so, or move out of the way for a firm that can. Whether a corporation or an individual, with the right information about the benefits of legal process outsourcing, smart clients will choose the service provider who does the right thing at the right price.

If Americans are truly concerned about maintaining confidence and privilege in an increasingly global society, the focus should not be on where their information is going, but on how it is being treated by the people to whom it is entrusted.

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¹ *Newman McIntosh & Hennesey v. The Honorable George W. Bush, President of the United States, et al.*, Civil Action No. 08-00787, United States District Court for the District of Columbia (filed May 12, 2008).

² ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 08-451 (2008).

³ *Id.* at 2.

⁴ Prof'l Ethics Comm. Fla. Bar, Op. 07-2 (2008); N.C. State Bar, 2007 Formal Ethics Op. 12 (2008); LACBA Prof'l Responsibility and Ethics Comm. Op. 518 (2006); Assoc. of the Bar of the City of New York Comm. on Prof'l and Judicial Ethics, Formal Op. 2006-3 (2006); Legal Ethics Comm. SDCBA, Op. 2007-1 (2007).

The World Trade Organization: A Vacant Playground?

By
Justin Waggoner

I. Introduction

Imagine a basketball court in a neighborhood playground. Two young boys, Mark and Bob, are the best basketball players in the neighborhood and the only kids with basketballs. Mark and Bob initially dominated the pickup games. The games became popular, attracting many children to the playground. Over time, the other players' abilities improved drastically. Consequently, Mark and Bob were no longer able to enjoy their previous dominance. Due to the large number of players and the "winner stays" rule, Mark and Bob would often sit out after their team had been defeated. Mark and Bob grew dissatisfied with the situation and took their basketballs home. Lacking a basketball, the other kids could no longer play.

In a situation analogous to the story above, the World Trade Organization (WTO) has become a vacant playground as it has stumbled through post-Uruguay Round difficulties and the problematic Doha Round. As negotiations became more challenging, the United States (U.S.) and the European Union/Communities (EU) "took the ball and went home" by focusing their efforts on bilateral free trade agreements (FTAs), as opposed to the WTO's multilateral framework.

The EU and the U.S. should enter into a moratorium on completing bilateral FTAs. Afterwards, both parties would still seek the benefits associated with the liberalization of international trade through the WTO framework. Full participation by the two largest negotiators would bring progress back to the WTO, much like Mark and Bob returning with their basketballs to the playground would lead to a resurgence of the pickup games.

II. The Most-Favored-Nation Rule and GATT Article XXIV

The General Agreement on Tariffs and Trade (GATT) was a treaty governing international trade between signatory members that was established in the aftermath of World War II.

The GATT was subsequently replaced by the WTO in 1994 and its provisions were incorporated into the WTO. A key principle within GATT is the most-favored nation (MFN) rule, as indicated in Article I:1.¹ The MFN rule requires all WTO members to provide their lowest tariff rates to all other WTO member countries. In short, the MFN rule allows all WTO members to benefit from across-the-board trade barrier reductions.²

Article XXIV contains an important exception to the MFN rule:

The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or of a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.³

Consequently, Article XXIV of GATT provides members with the opportunity to enter into FTAs or customs unions (CUs) in which the participants are permitted to enjoy tariff rates that are lower than the MFN rates enjoyed by countries that are not participants in the FTA or CU. An FTA is an arrangement that establishes lower restrictions (or sometimes no restrictions) to the flow of goods (and sometimes services) between partners regardless of national borders.⁴ A CU contains the same basic idea as an FTA, with the additional steps involving an integration of the economies of its members in which customs duties are eliminated with respect to substantially all of the trade between the CU's members and each of the separate members of the CU applies substantially the same duties to non-members.⁵ A regional trade agreement (RTA) is an FTA that has been established by countries within the same region. Since non-members cannot enjoy the trade liberalization benefits of FTAs, RTAs, and CUs,

such agreements erode the MFN principle and place non-member WTO countries at a competitive disadvantage.⁶

