

THE 1938 MEXICAN OIL EXPROPRIATION

The Mexican Labor Board found in favour of the Oil Workers Union in December 1937. The Workers had been arguing for increased pay and improved conditions. The oil companies, which were owned by British, Dutch and American interests, held that the industry was incapable of increasing wages because of its low productivity and profits. The oil companies appealed to the Mexican Supreme Court, which denied their petition and upheld the Labour Board's award. The companies however refused to comply with the Court's decision and President Lazaro Cardenas, seeing no option, expropriated the oil industry. The industry was declared to have a 'public utility' that necessitated such action.¹ Cardenas' response was, and remains, a controversial act. This paper will discuss the questions of international law the Expropriation raised, and detail the legal and legislative process that led to the decision. In conclusion I will discuss the question of the legality of the Expropriation and suggest why this might be problematic.

The ownership of subsoil rights has a basis in Roman law. Under common law the title of mines has generally resided in the owner of the surface land, but in civil law this has not always been the case. The Spanish Government held partial rights over mineral deposits in colonial South America, and Mexico prior to 1857 had its law based in the "Ordeanzas de Minas", which held that the subsoil deposits were under the 'dominion of the nation'.² Under the regime of Porfirio Diaz this changed, the Federal Mining Code of 1884 placed the ownership of the subsoil rights in the hands of the surface land holder. This code was strengthened in 1892, 1901 and 1909, where oil was added to the lists of minerals that could be exploited by the land owner.³ These laws were part of Diaz's program of national development through foreign investment, they were in effect when the first oil exploration and production started in 1901.

* BA(Hons), MPubMan (Flinders). Robert Bartlett works with non-profit organisations as a management consultant, and is honorary historian for the South Australian Olympic Council.

1 Woolsey, "The Expropriation of Oil Properties by Mexico" (1938) 32 *Am J Int L* 519, 520.

2 Coudert, "The Mexican situation and the Protection of American Property abroad" (1938) 24 *Am Bar A J* 813, 813.

3 Coudert, above n 2, p 813.

With a rapid increase in oil production, major companies such as Standard Oil and Royal Dutch-Shell began exploration and production in Mexico.⁴ The beginnings of the Mexican Revolution which toppled the Diaz regime, did not restrict the production of oil. In 1910 3.6 million barrels of oil were produced, by 1917 production was up to 55 million barrels.⁵

A new Mexican Constitution was enacted in 1917, containing a number of radical and nationalistic articles. Article 27 of the constitution nationalised subsoil ownership, stating that its provisions were retrospective, that subsoil ownership had always been in the hands of the nation. This was contested by the oil companies, who started amparo (protection) proceedings in the Mexican Supreme Court. Generally referred to as the Texas Company cases, the Court ruled that Article 27 was not retrospective.⁶ The Court however refrained from defining the companies legally acquired rights, rather it held that 'surface rights, in order to include rights to oil, must have been accompanied by "positive acts"',⁷ that is, acts which demonstrated the intent to exploit the subsoil for oil production prior to 1917.

A working definition of what constituted a positive act was arrived upon at the Bucarelli Conference in 1924, where among other agreements the Mexican Government promised prompt payment for Expropriation in cash.⁸ This was to alleviate foreign business concerns about the security of their investments and prevent a flight of capital. At issue however was still the actual ownership of the subsoil resources. The Mexican Government held that foreign interests could explore and produce oil, but not own deposits. The oil companies held that they could and did own the oil deposits where 'positive acts' had been demonstrated. President Plutarco Calles' government came to a solution in 1925, that oil companies who held property by positive act could be given fifty year concessions to the holdings. This was said by the oil companies to effectively put in place the retrospectivity of the 1917 constitution. The oil companies appealed to the Mexican Supreme Court, who in 1927 found Calles' legislation to be unconstitutional.⁹ Settlement was reached through the Morrow-Calles Agreement which granted concession to the oil companies without time

4 Meyer, *Mexico and the United States in the oil controversy, 1917-42*, (University of Texas Press, Austin, 1977), p 4.

5 Meyer, above n 4, p 8.

6 Coudert, above n 2, p 814.

7 Powell, *The Mexican Petroleum Industry, 1938-50* (Russell and Russell, New York, 1972), p 14.

8 Powell, above n 7, p 14.

9 Powell, above n 7, pp 40-41.

limit, and recognised the companies acquired rights on land were positive acts had been committed prior to 1917.¹⁰