There are four requirements that a preferential trade agreement (PTA – which encompasses FTAs, RTAs, and CUs) must satisfy in order to be valid under GATT Article XXIV. First, a PTA should cover substantially all the trade in goods originating within members of the agreement.⁷ Thus, members are not allowed to pick-and-choose items to reduce trade barriers *à la carte*.⁸ However, this requirement has not been applied strictly.⁹

Second, PTAs must remove all tariffs and quantitative restrictions within a reasonable length of time, which is generally about ten years.¹⁰ The third requirement is that the PTA must not cause higher barriers to trade for third member countries of the WTO.¹¹ FTAs are generally held to a higher standard for this requirement than CUs are.¹² The fourth and final requirement is that the rules of origin within the PTA must not be structured so as to erect barriers to trade in goods of non-members.¹³ Nevertheless, as José Antonio Rivas notes, many PTAs contain restrictive rules of origin that amount to protectionist devices for the member countries to the exclusion of all non-members.¹⁴

The central purpose of Article XXIV is to regulate the tension between regionalism and multilateralism so that PTAs do not block progress toward multilateral trade liberalization.¹⁵ Article XXIV has failed in achieving this purpose.¹⁶ One report revealed that only six of 80 PTAs complied with GATT rules.¹⁷ To be sure, strict compliance with the terms of Article XXIV would require additional oversight and enforcement costs for the WTO. Nevertheless, the WTO needs to provide a much more disciplined application of Article XXIV. Doing so could bring about two key benefits. First, the WTO could invalidate PTAs that do not satisfy Article XXIV and thereby reinstate the significance of the MFN Rule. Second, existing PTAs could be altered to conform with Article XXIV, and thus become more trade liberalizing.

III. The Development of Preferential Trade Agreements

A. Regional Trade Agreements

The first RTA originated in Europe with what is

now the EU.¹⁸ The EU's foundation was laid by the European Coal and Steel Community (ECSC) in 1952.¹⁹ The ECSC involved a pooling of steel and coal resources by France, West Germany, Italy, Belgium, Luxembourg, and the Netherlands into a common market.²⁰ The idea behind the ECSC was that by integrating the economies of these countries, there would be increased cooperation and a disincentive for conflict.²¹

Another significant RTA occurred when Canada and the U.S. agreed to the Canada-U.S. Free Trade Agreement (CUSFTA) in 1988.²² Shortly thereafter, the U.S. and Mexico began negotiations for an FTA.²³ Not wanting to be left out of the deal, Canada joined the negotiations, and all three countries' leaders agreed to NAFTA 20 months later.²⁴

After observing the advantages of RTAs, other nations began forming their own RTAs. Examples of such RTAs include MERCOSUR (between countries in South America) and ASEAN (between countries in Southeast Asia). RTAs have become exceedingly popular. In fact, more than 40 percent of world trade is conducted under RTAs.²⁵

B. Bilateral, Non-regional Trade Agreements

In contrast to RTAs, many bilateral FTAs are not between countries within the same region. The first bilateral FTA the U.S. signed was with Israel in 1985.²⁶ This FTA with Israel had political and strategic appeal for the U.S.²⁷ Given Israel's location in the Middle East, its small economy, and the military aid the U.S. has continually provided to it, there is reason to believe that trade liberalization had little to do with the resulting FTA between the countries.²⁸

In response to the U.S. involvement in NAFTA, the EU expanded its export markets with FTAs. An explanation of this "race" to enter into FTAs is provided by Guido Glania and Jürgen Matthes in which they assert that both parties have felt a need to "catch up" with each other in the collection of FTAs.²⁹ Although many bilateral FTAs possess a geographic nexus, the competition between the EU and the U.S. has spread to FTAs that extend to all parts of the world. Examples of such FTAs include agreements between: the U.S. and Malaysia, the U.S. and Oman, the EU and Mexico, and the

EU and Chile. In addition to the race between the EU and the U.S., many other countries have become involved in an increasing number of bilateral FTAs.³⁰ In fact, a 2005 report indicated that every WTO member, with the exception of Mongolia, was a member of an FTA.³¹

After the launch of the Doha Round in 2001, the EU adopted the Lamy Doctrine, named after then-European Commissioner for Trade and current WTO Director-General Pascal Lamy.³² The Lamy Doctrine gave highest priority to WTO negotiations and included a moratorium on entering new negotiations on bilateral FTAs.³³ As time passed without progress in the Doha Round, the EU abandoned the Lamy Doctrine and again began entering into bilateral FTAs.³⁴

IV. Emptying the Playground

A. Doha Round's Diminished Status

After efforts at trade negotiations had been thwarted in Cancún and the Doha Round's progress remained minimal, the EU and the U.S. turned increasingly toward bilateral FTAs to further trade liberalization. While both parties maintain the appearance of working hard to press the Doha Round forward, some observers believe that, in reality, both parties are merely paying political lip-service to multilateralism while they are really more concerned with devoting efforts and resources to securing bilateral FTAs.³⁵ Regardless of the truth of this belief, it does not appear either the EU or the U.S. are fully behind advancing the Doha Round. Rather, both are, at the very least, distracted with their attention focused on the completion of bilateral FTAs.³⁶

B. The Logic Behind the "Race" to Enter Into Bilateral Trade Agreements

It is important to analyze the justifications stated by the EU and the U.S. for entering into bilateral FTAs. One reason countries enter into bilateral FTAs is the relative ease with which they may be completed in comparison with the vast consensus that is required to arrive at agreements within the contentious WTO.³⁷ To be sure, negotiations within the WTO are more arduous than ever before. Decision-making within the WTO has been referred to as a "negotiating logjam."³⁸

However, the current challenge in the WTO

must be viewed in context. This is not the only time a GATT round has endured a long period of time without progress.³⁹ Moreover, the duration of GATT rounds have consistently lengthened as a result of enlarged membership, increased participation by members, an increased quantity of issues, and the growing complexity of such issues.⁴⁰ As a result of these factors, it should not have been a surprise to WTO members that progress in the Doha Round would be challenging. Instead, the framework provided by the WTO offers considerable trade benefits that are worth long negotiations and generous trade concessions.

There are two primary ways in which governments find bilateral FTAs to be politically favorable to multilateral agreements completed under the WTO. First, many domestic consumers, businesses, and politicians have a bias against trade concessions that occur under WTO negotiations.⁴¹ Domestic groups believe that concessions offered in WTO agreements are akin to giving jobs away to the rest of the world without receiving anything in return.⁴² "The pursuit of an RTA, however, can be sold more easily by politicians to their constituents because of the clear reciprocal nature of the agreement."⁴³ Such economic views are overly protectionist and ignore benefits that are provided through multilateral trade liberalization.

Second, bilateral FTAs are enticing to governments to use as economic tools to provide for political ends.⁴⁴ In fact, many FTAs do not have much actual trade coverage.⁴⁵ A country may choose to negotiate an FTA with a particular country based on a wide variety of political factors ranging from the location of the other party for military purposes to the world policy beliefs of its leaders.⁴⁶ Arguably this is an improper use of trade negotiations. While there is and always has been a strong link between trade policy and other forms of foreign policy, military concerns and strategic alliances should not be the guiding force for trade negotiations.

The EU and the U.S. include several non-trade aspects in the agreements regarding labor, environmental protection, intellectual property, and investment protection.⁴⁷ The presence of these terms are used as a justification for entering into bilateral FTAs due to the belief that eventually the terms embodied in such agreements may become the norm and ultimately gain application in the WTO.⁴⁸ While

these non-trade aspects negotiated are important, they should be addressed in multi-lateral agreements in which they could have the most far-reaching effects.