The Expropriation law was enacted on 23 November 1936. It gave the government legislative ammunition to expropriate land or property, with reference to areas of importance to the nation's economy and the development and utilisation of the nation's resources.¹¹ The first act of the oil industry was to challenge the constitutionality of the Expropriation in the Mexican Federal Court, using an amparo first raised in 1918.¹² The oil companies asserted that the act was unconstitutional

because it authorised [the seizure] of property without Court procedure as required by the Mexican Constitution ... and also because the Constitution [did] not authorise the Expropriation of any industries.¹³

The Federal Court found that the petition did not permit the oil companies the advantage of a writ of amparo in order to challenge the constitutionality of the 1936 law and Presidential Decree. The oil companies appeal to the Supreme Court in October 1938 was likewise denied. In Mexican law these two decisions meant that the Bucarelli Conference and the Morrow-Calles Agreement were no longer valid,¹⁴ for in dismissing the writ the Court recognised the Mexican Government's arguments regarding the ownership of subsoil rights, as Expropriation was based upon the legitimate ownership of subsoil resources resting with the state.

The Supreme Court however revised this ruling in December 1939, for it was aiming to be the last word on the issue.¹⁵ It found that the petition did have the ability to challenge the laws constitutionality, but ruled that the Expropriation law and Decree were valid. The Court did however modify the Decree and ordered the return of company documents, invoices, checks, drafts and cash reserves, 'for neither does the expropriatory Decree authorise it nor would it have been constitutional if it had'.¹⁶

10 Powell, above n 7, p 81; Coudert, above n 2, p 814.

11 Coudert, above n 2, p 814.

12 Rippy, *Oil and the Mexican Revolution* (Brill, Leiden, 1972), p 225.

13 Coudert, above n 2, p 817.

14 Rippy, above n 12, p 225.

15 Kuhn, "The Mexican Supreme Court decision in the oil companies Expropriation cases" (1940) 34 *Am J Int L* 297, 297.

16 Cited in Kuhn, above n 15, p 297.

The Expropriation, Decree, and Supreme Court decision highlight a number of issues of international law. First, in matters of procedure, the Mexican Government argued that the oil companies legal standing was defined by the 'Calvo Doctrine'.¹⁷ This is were the companies had in return for concessions agreed to renounce the protection of their home state. This agreement was so legal questions would be referred to the municipal Courts rather than the oil companies home Courts, international tribunal, or to prevent further diplomatic or even hostile action. This was maintained in article 27 of the constitution and subsequent oil legislation. Thus the Mexican Government maintained that oil companies were not under the protection of their home states in legal matters pertaining to Mexico.¹⁸

The English and United States governments disagreed, suggesting that this was an extremely narrow view of the 'denial of justice', an argument that is based on the assumption that there is an international standard of treatment of individuals under law. This was said to be based upon the normative legal rights of the majority of nations.

If a country's system of law and administration does not conform to that standard ... no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.¹⁹

Whilst a foreigner (alien) must submit to the laws and justice of a country, International Law was said to assume a certain degree of protection for life and property.²⁰ The Mexican Government held that the Montevideo convention on the rights and duties of states (article 9) was a response. It provided for the complete jurisdiction of states within the their territory over all inhabitants, to the effect that "the nationals and foreigners are under the same protection of the law and the national authorities may not claim rights other than or more extensive than those of nationals".²¹

17 Kunz, "The Mexican Expropriations" (1940) 17 *NYU L Rev* 327, 374. Kuhn, above n 15, p 298.

18 In this case and others the Calvo doctrine has proven to be ineffective, for it is seen as insufficient grounds to shield a clear violation of international law: I A Shearer, *Starke's International Law* (Butterworths, London, 1994), p 274.

19 Cheney Hyde, "Confiscatory Expropriation" (1938) 32 *Am J Int L* 758, footnote, 762.

20 Kunz, above n 17, p 356.

21 Borchard, "The "Minimum Standard" of Treatment of Aliens" (1939) 33*rd Proceedings of the American Society of International Law*, 51. Also suggested by Hyde, above n 19, p 762, and Kunz, above n 17, pp 356-58.