Another key reason for entering into bilateral trade agreements is the superior bargaining position that the EU and the U.S. enjoy over their counterparties.⁴⁹ In trade agreements, the EU and the U.S. are able to achieve extensive concessions in bilateral negotiations and better use their economic power than at the multilateral level.⁵⁰ This enables the EU and the U.S. to continue to protect sensitive sectors, while also pushing ahead with changes that are beneficial to domestic interests. This sometimes heavy-handed, force is precisely why lesser developed countries (LDCs) have become disenchanted with WTO negotiations.

V. A New Rendering of the Lamy Doctrine

Regardless of the perceptions of the proliferation of bilateral FTAs, such agreements adversely affect the negotiating environment at the multilateral level.⁵¹ As a result of this adverse affect, the EU and the U.S. should consider jointly revisiting the Lamy Doctrine. A neo-Lamy Doctrine would halt the race between the two parties. It would consist of a firm agreement in which both parties focus squarely on arriving at solutions in the Doha Round, while also ceasing any existing or planned attempts to negotiate bilateral agreements.

Bilateral FTAs cause a sizeable erosion of the MFN principle of non-discrimination because not all WTO member countries are able to enjoy the lowest tariff rates.⁵² The MFN rule is a key pillar of GATT and a primary incentive for joining the WTO precisely because it allows all members to receive the same benefits of tariff reductions. Thus, the MFN rule is intended to promote fairness, equality, and unity among WTO members. The explosion of PTAs has been unfair and unequal. Consequently, the ideal solution is to reign in PTAs and ensure that the MFN principle is not circumvented.

Another possible advantage of utilizing a Lamy Doctrine approach would be the comparatively lower negotiating costs. The bilateral negotiation process lacks the efficiency that can optimally be provided in the WTO's across-the-board application of trade liberalization to 150 countries.⁵³ While bilateral trade negotiations

may be easier to conclude because of the reduced number of players and complexities, if the EU and the U.S. were to offer better concessions in WTO negotiations, the deadlock in the Doha Round could be broken. Consequently, European and American business interests could benefit from the almost worldwide trade liberalization gains made possible within the WTO. Furthermore, the WTO is able to provide a harmonized and easily understandable operating system for its members, which allows for reduced transactions costs, in comparison with varying country-specific FTAs.

While bilateral FTAs are trade liberalizing, as most economists will acknowledge, they are merely "second bests" to the trade liberalization that arises from multilateral WTO agreements.⁵⁴ As second bests, the economic gains that are provided through bilateral FTAs are poor substitutes for multilateral trade solutions because bilateral FTAs achieve only a fraction of the potential trade benefits.⁵⁵ The EU and the U.S. argue that the expansion of bilateral FTAs could ultimately cause favorable changes within the WTO that mirror the terms of the bilateral agreements, but it is presumptive to assume that such changes will result. Moreover, this evolutionary process can be quite time-consuming, which is particularly troublesome since the fate of the Doha Round hangs in the balance.

In addition, bilateral FTAs are not evenly distributed among WTO members.⁵⁶ Instead, LDCs are members to a small portion of such agreements. Developed countries often see little reason to enter into agreements with LDCs, and LDCs often lack the resources to keep up with the negotiating pace for bilateral agreements that is maintained by developed countries. As a result, the LDCs are the most likely members of the WTO not to benefit—and actually be harmed—by the preponderance of FTAs.⁵⁷ When LDCs do enter into bilateral trade agreements, such agreements are generally with developed countries. As mentioned above, the developed countries use their relative strength to gain greater concessions from smaller countries in bilateral negotiations than would be allowable under the WTO's framework.⁵⁸ As a result, the LDC will often receive a deal that may not be in its best interests or provide it with any actual benefit.

VI. Suggested Changes

GATT should be altered to prevent bilateral FTAs from impeding multilateral trade liberalization. RTAs and CUs should still be allowed, but not non-regional, bilateral FTAs.⁵⁹ GATT Article XXIV would need to be amended to reflect this view.

There are two primary reasons why RTAs and CUs should be allowed and non-regional FTAs should not be permitted. First, RTAs and CUs do not cause as much trade diversion to third parties as non-regional FTAs.⁶⁰ In this context, trade diversion can be defined as the process that occurs when trade policies of a PTA place non-member third parties at a competitive disadvantage.⁶¹ RTAs and CUs cause less trade diversion than non-regional FTAs because of the geographic nexus of the members and the likelihood that the members will already have significant trade relationships with each other due to logistics and cultural ties. Secondly, RTAs and CUs should be allowed because such trade agreements can promote regional peace and security through economic integration.⁶² The linking of countries' economies within a region can be an excellent means of establishing economic stability. Moreover, this economic stability could transcend into political stability and correspond with a reduction of conflict within a region. After all, ensuring future security, both economically and militarily, was one of the key underpinnings in the formation of the European Coal and Steel Community, which laid the initial groundwork for the EU.⁶³

The WTO, as it currently operates, will not prevent or deter PTAs which are not in compliance with GATT.⁶⁴ Within the WTO, the Committee on Regional Trade Agreements (CRTA) assesses and examines preferential trade agreements. However, the CRTA has not functioned properly, due at least in part to the lack of clarity in the provisions governing PTAs.⁶⁵ The WTO needs to ensure that the CRTA can take a more proactive position on addressing the appropriateness of PTAs.

What should be done with existing trade agreements? First, trade agreements by WTO members should return to MFN treatment. Thus, bilateral, non-regional FTAs should be left to expire and the practice discontinued. Second, all RTAs and CUs that conflict with Article XXIV should return to MFN treatment with

the understanding that such agreements could be revised to come into compliance with Article XXIV. A return to MFN status would produce the greatest amount of fairness to all members of the WTO, despite the sunk costs and loss of trade liberalization that would result. The displaced trade liberalization could ultimately be more than made up for by future agreements within the WTO.

VII. Conclusion

In order to bring progress back into the WTO, its members should stop straying outside WTO negotiations to gain trade benefits. The weighty issues of the Doha Round will not be solved with half-hearted devotion and weak concessions by the EU and the U.S.. A new rendering of the Lamy Doctrine on both sides of the Atlantic provides the appropriate course of action to aid in the advancement of the Doha Round.

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¹ GATT Article I:1.

² European Union Center of Excellence, *The Demise of Doha: The End of the Multilateral Trading System?* 1, available at http://www.unc.edu/depts/europe/business_media/busbrief0705-doha.htm (click on the "download this brief" hyperlink) (last visited December 15, 2008) [hereinafter EUCE].

³ GATT Article XXIV:4.

⁴ RAJ BHALA, *MODERN GATT LAW* 572 (2005).

⁵ *Id.* at 571.

⁶ GUIDO GLANIA & JÜRGEN MATTHES, *MULTILATERALISM OR REGIONALISM? TRADE POLICY OPTIONS FOR THE EUROPEAN UNION* 15 (2005).

⁷ GATT Article XXIV:8. The same general rule applies to the trade of services under GATS Article V:1(a).

⁸ Thomas Cottier & Marina Foltea, *Constitutional Functions of the WTO and RTAs*, in *REGIONAL TRADE AGREEMENTS AND THE WTO LEGAL SYSTEM* 48 (Lorand Bartels & Federico Ortino eds., 2006).

⁹ See BHALA, *supra* note 4, at 604.

¹⁰ GATT Article XXIV:5(c); and BHALA, *supra* note 4, at 49.

¹¹ GATT Article XXIV:5(a).

¹² GATT Article XXIV:4.