In this way Mexico denied there was a minimum standard of treatment under international law, as being both inappropriate to the conditions of Mexico, and as Cardenas said 'an impairment of national sovereignty'.²² The Mexican Supreme Court likewise rejected the claim of 'denial of justice'.

The Court also justified its 1939 decision on the grounds of article 27 of the constitution, which says, 'private property shall not be expropriated except for reasons of public benefit'.²³ The oil companies argued that this 'public benefit' intended the interests of the nation collectively, and they held that as Oil Expropriation benefited a narrow class of workers in that one industry it was therefore unconstitutional. The British government likewise argued that public benefit was obscure. Mexico however held that it was up to the state to decide what its interests were, and the Court agreed. It found that the legislature had the power to decide what was in the public's benefit.²⁴ International Law was said to hold that Expropriation must be 'in good faith for the purpose of public utility'²⁵ and this was subject to the review of an international Court. Clearly the Mexican Government disagreed with this assumption, citing their adherence to the Calvo doctrine.

Assuming that the Expropriation was in good faith, the central issue became compensation for the seized property. The Mexican Government always admitted that compensation had to be paid to the owners of expropriated properties, where they differed from the oil companies and foreign governments was in the manner and timing of the compensation. International law recognised that Expropriation was legal if, it was in good faith, and if adequate payment of compensation was paid before or upon seizure. It was an accepted principle that domestic legislation did not overcome these responsibilities. This was based on an assumption that the standard of justice in commercial matters was necessary for the protection of international trade and the safety of transnational investments.²⁶

Article 27 of the 1857 constitution outlined Mexico's Expropriation procedure as 'indemnification having been made'.²⁷ The constitution of

22 Borchard, above n 21, p 52.

23 Kuhn, above n 15, p 298.

24 Kunz, above n 17, p 381, Kuhn, above n 15, p298-9.

25 Kunz, above n 17, p 381.

26 Anderson, "The Basis of the Law against confiscating Foreign Owned Property" (1920) 21 *Am J Int L* 525, 525-26.

27 Woolsey, above n 1, pp 521-522.

1917 changed this article for payment to read, 'by means of indemnification'. The revision is significant for it changes an immediate constitutional obligation, to merely an assumed future obligation. Thus Mexico argued that the necessity of immediate compensation was 'not universally accepted'.²⁸ It contended that foreign investors new that the nation had a policy of social improvement, and that Mexico's future should not be sidetracked by the 'impossibility' of immediate payment.²⁹

This was argued against in the United States and British government's diplomatic notes on a number of grounds. Firstly Mexico had to show international legal opinion was no longer valid, that dissenting states had become the majority and the old rule of immediate compensation had been modified or abolished, or that a new rule had been accepted. Mexico's defence was likewise criticised, because incapacity to pay was not an accepted feature of Expropriation.³⁰

The U.S. Secretary of State, Cordell Hull, pushed for a 'prompt, adequate and effective'³¹ level of compensation, yet the expropriatory Decree offered a ten year term, and the Mexican Government suggested that payment would be partly made in oil. Thus the companies asked, if Mexico could not pay immediately, and did not pay in cash, how was this justifiable under international law. Likewise the Mexican Government refused to accept the companies ownership of the subsoil and would not compensate them for the loss of their alleged property in this regard. Thus the oil companies argued that they should have their properties repatriated if Mexico could or would not pay as international law prescribed.

The main legal questions raised by the Oil Expropriation are first, the issue of denial of justice and whether Mexico complied with an international standard; secondly, the constitutionality of the Expropriation; third, whether it was in good faith and for reasons of public utility; fourth, whether the Expropriation covered the surface lands and properties or the subsoil; fifth, the compensation amount and payment dates, and lastly, in the event of financial default, was Mexico liable to return expropriated property?³²

28 Kunz, above n 17, p 359.

29 Hyde, above n 19, pp759-60.

30 Kunz, above n 17, p 359.

31 Shearer, above n 18, p 274.

32 Kunz, above n 17, p 384.

The central issues revolve around the interpretation of international law. The U.S. and British governments supported international standards in legal relations, in terms of the treatment of foreign nationals, recompense for Expropriation, and national utility and good faith. In these cases the Mexican Government disagreed. It saw no reason to be responsible to international requirements in regard to the treatment of foreigners, and while recognising the call for compensation disagreed with the so called accepted international standards. Further it held that only it could set applicable standards of public utility.

Mexico's position was part of a wider debate within international law, the community of states and national sovereignty. The claim was that it could not be bound by international law because it was a sovereign nation. Further that because it was 'constitutionally insular' it 'need not fulfil obligations emanating from international law' and the community of states. The U.S. and British governments disagreed with this stance. They believed that Mexico clearly breached recognised standards in International law, and its own commitments from the Bucarelli Conference of 1924.³³ More importantly that the entire basis of international relations rested upon the acceptance of international legal standards.

Municipal legal issues were likewise problematic. The decision of the Supreme Court in 1939 that the Expropriation law and Decree were valid was questioned. Article 27 of the constitution states:

The exercise of rights pertaining to the nation by virtue of this article shall follow judicial process.³⁴

Likewise article 14 provides:

that no one shall be deprived of his property, possessions or rights without due process of law before a duly created Court and in conformity with previously existing laws.³⁵

Clearly the legislation authorising Expropriation maybe unconstitutional as might the presidential Decree that orders its enforcement. A legalistic interpretation of the articles suggests clear legal obligations for any Expropriation and the recognition of laws pre-existing the 1917

33 Coudert, above n 2, p 817; Powell, above n 7, p 14.

34 Cited in Woolsey, above n 1, p 522.

35 Woolsey, above n 1, p 522.

constitution. Thus the issue of subsoil ownership and oil companies concessions does not appear to have been fully resolved. Prior to 1917 the companies owned the subsoil. The constitution reversed this making national ownership retrospective, but this was found to be unconstitutional in 1921, and subsequently the Morrow-Calles agreement settled that oil companies had no time limit to the exploration of oil. Therefore the Expropriation has to be seen in constitutional terms as being in opposition to the 'conformity with previously existing laws'. This is certainly the argument that oil interests would have followed, and suggests that there is considerable difficulty in determining the ownership of subsoil deposits. Added to this is the issue of compensation value, and determining the value of the expropriated property when ownership was not fully resolved. Thus the oil companies asked for over \$400 million whereas the Mexican Government suggested it was less than five percent of this figure. The unresolved issues of law suggest that both sides may have had a justifiable claim.

This paper has raised questions regarding the legality of the Expropriation. The central dilemma revolved around the complex issues of international standards of law, standards of treatment, and national sovereignty. Arguments centred upon different conceptions as to what a nation's rights and obligations were in regard to the international community. In this way the position of Mexico was challenged because it did not abide by U.S. and British perceptions of international responsibility. The oil companies did not restrict themselves to international responsibilities and rights but launched a concerted effort to have properties restored. In this paper I have suggested that in terms of the regular standard of law that our country and others treat as their guide to international relations, Mexico appeared in 1938 to not consider those standards as being legitimate arguments against its action. Certainly the Mexican Supreme Court agreed, it affirmed the legitimacy of the Expropriation law and dismissed opposing argument.

During the dispute foreign governments supported their nation's companies, but in the end encouraged them to negotiate with the Mexican Government, ultimately settling the compensation questions. It appears that World War II had a profound affect upon the negotiations result. The threat of Mexico selling oil to Germany, which increased because of the U.S. embargo after Expropriation, was enough to drive the U.S. to the negotiating table.

Stephen Randall suggests that:

The war highlighted official American concern about the security of its oil supply, it made officials increasingly reluctant to pursue policies that would alienate Latin American governments.³⁶

Mexico was able to avoid the most severe sanctions, as the war effort geared up. Thus the legality of the 1938 Mexican Oil Expropriation was not truly determined despite the clear fact that the issues involved were legally obscure and unresolved.

36 Stephen Randall, *United States Foreign Oil Policy, 1919-48: For Profits and Security* (McGill-Queen's University Press, Kingston, 1985), p 92.