¹³ See José Antonio Rivas, *Do Rules of Origin in FTAs Comply with Article XXIV GATT?*, in REGIONAL TRADE AGREEMENTS AND THE WTO LEGAL SYSTEM 150 (Lorand Bartels & Federico Ortino eds., 2006).

¹⁴ *Id.* at 170.

¹⁵ BHALA, *supra* note 4, at 590.

¹⁶ See *id.*

¹⁷ *Id.* at 591.

¹⁸ WILLEM MAAS, CREATING EUROPEAN CITIZENS 3 (2007).

¹⁹ *Id.*

²⁰ *Id.* at 4.

²¹ PAUL CRAIG & GRÁINNE DE BURCA, EU LAW: TEXT, CASES, AND MATERIALS 5 (4th Ed., 2007) .

²² WILLIAM A. LOVETT, ALFRED E. ECKES, JR., & RICHARD L. BRINKMAN, U.S. TRADE POLICY: HISTORY, THEORY, AND THE WTO 80 (2004).

²³ *Id.* at 81.

²⁴ *Id.* at 81.

²⁵ Chad Damro, *The Political Economy of Regional Trade Agreements*, in REGIONAL TRADE AGREEMENTS AND THE WTO LEGAL SYSTEM 23 (Lorand Bartels & Federico Ortino eds., 2006).

²⁶ LOVETT, *supra* note 22, at 79.

²⁷ *Id.*

²⁸ See *id.*

²⁹ GLANIA, *supra* note 6, at 15-16.

³⁰ GLANIA, *supra* note 6, at 9.

³¹ J.A. Crawford & R.V. Fiorentino, *The Changing Landscape of Regional Trade Agreements*, WTO Discussion Paper No. 8 (2005).

³² GLANIA, *supra* note 6, at 2.

³³ *Id.*

³⁴ EUCE, *supra* note 2, at 5.

³⁵ See GLANIA, *supra* note 6, at 48. Glania and Matthes do not necessarily adhere to this view. Instead, they merely point out how it is a concern.

³⁶ *Id.* at 50.

³⁷ Damro, *supra* note 25, at 38-39.

³⁸ Viet D. Do & William Watson, *Economic Analysis and Regional Trade Agreements*, in REGIONAL TRADE AGREEMENTS AND THE WTO LEGAL SYSTEM 9 (Lorand Bartels & Federico Ortino eds., 2006).

³⁹ GLANIA, *supra* note 6 at 10.

⁴⁰ See *id.* at 18-19.

⁴¹ See Damro, *supra* note 25, at 37.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.* at 39.

⁴⁵ Do, *supra* note 38.

⁴⁶ Damro, *supra* note 25, at 39.

⁴⁷ GLANIA, *supra* note 6, at 48.

⁴⁸ *Id.* at 45-46.

⁴⁹ GLANIA, *supra* note 6, at 50.

⁵⁰ *Id.*

⁵¹ T.K. BHAUMIK, THE WTO: A DISCORDANT ORCHESTRA 197 (2006).

⁵² Cottier, *supra* note 8, at 46.

⁵³ See http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm (last visited December 15, 2008).

⁵⁴ Do, *supra* note 38, at 10-11.

⁵⁵ See *id.*

⁵⁶ *Id.* at 10.

⁵⁷ GLANIA, *supra* note 6, at 50.

⁵⁸ See *id.*

⁵⁹ Cottier, *supra* note 8, at 66.

⁶⁰ Do, *supra* note 38, at 11-12.

⁶¹ *Id.*

⁶² Damro, *supra* note 25, at 30-34.

⁶³ The European Union Website (Treaty Establishing the European Coal and Steel Community), available at http://europa.eu/scadplus/treaties/ecsc_en.htm (last visited December 15, 2008).

⁶⁴ *Id.* at 51.

⁶⁵ *Id.* at 61-62; and http://www.dfat.gov.au/trade/negotiations/wto_agreements.html (last visited December 15, 2008).

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